SHOULD REQUIREMENTS WITH RESPECT TO THE SELECTION OF RESERVE BANK DIRECTORS BE CHANGED?

Howard H. Hackley
February 1970

CONTENTS

	Page
INTRODUCTION	1
THE ROLE OF RESERVE BANK DIRECTORS	4
Administrative functions	5
Monetary and credit policy functions	8
Powers of directors in relation to those of the Board of Governors	12
A "link" between Government and business	15
Summary	18
SELECTION OF RESERVE BANK DIRECTORS	19
The original Act	19
1938 consideration	26
Consideration since 1938	29
Analysis	34
CLASSIFICATION OF MEMBER BANKS FOR ELECTION PURPOSES	39
ELIGIBILITY REQUIREMENTS AND LIMITATIONS	48
Occupational requirements	48
Connections with banks	55
"Banking experience" of the chairman	60
Residence requirement	61
Tenure	63
BRANCH BANK DIRECTORS	66
SUMMARY	70

SHOULD REQUIREMENTS WITH RESPECT TO THE SELECTION OF RESERVE BANK DIRECTORS BE CHANGED?

INTRODUCTION

The framers of the Federal Reserve Act of 1913 deliberately rejected the concept of a single central bank with branches. Instead, they provided for a central banking "system" with two salient characteristics: (1) decentralization, achieved by a division of the country into 12 regions or districts and the establishment in each district of a separately incorporated and relatively autonomous Federal Reserve Bank, and (2) a blend of governmental and private interests, reflected principally by provisions under which the privately organized member banks in each district own the stock of the district Reserve Bank and elect six of its nine directors while the Board of Governors of the Federal Reserve System, an agency of the Federal Government, appoints three of such directors and exercises "general supervision" over the Reserve Banks. Regional decentralization and a combination of public and private interests are unique and important hallmarks of the Federal Reserve System. This paper deals with one of these hallmarks - the administration of the affairs of each Reserve Bank by a board of directors selected partly by the member banks and partly by the Board of Governors.

Under the law, the nine directors of each of the 12 Reserve Banks are evenly divided into three classes, designated as A, B, and

C.[1] The class A and class B directors are elected by the member banks of the district; the class C directors are appointed by the Federal Reserve Board.[2] Class A directors must be "representative of the stock-holding banks"[3] and in practice they are usually officers or directors of such banks. Class B directors must be "actively engaged in their district in commerce, agriculture or some other industrial pursuit",[4] and they may not be officers, directors, or employees of banks.[5] Class C directors are not subject to any occupational requirement; but they may not be officers, directors, employees, or stockholders of banks, and they must have been residents for two years of the district of the Reserve Bank to which they are appointed.[6] One of the class C directors is designated by the Federal Reserve Board as chairman and Federal Reserve agent and another is designated as deputy chairman.[7]

For purposes of elections of class A and class B directors, member banks are required to be classified by the Federal Reserve Board into three groups, each to consist "as nearly as may be of banks of similar capitalization".[8] An elaborate election procedure is prescribed

---

1/ Federal Reserve Act, § 4, ¶ 9 (12 U.S.C. § 302).

2/ Id., § 4, ¶¶ 10-12 (12 U.S.C. § 302).

3/ Id., § 4, ¶ 10 (12 U.S.C. § 302).

4/ Id., § 4, ¶ 11 (12 U.S.C. § 302).

5/ Id., § 4, ¶ 14 (12 U.S.C. § 303).

6/ Id., § 4, ¶¶ 15, 20 (12 U.S.C. §§ 303, 305).

7/ Id., § 4, ¶ 20 (12 U.S.C. § 305).

8/ Id., § 4, ¶ 16 (12 U.S.C. § 304).

under which each member bank annually nominates and votes for one class A director and one class B director.[9]

Over the years, it has been suggested from time to time that the selection of six of the nine directors of the Reserve Banks by the member banks, like the ownership of Reserve Bank stock by the member banks, gives rise to the impression that the Reserve Banks are owned and controlled by private bankers. It has also been suggested that, since the board of directors of each Reserve Bank appoints the Bank's president and since the Reserve Bank presidents are members, on a rotating basis, of the Federal Open Market Committee, the member banks have an influence upon the determination of national monetary policies. Such suggestions, whether valid or not, raise a question whether the manner of selection of Reserve Bank directors should be changed - whether, for example, a majority of such directors should be selected by the Federal Reserve Board rather than by the member banks.

Even if there is no need for a change in the present arrangement for election of six of the nine Reserve Bank directors by the member banks, questions may be raised regarding other provisions of the law relating to the selection of directors. For example, is the statutory procedure for the classification of member banks for purposes of elections of class A and class B directors an equitable and appropriate procedure? Are the "occupational" requirements imposed with respect to class B directors necessary and, if so, should they be clarified? Should any change be made in the restrictions imposed upon

9/ Id., § 4, ¶¶ 16-19 (12 U.S.C. § 304).

class B and class C directors with respect to connections with banks? Should the "residence" requirement imposed upon class C directors be repealed or should a residence requirement be imposed upon all directors?

This paper does not purport to provide definitive answers to all of these questions. Its purpose is simply to re-examine, in the light of the experience of more than half a century, statutory provisions regarding the selection of Reserve Bank directors that have never been substantially changed, and to stimulate thinking as to whether any changes in these provisions are desirable. At the risk of being unduly lengthy, the paper attempts to collect in one document most, although certainly not all, of the statements bearing upon the questions above raised that have been made in the past by members of Congress, Federal Reserve officials, bankers, and economists.

THE ROLE OF RESERVE BANK DIRECTORS

Whether the functions of Reserve Bank directors should be changed is beyond the scope of this paper. That question, which might include consideration of changes in the part played by the directors in the establishment of the Federal Reserve discount rate, or even the need for Reserve Bank directors at all,[10/] could be the subject

10/ With respect to Reserve Bank directors, Professor Norman F. Keiser stated in 1968:

> ". . . The makeup of the boards of directors. . .may not be particularly significant since it would, under present circumstances, be possible and reasonable to completely abolish them; they are not really necessary." Compendium on Monetary Policy Guidelines and Federal Reserve Structure, a print of the Subcommittee on Domestic Finance of the House Banking and Currency Committee (90th Cong., 2d Sess., Dec. 1968), p. 349. [This document is hereafter cited as 1968 Compendium.]

of a separate study. However, as a basis for considering possible changes in the law with respect to the selection of such directors - the limited subject of the present study, it is desirable to have in mind an understanding of the role of Reserve Bank directors as contemplated by the framers of the Federal Reserve Act and as that role is regarded today.

In general, the functions of Reserve Bank directors fall into three categories: (1) administration of the internal, local affairs of the Reserve Banks, (2) participation in the consideration, formulation, and interpretation of national monetary and credit policies, and (3) acting as a "link" between governmental and private interests. The first is entirely statutory; the second is partly statutory and partly nonstatutory; the third has no statutory basis, but it may well be the most important.

Administrative functions

The administrative functions of Reserve Bank directors are generally similar to those of directors of any commercial bank or of any private corporation. The original Federal Reserve Act apparently contemplated, as stated in the Glass version of the bill, that the powers of such directors would "be the same as those conferred upon the boards of directors of national banking associations under existing law."[11] In the Senate, the Owen bill omitted specific reference

11/ Report of House Banking and Currency Committee on Original Federal Reserve Act (Rept. No. 69, 63d Cong., 1st Sess., Sept. 9, 1913), p. 113. [This document is hereafter cited as House Report on Original Act.]

to the powers of directors of national banks, but it provided that each Reserve Bank should be conducted under "the supervision and control of a board of directors" that should "perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law."[12/] This language became part of the original Act and remains unchanged in the law as still in force.[13/]

Supplementing this general provision regarding the duties of Reserve Bank directors, the original Federal Reserve Act authorized each Reserve Bank, "by its board of directors", to appoint officers, define their duties, and dismiss them "at pleasure", and to prescribe by-laws regulating the manner in which the Reserve Banks' general business may be conducted.[14/] It further authorized each Reserve Bank, "by its board of directors, or duly authorized officers or agents", to exercise all powers specifically granted by the Act and such incidental powers as should be necessary to carry on the business of banking within the limitations prescribed by the Act.[15/] These provisions likewise have remain unchanged since 1913, with one exception: in 1935, the law was amended[16/] to provide that the president of each

---

12/ Report of Senate Banking and Currency Committee on Original Federal Reserve Act (Rept. No. 133, Part 2, 63d Cong., 1st Sess., Nov. 22, 1913), p. 38. [This document is hereafter cited as Senate Report on Original Act.]

13/ Federal Reserve Act, § 4, ¶ 7 (12 U.S.C. § 301).

14/ Id., § 4, ¶ 4, subpars. "Fifth" and "Sixth" (12 U.S.C. § 341).

15/ Id., § 4, ¶ 4, subpar. "Seventh" (12 U.S.C. § 341).

16/ By the Act of Aug. 23, 1935 (49 Stat. 703).

Reserve Bank shall be its "chief executive officer" and that the president and first vice president shall be appointed for five-year terms subject to the approval of the Board of Governors. Finally, the Federal Reserve Act includes an admonition that some members of Congress in 1913 considered unnecessary. It charges each Reserve Bank board of directors with the duty of administering the affairs of such Bank "fairly and impartially and without discrimination in favor of or against any member bank or banks."[17/]

In one important respect, the administrative powers and duties of Reserve Bank directors differ from those of commercial banks and other private corporations. The Reserve Banks are operated solely for public purposes and not for private profit. Their operations are subject to the "general supervision" of the Board of Governors,[18/] their directors and officers are subject to removal by the Board of Governors,[19/] the salaries of their officers and employees are subject to the Board's approval,[20/] and the Board has regulatory authority with respect to various operations of the Reserve Banks, e.g., discounts and advances and the collection of checks.[21/]

Within these limitations, however, the directors of a Reserve Bank have significant management responsibilities. Their appointment

---

17/ Federal Reserve Act, § 4, ¶ 8 (12 U.S.C. § 301).

18/ *Id.*, § 11(j) (12 U.S.C. § 248(j)).

19/ *Id.*, § 11(f) (12 U.S.C. § 248(f)).

20/ *Id.*, § 4, ¶ 22 (12 U.S.C. § 307).

21/ *Id.*, § 13, ¶¶ 10, 13; § 16, ¶ 14 (12 U.S.C. § 347c and § 248(o)).

of the Bank's president has special significance because the president is not only the Bank's chief executive officer but is also, in rotation, a member of the Federal Open Market Committee, a Federal agency that has a prominent role in the formulation of monetary policies. Equally important is their duty to provide for "management succession" - the selection of capable officers who one day will be able to take over the top positions in the Bank. Of only slightly less importance is their responsibility to see to it that each department of the Reserve Bank is operated under capable management and is adequately staffed.

Apart from personnel matters, the Reserve Bank directors have other responsibilities that are similar to those of directors of private corporations. They must make decisions, for example, with respect to the various operational functions of the Bank, such as the collection of checks, discounts and advances, distribution of coin and currency, and fiscal agency operations, and with respect to such matters as the construction of new buildings for the Reserve Bank and its branches.

Monetary and credit policy functions

In the area of monetary policy, Reserve Bank directors have only vaguely defined but nevertheless important responsibilities. One of the most important relates to the fixing of Reserve Bank discount rates. It is interesting to note that the law has never *specifically* required the directors themselves to fix such rates; it provides only that every *Reserve Bank* "shall have power. . .to establish" such rates, subject to "review and determination" by the Board of Governors.[22/]

22/ *Id.*, § 14(d) (12 U.S.C. § 357).

This function could be performed through "duly authorized" officers of the Reserve Bank. Nevertheless, the framers of the original Act clearly contemplated that the function would be exercised by the directors. In keeping with the general feeling at that time that interest rates might well be different in different sections of the country, Senator Owen explained that the fixing of a Reserve Bank's discount rate was being

> ". . .left primarily to the local board, and then to the final determination of the Federal reserve board. The reason for this is that it was believed that the conditions in one section of the country might be sufficiently different from those in another to justify at times a different rate of interest."23/

At the same time, there is no doubt that the framers of the Act contemplated that the Federal Reserve Board, as the "central board" in Washington, should determine national monetary and credit policies and should have the power to make the final determination of discount rates.24/ For example, Senator Owen said:

> "Another very important feature of the bill is that it places in the hands of the Federal reserve board the power to fix the rate of interest. This power primarily is placed in the hands of the Federal reserve bank directors; but the final determination of the rate is put in the hands of the Federal reserve board, in order to obtain the power which is necessary to protect the country as to the gold reserve by raising the rate where necessary; to protect the country against undue inflation; against undue expansion; against a speculative fever, by raising the rate, and, by forecasting the future, to protect the country in advance against any dangerous improvidence that might be brought about, by whatever cause.
>
> "Another very important feature is that allowing the Federal reserve board to fix the interest rate enables a standard to be set by which the business men of the country

23/ 50 CONG. REC. 5996 (Nov. 24, 1913).

24/ *Ibid*.

can hope to ascertain and know reasonably in advance what money will cost them in their enterprises, and, by knowing that they will have a stable rate of interest, to forecast the future with some degree of certainty."

Not long after enactment of the original Act, the legal authority of the Federal Reserve Board to make the final decision as to discount rates was confirmed by the Attorney General of the United States.[25] Nevertheless, it is the directors who must take the initiative; and they are not expected to perform, and they do not perform, a meaningless function. They are expected to establish a rate that in their best judgment is most consistent not only with local credit conditions but with national monetary policies.

Reserve Bank open market operations were not regarded as a tool of monetary policy in 1913, but they have become one of the most important of such tools since 1936, when the present Federal Open Market Committee was given statutory authority to regulate such operations.[26] Five of the 12 members of that Committee are presidents of Reserve Banks, and the presidents are appointed (with the approval of the Board of Governors) by the directors of the Reserve Banks. Thus, it is a responsibility of the directors of each Reserve Bank to select a president who, in their judgment, will be qualified to participate in the important monetary policy deliberations and decisions of the Committee. Each president so selected must exercise his own best judgment as a member of the Committee and, contrary to assertions

25/ 32 Op. Atty. Gen. 81 (1919).

26/ Federal Reserve Act, § 12A (12 U.S.C. § 263).

sometimes made by Representative Patman,[27] he is not obligated to carry out the wishes of the directors by whom he was appointed; he does not even reveal to his directors the actions taken by the Committee at meetings attended by him. Nevertheless, the president must rely to a large extent upon the economic data and recommendations provided by the research staff of his Bank; and the directors have overall responsibility for the adequacy of that staff. Moreover, they are free to express, and they are expected to express, their own views as to open market policies.

Although indirect and intangible, the influence of Reserve Bank directors upon open market policies may be greater than their influence upon credit conditions through the establishment of the discount rate. In 1952, a subcommittee of the Joint Economic Committee, of which Representative Patman was chairman, made the following statement:[28]

> "The influence of the directors of the Federal Reserve banks on the formulation of monetary policy is in large part intangible and is both difficult and unrewarding to measure and to define. But, the most important single way in which the directors have an impact on central policy decisions is through the participation of the presidents whom they have elected in the deliberations of the Federal Open Market Committee. . . ."

27/ The Federal Reserve System After Fifty Years, Hearings before Subcommittee on Domestic Finance of House Banking and Currency Committee (88th Cong., 2d Sess., Jan. 21-23, 29, 30; Feb. 3-6, 1964), Vol. 1, p. 61. [These hearings are hereafter cited as 1964 Hearings on Federal Reserve.]

28/ Report of Subcommittee on General Credit Control and Debt Management of Joint Committee on the Economic Report (82d Cong., 2d Sess., June 1952), p. 54. [Hereafter cited as 1952 Patman Subcommittee Report.]

Powers of directors in relation to those of the Board of Governors

At the time of enactment of the original Federal Reserve Act, it was apparently contemplated that the Reserve Bank boards of directors would be more autonomous than they are regarded today, both with respect to the administration of the affairs of the Reserve Banks and with respect to monetary and credit policies. Stated differently, it seems clear that the powers of the boards of directors vis-a-vis those of the Board of Governors have declined since 1913.

For example, in 1913, Senator Shafroth, a supporter of the Owen bill, obviously assumed that Reserve Bank directors would have complete control of the "discount window" and of the manner in which the funds of the Reserve Banks would be invested. On the floor of the Senate he stated:[29/]

> ". . .These Federal reserve banks are the ones that deal with the individual banks, pass upon the securities presented, direct what paper shall be discounted, and attend to all matters involving the care and investment of the enormous sums of money which will be held by them. It is upon the boards of directors of these Federal reserve banks that bankers should be placed, as is provided in the bill."

In the same vein, Senator Shafroth later said:[30/]

> ". . .The Federal reserve board is paramount upon all questions where the Government has an opportunity to exercise the powers of Government in a governmental matter, but dealing with the question of the amount of money, the paper to be discounted, is not a matter in which the Government can be interested."

In contrast, the discount window practices of the Reserve Banks today are clearly subject to policies prescribed by the Board of Governors,

29/ 50 CONG. REC. 6023 (Nov. 25, 1913).

30/ 51 CONG. REC. 538 (Dec. 9, 1913).

and their investments are subject to the directions and regulations of the Federal Open Market Committee.

In 1913, most Congressmen apparently assumed that the Reserve Bank boards of directors would be practically autonomous and that the Federal Reserve Board would seldom interfere with their management of the Reserve Banks. Thus, Senator Nelson said:[31/]

> ". . .While we place at the head of this system a general reserve board here in Washington, we establish in the system a number of reserve or regional banks. We equip them with a board of directors and give the board of directors practically plenary banking powers. It is only in a few special cases and in remote contingencies that the Federal reserve board can exercise any controlling power. . . ."

Some members of Congress felt that the Reserve Bank directors should have even greater autonomy and more freedom from control by the Federal Reserve Board. They objected, for example, to provisions of the Act authorizing that Board to remove Reserve Bank directors. Representative Fess argued that the removal power would place "the local directorates in the hands of the Federal board";[32/] and Representative Temple contended that "the real directors of these 12 reserve banks are the 7 men of the Federal reserve board."[33/]

Since 1913, the powers of Reserve Bank directors have declined vis-a-vis those of the Federal Reserve Board, principally because of various changes in the law and increased recognition of the need for determination by the Board of national monetary policies. In 1933,

---

31/ Id., 516.

32/ 50 CONG. REC. 4872 (Sept. 13, 1913).

33/ Id., 4908.

Reserve Board Chairman Eccles said:[34]

> "Since its establishment in 1914, the Federal Reserve System has undergone many changes in the direction of increased control by the Board of Governors. With the passage of the Banking Act of 1935 this control has been greatly strengthened insofar as national policies are concerned. . . ."

In 1952, Reserve Board Chairman Martin noted that changes in the law had "modified the role of the boards of directors of the Federal Reserve Banks in the formulation of System credit policies."[35] And the 1952 Patman Subcommittee Report stated:[36]

> ". . .At one time this independence [of the Reserve Banks] was much greater. The original Federal Reserve Act appears to have conceived the individual Federal Reserve Banks as important policy-making agencies and the Board of Governors (then the Federal Reserve Board) as principally a regulatory agency, like the Interstate Commerce Commission. The subsequent trend has been toward a somewhat greater degree of independence of the central board from the President but a much diminished autonomy for the individual banks. The most important changes in this direction were made by the Banking Act of 1935, but it has been the trend for the whole period since the adoption of the original Act and is, for the most part, merely a reflection of the growth in the importance of monetary policy and the recognition of the fact that this policy cannot be determined by regions but must apply over an entire currency area."

Even with respect to the administration of the internal affairs of the Reserve Banks, the powers of the directors probably are less than was contemplated in 1913. Thus, the Board of Governors,

---

34/ Hearings before House Banking and Currency Committee on Government Ownership of the Federal Reserve Banks (75th Cong., 3d Sess., Mar., Apr. 1938), p. 448. [These hearings are hereafter cited as 1938 Hearings on Government Ownership of Federal Reserve Banks.]

35/ Monetary Policy and the Management of the Public Debt (Joint Committee Print of Joint Committee on the Economic Report, 82d Cong., 2d Sess., Feb. 1952), p. 249. [This document is hereafter cited as 1952 Patman Questionnaire.]

36/ 1952 Patman Subcommittee Report, p. 53.

under its statutory power of "general supervision", its authority to approve salaries, and its regulatory authority in particular areas, now determines general policies with respect to salary scales of Reserve Bank officers and employees, expenditures for building construction at the Reserve Banks and their branches, and the exercise of the Reserve Bank discounting and collection functions.

A "link" between Government and business

If the administrative and monetary policy responsibilities of Reserve Bank directors are now more circumscribed than was contemplated in 1913, they have one function, without express statutory sanction, that was understood in 1913 and that has become more important with the passing of the years. To state this function briefly - and inadequately - Reserve Bank directors provide an intangible "link" between public and private interests - between Government and business - that works in both directions: on the one hand, it brings to bear upon decisions relating to the day-to-day administration of the regional Reserve Banks and to the formulation of national monetary policies the varied viewpoints of persons with widely diversified backgrounds and experience; and on the other hand, it provides a means of interpreting System policies to business and the general public and of achieving "grass-roots" understanding and support of such policies.

The idea that the boards of directors of the various Reserve Banks would give the System greater contact with and knowledge of local business conditions than would a single central bank was expressed by Senator Pomerene in the debates on the original Act. He pointed out

that each Reserve Bank would have a separate board of directors

> ". . .that can be in a particular locality and can have a much more intimate knowledge of business conditions, of credit conditions, and of property conditions than the officers of one central bank could have."37/

In 1952, Reserve Board Chairman Martin described the role of Reserve Bank directors in bringing to the Federal Reserve System the advantages of diversified backgrounds and in interpreting System policies to the business community:38/

> "Selection of directors in this manner assures a diversity of background and experience in the policy and administrative decisions of the Reserve Banks. Each director's training and experience as banker, businessman, farmer, educator, or professional man provide qualifications for participation with others of different background and experience in dealing with credit problems that affect all phases and walks of life.
>
> * * * * *
>
> ". . .They are outstanding men in their communities who are in close contact with banking and business conditions in their respective districts. They include successful operators of banks, manufacturing and processing concerns, farms, department stores, and various other enterprises, as well as men prominent in the field of education or the law.28 [Footnote omitted.] Thus they are able to bring to the deliberations of the System the benefit of broad experience and training at a very high level and to perform an essential service in supplying judgment and advice on the credit problems of their respective districts and on other important problems confronting the System as a whole. In the formulation of national policy, the Board and the Open Market Committee have a unique advantage in being able to obtain information on conditions in their respective districts directly from the more than 250 directors who are representatives of diverse fields of endeavor in all sections of the United States. Though the directors may not make their views prevail on national credit and monetary policy, it is their duty to inform the Board and the Open Market

37/ 51 CONG. REC. 837 (Dec. 13, 1913).

38/ 1952 Patman Questionnaire, pp. 249-51.

Committee on national credit developments as they see them from their varying vantage points and to execute in their districts fairly, impartially, and as effectively as possible the credit and monetary policies decided upon by the System.

"When a System policy has been determined, Reserve Bank directors are in a position and have a duty to interpret that policy to interested people in their respective districts. It is important that System policies and the reasons therefor be understood by businessmen, bankers, and others. The greater the understanding, the greater is the likelihood that the sound features of such policies will be accepted and supported and, conversely, that defects in such policies will be pointed out. For these and other reasons, it is important that men of competence and broad experience continue to serve as directors of the Federal Reserve Banks."

Apparently agreeing with Chairman Martin's views, the 1952 Report of Representative Patman's Subcommittee contained the following observations with respect to Reserve Bank directors:[39/]

". . .They are an invaluable link between the Government and the business community. Because of them, the Government is better able to understand the point of view of business and business is better able to understand the point of view of Government. The Subcommittee believes that it is important that their responsibility, not merely in the business management of their banks but also in the formulation of monetary policy, should be kept sufficiently great to attract men of high caliber. . . ."

In 1964, the president of the St. Louis Reserve Bank said:[40/]

". . .I think that the present structure and control of Federal Reserve banks provide a desirable and effective blending of the national and the regional. There is strong control by the Board in Washington. There is benefit from the knowledge and judgment of the local boards of directors."

And President Hayes of the New York Reserve Bank similarly emphasized the value of the local boards of directors:[41/]

"The service on the boards of directors of the Reserve banks of men who are generally well known and highly regarded

39/ <u>1952 Patman Subcommittee Report</u>, p. 53.

40/ <u>1964 Hearings on Federal Reserve</u>, p. 293.

41/ <u>Id</u>., p. 535.

in their communities and who have backgrounds in banking, business, agriculture and public affairs, has furnished the Reserve banks with valuable sources of information as to the economic conditions within each district and has helped to foster efficiency and businesslike methods in the operations of the Reserve banks. . . ."

The importance of the link between Government and business provided by Reserve Bank directors is enhanced by the very number of such directors. The 12 Reserve Banks have a total of 108 directors; and to this number should be added the 154 directors of the 24 branches of the Reserve Banks.

Summary

To summarize, it may be said that the functions of Reserve Bank directors are (1) to administer the affairs of the Reserve Banks, much like directors of private corporations, but subject to the general supervision of the Board of Governors; (2) to participate in the formulation of monetary policies through establishment of discount rates and selection of Reserve Bank presidents to serve on the Federal Open Market Committee; and (3) to serve as a link between the Government and the public in the implementation and interpretation of monetary policies. With these functions in mind, it is now in order to consider whether any changes should be made in present provisions of law regarding the selection of Reserve Bank directors.

SELECTION OF RESERVE BANK DIRECTORS

The original Act

One of the principal issues involved in Congressional consideration of the original Federal Reserve Act was whether a majority of Reserve Bank directors should be chosen by the member banks or by the Government, i.e., by the Federal Reserve Board. The issue was not so pronounced in the House of Representatives, where the Carter Glass concept of the Reserve Banks as "bankers' banks", with their stock owned and a majority of their directors elected by the member banks, easily prevailed.[42/] In the Senate, however, Senator Hitchcock led a vigorous battle for ownership of Reserve Bank stock by the "public" and for selection of a majority of Reserve Bank directors by the Federal Reserve Board.

It was this issue that was chiefly responsible for an even split among the 12 members of the Senate Banking and Currency Committee and that made it necessary for the chairman of the Committee, Senator Robert Owen, to report the House-passed bill "without recommendation".[43/] However, that report was accompanied by the "views" of the two sections of the Committee, each submitting a separate draft of the bill. Senator Owen, on behalf of himself and Senators O'Gorman, Reed, Pomerene, Shafroth, and Hollis, proposed a bill, generally known as the "Owen bill", providing for stock ownership of the Reserve Banks by the member banks and for the

42/ For text of provisions of the House-passed bill, see House Report on Original Act, p. 113.

43/ Senate Report on Original Act, Part 1.

election of six Reserve Bank directors by the member banks and the appointment of the other three by the Federal Reserve Board.[44] Senator Hitchcock, on behalf of himself and Senators Nelson, Bristow, Crawford, McLean, and Weeks, submitted what became known as the "Hitchcock bill", providing for ownership of Reserve Bank stock by the public and for the appointment of five Reserve Bank directors by the Federal Reserve Board and the election of the other four directors by the member banks.[45]

Senator Owen and his supporters argued that the member banks were being required to place their reserves in the Reserve Banks and that, in order to safeguard those funds, the member banks should select a majority of the board of directors. It was also argued that, unless the member banks had such a majority on the board of directors, they could not be induced to join the System. The arguments were summarized by Senator Owen as follows:[46]

> "The point has been raised - and that is in issue between the two sections of the committee - that we ought not to allow the banks to have a majority of directors, but that the Government ought to name a majority of the directors. The reason why those agreeing with me and with the House of Representatives believed it was wiser to have the banks name a majority of these directors was this: We are requiring of the banks to put their reserves into these reserve banks; we are requiring the national banks to put approximately $400,000,000 into these great reserve banks and inviting the State banks and trust companies to contribute in proportion, for their own safeguarding, it is true, but also for the safeguarding of the national financial system and our national commerce; but we are requiring them

44/ Id., Part 2, pp. 38-40.

45/ Id., Part 3, pp. 8, 9.

46/ 50 CONG. REC. 5995 (Nov. 24, 1913).

to put in $400,000,000. When we do that, it is going too far to say to the men from whom we require these reserves to be so placed that they shall not be permitted to safeguard those funds. It is our duty to them, it is our duty to the country, to put upon them the responsibility of safeguarding their own funds by giving them a majority of the board of directors in those banks. Moreover, we must rely upon the friendly cooperation of these banks in order to induce them to put these reserves in the hands of the Federal reserve banks."

Along the same lines, and contending that the Hitchcock proposal would change the whole theory of the legislation, Senator Shafroth stated:[47/]

". . .These Federal reserve banks are the ones that deal with the individual banks, pass upon the securities presented, direct what paper shall be discounted, and attend to all matters involving the care and investment of the enormous sums of money which will be held by them. It is upon the boards of directors of these Federal reserve banks that bankers should be placed, as is provided in the bill.

"The amendment of the section of the committee represented by the Senator from Nebraska provides that there shall be five directors appointed by the Government of the Federal reserve bank and that four shall be elected by the member banks. That very amendment, if adopted, would destroy the entire character of this bill; it would make an entirely different kind of a bill, upon an entirely different theory. The theory of the bill as it came from the House and as it is preserved by our section of the committee is that there should be a bank of banks; that the banks should be required to take the stock in the Federal reserve bank. It can not be possible that banks would come into a system which creates a Federal reserve bank and provides that member banks shall deposit their reserves, aggregating $400,000,000, and not have a majority of the board of directors. It is absurd to think that any bank on earth would come into a system of that kind. . . ."

Supporters of the Hitchcock bill, on the other hand, insisted that, since the Reserve Banks were to be public institutions, a majority of their directors should be appointed by the Government of the United

47/ Id., 6023 (Nov. 25, 1913).

States through the Federal Reserve Board and that, otherwise, the Reserve Banks would be controlled by private bankers who might abuse their authority as directors in their own self-interests. Thus, Senator Hitchcock argued:[48/]

> "Now Mr. President, I come to the next item of difference, which is the control of these reserve banks. The section of the committee to which I belong proposes that the Government of the United States, through its Federal board, shall select five of the directors of each reserve bank, and the bank of the district shall select four. We defend that upon the ground that this reserve bank is established as a public utility. It is not to make money; it is to protect the depositors against loss; and it is to give the borrowing public a stable and uniform low rate of interest.
>
> "We realize that the banking interests should be represented upon each board, because the banks have their reserves in these reserve banks, and by giving them the power to elect four members they will have sufficient representation of their own selection there to cooperate with five men chosen by the Federal board."

At another point during the Senate debates, Senator Hitchcock said:[49/]

> "It is easy to see that if you place the control of a board of directors in the hands of the banking interests the powerful banks are the ones that are going to dominate it. Through their country correspondents and their great acquaintance they will be the ones who will elect the directors. They have an interest at stake; they have axes to grind."

Similarly arguing that a board of directors principally elected by the member banks would operate the Reserve Banks for their "personal gain", Senator Borah stated:[50/]

> "Mr. President, this bill, as it comes to the Senate, bearing the name of the distinguished Senator from Oklahoma, and the amendment which is proposed, present clearly and

48/ Id., 6016.

49/ 51 CONG. REC. 703 (Dec. 11, 1913).

50/ Id., 763 (Dec. 12, 1913).

fairly to this body the question whether we are in favor of giving over to the Government the directorship of the Federal bank or leaving it in the hands of those whose prime interest must be that of personal gain. The issue is clearly presented. We can not dodge it. We can not evade it. We must meet it in this amendment. To my way of thinking there can be no sound reason against Government control of the directorship, whatever may be said as to the stock ownership, which reaches into a different field of finance."

Arguing that the business of each Reserve Bank would be controlled by its board of directors and that that board would be biased in favor of the banks as against the public if a majority of its members should be elected by member banks, Senator Nelson stated:[51/]

"It seems to me, Mr. President, that the plan of the Hitchcock bill is in every way superior in this respect to that of the other two bills. The banking business of this system will be practically controlled and conducted by the board of directors of the several reserve banks, for the Federal reserve board will have only a supervisory power, which is likely to be invoked only in cases of great emergency. It is this board of directors that will be in constant touch with the member banks and the public, and to my mind it is important to divorce these banks as far as possible from the exclusive control of the bankers. The purpose of establishing this new system is to place as much power as possible in the hands of the Government and to minimize as far as possible the power of the banks, not so much because of hostility to the banks as the fear that the directors may be unduly biased in favor of the banks as against the public. They constitute the power to which the member banks must apply when they seek to obtain discounts for the purpose of securing bank credits and bank circulation, and therefore it is of the utmost importance to have an unbiased and impartial tribunal to act as a just and fair umpire in such cases.

"The directors of the reserve bank have it in their power, by indirect methods, to make or unmake a member bank. For these reasons I think it safer that the preponderance of power in the board of directors be placed in the hands of men who are likely to deal impartially with the public and with the member banks. . . ."

51/ Id., 516 (Dec. 9, 1913).

In the same vein, Senator Gronna said: 52/

". . .The pending bill provides for a concentration of the control of money and credit within the eight districts provided for, and hands this concentrated control over to the bankers of that district. If the interests of the banks of that district and the interests of the people and business in that district conflict, does anyone doubt what interests the reserve banks so controlled will take care of? . . ."

And Senator Bristow felt that, unless the Reserve Banks were controlled by directors appointed by the Government, he could not vote for the bill at all: 53/

". . .It is a question as to whether these banking monopolies, which we are creating under the proposed law, shall be controlled by their own boards of officers selected by themselves or whether they shall be controlled by officers of the Government. . . .

* * * * *

"So important do I regard this provision in the bill that, if I indorsed the majority of its other features, I would not vote for it because it contains this provision, for I never intend to cast my vote for a measure which legalizes a monopoly and legalizes the control of that monopoly by private interests. . . ."

Defenders of the Owen bill attempted to refute the charge that abuses would result from the election of a majority of Reserve Bank directors by member banks. They pointed out that the Federal Reserve Board in Washington, a Government agency, not only would appoint three of the nine directors but would have power at any time to remove any of the directors who might abuse their authority. Thus, after referring to the broad supervisory powers of the Federal Reserve

52/ Id., 1040 (Dec. 17, 1913).

53/ Id., 1121 (Dec. 18, 1913).

Board, Senator Owen said:[54/]

"I do not think that it is necessary to take the time of the Senate at this general presentation of the bill to discuss in detail those powers, except to say in a broad way that the powers are intended to cover the complete supervisory control of this system. It is perfectly obvious that these powers make it entirely unnecessary to deprive the banks of six directors on the Federal reserve bank board on any theory that the banks could use such powers injuriously. The Federal reserve board even has the power to remove the directors of the Federal reserve banks or any of their officers for cause, so that the supervisory control of the United States will be complete. . . ."

Similarly, Senator Pomerene defended the Owen bill as follows:[55/]

"Is it possible that anything radically wrong can be done by this board against the public interests when the Government has at least three representatives on the board who can keep, and will keep, the Federal reserve board fully advised as to what is going on, and when it has at the same time the power to remove arbitrarily upon its own motion, when the circumstances are such, in its opinion, to justify it, every member of that board?"

The battle was a close one and was not finally resolved until just five days before the Federal Reserve Act was signed by President Wilson. On December 18, 1913, the test came when Senator Hitchcock offered an amendment on the floor that would have specifically provided for the appointment of five directors by the Federal Reserve Board and the selection of the other four by member banks. Senator Owen immediately moved to lay the amendment on the table and his motion was adopted by a close vote of 44 to 36.[56/]

54/ 50 CONG. REC. 5998 (Nov. 24, 1913).

55/ 51 CONG. REC. 839 (Dec. 13, 1913).

56/ Id., 1121 (Dec. 18, 1913).

1938 consideration

Twenty-five years later, an attempt was made to renew the battle for selection of a majority of Reserve Bank directors by the Government; but it was only a brief and unsuccessful skirmish. In 1938, Representative Wright Patman introduced a bill[57] that went beyond Senator Hitchcock's 1913 proposal. Mr. Patman's bill would have required the appointment of all nine directors of each Reserve Bank by the President of the United States, with the advice and consent of the Senate, although, during hearings on the bill, he agreed to an amendment providing for the appointment of all directors by the Federal Reserve Board.[58] Incidentally, the bill would have also provided for Government ownership of Reserve Bank stock, abolition of the Federal Open Market Committee and the Federal Advisory Council, audit of the Federal Reserve Board and the Reserve Banks by the General Accounting Office, and other changes in the structure of the Federal Reserve System.

On the premise that member banks, through the election of a majority of Reserve Bank directors, controlled the Reserve Banks, Mr. Patman argued that "the money-issuing privilege should not be farmed out to private banks of the country."[59] Echoing Senator Hitchcock's 1913 argument that bank-elected directors would be motivated by selfish interests, Mr. Patman contended:[60]

> ". . .Not a one of those directors should be a banker. It is not in the interest of this country for those who are

57/ H.R. 7230, 75th Cong., 1st Sess.

58/ 1938 Hearings on Government Ownership of Federal Reserve Banks, p. 175.

59/ Id., p. 5.

60/ Id., p. 12.

> selfishly interested and who will do as all of us would naturally do, for we would befriend an interest that we are interested in, because we see it from that viewpoint - not a one of those nine members should be a banker. . . ."

Surprisingly, the principal and almost only supporter of Patman's bill was former Senator Robert Owen. Although in 1913 he had led the fight for selection of a majority of Reserve Bank directors by the member banks, Owen now said that actually he had "favored giving the Government a majority on the board of directors of the Reserve banks".[61/] Contending that Reserve Bank directors exerted too much influence on monetary policies, he said:[62/]

> ". . .They reflect the interest of their group, which is adverse to the public interest . . . .
>
> "They [the Federal Reserve Board] have not the power which they ought to have, because they should absolutely control the instrumentalities by which to regulate the value of money.
>
> "That is a governmental function, in my judgment, charged as a duty upon the Congress by the Constitution. That is not a question of debate with me; it is a question of obedience or disobedience, and the instrumentality should be sufficient to enable the Congress to obey the mandate of the Constitution.
>
> "Therefore, I favor as a part of that instrumentality the taking over of the Reserve banks, so that the United States can control its monetary operations. It has certain banking operations, acting as a great clearing house for all of the banks of the country - a very useful service."

Reversing his 1913 position, but still not going as far as Mr. Patman, he stated that he would "have no objection to the banks having three of the nine directors, so that they might be heard with regard to

61/ Id., p. 104.

62/ Id., p. 238.

matters which relate to the banking elements in the Federal Reserve banks, which operate as clearing houses for all banks."[63]

Chairman Eccles of the Federal Reserve Board opposed the Patman bill. He denied that either ownership of Reserve Bank stock or the election of two-thirds of Reserve Bank directors by the member banks enabled those banks to dominate the Federal Reserve System; on the contrary, he stated that the System clearly was "dominated not by the banks but by the Board of Governors" of the Federal Reserve System.[64] Arguing for retention of the existing arrangement, Mr. Eccles said:[65]

> ". . .In regard to local matters, the maintenance of local autonomy under general supervision and close Government regulation is advantageous in a country like the United States, consisting of various regions with diverse economic interests. The maintenance of locally elected directors on Federal Reserve bank boards is of great advantage in creating local pride and local interest in the System and in inspiring the business community with confidence in its management. This advantage would be lost if the appointments of all local directors were handled entirely from Washington. Consequently, the System's ability to render a disinterested public service to all classes of the community would be greatly diminished."

Eccles was joined in opposition to the Patman bill by a number of economists who felt strongly that appointment of all Reserve Bank directors by the Government would be a backward step that would make the System subject to political pressures.[66] One of them, for example, felt that this method of appointment "would certainly lend itself to political influence and packing of the boards" of directors.[67]

63/ *Ibid.*

64/ *Id.*, p. 446.

65/ *Id.*, p. 448.

66/ *Id.*, pp. 287-302.

67/ *Id.*, p. 295 (Professor Ray V. Leffler).

Consideration since 1938

Mr. Patman failed in his 1938 effort to have all Reserve Bank directors appointed by the Government; and in 1952 a subcommittee of the Joint Committee on the Economic Report of which he was chairman concluded that the existing arrangement for selection of such directors should not be changed.[68/] No bill to alter the arrangement has been considered since 1938.

Nevertheless, Mr. Patman has lost no opportunity to express his view that the bankers have too much influence on the boards of directors of the Reserve Banks. Thus, during 1964 hearings on "The Federal Reserve System After Fifty Years", he said that the boards were "topheavy with bankers".[69/] Mr. Patman has not been alone in making such charges. Others have suggested that the boards are dominated by bankers and big business,[70/] and that the Reserve Banks are too closely tied to commercial banks.[71]

One of the arguments often made by Mr. Patman, and sometimes by others, is that member banks elect a majority of Reserve Bank directors, that the directors appoint the presidents of the Reserve Banks, that the presidents serve as members of the Federal Open Market Committee, and that therefore the member banks exert an influence on the formulation of national monetary policies. Although the five presidents who are

68/ 1952 Patman Subcommittee Report, pp. 53, 54.

69/ 1964 Hearings on Federal Reserve, p. 894.

70/ 1968 Compendium, p. 349.

71/ Id., pp. 613, 614.

members of the Committee at any particular time are outnumbered by the seven members of the Federal Reserve Board, it is argued that, if the members of the Board are divided on an issue of monetary policy, the views of the Reserve Bank presidents may prevail and that thus national monetary policy may be dictated not by Government officials appointed by the President of the United States but by men who are indirectly selected by and are "beholden" to private banks. In response, members of the Federal Reserve Board and the Reserve Bank presidents have pointed out that the appointment of a president by his Reserve Bank's directors is subject to approval by the Federal Reserve Board and that, in any event, each president as a member of the Open Market Committee exercises his own judgment in voting on monetary policy decisions without regard to whatever may be the views of his board of directors or of the member banks that elect two-thirds of the directors. Nevertheless, the Patman argument cannot easily be brushed aside; to the layman it may seem quite plausible. The argument was particularly plausible when for a time there were two vacancies on the Federal Reserve Board, so that half of the voting members of the Committee were Reserve Bank presidents; and Mr. Patman made the most of that fact during the 1938 hearings on his bill to provide for the appointment of all Reserve Bank directors by the Government.[72/]

The Patman argument, as well as the answer of Federal Reserve officials, may be illustrated by the following colloquy between

72/ 1938 Hearings on Government Ownership of Federal Reserve Banks, p. 338.

Mr. Patman and Federal Reserve Chairman Martin in 1964:[73]

"THE CHAIRMAN. [Mr. Patman] But anyway, those six directors are elected by the private banks. They nominate them, they submit them to the banks, and the banks all vote.

"And six out of the nine are elected by the private banks.

"There is no dispute about that, is there?

"MR. MARTIN. That is correct.

* * * * *

"THE CHAIRMAN. Well, six are the majority. The directors select the President of the bank, don't they?

"MR. MARTIN. They do, subject to our concurrence.

"THE CHAIRMAN. That is right.

"Of course, you have to make sure he is a good man, that he hasn't been in the penitentiary or something.

"MR. MARTIN. Oh, no. We have the control.

"THE CHAIRMAN. I know - you have the veto. But you have to approve somebody that they recommend, if he is a good man, don't you?

"MR. MARTIN. No; we don't have to.

"THE CHAIRMAN. You have to have a president.

"MR. MARTIN. We have to have a president; yes.

"THE CHAIRMAN. Well, as long as they submit names, and they submit one that is all right, you approve him, don't you?

"MR. MARTIN. We could suggest people, also, if we wanted to.

"THE CHAIRMAN. Well, now, you have never turned down but one, have you?

"MR. MARTIN. Oh, we have -

73/ 1964 Hearings on Federal Reserve, pp. 60-62.

"THE CHAIRMAN. Well, just answer that question, please.

"You have only turned down one, have you not?

"MR. MARTIN. No.

* * * * *

"THE CHAIRMAN. Well, now, this fellow, the President, he is selected for 5 years. And he is naturally obligated to the directors, is he not?

"They elect him.

"MR. MARTIN. Three of the directors are directly appointed by us. All of the directors are responsible to us -

"THE CHAIRMAN. I am talking about the six. Let us say that there was a controversy, and six of them wanted him, and three didn't, and he is elected. Now, it is his duty to serve all the directors, is it not?

"MR. MARTIN. Let me get this straight.

"There are six to three. Now, it comes up to us.

"Do you think we would approve it?

"THE CHAIRMAN. Well, I am talking about something after he was all approved and everything. That question of approving; Mr. Martin, I think you are emphasizing that a little bit too much, because it seldom, if ever, comes up, as you know. And that hasn't been a major issue in the Federal Reserve System.

"But I am talking about when you have a President who has been selected, he has been approved, everything.

"Now, what is his duty? His duty is to work with the Board that selected him, is it not? He works with them, and carries out their will, doesn't he?

"MR. MARTIN. Quite frequently he leads the Board, and shows them - takes the leadership in the System, and the Board doesn't contribute as much as it should to the management of the bank.

"THE CHAIRMAN. That doesn't exactly answer my question, Mr. Martin.

"It is his duty - in other words, he is a sort of a servant of the board of directors, is he not?

"MR. MARTIN. He is elected by the board of directors.

"THE CHAIRMAN. And he is under obligation to carry out their will and wishes, is he not?

"MR. MARTIN. Well -

"THE CHAIRMAN. When he knows their will.

"MR. MARTIN. Well, to show you how complicated this is, Mr. Patman, in the case of open market operations, the board of the bank cannot be told what - I have often wondered why some of the boards accept the responsibility. But the responsibility is back here, and the knowledge is back here. The President comes on to the Open Market Committee, and he is not at liberty to reveal the Committee's deliberations on the policy, even to his board of directors."

Perhaps even more explicitly, the Patman argument is exemplified by the following colloquy between Representative Weltner and Governor Robertson of the Federal Reserve Board:[74]

"MR. WELTNER. May I ask a question, turning now to the issue that was raised in regard to whether or not the general public believes that the Federal Reserve System is 'banker dominated.'

"It is true, is it not - I direct this question to Governor Robertson because I believe he was the most explicit on that - it is true that banks do elect six out of nine directors -

"MR. ROBERTSON. That is right.

"MR. WELTNER (continuing). Of the Federal Reserve bank, and those directors elect a president. Is that not so?

"MR. ROBERTSON. That is right subject to the approval of the Board of Governors.

"MR. WELTNER. Right; and as the president is elected by the bankers, 5 out of 12 members of the Open Market Committee are elected indirectly by banker members. They comprise 5 out of 12 members of the Open Market Committee?

"MR. ROBERTSON. That is right.

74/ Id., pp. 118, 119.

"MR. WELTNER. Well, now wouldn't you say that that is a pretty fair indication as to the situation that the Federal Reserve System is banker dominated?

"MR. ROBERTSON. On the face of it you would certainly take it for granted that the System is subject to banker influence. Whenever you have a majority of the directors of the Federal Reserve banks elected by the commercial banks that are members of the System, and you have the President selected, as you indicated, by them, you would think certainly he is going to speak for them.

"I think a very good case can be made in logic. This relates of course to the proposition that the Federal Open Market Committee operations should be transferred to the Board, which hasn't been raised here this morning but is contained in this bill. I think a very good case can be made for that proposition; namely, that this is so important a function that the decision should be made by a body composed exclusively of people who are 100 percent Government officials - men who are appointed by the President with the advice and consent of the Senate, and are, therefore, in the fullest sense of the word Government employees.

"A very good case can be made for that. But I must say that on the basis of my observation of open market operations over the past 12 years, I do not believe that any Federal Reserve bank President could have been more objective if he had been an employee of the United States rather than the Federal Reserve. It has been amazing to me to see the extent to which they have remained objective.

"And I think the traditions within the System are such as to assure real effort on the part of every individual to remain impartial and objective, and avoid any conflict of interest."

Analysis

In the light of the foregoing discussion of the history of the matter, it is worthwhile to consider objectively, after the lapse of 57 years, whether there is any reason to change the manner in which Reserve Bank directors are selected. At one extreme, Reserve Bank directors could be dispensed with entirely; conceivably the Reserve Banks could continue to function, without directors, under the

direction of presidents appointed by the Board of Governors. At the other end of the spectrum, the present arrangement could be allowed to continue without any modification. In between these extremes there is the possibility of providing for the selection of a majority of the directors by the Board of Governors instead of by the member banks.

The principal arguments for maintenance of the status quo are that it has "worked well"; that it elicits support from member banks; that it affords the Reserve Banks the benefits of the experience of men from varied walks of life - from banking, business, and the professions; that it provides a "link" between public and private interests, between Government and business; and, perhaps most important, that it symbolizes the traditional concept of a regional and quasi-independent central banking system. The "link between public and private interests" argument rests upon the considerations discussed earlier in this paper in connection with the functions of Reserve Bank directors.

Despite such arguments, it is logically conceivable that the same advantages - the benefits of diversified backgrounds and a "link" between public and private interests - could be obtained even if all or a majority of Reserve Bank directors were appointed by the Federal Reserve Board; the law could still require that three directors be bankers, that three should be businessmen, and that three should be selected from the "general public" - professional men, educators, etc.

If the law were changed to provide that all Reserve Bank directors should be appointed by the Government, i.e., by the Board

of Governors, as proposed by Mr. Patman in 1938, such action could be interpreted as a move toward "nationalization" of the banking system and as an impairment of the Federal Reserve's "independence". The same construction might be placed upon a change in the law that would provide for appointment by the Board of a majority or of six of the nine directors of each Reserve Bank.

On the other hand, one cannot ignore the facts that six of the nine directors of each Reserve Bank _are_ elected by member banks, that the directors _do_ appoint the Reserve Bank presidents, and that the presidents _do_ serve as members of the Federal Open Market Committee, which determines important national monetary policies. These facts may logically and naturally suggest, as Mr. Patman so often has said, that "private bankers" control the Reserve Banks or at least exercise an undue influence on the formulation of monetary policies.

The issue here is similar to that regarding ownership of Reserve Bank stock by the member banks in that it involves public psychology and an "image" of the Federal Reserve System. Does the election by member banks of a majority of Reserve Bank directors provide a desirable "symbol" of a blend of public and private interests and of the political independence of the System? Or does it symbolize instead an undesirable dominant influence by private interests in the performance of the public functions of the System?

In 1964, one Reserve Bank president suggested that, if ownership of Reserve Bank stock by member banks does permit an image of member bank control of the Reserve Banks, it could be corrected, without cancellation of such stock ownership, simply by providing for

appointment of a majority of Reserve Bank directors by the Board of Governors.[75/] Such a change in the selection of directors would also break the chain of reasoning by which it may now be alleged that the Reserve Bank presidents who serve on the Federal Open Market Committee are indirectly "beholden" to private bankers.

It may also be suggested that, while it may be appropriate for the member banks to elect their own "representatives" on the Reserve Bank's board of directors - the class A directors, it is somewhat illogical that they should also elect the class B directors who are supposed to represent commerce, agriculture, and other industrial pursuits. Why shouldn't the class B directors be elected by the interests they represent? The answer may be that this would be impracticable. Nevertheless, the fact remains that the banks theoretically are in a position to place on the Reserve Bank's board of directors not only bankers but businessmen who quite possibly may be their own customers. Thus, the large group 1 banks might naturally select as class B directors top officers of national business concerns that have substantial accounts with such banks. Since group 1 banks in all Federal Reserve districts are relatively few in number compared to the number of smaller banks in groups 2 and 3, some credence may attach to the assertion that the Reserve Banks are dominated by big banks and big business.

Provision for appointment by the Board of Governors of a bare majority of the directors of each Reserve Bank - five out of nine - would disturb the present three-way division of directors into

75/ Id., p. 756.

classes respectively representing banks, business, and the public. Granting that such a representation of different interests has value, it could be preserved by providing for the appointment of six directors by the Board of Governors, i.e., of the three class B as well as the three class C directors, without any change in the requirement that class B directors shall be actively engaged in commerce, agriculture, or some other industrial pursuit.

It is possible, perhaps likely, that a change in the law to provide for appointment by the Board of Governors of either five or six of the nine directors of each Reserve Bank might have an initial adverse effect upon the attitude of member banks and the public toward the Federal Reserve System. They might regard this change - like cancellation of ownership of Reserve Bank stock by the member banks - as a move toward "nationalization" of the banking system or as a weakening of Federal Reserve "independence". On the other hand, it is equally possible that the reasons for the change could be satisfactorily explained and that it would eventually be understood and accepted by the banks and the public. Such a change certainly would not imply such a drastic alteration of the structure of the System as would be implied by provision for audit of the System by the General Accounting Office or for the operation of the System with funds appropriated by Congress.

CLASSIFICATION OF MEMBER BANKS

FOR ELECTION PURPOSES

In connection with the selection of Reserve Bank directors, the sixteenth paragraph of section 4 of the Federal Reserve Act prescribes a somewhat complicated procedure under which one class A director and one class B director are elected by each of three "groups" of member banks. In effect, this procedure means that, while collectively the member banks elect six of the nine Reserve Bank directors, a particular member bank actually elects only two of the directors. For purposes of such elections, the law provides: 76/

> "The Board of Governors of the Federal Reserve System shall classify the member banks of the district into three general groups or divisions, designating each group by number. Each group shall consist as nearly as may be of banks of similar capitalization. . . ."

This provision presents certain questions that may not be as important as whether a majority of the directors should be selected by the member banks or by the Board of Governors but that nevertheless merit some consideration.

The original Act provided that the member banks in each district should be classified in three groups by the chairman of the board of directors of the district Reserve Bank. It then provided: 77/

> ". . .Each group shall contain as nearly as may be one-third of the aggregate number of the member banks of the district, and shall consist, as nearly as may be, of banks of similar capitalization."

76/ Federal Reserve Act, § 4, ¶ 16 (12 U.S.C. § 304).

77/ Act of Dec. 23, 1913, § 4 (38 Stat. 251).

The avowed purpose of this provision was to assure a "democratic" representation on each board of directors of the interests of large, medium-sized, and small member banks of the district. The provision was explained in the House Committee Report as follows:[78/]

"In dealing with the organization of the reserve banks the bill proposed by the committee has sought in section 4 to furnish a democratic representation of the several institutions which are members and stockholders of a reserve bank. To this end, the directorate is divided into three classes, each consisting of three members, while the stockholder banks are similarly divided into three groups or classes. The bill provides that the election of one member of class A and one member of class B shall be intrusted to each one of the groups into which the stockholding banks are subdivided. As it is required that each of the banking groups thus created shall contain approximately one-third of the number of banks in the district, it is clear that the banks comprising one-third of such capitalization would have a representative of their own in class A and also in class B. It might well be that the one-third in any given district would include a very small number of banks and that the director in question would thus be the representative of but few institutions. This, however, is deemed far better than to permit of the general choice of directors by all banks voting indiscriminately, it being the belief of the committee that by the method proposed each group of banks will preserve its autonomy and secure due hearing on the board of directors."

Elaborating on the intent to protect the smaller banks against dominating control by the larger banks, Carter Glass on the floor of the House said:[79/]

"In order to provide against control by the larger banks of a given district, the member banks of each region are divided into three groups equal, as nearly as may be, in number and of similar capitalization. Each bank, regardless of its size, is given one vote in the selection of directors. Notwithstanding the care which has been exercised to protect the rights of the small banks in the selection of directors, fears continue to be expressed that the larger banks of the district

78/ House Report on Original Act, p. 36.

79/ 50 CONG. REC. 4643 (Sept. 10, 1913).

may control the system. By reference to the last annual report of the Comptroller of the Currency anybody who entertains a doubt on this point may readily have his apprehension quieted. I shall embody the table taken from the comptroller's report in my remarks:

* * * * *

"It will be noted that of the 7,397 national banks 2,004 have not more than $25,000 capital; 2,321 have less than $100,000; 2,006 have less than $250,000; while only 685 banks exceed a capitalization of $250,000. Thus of the 7,397 national banks in the system 6,712 may be classified as small banks, making it next to impossible for the larger banks to control."

While the Committee Report explicitly recognized that one of the three groups (that with the highest capitalization) might include only a "few institutions", i.e., less than one-third of the number of member banks in the district, Representative Temple apparently construed the provision as literally requiring an equal number of banks in each group. He said:[80/]

". . .All the banks in the district that enter this system are divided into three groups which shall be equal in number, and the banks in each group are to be, as nearly as may be, equal in capitalization. A practical way to arrive at the grouping would be to make a complete list of all the banks of the district, at the top the one with the highest capitalization, say twenty-five millions in the case of the New York district, and then running down to the banks of $25,000 in the small country towns.

"The banks would be arranged in the whole list according to the amount of their capitalization. Then that list may be cut into three sections, each containing an equal number of banks. The banks of the highest capitalization would be in the first section, and those of the medium capitalization in the second, and in the third section would be the banks of small capitalization. . . ."

80/ Id., 4907 (Sept. 13, 1913).

In the Senate no emphasis was placed on making the banks in the three groups numerically equal. On the contrary, Senator Owen made it clear that the principal purpose was to give "proper representation" to large, medium-sized, and small banks:[81/]

> "Moreover, in order that the members of class A and class B directors should be judiciously chosen, to avoid any attempt on the part of any particular set of banks to control the whole six directors, it is proposed to classify these banks into the banks of the largest size, the banks of medium size, and the banks of the smallest size, allowing the small banks to choose one of class A and one of class B, the medium-sized banks to choose one of class A and one of class B, and the larger banks to choose one of class A and one of class B. In that way each one of the classes of the banks will have their proper representation upon the board. Each bank has one vote."

After the System went into operation, it soon became apparent that it was impossible to give member banks fair representation according to size if the three groups had to be even "as nearly as may be" numerically equal. Accordingly, in its Annual Report for 1917, the Federal Reserve Board recommended that the numerically-equal requirement be omitted:[82/]

> "The Board would suggest. . .that there be no requirement that the groups be as nearly equal numerically as may be, but that the grouping be left to the discretion of the Federal Reserve Board. The average capitalization of the banks differs so greatly in the various districts that it is impossible to carry out the evident intent of Congress to give the large banks, the medium-size banks, and the small banks equal representation unless the banks can be grouped more strictly with reference to their capitalization than is possible under the law as it now stands."

81/ *Id.*, 5995 (Nov. 24, 1913).

82/ 1917 ANN. REPT. OF FEDERAL RESERVE BOARD, pp. 31, 32.

In response to the Board's suggestion, Congress amended the classification provision to read as it reads today, requiring only a classification according to capitalization and at the same time requiring the classification to be made by the Federal Reserve Board instead of the chairman of each Reserve Bank's board of directors. With respect to this amendment, the House Committee Report said:[83/]

> ". . .The purpose of this modification is to make as secure as possible a fair and equal representation on the directorate of the Federal reserve banks for each group of banks, the large, the medium sized, and the small. The desirability of such representation is too manifest to need comment. It was undoubtedly the purpose of the Federal reserve act to secure such representation. It has been found practically impossible, however, to group banks under these three designations and yet have the banks in each group anything like numerically equal. The modification will enable the Federal Reserve Board to group the member banks in a way to carry out better the plain intent of the Federal reserve Act."

Representative Phelan, in explaining the amendment, made it clear that its purpose was to permit the Board to put fewer large banks in group 1 than the number of medium-sized and small banks in groups 2 and 3, in other words, that the three groups need not be numerically equal and that the purpose was to afford representation to banks of "similar capitalization". Thus, he stated on the floor:[84/]

> ". . .The first change takes certain words out of the Federal reserve act. Under the Federal reserve act the Federal Reserve Board is obliged in grouping banks whereby directors may be elected to make the banks as nearly as possible of the same capitalization and also to make the number of banks in each group as nearly as possible equal. This amendment removes the provision relative to making

83/ Report of House Banking and Currency Committee (H. Rept. No. 479, 65th Cong., Apr. 9, 1918), p. 1.

84/ 56 CONG. REC. 5574, 5575 (Apr. 24, 1918).

them as nearly as possible of the same number. The purpose is this: The principle in the Federal reserve act in the election of directors is that the three classes of banks--the large, the medium sized, and the small--shall each have representation upon the Federal Reserve Board. Where it is necessary to make the capitalization as nearly as possible equal, and at the same time the number, it has been found impossible to put the same number of large banks in a group as the number of medium sized and small, because there are fewer large banks. As a result, the present law makes it difficult if not impossible to do what was actually intended. This provision leaves it to the discretion of the Federal Reserve Board as to the number which shall go in each group, leaving in the law, however, the provision that the banks in each group shall be as nearly as possible of the same capitalization. In other words, it enables the board to carry out the plain intent of the original Federal reserve act."

In an attempt to carry out the purpose of the law, the Board of Governors since 1934 has applied the following formula in classifying member banks for election purposes:

"The number of member banks in Group 2 will be approximately one-third of the total number of member banks in the district, with the number of member banks in Group 1 as nearly as may be in the same ratio to the total number of all member banks as the combined capital and surplus of member banks in Group 3 bears to the combined capital and surplus of all member banks."

In practice, this formula has not always been closely followed. Over the years, periodic adjustments have been made in the grouping of banks in the various districts in an effort to adhere to the formula; but the results have not been notably successful. In many districts, for example, the ratio of the number of banks in group 1 to the total number of banks in the district has been far from the same as the ratio of the capital and surplus of group 3 banks to the capital and surplus of all member banks in the district. But the result most subject to criticism (although apparently consistent with Representative Phelan's explanation of the 1918 amendment) is that in some districts the number

of banks in group 1 - the larger banks - has been disproportionately small in comparison with the total number of banks in such districts. For example, at the end of 1967 there were only 17 banks in group 1 out of a total of 384 member banks in the New York District. This meant that 4.4 per cent of the member banks of the District elected two of the six Reserve Bank directors chosen by the member banks.

The Board of Governors from time to time has considered the possibility of changing its formula for classification of banks in order to avoid such results. Various alternatives have been considered, and others might be suggested, in order to place a greater number of banks in group 1. For example, the formula might provide that no group shall have less than a certain percentage, say 10 or 20 per cent, of the total number of member banks in the district; or that banks in group 1 shall be those with a capital and surplus of more than a specified amount, such as $15 million; or that group 1 banks should include those with a capital and surplus of more than twice the capital and surplus of the "median" bank in the district, i.e., the bank exactly half way down in a listing of member banks according to capitalization.

Any of these alternatives, however, is subject to some objection. One of the difficulties is that what may be regarded as a relatively small bank in one district may be considered a "large" bank in another district. Thus, application of the second alternative mentioned above - placing banks with capital and surplus of more than $15 million in group 1 - would increase the number of banks in that group in the New York District but would actually <u>reduce</u> the number of group 1 banks in other districts.

Moreover, any formula increasing the number of group 1 banks would of course widen still further the disparity in capitalization between the largest and smallest banks in the group.

The "median" bank alternative would come closest to equalizing the number of banks in the three groups. If such a formula had been applied on the basis of 1967 year-end figures, the number of banks in each group would have been approximately the same in almost all Federal Reserve districts. For example, in the Boston District the numbers of banks in groups 1, 2, and 3 would have been 81, 82, and 84, respectively; in the New York District they would have been 122, 128, and 134, respectively; and in the San Francisco District they would have been 65, 66, and 68, respectively.

So close would the "median" bank formula come to producing numerical equality among the groups that it would seem much simpler to arrange all banks according to capital and surplus and divide the list arbitrarily into three numerically equal groups. As has been noted, this was the manner in which Representative Temple in 1913 would have implemented the provision of the original Act.

Either the "median" bank formula or an arbitrary division of banks into three groups of equal numbers might be regarded as paying at least lip service to the requirement of present law and might be legally upheld. However, in the light of the 1918 amendment to the law, one might question whether any such approach would be consistent with the spirit of the law. Obviously, if the 122 largest member banks in the New York District should be placed in group 1, the largest and smallest banks in the group would not be banks of "similar capitalization" and

would be unlikely to have the community of interests contemplated by the statute.

One possible solution, of course, would be an amendment to the law that would explicitly provide for classification of banks into three numerically equal groups according to capitalization. An alternative that might more realistically result in a "community of interests" by the banks of each group would be an amendment requiring such a numerically equal classification in accordance with total deposits.

If changes in law are to be considered, however, one may go further and question whether member banks should be divided into groups at all for voting purposes, i.e., whether any directors should be considered as "representatives" of large, medium-sized, and small banks. When the original Act was passed, there was apparently an assumption that member banks, through their election of six directors, would exercise considerable "control" over the Reserve Banks, and for this reason it was felt necessary to provide an election procedure that would prevent the "big" banks from exercising a disproportionate degree of control. Under present-day concepts of the System, Reserve Bank directors, while drawn from diverse backgrounds, presumably are not the "champions" of any special interests. Perhaps it would be preferable for all member banks, without classification as to size, to vote directly for class A and class B directors.

On the other hand, it may be argued that, just as there are advantages in having three classes of directors with varied backgrounds and experience in banking, business, and other pursuits, so also is it advantageous to have the banker-members of the board of directors drawn from banks of different sizes and interests.

ELIGIBILITY REQUIREMENTS AND LIMITATIONS

Occupational requirements

As has been noted, the law requires that the class A directors of each Reserve Bank shall be "representative of the stock-holding banks" and that the class B directors shall be "actively engaged in their district in commerce, agriculture or some other industrial pursuit."[85/] No such representative or occupational requirements are prescribed with respect to the class C directors appointed by the Federal Reserve Board.

With respect to class A directors, it should be observed that, while they are required to be elected by and to be representative of member banks, they are not specifically required to be officers or directors of such banks. In practice, however, they have always been officers or directors of member banks; and, because of the grouping of member banks for election purposes according to size, one of the class A directors comes from a large bank, one from a medium-sized bank, and the third from a small bank.

The evolution in the original Federal Reserve Act of the occupational requirement with respect to class B directors is of particular interest. The Glass bill in the House provided that such directors should be "representative of the general public interests of the reserve district", but in another place it provided that they should "be fairly representative of the commercial, agricultural, or industrial interests of their respective districts".[86/] The Owen bill in the

85/ Federal Reserve Act, § 4, ¶¶ 10, 11 (12 U.S.C. § 302).

86/ See House Report on Original Act, pp. 113, 114.

Senate contained identical provisions. However, as the bill passed the Senate, the reference to representation of the "general public interests" was omitted and instead it was provided that class B directors at the time of their election should be actively engaged in their district in commerce, agriculture, or some other industrial pursuit. With minor changes in punctuation, this was the form in which the provision was finally enacted.

In the House, because of the two provisions of the Glass bill, class B directors were sometimes referred to as representatives of the general public interest and sometimes as representatives of commerce, agriculture, and industry. Thus, Carter Glass himself and Representative Hardy said such directors would "fairly represent the commercial, industrial or agricultural interests of the community";[87/] but Representatives Collier,[88/] Neeley,[89/] Sinnott,[90/] and Hinebaugh[91/] referred to them as representing the general public interest. In the Senate, however, the class B directors were usually described as representing or identified with "the commercial and industrial interests",[92/] "the agricultural, commercial, and industrial interests",[93/] or "the

87/ 50 CONG. REC. 4643, 4867 (Sept. 10, 13, 1913).

88/ Id., 4805 (Sept. 12, 1913).

89/ Id., 4844 (Sept. 12, 1913).

90/ Id., 4989 (Sept. 15, 1913).

91/ Id., 4817 (Sept. 12, 1913).

92/ Id., 5994 (Nov. 24, 1913, Senator Owen).

93/ Id., 6023 (Nov. 25, 1913, Senator Shafroth).

business, the agricultural, and the commercial interests of the country".[94/] The Owen Report in the Senate referred to them as "business men".[95/]

Whether the class B directors were intended to represent the general public or only the interests of commerce and business, it seems that the framers of the Act contemplated that the class C directors appointed by the Federal Reserve Board would represent the Government of the United States. Thus, Representative Neeley said that they would "represent the Federal Government";[96/] Senator Owen referred to them as "representing the interests of the United States";[97/] and Senator Pomerene stated that they would be "Government officers" and that the Government would have "three representatives on the board."[98/]

Over the years, the concept of the representative role of the class C directors has apparently changed. Today it is the class C directors who are regarded as representing the "general public interest", but not precisely as representatives of the Federal Government. Thus, in 1952 the Patman Subcommittee Report stated that they are appointed by the Board of Governors "to represent the public interest."[99/] They may be, and are, drawn from various occupations and backgrounds; the only thing they cannot be is bankers. For example, they are educators,

94/ 51 CONG. REC. 839 (Dec. 13, 1913, Senator Pomerene).

95/ Senate Report on Original Act, Part 2, p. 10.

96/ 50 CONG. REC. 4844 (Sept. 12, 1913).

97/ Id., 5994 (Nov. 24, 1913).

98/ 51 CONG. REC. 839 (Dec. 13, 1913).

99/ 1952 Patman Subcommittee Report, p. 53.

economists, newspaper publishers, lawyers, and officers of manufacturing companies, public utilities, and insurance companies. It may be noted that many class C directors - those engaged in manufacturing or other commercial businesses - would also be eligible for election as class B directors; indeed, some class B directors have subsequently been appointed by the Board of Governors as class C directors.

In the light of this background, it is appropriate to ask whether there are any reasons that would make it desirable today to change the traditional arrangement under which the nine directors of each Reserve Bank are divided into three classes, one representing banks, one representing business, and the third representing the general public.

For example, question has sometimes been raised whether the law should be amended to provide specifically for representation of "labor" on the Reserve Bank boards of directors. Thus, in 1952 Mr. Patman's Subcommittee on General Credit Control and Debt Management stated in its Report:[100/]

> "We note with concern the complete absence of any representation of labor on the directorates of the Federal Reserve banks, despite the fact that labor is so vitally affected by monetary policy. We recommend that the Board of Governors give consideration to including representatives of labor among those whom it considers eligible for appointment as class C directors."

The Report indicated that Senator Flanders, while feeling that representatives of labor should be considered eligible for appointment as class C directors, was opposed to any requirements - presumably specific

100/ *Id.*, p. 4.

statutory requirements - that would tend to make the directorships "partisan by parceling them out to members of special-interest groups, whether business, agriculture, or labor." 101/

During 1964 hearings, Representative Pepper queried President Irons of the Dallas Reserve Bank as to whether that or any other Reserve Bank had directors who represented labor. He questioned specifically whether the statutory requirement that class B directors be engaged in commerce, agriculture, or some other industrial pursuit was broad enough to include an officer of a labor union. 102/ Mr. Irons indicated that he did not know whether any Reserve Bank had a director who could be regarded as representing labor. 103/ He added that, in his opinion, Reserve Bank directors did not regard themselves "as being associated or tied to a representation of any particular group" and that "it would be much better if we could get the thought. . .that a director of a Federal Reserve bank is a public servant whether he is associated with labor, banking, retail selling or whatever it is . . . ." 104/

As indicated by Representative Pepper's question, the exact scope of the phrase "commerce, agriculture or some other industrial pursuit", as applied to class B directors, is by no means clear. It is questionable whether it covers a person whose principal occupation is that of an officer of a labor union. And it presents other questions:

101/ Id., p. 5.

102/ 1964 Hearings on Federal Reserve, p. 879.

103/ Id., p. 877.

104/ Id., p. 878.

does it, for example, cover an officer of an insurance company or of a mutual fund? In a sense such officers may be regarded as engaged in "commerce". On the other hand, it may be argued that, whereas class A directors are intended to represent the "lending" segment of the economy, class B directors are intended to represent the "borrowing" segment; and it appears that the Board of Governors has tended to follow this rationale. Such questions may suggest that the law should be clarified. For example, it might be changed to make any person engaged in a commercial, industrial, agricultural, or "financial" pursuit other than banking eligible for election as a class B director.

However, a more basic change in the law might be considered: should it provide at all for representation by Reserve Bank directors of any specific interests? Like President Irons of the Dallas Reserve Bank, former Reserve Board Governor Abbot L. Mills, Jr., once stated that, while three of the directors purport to represent banking, three to represent business, and three to represent the public, they had all refrained from "any inclination to press the private interests above the public interest."[105/] In 1968, one economist expressed the view that there was no reason why three of the directors should be bankers or "why another three of these positions should be held by businessmen of the district (also chosen by the member banks and presumably sympathetic to their interests), and why only three places should be reserved for representatives of the 'public interest' . . . ."[106/]

105/ Id., p. 105.

106/ 1968 Compendium, p. 362.

The question may be analogous to the question sometimes raised as to whether the Federal Reserve Act should be amended to eliminate the requirement that, in appointing members of the Board of Governors, the President "shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests. . .of the country."[107/] It has been asserted that Board members should be, and are, representatives only of the <u>public</u> interest and not of any special interests. Similarly, it may be argued that, whether chosen by the member banks or by the Board of Governors, directors of the Reserve Banks should not be subject to <u>any</u> occupational requirements, either as bankers or businessmen, but should be selected solely on the basis of their qualifications and, in the words of President Irons, as "public servants".

Again, however, there is an "on the other hand". The present arrangement for division of Reserve Bank directors into three classes chosen respectively from banking, business, and the public need not be regarded as meaning that any director is the protagonist of a special interest. On the contrary, once a person becomes a director he is expected, like members of the Board of Governors, to act objectively and only in the public interest. The advantage of the present arrangement is that it tends to enhance the likelihood that Reserve Bank directors will be drawn from diversified backgrounds and that various viewpoints will be brought to bear upon decisions relating to the administration of the different Reserve Banks and upon decisions

107/ Federal Reserve Act, § 10, ¶ 1 (12 U.S.C. § 241).

and advice with respect to banking and monetary policies. If there is any defect in the present arrangement, e.g., insufficient representation of some interests, such as labor, it can be corrected within the framework of present law: the Board of Governors has the power, through its appointment of class C directors, to provide for an even greater diversification of backgrounds on the part of Reserve Bank directors than exists today.

Connections with banks

The Glass version of the original Federal Reserve Act provided that class A directors "shall be chosen by and be representative of the stock-holding banks" and this provision was carried over without change in the Owen bill and in the Act as finally passed. However, under the election procedure prescribed by the Glass bill, the board of directors of each member bank was required to elect "one of its own members" as a district reserve "elector", and these electors then voted for one name on the list of such electors, not his own, as representing his choice for a class A director of the Reserve Bank.[108] The effect of this procedure was to require all class A directors to be *directors* of member banks; *officers* of such banks would not have been eligible.

The election procedure was changed in the Senate to eliminate the requirement that the "electors" be chosen by a member bank's board of directors from its own members. Thus, as the Act was passed and as it exists today, class A directors are required only to be "representative" of the member banks. Technically, they need not have any connection

108/ See *House Report on Original Act*, p. 113.

whatsoever with member banks. In practice, however, and apparently in accordance with the intent of the original Act, all class A directors are either officers or directors of member banks.

With respect to class B directors, the Glass bill provided for their election by the "electors" chosen by the boards of directors of the various member banks, but it was specifically provided that they should not be "officers or directors of any bank or banking association."[109/] In the Senate, the Owen bill followed the election procedure contained in the Glass bill for the selection by the board of directors of each member bank of one of its own members as a district "elector" and provided that, from a list of such electors, there should be chosen both class A and class B directors.[110/] This procedure would have required class B as well as class A directors of the Reserve Banks to be directors of member banks. In conflict with this requirement, however, another provision of the Owen bill stated that no class B or class C director of a Reserve Bank should be "an officer, director, or stockholder of a member bank." This conflict was eliminated on the floor of the Senate, and the Owen bill as finally passed omitted the requirement that the "elector" chosen by the board of directors of each member bank should be one of its own members.

The Glass bill contained no provision prohibiting a class C director from having bank connections. The Owen bill, as previously noted, provided that neither a class B nor a class C director should

---

109/ Ibid.

110/ See Senate Report on Original Act, Part 2, p. 40.

be an officer, director, employee, or stockholder of any bank. In conference, the restriction upon the ownership of bank stock by class B directors was eliminated.

In summary, while class A directors are expected to be officers or directors of member banks, class B directors may not be officers, directors, or employees of banks, and class C directors may not be officers, directors, employees, or stockholders of banks.

The freedom of class B directors to own bank stock has been cited by Representative Patman in support of his often-reiterated thesis that the Reserve Banks are unduly dominated by commercial banks. He has pointed out that, in addition to electing the three class A banker-directors, the member banks also elect the three class B directors and that a majority of such directors actually are stockholders of banks. From this, he concludes that the class B directors "are very close to the banks, or they would not be selected by the banks"[111/] and that "normally we would expect them [the member banks] to select people who were favorable to them."[112/]

A committee staff report regarding the 1964 hearings before the Subcommittee on Domestic Finance of the House Banking and Currency Committee on "The Federal Reserve System After Fifty Years" contained the following observations on ownership of bank stock not only by class B directors but also by class C directors prior to their appointment:[113/]

111/ 1964 Hearings on Federal Reserve, p. 60.

112/ Id., p. 893.

113/ Proposals for Improvement of the Federal Reserve and Staff Report on Hearings before the Subcommittee on Domestic Finance of House Committee on Banking and Currency (88th Cong., 2d Sess., Aug. 25, 1964), pp. 67, 68.

". . .Chairman Patman, early in 1964, conducted a confidential inquiry as to the banking affiliations of class B and class C directors of the Federal Reserve banks. Individual responses remain confidential, in sole custody of the chairman and available only to members of the committee. Only aggregative figures were made available to staff. These indicate that out of 36 class B directors, 20 presently own stock in banks, and 11 others have owned bank stock in the past. In addition, 17 have been commercial bank directors before becoming Federal Reserve directors, and 12 have held other positions and officerships in banks.

"Of the class C directors, 18 had formerly been directors of banks and 20 of the present class C directors owned bank stock in the past. When it is considered that class A directors are directly chosen from the banking community, the heavy incidence of banking connections of the B and C directors all add up to a strong banking orientation among those who direct the affairs of the Reserve banks and select men who participate in open market deliberations."

During the House debates on the original Federal Reserve Act, it was argued that class B directors should not be associated with commercial banks even as stockholders. Representative Sinnott stated:[114/]

"Mr. Chairman, the amendment which I have offered relates to the directors under class B. The directors under class B are the directors who shall be the representatives of the general public in said district; that is, I take it the general public in said district as distinguished from the banking interests of the district. Now, on page 8, line 22, the provision provides that the directors of class B shall not be officers or directors of any banking institution. That, I assume, is inserted for the purpose of getting directors who are not in any way interested or associated with banks and banking as officers or directors. I think that the object in getting directors wholly divorced and disassociated from banks and bankers can be better attained and that object can be better safeguarded if those directors are not only not taken from the directors and officers of banks, but they shall not even be taken from the stockholders of banks."

In response to this suggestion, Representative Phelan explained why it was deemed undesirable to prohibit the ownership of bank stock by

114/ 50 CONG. REC. 4989, 4990 (Sept. 15, 1913).

class B directors:[115]

"In a great many towns and small cities it is almost impossible to find men who are representative of the agricultural, industrial, and commercial interests who are not stockholders in banks. I know in my State it is true that many of the men who are prominent in business in one way or another are stockholders in the banks. Now, if you excluded stockholders, and this would apply particularly to the smaller places, by that very exclusion you might prevent the bank from getting just the kind of men whom you want to represent those great interests. In large cities it is not so difficult, but in small cities it is. That and other reasons were the controlling reasons why the committee did not exclude stockholders from banks serving as directors in Federal reserve banks in class B."

In the light of Mr. Patman's criticism and in order to minimize any impression that the directorships of the Reserve Banks are unduly controlled by the member banks, consideration might be given to an amendment to the law, like that suggested by Representative Sinnott, that would prohibit class B directors from owning bank stock. On the other hand, the argument against such an amendment presumably would be very much like that made by Representative Phelan in 1913. Certainly, it is at least as likely today as it was in 1913 that many businessmen who would make desirable Reserve Bank directors are owners of some bank stock. The difficulty of finding persons with the necessary qualifications who are willing to serve as Reserve Bank directors has become more and more pronounced in recent years. An amendment of the kind suggested would be likely to enhance that difficulty.

115/ Id., 4990.

"Banking experience" of the chairman

One of the nine directors of each Reserve Bank is subject to a special eligibility requirement. The class C director who is designated by the Board of Governors as the chairman of each Reserve Bank's board of directors (and also as "Federal Reserve agent") is required by the statute to be "a person of tested banking experience".[116/] The original Act also applied this requirement to the class C director designated as deputy chairman; but this requirement was repealed in 1917.[117/]

The requirement that the chairman of the board of directors shall be a person of tested banking experience appears to be inconsistent with the intent of the law that all class C directors shall be representative of the general public and shall not be associated in any way with banks, even as stockholders. In any event, this requirement seems to have been completely ignored in practice. Of the Reserve Bank chairmen designated by the Board of Governors for 1970, not one would appear to meet this requirement. Four of them are industrialists or businessmen, four are educators, one is president of a public utility company, one is an officer of an insurance company, one is a newspaper editor, and one is a lawyer.

If other suggested changes in the law with respect to Reserve Bank directors may be subject to some debate, it seems fairly clear that in this instance the law should be amended to eliminate the

---

116/ Federal Reserve Act, § 4, ¶ 20 (12 U.S.C. § 305).

117/ By Act of June 21, 1917 (40 Stat. 232).

contradictory and impractical requirement that the chairman of a Reserve Bank's board of directors should be a person of tested banking experience.

Residence requirement

The Glass version of the original Act provided that the class C directors should be residents of the districts for which they are selected.[118/] As changed in the Senate, the provision was finally enacted in a form that requires that class C directors "shall have been for at least two years residents of the district for which they are appointed."[119/]

During the debates on the bill in the Senate, Senator Burton pointed out that, under the wording of this provision, it would seem possible that a man who had lived in the Atlanta District for two years and had then moved to New York and had lived there for ten years could be appointed a class C director of the Atlanta Reserve Bank. Senator Owen replied that such a construction of the provision would be possible and that the language of the bill "would have been more aptly phrased to express its real meaning if the words 'immediately previous to appointment' had been inserted." He went on to say:[120/]

> "The House bill would have permitted a man to move into the section, and then say he was a resident, and be appointed. This was intended to prevent that being done, in order that those who were appointed from a district should have been

118/ See House Report on Original Act, p. 114.

119/ Federal Reserve Act, § 4, ¶ 20 (12 U.S.C. § 305).

120/ 51 CONG. REC. 875 (Dec. 15, 1913).

bona fide residents there at least two years previous to appointment. I think the construction the Senator suggests might be possible; but any doubt on the point can be easily removed by inserting the words 'immediately previous to appointment.'"

Unfortunately, the bill was not specifically amended as suggested by Senator Burton; and, despite this clear legislative history as to the intent of the provision, it appears that the Board of Governors has interpreted the law as permitting a person to be appointed a class C director if at any time in the past he had resided for two years in the district of the Reserve Bank to which he is appointed.

The law contains no requirement with respect to the residence of class A and class B directors. Since the class A directors are required to be representative of the stock-holding member banks and since the class B directors are required to be actively engaged in "their district" in commerce, agriculture, or some other industrial pursuit, it seems to have been contemplated that these directors should be residents of the district not only at the time of their appointment but throughout their terms of office. Strictly speaking, however, a class B director conceivably could reside in one Federal Reserve district and yet be actively engaged in business in another district and thus technically be eligible for election as a director of the Reserve Bank of such other district.

It seems questionable whether there is any sound reason for imposing a residence requirement upon class C directors and not also upon class A and class B directors. In the interest of uniformity

and clarification of the law, it would appear desirable to require that all Reserve Bank directors shall be residents of the district of the Reserve Bank to which they are elected or appointed as of the time of their election or appointment and that they shall cease to be such directors if and when they should cease to be residents of the district.

Such a change in the law was recommended by the Board of Governors in 1956 in connection with Congressional consideration of a proposed "Financial Institutions Act". 121/ As that bill passed the Senate in 1957 (the bill died in the House), it contained the following provision in line with the Board's recommendation but with a modification permitting a director to reside in another district if his residence was not more than 50 miles from the Reserve Bank of which he was a director: 122/

> ". . .Each director shall be a resident of the district of the Federal Reserve bank on the board of which he is serving, or shall reside within a fifty-mile radius of the Federal Reserve bank on the board of which he is serving. Each director shall cease to be a director when he ceases to meet the residence requirement."

Tenure

Each Reserve Bank director is elected or appointed for a term of three years. 123/ However, there is no provision of the law that makes him ineligible for indefinite re-election or reappointment for additional terms.

121/ Legislative Recommendations of the Federal Supervisory Agencies, Committee Print of Senate Banking and Currency Committee (84th Cong., 2d Sess., Oct. 12, 1956), p. 73. [Hereafter cited as 1956 Legislative Recommendations.]

122/ S. 1451 (85th Cong., 1st Sess.), § 17(a).

123/ Federal Reserve Act, § 4, ¶ 9 (12 U.S.C. § 302).

As a matter of policy, the Board of Governors in appointing class C directors will not reappoint such a director if he has served two full terms of three years each, except that, if a director who has served more than three years as a class A, B, or C director is designated by the Board of Governors as chairman, he may serve not to exceed one full three-year term as chairman for a total of not more than three full terms as a director.

While the Board has encouraged the adoption of a similar policy with respect to the tenure of class A and class B directors, such a policy has not always been adhered to in the election of such directors by member banks. The average length of service of class A and class B directors is now shorter than it was some years ago, but there have been instances in which a class A director has been consistently re-elected for a period of 20 years and, in one case, for 27 years. If diversity of background and experience is a desirable element in the makeup of Reserve Bank boards of directors, it seems equally clear that a greater diversity of viewpoints can be achieved by a reasonable degree of rotation in the service of individual directors.

In 1949, in reply to a questionnaire submitted by the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Economic Committee, under the chairmanship of Senator Douglas, Chairman McCabe of the Board of Governors stated:[124/]

> "One of the major advantages of having a board of directors at each of the Federal Reserve banks is that it brings to bear on the problems of the System the wide

124/ Monetary, Credit, and Fiscal Policies: Collection of Statements Submitted to Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report (Nov. 1949), p. 69.

range of training and experience possessed by the directors. This advantage can be most effectively utilized, however, if there be injected regularly into the membership of the board of directors fresh points of view. This can best be accomplished by a system of rotation of membership on the bank boards. Another advantage of such a system would be that a more frequent turn-over of directors would result in more of the outstanding businessmen in the various Federal Reserve districts having close contact with and understanding of monetary and credit policies. These problems are complex. They are not generally understood by the public. Men who serve as directors of the Federal Reserve banks or as members of the Federal Advisory Council gain a much better understanding of national monetary and credit problems and of policies designed to meet such problems, and they are thus able to inform other businessmen and bankers on these subjects. This results in a far wider understanding and acceptance of System policies."

In connection with the proposed "Financial Institutions Act", previously mentioned, the Board of Governors in 1956 recommended that directors of the Reserve Banks, other than the chairman of the board of directors, be prohibited from serving more than two consecutive terms of three years each. In support of this recommendation, the Board stated:[125/]

"A certain degree of rotation in the directorates of the Reserve banks and the membership of the Federal Advisory Council is desirable in order to obtain the advantages of broader representation and wider experience over a period of time. Such rotation would help to bring a wider variety of experience into the councils of the Federal Reserve System and would also help to bring about a more widespread knowledge of System policies and problems. It would thus serve the public interest in both directions. At the same time, the length of service permitted under the proposed amendment would be adequate to assure for the System and the public interest the benefits of suitable continuity of policy and acquired experience.

"In connection with the appointment of class C directors of the Federal Reserve banks, the Board as a matter of policy does not reappoint any such director who has served 2 full

125/ 1956 Legislative Recommendations, p. 75.

terms of 3 years each, except that the class C director who is designated by the Board as Chairman and Federal Reserve agent may serve for a total of not to exceed 3 full terms. The proposed amendment would limit the terms of service of all directors, class A and class B, as well as class C directors, but would continue to permit an exception as to the Chairman."

The Board's recommendation would have been incorporated in the following language in that bill as it passed the Senate in 1957:[126/]

". . .no director of a Federal Reserve bank who has served two full consecutive terms of three years each shall be eligible to serve again as a director pursuant to a new election or new appointment until after an intervening period of not less than three years, except that a director designated as chairman of the board of directors of such bank may serve three full consecutive three-year terms without such an intervening period. . . ."

BRANCH BANK DIRECTORS

Any consideration of Reserve Bank directors naturally focuses upon the directors of the head offices of the 12 Federal Reserve Banks. It should not be forgotten, however, that each of the Reserve Banks, except Boston and Philadelphia, has one or more branches and that altogether there are 24 Reserve Bank branches, each with its own directors.

Under section 3 of the Federal Reserve Act, the Board of Governors may permit or require any Reserve Bank to establish branch banks to be operated, subject to regulations of the Board of Governors, "under the supervision of a board of directors to consist of not more than seven nor less than three directors, of whom a majority of one

126/ S. 1451 (85th Cong., 1st Sess.), § 17(a).

shall be appointed by the Federal reserve bank of the district, and the remaining directors by the Board of Governors of the Federal Reserve System."[127/] The branch directors hold office during the pleasure of the Board of Governors. This is all that the law provides with respect to such branch directors; it says nothing about their qualifications or their functions.

Pursuant to the law, however, the Board of Governors has prescribed regulations relating to Reserve Bank branches.[128/] With respect to their directors, the regulations provide that each branch board shall consist of seven or five members as may be determined by the Reserve Bank with the approval of the Board of Governors; that such directors shall be persons of "high character and standing" with business and financial interests "primarily within and representative of the branch territory"; that the directors appointed by the parent Reserve Bank shall be "either well qualified and experienced in banking or actively engaged in commerce, agriculture or some other industrial pursuit"; and that those appointed by the Board of Governors shall be persons who are "actively engaged in commerce, agriculture, some other industrial pursuit, or the practice of a profession, who are not primarily engaged in banking and preferably are not directors of banks, although they may be stockholders." Under the regulations,

---

127/ Federal Reserve Act, § 3, ¶ 1 (12 U.S.C. § 521).

128/ These regulations, which are not published in the Federal Register, were last amended effective January 1, 1947.

each such director must reside within the branch territory, but at least one must reside outside the city in which the branch is located. The terms of such directors are fixed at three years where the branch board has seven members and at two years where the board has five members; and limitations are placed upon the continuance of service of any such directors.

Practically nothing has been said in the past about the manner of selection or the qualifications of Reserve Bank branch directors. During 1964 hearings before the House Banking and Currency Committee, there was a passing reference to the representation of agriculture on the boards of directors of the branches.[129/] Otherwise, Representative Patman and other members of Congress have directed attention solely to directors of Reserve Bank head offices. Nevertheless, this study would be incomplete without brief mention of at least three points relating to Reserve Bank branch directors.

The first has to do with the selection of the branch directors. As has been noted, a majority of the directors of each branch is selected by the parent Reserve Bank and the others are appointed by the Board of Governors. This means that the board of directors of the Reserve Bank head office has a dominant voice in the selection of the branch directors. Since six of the nine head office directors are elected by the member banks, the provision of present law as to the selection of branch directors could be cited by Representative Patman as another illustration

129/ See colloquy between Representative Pepper and President Irons of the Dallas Reserve Bank, 1964 Hearings on Federal Reserve, p. 884.

of the undue influence of private bankers upon the operations of the Federal Reserve System. Should the law be changed to provide for the appointment of a majority of the branch directors by the Board of Governors instead of by the parent Reserve Bank of the district?

The second point relates to the qualifications of the branch directors. While the law itself prescribes no requirements in this respect, the regulations of the Board of Governors, as has been noted, require that the directors appointed by the Reserve Banks be experienced in banking or actively engaged in commerce, agriculture, or some other industrial pursuit, and that the directors appointed by the Board of Governors shall not be primarily engaged in banking and, "preferably", shall not be directors of banks. Are these requirements appropriate? For example, should they be changed to require that at least one branch director shall be a representative of agriculture - or a representative of labor? On the other hand, as in the case of head office directors, the question arises whether the branch directors should be regarded as "representatives" of any special interests.

The final, and basic, point is whether there is a need for Reserve Bank branch directors at all. Do they serve any meaningful purpose? Would it be preferable to dispense with them and to provide for the operation of each branch under the direction of a "manager" designated by the Reserve Bank head office? Actually, under present practice, each Reserve Bank assigns one of its vice presidents to be "in charge" of the day-to-day operations of each of its branches.

The argument against elimination of Reserve Bank branch directors is much the same as the argument against elimination of Reserve Bank head office directors - that such branch directors play an important role in the formulation, implementation, and interpretation of System policies. Granting that the role of the branch directors may be less important than that of the head office directors, it may still be contended that they provide a "link" between governmental and private interests that should be preserved. Indeed, it may be argued that they come closer to a "grass-roots" contact with private interests than even the head office directors. Seventeen of the 24 Reserve Bank branches have seven directors; the other seven branches have five directors. Thus, there are 154 Reserve Bank branch directors, as contrasted with 108 head office directors. The net result is that the branch directors (and, because of "rotation" requirements, the ex-branch directors) enhance the likelihood that the Federal Reserve System will have the advantage of the counsel of many persons of diversified backgrounds and, at the same time, that a better understanding of the System and its policies will be transmitted to bankers, businessmen, and the general public.

SUMMARY

As indicated at the beginning of this paper, its purpose is not to recommend specific changes in the law with respect to the selection of Reserve Bank directors but only to provoke thought as to the desirability of such changes and to recount what has been said in the past with respect to this subject.

It seems clear, however, that at least some minor changes in present law would be desirable. For example, the law should be amended -

(1) to insure rotation in the membership of Reserve Bank boards of directors;

(2) to eliminate the unrealistic requirement that the chairman of each Reserve Bank board of directors shall be a person of "tested banking experience"; and

(3) to require all Reserve Bank directors to be residents of their districts while they serve as such directors.

The answers to the other questions discussed in this paper are not so clear. As to some of them, persuasive arguments can be made on both sides of the question; as to others, more than two alternative solutions may be suggested.

The present requirement that member banks be classified into three groups according to "similar capitalization" in the election of class A and class B directors may be criticized on the ground that it gives disproportional voting power to the larger banks; but it may be defended as according a proper representation of the different interests of large, medium-sized, and small banks. The law could be changed in various ways, e.g., to provide for arbitrary division of member banks into three numerically equal groups according to rank in capitalization or in aggregate deposits or to provide for direct voting by all member banks without division of such banks into three classes at all. On the other hand, one may argue that the present election procedure, however cumbersome and inequitable, is probably as good as any other that might be suggested.

As to the present division of Reserve Bank directors into three classes purporting to "represent" banking, business, and the general public, it may variously be contended that some interests, e.g., those of labor and of consumers, are not adequately represented; that any suggestion of representation of "special" interests should be abandoned in favor of a procedure for the selection of persons who represent only the "public" interest; or that the present statutory scheme should be retained on the ground that it assures the selection of directors with widely diversified backgrounds and provides a desirable "link" between the Government and private interests in accordance with the basic intent of the Federal Reserve Act.

The most fundamental question is whether a majority of each Reserve Bank's directors should be selected by the member banks or by the Board of Governors - and, by the same token, whether a majority of the Reserve Bank branch directors should be appointed by the respective Reserve Banks or by the Board of Governors. Does the present statutory arrangement imply undue control of the System by the member banks? Or, on the other hand, would an alteration of that arrangement imply a trend toward "nationalization" of the banking system and weaken the "independence" of the Federal Reserve System? Obviously, this is a question of judgment. However, it is at least worth considering whether the selection of a majority - or even of six - of the nine directors of the Reserve Banks by the Board of Governors of the Federal Reserve System might not serve to refute any implication of control of the System by private bankers and at the same time preserve the concepts of decentralization and combination of public and private interests in the operations of the System.