The Richmond Fed at 100 Years

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On Nov. 16, 1914, the Federal Reserve Bank of Richmond opened its doors in a former store building at 1109 East Main St. It had fewer than 50 employees; George Seay, a banker who was instrumental in bringing a Reserve bank to Richmond, was at its helm. It opened alongside 11 other regional Reserve banks that were spread across the nation and that, along with the Board of Governors in Washington, D.C., made up the new Federal Reserve System. It opened in a country and a region in which agriculture was still a large share of the economy. And it opened in a country that had no unified currency, no unified or consistent means of clearing checks, no uniform supervision of the banking sector, and little knowledge of monetary policy or economics in the way that we think of it today.

In the 100 years since, events such as war, recession, urbanization, technological innovation, the rise of the service economy, and national policy changes have all shaped the way that the Bank approaches its key operations, which revolve primarily around payments processing, the supervision and regulation of financial institutions, and monetary policy research.

The Richmond Fed and the Fifth District in 1914

To choose the Reserve bank cities, the Federal Reserve Act called for the establishment of a Reserve Bank Organization Committee; Richmond would be one of 37 cities asking to be made headquarters of a Reserve bank. The committee for locating a Reserve bank in Richmond concentrated its promotional efforts heavily in the Carolinas, so that even when Charlotte, N.C., and Columbia, S.C., decided to seek regional banks, many leading bankers in those states had already endorsed Richmond.

In its final brief, the Richmond group emphasized four key advantages. First, the city's geographic location provided a link between the South Atlantic and the Northeast. Second, the city had extensive transportation and communication facilities — including north-south and east-west rail lines, and river and coastal waterways — which allowed efficient contact with every point in the proposed district and provided a natural point for clearing checks and distributing currency. Third, Richmond had extensive banking connections, both as a holder of bankers' balances and as a lender. Richmond's national banks were lending in the 13 Southern states more than the national banks of any city except New York City. Finally, the city was important as a commercial and financial center. On April 2, 1914, the Organization Committee announced that Richmond was one of the 12 selected cities. (See "A Division of Power," *Region Focus*, Winter 2007.)

When the Reserve banks opened on Nov. 16, 1914, the country was still responding to the declaration of war in Europe in July of that year. According to the Federal Reserve Bank of Richmond Annual Report from 1915, of all the regions of the United States, "in no section was the strain [of the war] more keenly felt than in the territory within the limits of the Fifth Federal Reserve District." Primarily, this strain was due to potential trade obstacles. Many farmers and merchants in the Fifth District relied upon cotton exports and with the uncertainty of war, credit became scarce, and cotton prices started to fall. In addition, all Reserve banks had to quickly ramp up operations to facilitate the federal government's financing of the war effort, which started officially for the United States in 1917.

Agriculture was predominant in the Fifth District economy at this time. In 1910, more than 70 percent of the Fifth District population lived in rural areas, compared with a little less than 50 percent of the U.S. population. (See chart.) This was particularly true in the southern part of the District. Cotton, according to the Bank's 1915 Annual Report, "most intimately touches the interest of the greatest number," while tobacco was also cited as an "endeavor of commanding importance." In fact, the need for credit and banking services in rural areas was one key reason for the establishment of the Federal Reserve System; the United States needed a banking system that could serve all interests — urban and rural — in the developing nation.

One of the most important reasons to develop a central bank — to furnish an elastic currency that could expand or contract with demand — was also illustrated in the 1915 Annual Report. "Credit is shortest in supply in the months of August and September, and, as a rule, is easiest immediately following the maturing of cotton in the early fall." The inelasticity of the currency and the subsequent rise in interest rates during the periods of highest demand (primarily harvest season, holiday seasons, and financial crises) was a driver of the movement to reform the U.S. financial system that resulted in the Federal Reserve Act.

In addition to a strong agricultural presence, the Fifth District manufacturing sector had started to develop. According to the 1910 Census, 11.6 percent of employment (of those 10 years of age and older) in the District was employed in manufacturing, compared with 17.3 percent in the nation as a whole. This varied considerably by state, with 19.9 percent of Maryland workers employed in manufacturing, compared with only 0.6 percent of workers in West Virginia.

Changes in the Role of the Richmond Fed

In 1913 — as is still the case today — the United States operated under a dual banking system in which a bank can either

be nationally chartered or state chartered. The Federal Reserve Act required the approximately 7,500 national banks in the United States to be members (although they continued to be supervised by the Office of the Comptroller of the Currency), but state-chartered banks had a choice of whether or not to be members of the Federal Reserve System. (The Fed now has supervisory authority over all bank holding companies as well, regardless of whether the subsidiary bank of the holding company is a national bank, state member bank, or state nonmember bank.) As of June 30, 1915, only 17 of nearly 20,000 state banks had elected to join the Federal Reserve System; one year later, that figure had increased to only 34. In the Fifth District, by the end of 1915, all 503 national banks and five of the state banks were members of the Federal Reserve System. By the end of 1920, the number of national banks had grown to 554 and state members to 56 banks — still a very small percentage of state banks in the Fifth District in that year.

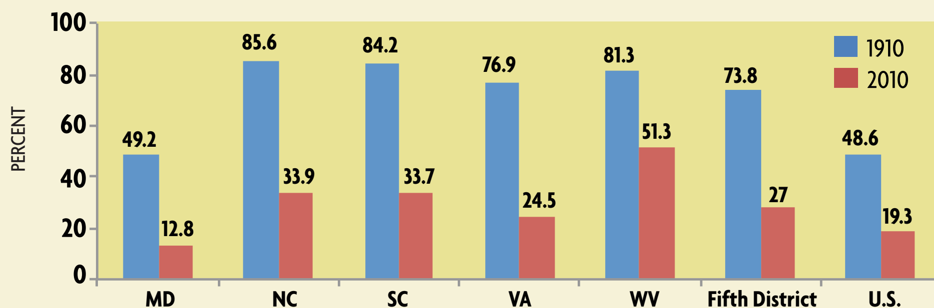
The 1920s were a period of rapid economic growth, fueled by the development of the automobile, radio, major appliances, and innovations in the organization of production. But the agricultural sector remained depressed for the entire decade, and large numbers of bank failures occurred almost every year. The failure of banks was not necessarily in line with economic growth — although the pace of bank failure generally grew during the Great Depression from 1929 through 1934. Richmond Fed economist John Walter showed in a 2005 *Economic Quarterly* article that the ratio of the number of banks to GDP fell notably from 1921 to 1934. As U.S. banks dropped from a peak of more than 30,000 in 1920 down to a little more than 15,000 in 1934, the number of banks in the Fifth District (excluding Washington, D.C.) dropped from about 2,200 in 1920 to about 1,100 in 1935. Some of these failures might have been due to macroeconomic weakness, although some have argued that the banking industry generally had become overbuilt and that it was the macroeconomic shocks in conjunction with overbuilding that produced the 12-year retrenchment in the banking industry.

Another reason for steady declines in the number of banks in the country was changes to branching laws. According to a 2007 *Journal of Law and Economics* article by Rajeev Dehejia and Adriana Lleras-Muney of New York University and the University of California, Los Angeles, respectively, in 1919 only Maryland of all Fifth District states allowed branching. The McFadden-Pepper Act, passed in 1927, allowed national banks to establish local branches in the city of their home office if state law allowed branching. In 1933, the Glass-Steagall Act permitted national banks to branch within any state that allowed state banks to branch. States were still free to set branching regulations for state banks. By 1931, in the Fifth District, only West Virginia prohibited state bank branching. In 1994, with the passage of the Riegle-Neal Interstate Banking and Branching Efficiency Act, interstate branching by national banks became legal regardless of state laws. The steady decrease in the number of banks in the Fifth District and in the United States over the 20th century largely reflected the consolidation in the banking industry that resulted from this slow liberalization of restrictions on bank branching.

The operation of the supervision and regulation function in the Fifth Federal Reserve District has also been affected by the steady technological innovation and cultural changes of the 20th century. In the 1940s, the examination staff consisted of 10 examiners and 11 assistant examiners. They were all white males who were supported by the "girls" of the office staff. Also in that decade, the Examining Department got electric typewriters, with the following report from a Richmond Fed publication: "The girls in the Examining Department are finding it a little difficult to become accustomed to the machines but are hoping to soon love them, as those who are experienced predict." The first female and black bank examiners were hired across the System in the late 1960s.

An addition to the supervision and regulation role came in 1977 when Congress enacted the Community Reinvestment Act (CRA), which was intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. By requiring that each depository institution's record in helping to meet the credit needs of its communities be evaluated by its regulator, the CRA in effect required the Reserve banks to have bank examination staff qualified to conduct these exams. At the Richmond Fed, a compliance unit was formed in 1977 and separate consumer affairs examinations began to be conducted.

Share of Population Living in Rural Areas



NOTE: The share of the population in the District of Columbia living in rural areas, as defined by the Census Bureau, was zero in both 1910 and 2010.
SOURCE (1910): U.S. Statistical Abstract 1914, http://www2.census.gov/prod2/statcomp/documents/1914-04.pdf
SOURCE (2010): U.S. Census Bureau, https://www.census.gov/geo/reference/ua/urban-rural-2010.html

Interstate Banking and Charlotte

Charlotte has always played a big role in the operations of the Richmond Fed, particularly for supervision and regulation staff. Although North Carolina was the last of the 13 original states to charter a privately owned bank, it allowed branching early: In 1814, its General Assembly gave bank directors permission to establish branches or agencies at any locations they saw fit. In 1911, Wachovia National Bank and Wachovia Loan and Trust Company merged, forming the Wachovia Bank and Trust Company, with $4 million in deposits and $7 million in total assets. In 1927, the Richmond Fed expanded to open a branch in Charlotte (the first branch was opened in Baltimore in 1918).

The importance of North Carolina as a banking center increased with the rise of a second major institution. By 1960, through a series of mergers and acquisitions, North Carolina National Bank (NCNB) emerged as the second-largest bank in North Carolina ($500 million in assets, behind Wachovia's $658 million); by 1972, NCNB had surpassed Wachovia in total assets.

In 1981, NCNB used a loophole in the McFadden Act to buy a Florida bank because it already owned a trust company in the state. NCNB bought First National Bank of Lake City and the Fed signed off on the purchase, so NCNB became a two-state bank. In June 1985, the U.S. Supreme Court upheld regional banking compacts that allowed banking companies in Southern states to acquire and be acquired by banking companies in other Southern states, enabling them to grow without fear of competition from the much larger Northern banks. In 1988, NCNB bought First RepublicBank Corporation in Dallas. Once the acquisition was complete, NCNB nearly doubled in size to $55 billion in assets, making it the nation's 10th biggest bank. At the end of 1991, NCNB became NationsBank.

By the end of 1997, with help from the passage of the Riegle-Neal Interstate Banking Act and another series of mergers and acquisitions, Charlotte was the nation's number-two banking city by assets. In the fall of 1998, the Richmond Fed set up a permanent staff of examiners in Charlotte. That year, NationsBank and BankAmerica (headquartered in San Francisco) merged to become Bank of America, headquartered in Charlotte. In 2001, First Union merged with Wachovia to create the fourth largest bank in the nation, named Wachovia and headquartered in Charlotte. Thus, Charlotte now had the second- and fourth-largest banks in terms of assets.

Although Charlotte lost one of its big bank headquarters when Wachovia was bought by Wells Fargo at the end of 2008, several developments caused the number of supervision and regulation staff in Charlotte — particularly those examining large banks — to keep growing. First, Bank of America grew through its acquisition of Merrill Lynch. Second, all Federal Reserve Banks took on more responsibility with regard to large bank operations, primarily as outlined by the most comprehensive piece of banking legislation since 1935: the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Richmond Fed's supervision and regulation function will continue to adapt to changes in the banking environment, such as the decline in the number of community banks and the increased public scrutiny of large banks after the financial crisis.

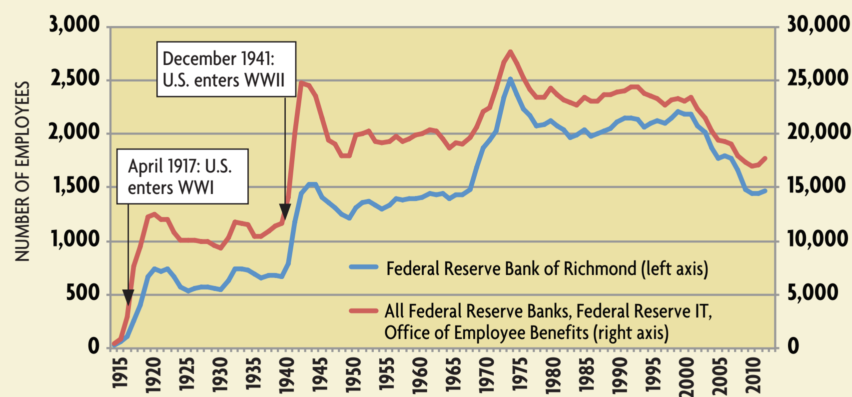
Payments and Check Processing

Facilitating payments systems — and most particularly in 1914, the clearing of checks — was a critical part of the Federal Reserve System's early responsibility. Checks were the most convenient and secure means of payment, but outside of the major cities, clearing checks could be a hassle, even

World War II and the Richmond Fed

Many of the changes in Richmond Bank activities are mirrored in its employment levels. The effort surrounding World War II led to the Bank's largest employment expansion. At the end of 1941, the Bank employed 795 people, but by the end of 1945, employment had almost doubled to 1,534 people. Much of the increase was connected to the war effort. Practically the entire increase consisted of women, with 1,472 employees of Reserve banks leaving to enter military service. Although the employment expansion was largely related to war savings bonds, war production loans, and consumer credit control, economic research activities also grew at this time. And this employment expansion was not limited to the Richmond Fed. Systemwide, employment rose from 14,083 workers in 1941 to 23,522 employees in 1945 — a 67 percent increase.

Employment in the Federal Reserve Banks

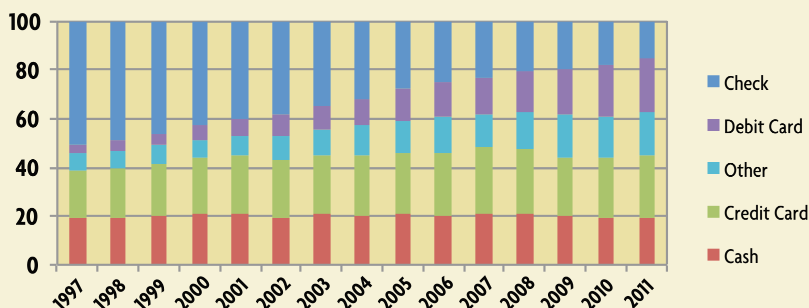


SOURCE: Federal Reserve Bank of Richmond Annual Reports

with the correspondent banking system. The Richmond Fed Transit Department opened with seven people in 1915, but quickly grew to 276 people by 1920, and continued to grow.

In fact, the number of checks handled by the Fed grew quickly in the Fed's first 75 years. The same was true in the Fifth District. In 1920, the Richmond Fed processed about 33 million checks; by 1950 that number had more than quadrupled to almost 150 million, and by 2000 the Richmond Fed was processing over 1.7 billion checks per year. In 1970, a regional check-clearing center opened in the Baltimore branch — the first operation of its kind to be established by a Federal Reserve Bank. In 1974, regional check-processing operations began in the Richmond and Charlotte offices, as well as in Columbia. Another regional check-processing center in Charleston, W.Va., became fully operational in 1977.

Share of U.S. Personal Consumption Expenditures by Payment Type



SOURCE: Nilson Report, Federal Reserve Bank of Richmond

Technological developments again created a need for change in the way the Fed operated. In 2003, Congress passed legislation endorsing Check 21, an electronic means of processing checks, which took effect in October 2004. Also in 2003, the number of electronic payments exceeded the number of check payments for the first time, and the gap has only widened since. (See chart.) In response, check-clearing operations across the country began to close, including those in the Fifth District. In 2003, the Federal Reserve System had 45 check-processing sites; in 2009, the Fed went down to one paper-processing site in Cleveland and one Check 21 site in Atlanta. On the other hand, the Fed continues to process and distribute cash, the demand for which has remained high among consumers despite the proliferation of electronic means of payment.

Research and Monetary Policy

Unlike banking supervision and payments services, the role of the Reserve bank research departments — either in the area of monetary policy or in the area of regional analysis — was not explicit in the Federal Reserve Act. Despite that, research has always been part of Reserve bank activities.

Initially, research departments focused on keeping up with regional economic conditions and developments, both for the individual Reserve banks and for the Board of Governors. As the Board's 1942 Annual Report explained, "the location of the Federal Reserve Banks and branches throughout the country and the inclusion on their directorates of local representatives of industry, trade, and agriculture, as well as finance, provide an unusually good opportunity for regional studies."

Research departments at Reserve banks still study regional conditions, but they have broadened their scope to include many areas of academic economics. One reason these areas of research came later is that monetary policymaking through the Federal Open Market Committee, as we know it today, was not instituted until the Banking Act of 1935.

Primarily due to the difficulty of cross-country travel at that time, either the president of the Richmond Bank or the president of the Philadelphia Bank would, in the late 1940s and 1950s, participate in the meetings where most monetary policy decisions were made. This created an early need for the Richmond research department to develop a strong base of economists well-versed in economics and monetary policy. Even then, a research department filled with Ph.D. economists who inform monetary and banking policy did not start to develop until the late 1970s. In 1975, the research department had fewer than 10 Ph.D. economists. That number grew particularly in the 1980s and first half of the 1990s so that the department has consistently had between 15 and 25 Ph.D. economists since the 1990s.

Several from their ranks have become Richmond Fed presidents. Robert Black, president from 1973 through 1992, was the first Ph.D. economist to do so. The two subsequent presidents, Alfred Broaddus (1993-2004) and Jeffrey Lacker (2004-present), also have doctorates in economics and served as directors of research at the Richmond Fed before becoming president.

Conclusion

It would take a book, and not a short one, to cover the full history of the Richmond Fed's operations. Not only has the Bank established new departments such as human resources and information technology, but banking legislation has also brought about new areas of operation, such as a community development department required by the CRA and an Office of Diversity and Inclusion required by the Dodd-Frank Act.

The Federal Reserve Bank of Richmond — and the Federal Reserve System — has evolved over the past 100 years. As changes in technology and in the political and financial landscape of the United States and the Fifth District continue, so will the operations of the Richmond Fed. **EF**