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Two-Way Street

The Board of Directors Provides a Vital Link Between Fifth District Communities and Fed Officials

BY CHARLES GERENA

Get a bunch of people together over a hot meal and there's no telling what conversations will ensue. Who's the favorite to win the Super Bowl? Which Democratic presidential candidate might face President Bush in the 2004 general election? But when the directors of the Federal Reserve Bank of Richmond's board gather for dinner on Wednesday nights before their monthly meetings, it's a safe bet they'll be talking about one thing—the economy.

The men and women on the board look for ways to use their time together to "explore the important issues of the day," says Wesley Williams Jr., chairman of the board and partner of the law firm Covington & Burling in Washington, D.C. They have discussed the economics of health care and other topics while dining on Virginia cuisine. "We had one [discussion] that was so heated that we ended up breaking it down into several sessions—it was called 'What's really wrong with the economy?' "

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The Federal Reserve Bank of Richmond held a joint meeting of the boards of its Richmond, Baltimore, and Charlotte offices in Washington, D.C., in October.

As illustrated by the unique table talk of Richmond Fed directors, the board at each of the 12 Reserve Banks has a broad range of responsibilities beyond the usual job description of a corporate board. In addition to overseeing operations, reviewing budgets, and setting priorities for their organizations, Reserve Bank directors represent the private sector's interests in the public formation of monetary policy. They accomplish this task through their discount rate recommendations and through their communications with Fed officials.

"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, chairman 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."

Even though board members usually have long histories of working in a specific industry, they don't view themselves solely as industry spokespeople.

For example, Fred Green III, chairman, president and CEO of National Bank of South Carolina, didn't just represent community banks when he served on the Richmond Fed's board. Because he was the only director from the Palmetto State during the first two years of his three-year tenure, Green felt obliged to comment on statewide economic activities. "I talked to a wide variety of people in different industries, trying to get a feel for what the most current trends were," says Green, who gave his fellow directors a book on

South Carolina history as background information.

During the roundtable discussion at every board meeting at the Richmond Fed, directors provide a bird's-eye view of the economy. They admit they do a lot of homework, knowing they have a unique opportunity to communicate with J. Alfred Broaddus Jr., president of the Richmond Fed, and staff economists.

For example, Joan Zimmerman, a member of the board of directors of the Bank's Charlotte office for five years, made use of her position as chief executive of Southern Shows Inc. The company regularly surveys businesses and consumers about their buying plans for the next six months. This enabled Zimmerman to cull reports on consumer intentions to make home improvements, buy houses, and purchase appliances.

For Craig Ruppert, president of Ruppert Companies, reporting on the economy was the most fun part of his six years on the Richmond Fed board. A few days before a board meeting, he would call five to 10 people from his network of businesspeople in and around his home base of Laytonsville, Md., to get a sense of how things were going. They represented a variety of industries, from manufacturing to construction and real estate. "They came to expect my calls [and] prepare for my calls," says Ruppert. Other directors also say they have conducted surveys.

Such information is subjective and informal, but it is nevertheless invaluable to board members and Fed policymakers. "What you get from the anecdotal information is, perhaps, an inkling of a trend…so that you can be ready if the numbers support it," explains Dyan Brasington, president of Technology Council of Maryland and a member of the board of directors of the Bank's Baltimore office since 2000.

It also provides fodder for the deliberations of the Federal Open Market Committee (FOMC), which sets interest rate policy. "Al Broaddus used to say the information that we bring is a major part of what he took to the FOMC," notes Zimmerman. (The FOMC consists of the Board of Governors and five Reserve Bank presidents, four of which serve on a rotating basis.)

The exchange of information at board meetings isn't a one-way street. Board members hear Fed economists present information about the national and international economy. This gives them a macroeconomic perspective that they use in their day jobs.

"In this fast-paced, changing global economic environment, it is important for people in academia to have [an economic] perspective in planning for our institutions," says Lucy Reuben, provost and vice chancellor for academic affairs at North Carolina Central University. Since joining the Charlotte office board in 1999, Reuben has also used her directorship to inform the Research Triangle's business community about the intricacies of monetary policy. "We can take back a better understanding of the role of the Fed in the community."

In addition to serving as a conduit of information, the board of directors has important supervisory duties. Breaking up into working committees (i.e. Audit, Executive Compensation, Building, Human Resources, etc.), directors review the Richmond Fed's budget, oversee internal audits, and provide guidance on a variety of Bank-wide issues.

Barry Fitzpatrick, CEO of Branch Banking and Trust Company of Virginia and a newcomer to the Richmond Fed board in 2003, is a member of the Audit Committee. The information he receives on the Richmond Fed's policies, procedures, and operations is broad. "When you leave that committee meeting, you have a good perspective of areas that need attention and [areas] that are doing well."

The board also appoints the president and first vice president of the Richmond Fed and all officers, subject to approval by the Board of Governors. Currently, directors are working with a search firm to find a replacement for Al Broaddus, who will retire this year after serving 11 years as the Richmond Fed's president.

Another highly visible duty of the board is recommending a level for the discount rate, the interest rate that the Fed charges for credit to banks. Broaddus suggests whether the rate should be raised, lowered, or kept the same. The directors discuss the proposal and vote on it, then their request is forwarded to the Board of Governors for final approval. The full board, during its monthly meeting, and an executive committee of directors alternately handle this task every two weeks.

The board of any Reserve Bank may request a change in the discount rate. However, past history indicates that a majority of boards usually must be on the same page before a change is made.

For example, the directors of Reserve Banks in Cleveland, Richmond, St. Louis, and Kansas City requested an increase in the discount rate seven times between June and August of 1999. According to meeting minutes, they were concerned about unsustainable growth, tight labor markets, and rising prices. But the directors on other boards weren't as worried about inflationary pressures and they didn't feel a rate increase was necessary. As a result, the Board of Governors didn't hike the discount rate until 10 out of 12 boards favored the action in late August 1999.

Obviously, directors don't always agree with Fed policymakers. But Tom Schlesinger, executive director of Financial Markets Center, a Virginia-based nonprofit that closely follows the Fed and the financial sector, believes that's a good thing. "The built-in tensions between a centralized element of the Fed—the Board of Governors—and the regional elements scattered around the country is very healthy."

Debate doesn't always lead to consensus, but it gives everyone a say in the decision-making process. "That's crucial because without the support [of different groups] the system would break down," notes J. Lawrence Broz, a political science professor at the University of California at San Diego who has written about the Fed's origins.

When lawmakers crafted the Federal Reserve System in 1913, ensuring that diverse interests were represented in policymaking was an important goal.

According to Broz, financial institutions feared that the central bank wouldn't pay attention to their perspectives. There also were concerns about having regional diversity in the Fed's management.

At the same time, people from the agricultural sector and other industries feared that bankers would be seated at the Fed's steering wheel. "People understood that the banks' interests wouldn't necessarily be the interests of all sectors," says Broz.

As a result, a board of directors, primarily selected by private interests in each region supervises the day-to-day operations of each Reserve Bank. Furthermore, the directors cannot be members of Congress or engage in partisan political activity.

To balance the independent perspective of businessmen and bankers on Reserve Bank boards, the Board of Governors sits above the banks and coordinates the nation's monetary policy. The seven members of the Board of Governors are nominated by the President and confirmed by the U.S. Senate.

Further, the nine directors on a Reserve Bank board are divided into three classes to provide some differentiation in their selection and representation. Three "Class A" directors are elected by and represent the interests of commercial banks which are members of that Reserve Bank, while three "Class B" directors are chosen by member banks to represent different parts of the regional economy. The remaining "Class C" directors are selected by the Board of Governors to represent regional interests as well, again striking a balance between political independence and public accountability.

The branch offices of Reserve Banks have their own boards as well, each with as many as seven directors. The Reserve Bank appoints the majority of these directors and the Board of Governors appoints the remaining members. The branch boards don't have supervisory duties but they help relay information about local economies to Fed officials throughout the district.

Even though this structure is intended as a means for people across ideological and geographical boundaries to contribute to Fed policymaking, Broz argues that the people selected as Bank directors tend to be a relatively homogenous group. "[Since most of] the electing members are bankers, they are unlikely to appoint people to their governing body with interests that are very different from their own," he says.

In fact, a 1976 report by the Banking Committee of the U.S. House of Representatives found that banks and large corporations were disproportionately represented on Reserve Bank boards. So Congress required in the Federal Reserve Reform Act of 1977 that Class B and C directors be selected "with due but not exclusive consideration to the interests of agriculture, commerce, industry, services, labor, and consumers."

However, the legislation did not spell out how many directors should be named to represent each sector so imbalances in board representation still occur. "It's generally been true of all Reserve Banks that the interests and perspectives of labor, consumer, and community organizations have been underrepresented," says Tom Schlesinger.

This problem has improved in the past decade. Shifts in the economy have resulted in new business sectors rising to prominence on boards, while efforts by Reserve Bank presidents to encourage board diversity have had an impact. According to Schlesinger's organization, 12.8 percent of Class B and Class C directors who served between 1999 and 2002 were from the labor, consumer, or community sector, compared to 9.4 percent during the 1991-94 period.

A dramatic change occurred at the New York Fed's board, which was historically dominated by Fortune 500 executives. That board now includes two educators, an attorney, and the head of a nonprofit agency.

Wesley Williams has seen an improvement in board representation at the Richmond Fed during his seven years as a director. "I think there have been imbalances here and there, but they have been usually addressed fairly quickly," he says. "There was a time when ... we had no labor representatives on the board. We now have a deputy chairman [Thomas Mackell] who has been intimately involved with a lot of the major labor organizations in the country." Williams credits Al Broaddus for keeping an eye on the board's diversity.

Each perspective has provided a well of expertise for the Richmond Fed to tap. Elleveen Poston of Quality Transport, a South Carolina trucking company, provided information on fuel prices until her term on the Charlotte office board expired last December. The late Irwin Zazulia of Arlington, Va.-based Hecht's was a fountain of information about the retail sector at Richmond Fed board meetings.

Schlesinger concurs that the composition of Reserve Bank boards has gradually broadened. "There has been forward movement and some backsliding from Bank to Bank." But generally, "there is a good deal more diversity of perspectives on boards today." **RF**

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