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The Establishment and Scope of Branches of Federal Reserve Banks

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THE establishment and operation of the Federal Reserve Banks and branches is the direct result of intensive research and study on the part of economists, financiers and statesmen regarding the inadequacy of the banking system of the United States as developed under the national banking system, established in 1863, remodeled by enactment of Congress in 1864, and patched up from time to time by more than sixty legislative amendments. The national banking system as it formerly existed, was sup-

plemented by the state banks and trust companies created by state laws, all functioning independently or separately. The entire system passed through various so-called panics up to 1907, at which time the attention of the whole country was brought sharply to the inherent weaknesses of our banking and credit system, while the crisis of that year compelled definite action along remedial lines. The system had proved inadequate to cope with modern commercial needs. It failed to supply commerce and in-

dustry with adequate credit facilities in normal times, and in times of financial stress it broke down completely, spreading disaster and ruin throughout the land.

The Aldrich-Vreeland Currency Act, approved by the President May 30, 1908, in providing for emergency currency based upon certain classes of securities other than government bonds, authorized the uniting of ten or more national banks in any one city or community into a "National Currency Association." It may be stated that that law was the beginning of the regional idea, and of its later development into the thought of additional services and conveniences to areas, communities or centers, which has brought about establishment of branches of Federal Reserve Banks. The National Monetary Commission was also authorized by the Aldrich-Vreeland Act.

BRANCHES OF FIRST AND SECOND BANKS OF THE UNITED STATES

Alexander Hamilton's original plan for the First Bank of the United States, organized in Philadelphia in December, 1791, did not contemplate the establishment of branches; but early in 1792 branches were opened in New York, Boston, Baltimore and Charlestown, and later, additional ones were opened at Norfolk, Savannah, Washington and New Orleans, making in all, eight branches.

In stating the advantages derived from the bank by the government, Secretary of the Treasury Gallatin laid stress upon the safe-keeping and transmission of the public funds, the economical collection of the revenue, and the aid furnished to the government in the matter of loans. The punctuality of payments introduced by the banking system, and the facilities afforded by the bank to importers indebted for revenue bonds, were

among the causes which had enabled the government to collect with such facility and with so few losses, the great revenue derived from imports. The numerous state banks might afford considerable assistance to the government in its fiscal operations, but they could not effect the transmission of public funds with the same facility or to the same extent as the Bank of the United States through its several branches.

The Second United States Bank, chartered in 1816, commenced operations in January, 1817, and by October, 1817, nineteen branches in fourteen states had been designated, and, subsequently, eight other branches or agencies were established.

The establishment of branches was the most characteristic and the most essential feature of the plan of the First and Second Banks of the United States. Without them they would have been virtually useless to the government, unable to exercise an efficient control over the state banks, and incapable of furnishing accommodations in discounts and exchange throughout a country unprovided with a note circulation of uniform value, or with any extended currency.

The general control of the branches was almost wholly in the power of the central directorate through its authority to appoint the local directors and to create by-laws for the branches, the election of the president being the one important privilege left to the uncontrolled will of the branch directorates. It was, of course, essential to the safety of the bank, to the security of its operations and to the unity of its policy, that the control of the central board over the branch officials and directors should be real and effective.

Both the First and Second Banks of the United States became involved in

political strife without any intention of their own and in spite of their earnest efforts to avoid such entanglements.

These two central banks were very largely government instrumentalities; out of them grew the independent treasury system established in 1846, and from that time until the Civil War the government made its collections and disbursements entirely in specie and kept its funds in the Treasury and its branches, called subtreasuries. Important changes were made in this system during and after the war, bringing the Treasury into close relations again with the banking and credit system of the country.

THE INDEPENDENT TREASURY AND ITS BRANCHES

The national banking system, established in 1863, grew out of the financial difficulties of the Civil War. After the adoption of the independent treasury system in 1846, the government had no relation with the banks of the country, keeping its funds with the various subtreasuries established in several leading cities. When the war broke out the government was compelled to turn to the banks for help. Instead of meeting the war expenses by taxation, it resorted to loans, which could be obtained quickly only from the banks.

The policy of separating the fiscal activities of the government from banks and banking—which was adopted with the establishment of the independent treasury system—was discontinued when the national banking system came into existence, and thereafter the subtreasuries became largely depositories of surplus coin, distributors of currency and coin, and redemption agencies.

Under the Aldrich-Vreeland Act there were formed no less than eighteen national currency associations, and in

the bill suggested by the National Monetary Commission, as a result of its investigations, provision was included for a central reserve association, for at least fifteen branches of the parent association and for further districts when necessity might arise. All through the studies of the National Monetary Commission and in the various important writings of financiers and economists, the necessity for adequate accommodations in industrial communities or centers, the interest of which might demand direct personal contact with properly accredited representatives of the parent institution, was recognized.

POPULAR OPPOSITION TO CENTRAL BANKS

Throughout the history of the country, it is apparent that the people have been opposed to placing in one single institution the financial power which a central bank might exercise. This was manifest in the failures of both the First Bank of the United States and the Second United States Bank to secure charter renewal; and the antagonism which was most apparent during the administrations of President Jackson continued and asserted itself in the preparation of the legislation that finally resulted in the enactment of the Federal Reserve Act, approved by the President, December 23, 1913.

Division of the United States into regions, as begun in the formation of the Currency Association, prevailed in the Act; and the establishment of not exceeding twelve independent Federal Reserve Banks with power in each of the banks to establish and operate branches was provided.

The original law, Section 3 of the Act, was as follows:

Each Federal Reserve Bank shall establish branch banks within the Federal

Reserve district in which it is located and may do so in the district of any Federal Reserve Bank which may have been suspended. Such branches shall be operated by a board of directors under rules and regulations approved by the Federal Reserve Board. Directors of branch banks shall possess the same qualifications as directors of the Federal Reserve Banks. Four of said directors shall be selected by the Reserve Bank and three by the Federal Reserve Board, and they shall hold office during the pleasure, respectively, of the parent bank and the Federal Reserve Board. The Reserve Bank shall designate one of the directors as manager.

The Organization Committee, provided in the Act, gave consideration to these provisions and reported at length regarding the development of branches. The final recommendations of the Committee, in part, were as follows:

It is recommended that in the event of the establishment of such branches they be assigned a proportionate capitalization based upon the capitalization and surplus of the member banks included within the territory assigned to the branch. This, however, should be only a tentative matter, and such assignment of resources should be merely to bridge over the period during which it is found from experience about what amount of paper will on the average be presented by the banks in each branch district. When sufficient experience has been had to determine this point the resources to be employed should be distributed among the branches in proportion to the quantity of paper presented on the average by the member bank in each such branch district.

It is recommended further that the parent bank of the district shall in every case retain for itself a substantial portion of the district as a territory from which paper shall be directly presented for rediscount. This would mean simply that the branch districts would be established whenever there was a special need for them in a particular part of a district which presented a clear cut, independent trading

area, whose territory was an economic unit and whose member banks naturally stood in close relationship to one another. The suggestion also amounts to a rejection of any plan for subdividing a district completely into branch areas while the District Reserve Bank itself exercised no distinct banking functions except those of oversight. It is believed that this latter plan would not be desirable, but that in every district there should be a strong independent Reserve Bank organization performing actual banking functions and directly rediscounting the paper of a considerable number of the member banks included within such district.

In responding to criticism of the Organization Committee in fixing Federal Reserve districts and designating Federal Reserve cities, the Honorable Carter Glass, then Chairman of the House Committee on Banking and Currency, stated early in 1914:

With my knowledge of facts and study of the situation, covering a period of sixteen months, I would not, had I the power, make more than a single change in the districts as defined by the Organization Committee, and that change I do not care to point out, as no good could be expected from any suggestion that now might be made. Referring again to the relative importance of the branch banks and the regional Reserve Banks, in the practical operation of the system, no business center will lose its identity nor have its business relations seriously interrupted. The banking operations and the commercial transactions of any given territory will be practically maintained as they exist today, for the reason that such territory will transact its business with the branch bank, if more convenient than with the regional reserve bank, so that there is no earthly reason why any large financial or commercial community should be in the least degree uneasy over the prospect of losing any business which it now commands.

EARLY DISADVANTAGES

In the original Federal Reserve Act, the mobilization in the Federal Reserve

Banks of reserves of member banks extended over a period of thirty-six months. In carrying these provisions of the law—as long as they existed—into effect, it became apparent that the cities in which Federal Reserve Banks were located had an advantage over cities of former equal standing, especially in regard to accounts of country banks, and the advantage of correspondent banks in Federal Reserve cities was further accentuated when the early steps in the par collection of checks were taken. At first, banks in the other cities endeavored to offset the advantage by maintenance of excess reserves in the Federal Reserve Banks and agreement for immediate charging against such reserves of their checks by the Federal Reserve Banks. This proved both burdensome and unsatisfactory.

In its Second Annual Report to Congress, for the year 1915, the Federal Reserve Board states:

The question of branches of Federal Reserve Banks has received careful attention during the past year. There has been intimation from several quarters that the establishment of a branch at a given point would be acceptable to the banks of that place. Only in one instance—that of New Orleans—did the Board receive a definite request from a Federal Reserve Bank to establish a branch. Believing that New Orleans and the adjacent territory could make advantageous use of this additional banking machinery, the Board authorized the establishment of a branch of the Federal Reserve Bank of Atlanta to be located in New Orleans, and this branch was opened for business on September 10, 1915. Operations at the New Orleans branch have proceeded satisfactorily, and the institution has been of considerable use to the local banks. The branch is already more than self-supporting.

Investigation and experience have seemed to show that, at least for some years to come, the organization of branches with completely equipped offices, vaults, and

the like, and with a full staff of salaried officials, will be too heavy an expense for most of the reserve banks, yet, that valuable service could be performed by local offices of the several banks in not a few places. The Board has, therefore, had under consideration the question whether establishing local agencies might not meet the requirements of the case better than the more fully organized branch office. Competent legal opinion is to the effect that the creation of such local offices is permissible under the terms of the law, and the Board believes that it may prove practicable to meet banking necessities in many sections of the country by this means.

The entrance of the United States into the Great War in April, 1917, forced upon the Federal Reserve Banks greatly increased responsibilities and duties. By reason of the government's financial requirements and the assistance rendered to member banks to enable them to meet obligations and give the wonderful support accorded by the banks to the nation's demands, the Federal Reserve Banks were enabled to show substantial earnings, and, on account of the favorable position thus attained, the early establishment of branches was possible.

The section of the Act relating to branches was amended in June, 1917, and in its Fourth Annual Report, the Federal Reserve Board made the following statements:

As originally enacted, this section provided that each Federal Reserve Bank "shall establish branch banks" to be "operated by a board of directors under rules and regulations approved by the Federal Reserve Board," and provided also that there be seven directors having the same qualifications as directors of Federal Reserve Banks. The section as now amended provides that the Federal Reserve Board may permit or require any Federal Reserve Bank to establish branches within its district, and that such branches, subject to such rules and regulations as the Federal

Reserve Board may prescribe, shall be operated under the supervision of a board of directors to consist of not more than seven or less than three directors, of whom a majority of one shall be appointed by the Federal Reserve Bank of the district and the remaining directors by the Federal Reserve Board.

During the year branches have been established at Omaha by the Federal Reserve Bank of Kansas City, at Louisville, by the Federal Reserve Bank of St. Louis, and at Portland, Seattle and Spokane, by the Federal Reserve Bank of San Francisco, and are now in operation. The Board has, in addition, authorized the establishment of branches at Pittsburgh and Cincinnati by the Federal Reserve Bank of Cleveland, at Detroit, by the Federal Reserve Bank of Chicago, at Baltimore, by the Federal Reserve Bank of Richmond, and at Denver by the Federal Reserve Bank of Kansas City. It is expected that all of these branches will begin business at an early date.

The policy of the Board in the establishment of these new branches has been to recognize the unity and paramount responsibility of the Federal Reserve Bank, while extending full facilities to the banks in the territory served by the branch. By avoiding duplications in bookkeeping, and by a consolidated control of accounts at the Federal Reserve Bank, it is expected that branches can be operated at a comparatively small expense.

In the organization of the branches in the various Federal Reserve districts, the parent banks have retained definite portions of their districts in which they exercise distinct banking functions for member banks, and have delegated to the branches like functions for member banks in territories or areas assigned to such branches.

BRANCHES ARE SUBSIDIARY

There are now in operation twenty-four branches of the twelve Federal Reserve Banks. These branches have all been located in the several districts in harmony with the underlying direc-

tion of the Act that they shall exist "with due regard to the convenience and customary course of business." The actual operation of all the branches in the final results is subsidiary to the parent banks and forms part of their functions. The figures of the branches are embraced in the reports and statements of their parent. Matters of policy and questions of operation are determined by the head offices in the respective districts.

By reason of remoteness from the head office, some of the branches maintain separate books and perform practically all of the functions of the parent bank in relations with member banks in their assigned zones or territories. In others, a method prevails by which all figures and accounts are maintained in the head office through private telegraphic connections with the branches and under a satisfactory system of communication and accounting.

FUNCTIONS OF BRANCH BANKS

The powers and functions exercised by the branches of the Federal Reserve Banks embrace:

- (1) Receiving deposits of member banks and the government;
- (2) Paying out currency and coin to banks;
- (3) Receiving from member banks applications for loans and discounts and tenders of bills eligible for purchase by Federal Reserve Banks, and examining all paper presented for technical defects, generally passing immediate credit for proceeds subject to final review by the head office;
- (4) Operating city and country collection departments for handling of bonds, coupons, notes, trade acceptances, sight, time, and documentary drafts, insurance and railroad vouchers, and certificates of deposits;
- (5) Operating a transit department

for handling checks and bank drafts and other cash items payable on demand;

(6) Clearing of checks and drafts and other clearable items payable through clearing houses in cities wherein branches are located;

(7) Making wire transfers to and from other Federal Reserve and branch cities for member banks in branch territory;

(8) Converting, exchanging and interchanging all issues of Liberty Loan bonds, Victory Liberty Loan notes and certificates of indebtedness;

(9) Redemption of United States securities, coupons, War Savings Certificates and stamps.

In the establishment of branches of the Federal Reserve Banks, efforts were made to give to those communities wherein the branches are located the fullest measure of Reserve Bank service demanded by banking and business conditions within limits of reasonable expenditure and avoiding unnecessary duplication of work. In each branch there is maintained an adequate currency supply to meet the needs of the community. The sub-treasuries were discontinued, prior to July 1, 1921, under an amendment by Congress to the organic law, and the functions and duties of those offices have been undertaken also by the Federal Reserve Banks and branches.

BRANCHES AID COLLECTIONS

The branches have been notably effective in the collection operations as developed in the Federal Reserve System. Checks and drafts and other collection items upon banks in a given branch or parent bank territory are sent directly to the branch or bank serving that territory by all other Federal Reserve Banks and branches, and arrangements have been perfected permitting the larger member banks

in the centers to send direct to the proper Federal Reserve Bank or branch all such items payable in its respectively allotted areas.

It is apparent that, in every practicable way, the banks in cities and areas wherein branches of Federal Reserve Banks are located are accorded all the facilities and services of the System in like manner as those in designated Federal Reserve cities. Capital stock adjustments and dividend payments naturally appertain to the head offices, and these functions are necessarily reserved, but otherwise the branches render available in their cities and assigned areas all Federal Reserve banking powers.

A notable instance of the use to which these facilities have extended is that, in one of the leading branches during the calendar year, 1920, over \$510,000,000 in currency was deposited, and approximately \$490,000,000 paid out and about 14,000,000 checks, aggregating nearly \$9,000,000,000, were handled by this one branch.

BRANCH BANKS GROWING RAPIDLY

In many of the locations the facilities demanded and accorded have already assumed such magnitude and importance as to require the services of large clerical staffs occupying considerable office space, and in not a few instances, already, the branches have been compelled to acquire separate buildings or to plan independent quarters in order to secure proper safeguards and efficient handling of the volume of work passing through their hands. Some of the Federal Reserve Banks now have under consideration necessary office location of branches; some branches now already established are being placed in their own buildings, the property of the parent banks. It is manifest that considerable expendi-

ture by the Federal Reserve Banks for office buildings and vaults for branches is necessary in order to conduct the work properly.

It is not improbable that in the future development and progress of the Federal Reserve System, there will arise the necessity for the location of

other branches to meet the demands or requirements of business communities or industrial centers. These situations will be met and provided for and any additional functions which may be properly assumed by the Federal Reserve Banks will likewise be allotted to the branches.