BY MATTHEW WELLS

Reserve Bank Boards of Directors

Directors are a key link between the Federal Reserve System and the communities it serves

The boards of directors of the 12 Federal Reserve Banks are not typical boards. To be sure, they carry out many of the usual responsibilities of corporate governance, such as approving a strategic plan and monitoring operations, auditing and risk, human resources, executive compensation, and the like. But unlike private sector boards that are primarily concerned with firms' financial health and growth projections, Fed directors are also charged with a much broader task that makes them not just unique among institutional boards, but within American society at large: assisting in the formulation of monetary policy.

The Fed conducts its monetary policy with two legislatively mandated objectives in mind: price stability and maximum employment. To achieve these goals, it relies not only on the expertise of economists and banking and finance professionals, but also on the input and shared experiences of the institutions and communities across the country that experience the economy in real time. The Reserve Bank boards are one of the primary sources of such data points, as directors represent a wide range of interests, each of whom sees the economy in different ways. From executives at Fortune 500 companies such as IBM to leaders of organizations like the Paso del Norte Community Foundation, which works to expand and coordinate philanthropy in communities in and around El Paso, Texas, all are given equal voice, providing crucial information to Reserve Bank presidents as they grapple with how to best pursue the Fed's mandated goals.

Who can serve as directors and the kinds of interests represented on the Reserve Bank boards have both changed over time, however, as has the model through which directors contribute to policymaking. This evolution has not been without controversy and has led to real changes in Reserve Bank operations and practices.

THE BOARDS' CREATION AND EVOLUTION

The Federal Reserve framework established by Congress in 1913 was the country's third effort to create a central bank system, following attempts in 1791 and 1816. (See "Jekyll Island: Where the Fed Began," *Econ Focus*, First Quarter 2015.) The first two efforts were plagued by tensions over their constitutionality, as well as passionate disagreements about whether a national bank would benefit urban and moneyed interests in the northeast at the expense of citizens in more rural and poorer areas of the expanding country. (See "The Bank War," *Econ Focus*, Second Quarter 2023.) Political leaders exploring what a third effort might look like were also split over whether the banking system should be administered by the federal government in Washington or devolved to the states and regions.

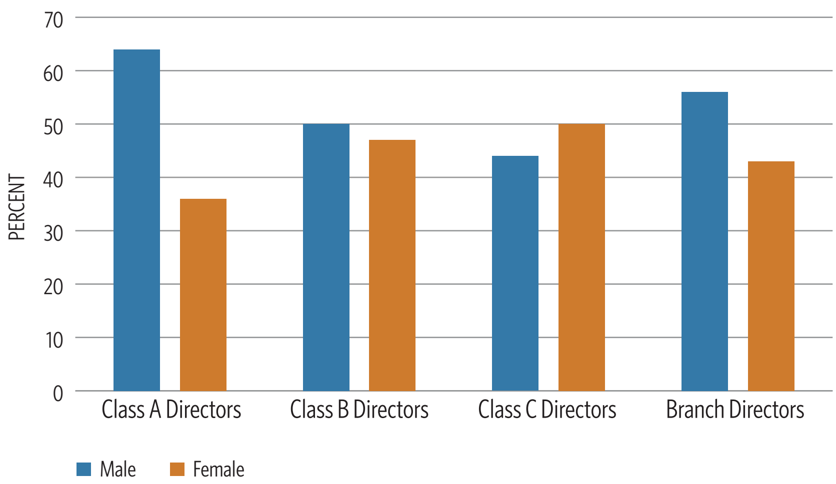
The Federal Reserve Act of 1913 sought a middle path, accommodating the desires and concerns of both groups. In *A History of the Federal Reserve*, economist Allan Meltzer noted that, while there would be a central governing board in Washington, the system's architects also set up a network of 12 regional or district-level banks that would "function cooperatively but independently... to achieve the advantages of central banking without acquiring the monopoly powers of a single central bank." In truth, however, the regional banks carried more power than the board in Washington, as they were tasked with ensuring monetary stability within their districts, which meant that they established their own lending rates to banks within their jurisdictions. They also held their own gold reserves, which backed the paper dollar.

Each of the 12 regional banks was managed by a nine-member board of directors, which, in the words of one of the act's primary authors, would be "thoroughly representative of the various interests and districts of the country" and capable of dealing with "broad questions of policy affecting the whole country." The nine directors came from three classes: Class A directors were all bankers elected by member banks to provide expertise and represent banking interests; Class B directors were also elected by member banks but represented community and commercial interests; and those in Class C were chosen by the Fed Board in Washington for their ability to manage large corporations and were intended to represent the general public. Serving staggered three-year terms, all nine directors had a vote in appointing their Reserve Bank's CEO, then known as a governor and now called a president.

This original structure has evolved over time. The Reserve Banks' ability to carry out their own monetary policies independent of the others proved problematic, as a lack of coordinated policy at the federal level may have accelerated the onset of the Great Depression. The fact that some Reserve Banks were more accommodative and willing to lend than others also created varying economic outcomes among regions. These problems led to the Banking Act of 1935, which turned monetary policy over to the modern Federal Open Market Committee (FOMC) structure

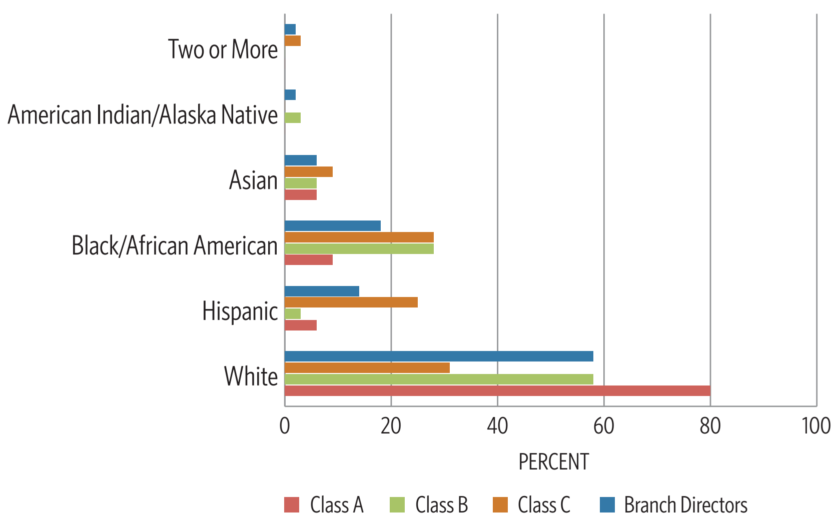
Striving to Reflect the Communities They Serve

Federal Reserve Bank Directors by Gender



SOURCE: Report to the Congress on the Office of Minority and Women Inclusion, March 2023
NOTE: Data from January 2023.

Federal Reserve Bank Directors by Race/Ethnicity



SOURCE: Report to the Congress on the Office of Minority and Women Inclusion, March 2023
NOTE: Data from January 2023. No directors currently identify as Native Hawaiian or Pacific Islander.

still in place today. The Board of Governors' powers also increased, as it was given the authority to veto Reserve Bank presidential appointments and appoint each board of directors' chair and deputy chair, who came from Class C representatives.

More reforms came in 1977 with the Federal Reserve Reform Act, broadening the scope of what "representation" on the boards would look like. The 1913 Federal Reserve Act stated that Class B and C directors had to come from specific sectors of the economy, namely agriculture, commerce, or industry, but this requirement was amended to include the possibility that these directors could come from the services sector or organized labor, or could be representatives of consumers. These rule changes have had visible effects: The percentage of Reserve Bank board members across the country with formal banking affiliations dropped from 52 percent in 1920 to 36 percent in 2015, with directors from academia, nonprofits, medicine, and the service sectors largely filling those positions.

The 1977 reform legislation also stated that all directors would be appointed "without discrimination on the basis of race, creed, color, sex, or national origin." This change occurred alongside the appointment of the first five women directors throughout the Federal Reserve System that same year, and by 2017, 31.5 percent of Reserve Bank directors nationwide were women. The Dodd-Frank reforms of 2010 also directed the banks of the Federal Reserve System to establish an Office of Minority and Women Inclusion, and as of January 2023, 43 percent of Reserve Bank board positions were held by women. The percentage of positions held by minorities also increased since 2017, rising from 30 to 42 percent. (See charts.)

A UNIQUE BOARD MEETING AGENDA

The nine-member Richmond Fed board meets in the 23rd floor boardroom of its headquarters overlooking the James River in Richmond — or sometimes virtually — eight times a year, typically in the week preceding the FOMC meetings in Washington. Similar meetings take place regularly across the country at the Fed's regional Reserve Banks, as well as at their respective branch offices, although there is no set schedule that all of them must follow. The FOMC conducts monetary policy by setting a target range for the federal funds rate, which is the interest rate that banks charge when they lend money to other financial institutions. The behavior of this overnight interest rate is an important factor for the entire term structure of interest rates like those for home and business loans. Each Reserve Bank president participates in FOMC meetings every eight weeks, and they come equipped with data from a wide range of sources, including economic intelligence gathered from the directors on their boards.

"As keen observers of local economies, the directors ... contribute vitally to the formulation of monetary policy by offering important insights absent, by definition, from even the most careful analysis of aggregate data," noted Alan Greenspan, then-chair of the Federal Reserve Board of Governors, in a December 2000 speech. "Most importantly, this singular system of broad and diverse representation, nurtured by close contacts at the regional and local levels, fosters a long-term perspective and a continuity."

The Reserve Banks set their own meeting schedules and they all run a bit differently, although they end up in the same place: a rich roundtable discussion of the various dimensions of the economy at both the district and national levels. Jodie McLean is the CEO of EDENS, one of the country's leading retail and mixed-use real estate companies, and she chairs the Richmond Fed board. In her preparations for board meetings, she focuses on providing Richmond Fed President Tom Barkin with new information that might not have shown up yet in the quantitative data the Fed has collected, just as Greenspan envisioned. To get those insights, she stays in constant communication with national and local retailers and restauranteurs to understand what they are seeing in terms of customer traffic, sales trends, and more. Noting that consumers make up 65 to 70 percent of GDP, she will ask restaurant owners not just if customers are still eating out, but what, if any, changes they're making in their dining choices. "If consumers are still coming to restaurants, are they still ordering appetizers or desserts? If not," she suggests, "this can be a real canary in the coal mine," signaling that diners might still be willing to spend but not as much as before.

McLean also makes a point to speak with other commercial real estate sectors, including office and multifamily residential property owners, construction firms, and architectural firms. While primarily anecdotal, such data points inform Barkin's discussions with the other Reserve Bank presidents and Federal Reserve governors on the FOMC as they deliberate on where to set the federal funds rate.

In Richmond, these discussions are usually preceded by a presentation of national economic conditions given to the members by an economist from the research department, which also provides a set of questions to each board member in advance of their meetings to address a specific dimension of the economy in their sector, whether prices, wages, or prospects for the coming year.

The same is true at the Cleveland Fed. Toby Trocchio is the corporate secretary in Cleveland, where he acts as the primary liaison between the board and the Bank's executive leadership — that is, the president and the first vice president, Fed-speak for chief operating officer. He notes while these questions are helpful, "our directors always know that we want them to also bring their own economic intelligence from their own company and industry, even if we aren't asking that particular question." And like McLean who captures a wider picture beyond just real estate, Trocchio says that in Cleveland, "we'll see a combination of company or local, right up through national and even global perspectives."

The board meetings' agendas also include a discussion of the discount rate, another key element of monetary policy. Known as the discount window, banks and other financial institutions in need of cash can access credit directly from the Fed when they need to manage their liquidity risks and ensure that they are able to provide credit to businesses and households. Under the decentralized system prior to the Great Depression, each Reserve Bank set its own interest rate — the discount rate — for these transactions, but responsibility for setting the rate moved to the Board of Governors in Washington at the same time the FOMC powers were established in 1935. But each Reserve Bank still votes on a recommendation every two weeks, either at a full meeting or during a separate conference call or electronic vote, and submits that recommendation to the Board of Governors.

These conversations in Richmond can be quite lively. Barkin will offer his perspective on the economy and a recommendation for the discount rate and then open the floor to discussion. "The directors don't always agree with him," says Jessie Romero, who is Trocchio's counterpart in Richmond, adding that they may suggest an alternative rate if their information and experience suggests a different direction may be more appropriate. "He likes having his views challenged."

"The data we look at during board meetings is typically just national averages. Those data mask a lot of instability, particularly for those living in poverty," says Lisa Hamilton, the deputy chair in Richmond. Hamilton currently serves as the president and chief executive officer of the Annie E. Casey Foundation, a Baltimore-based philanthropy devoted to making sure that all children and youth in the United States have a bright future. Because she represents members of the community who historically have been left out of larger economic policy decisions, she believes she needs to bring that critical perspective to the conversation. "The impacts of different policies don't fall equally on everybody. And if there are a lot of people who are low income and can't participate in the economy, we don't have the economy we want."

Romero notes that Barkin really appreciates and values hearing a wide range of viewpoints. Similarly, Cleveland Fed President Loretta Mester "consistently makes an effort to ensure that the directors are aware of how much she values their contributions," adds Trocchio. "She knows the directors put in a lot of time and do a lot of research leading up to the meeting, so she always conveys sincere appreciation for those efforts."

The Richmond Fed has branch offices in Charlotte and Baltimore, which also have their own boards made up of business and community leaders in those areas. The branch boards typically meet the week before the Richmond board and are another key input into the policymaking process. "Our branch directors are incredibly connected to their communities and regional economies, and they provide us with really valuable insights into economic conditions on the ground," says Romero. Most of the other Reserve Banks also have regional offices managed by their own boards who make similar contributions.

SELECTING A BANK PRESIDENT ... AND A WHOLE LOT MORE

While directors are connecting the communities and their districts to the FOMC's work in managing the economy, many of them also have another important responsibility: selecting Reserve Bank presidents. Under the original framework enacted in 1913, all nine directors, regardless of their class designation, had a vote when it came to choosing a new president. Reserve Bank presidents are appointed to five-year terms, and they are limited to two terms if they are appointed after age 55. The Dodd-Frank reforms of 2010, however, forbid Class A directors — those from the banking industry — and any Class B directors affiliated with thrift holding companies from participating in the appointment process due to the potential for conflicts of interest from bankers who are subject to the federal bank supervision process that is run by the Reserve Banks. In other words, they cannot play a role in selecting the individuals who manage the supervision of their banking activities. (Also, these same directors are not allowed to vote on any supervision-related matters, such as approving the department's budget or reviewing audit reports. And no director has access to any confidential supervisory information.)

The appointment process usually begins with the formation of a search committee made up of Class C and eligible Class B directors who may hire an outside search firm to assist in putting together a large pool of diverse and qualified candidates. (See "The Reserve Bank Presidential Search," *Econ Focus*, Third Quarter 2022.) The directors will usually consult with the Board of Governors to establish the qualities that the Bank and the Fed as a whole are looking for in a new president. These qualities can vary across Reserve Banks and over time, depending on economic conditions or other factors. Transparency and public input are also hallmarks of the appointment process: When boards begin the search process, a website is usually set up that lets the public know the job profile and allows the public to stay informed as the process unfolds. The search committee will interview a range of candidates, and finalists are also interviewed by the Board of Governors. At the conclusion of the process, the Class B and C directors vote on a candidate who must then be approved by the Board of Governors.

Who these directors ultimately select as Reserve Bank presidents matters a great deal when it comes to policy. In the Federal Reserve's first several decades, boards generally favored bankers for the position, but that began to shift in the 1960s, when board increasingly appointed Ph.D. economists. By 1980, eight of the 12 Reserve Bank presidents were Ph.D. economists, and that ratio remains similar today. A 2014 study by the St. Louis Fed argued that boards tend to select policymakers who favor monetary or price stability above other policy goals when making decisions on the FOMC. Specifically, they found presidents were significantly more likely to dissent in favor of tighter, less inflationary policy, while governors were more likely to dissent in favor of looser, more inflationary policy.

The Fed is tasked by Congress with the dual mandate to pursue price stability and maximum employment. The Reserve Banks' boards of directors play a key role in that effort, ensuring that the Banks are operationally and financially sound and that their strategic objectives contribute to achieving the mandate. They also represent their communities and industries in the development of monetary policy. "We're thinking big and thinking about the whole country. We're thinking about policies that are going to affect people's businesses and personal livelihood," says Hamilton. "I can't think of a better way to utilize the perspective and insight I have than to help our country make better decisions that can help everyone thrive." McLean echoes this sentiment. "We have to listen and understand all points of view. It won't work otherwise," she says. "I'm so grateful for that exposure and how it changes my own way of thinking around what is best for this entire country." **EF**

READINGS

Binder, Sarah, and Mark Spindel. *The Myth of Independence: How Congress Governs the Federal Reserve*, Princeton: Princeton University Press, 2018.

Fessenden, Helen, and Gary Richardson. "Whom Do the Federal Reserve Bank Boards Serve?" Federal Reserve Bank of Richmond *Economic Brief* No. 16-08, August 2016.

Jarque, Arantxa, and Caroline Davis. "Gender Composition of the Boards of Directors of the Regional Federal Reserve Banks." Federal Reserve Bank of Richmond *Economic Quarterly*, Fourth Quarter 2019, vol. 105, no. 4, pp. 201-250.

Wolla, Scott A. "Independence, Accountability, and the Federal Reserve System." Federal Reserve Bank of St. Louis Page One Economics, May 2020.