The Freedman's Savings Bank: The (Broken) Promise of America's First "Black Bank"

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Please note that quotations throughout this case maintain their authors' original language. This includes quotations from historical sources using terms that were widespread when written, but can carry negative connotations.

I am grateful to David Davidson for comments on an earlier draft.

1 *Historical background*[*]

[*] This section draws heavily on Todd (2019) and Stein and Yannelis (2020).

Prior to the Emancipation Proclamation in 1863, approximately 13% of the American population—one third of the total population of the American South—were enslaved, and only 8–14% of African Americans were considered "free." The freedom of free African Americans was significantly constrained, especially among those living in the South, with educational, economic, and other opportunities limited by laws and social norms that embedded longstanding anti-Black racism.

At the end of the Civil War, a vast majority of the recently emancipated could not read or write, and those who worked did so overwhelmingly in agriculture. There was widespread desire to acquire property and education, and many African Americans wanted jobs off of farms, perhaps by starting their own businesses.

Segregation was extreme during the post-Civil War "Reconstruction" era. And although there were a small number of African Americans with bank accounts as early as 1819, they were not legally allowed to patronize "white" banks until the 1868 passage of the 14th Amendment. In the decades before the Civil War, abolitionist groups had been discussing the possibility of starting a "Black bank," but these plans did not succeed until after emancipation. For example, at the 1847 National Convention of Colored People and Their Friends in Troy, NY,

> "[Thomas] Van Rensselaer[†] spoke in favor of a banking institution originating among the colored people of the U. States, because at present they contribute to their own degradation by investing capital in the hands of their 'enemies.'" (Todd, 2019, p. 17)

[†] Van Rensselaer, a formerly enslaved person, was a New York City newspaper publisher, restauranteur, and prominent abolitionist.

Ultimately the creation of America's first "Black bank" was spurred by African American soldiers who fought in the Civil War, and who accounted for about 10% of all soldiers in the Union Army. Soldiers were paid for their military service, and for the vast majority of Black Union soldiers who were formerly enslaved, this may have been their first time ever being paid.

Government authorities started to set up systems for soldiers to distribute money to their families, or to save some for use later. At the end of the war, plans were made by Anson M. Sperry (an army paymaster) and John W. Alvord (a military chaplain) to formalize and consolidate these military banks. A bill to incorporate the Freedman's Savings and Trust Company was introduced to Congress on February 13, 1865, quickly passed on March 3, and was signed into law by President Abraham Lincoln.

Chartered to receive deposits "by or in behalf of persons heretofore held in slavery in the United States, or their descendants," the Freedman's Bank grew quickly. In addition to incorporating soldiers' unclaimed deposits at various military banks, it solicited new customers; as a contemporary observed:

> "The institution proceeded at once to collect deposits.... Its emissaries went with hasty step into every quarter where the colored people lived and urged them to save their money and deposit it for safekeeping with the Freedman's Savings and Trust Company." (Todd, 2019, p. 24)

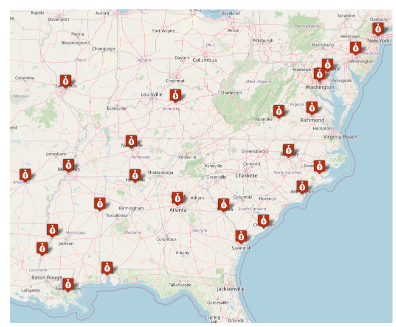


Figure 1: Freedman's Savings Bank Branch Locations (from Carrier and Walton-Raji, 2014)

Branches also proliferated, mainly throughout the South, but also in New York City and Philadelphia (Figure 1). The Bank ultimately attracted over 100,000 depositors, suggesting that perhaps one in eight African Americans in the South had an immediate family member with an account.

The Freedman's Savings Bank was fundamentally a *savings* bank. That is, while depositors could earn interest on their accounts, the Bank did very little financial investment in the communities it purportedly served. The money deposited was invested from the Bank's headquarters, and it was these investments that ultimately caused the Bank's collapse, as described in Section 2.

Arguably, Black depositors had never avoided Van Rensselaer's decades old concern about "contribut[ing] to their own degradation by investing capital in the hands of their 'enemies.'" Mehrsa Baradaran echoes this in her history of Black banks and the racial wealth gap:

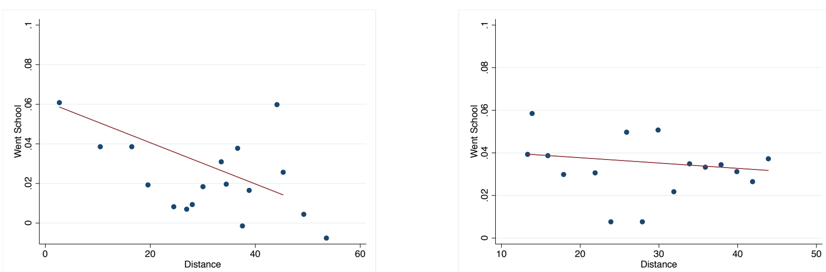
> "The whole point of banking is to collect money and put it into productive use through lending. Yet the Freedmen's Bank was purposefully set up as a savings bank, a teaching institution, rooted in a paternalistic and condescending mission of instructing blacks in the ways of

> thrift and capitalism. But the bank left out the most important part of capitalism—the part where capital is able to grow and multiply through credit. By not lending to depositors, the Freedmen's Bank was counterfeit capitalism from its inception." (Baradaran, 2017)

Despite the fact that the Bank did little local lending, it seems to have had *some* positive short-term effects for its customers; even simple savings accounts could perhaps contribute to families' resource accumulation. According to banking historian Tim Todd,

> "the institution did benefit many individuals during its operation. By one estimate, $54 million was saved by depositors, allowing them to purchase farms, equipment, business, homes and education that may not have otherwise been possible." (Todd, 2019, p. 67)

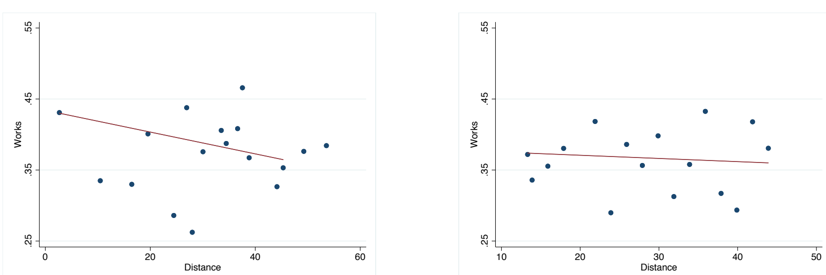
Indeed, research using 1870 Census data suggests that African Americans who lived nearer Bank branches were more likely to have children in school, be literate, work, and have higher income, business ownership, and real estate wealth (Stein and Yannelis, 2020). Some of these effects are illustrated in Figures 2–3, which also show that the positive effects of living near a branch were not present for African American families living near "control" locations where the Bank was planning to open a branch but hadn't yet.



(a) By distance from a FSB branch (opened pre-1870)

(b) By distance from a *planned* FSB branch

Figure 2: Black Americans' school attendance by distance from a FSB branch (from Stein and Yannelis, 2020, Figure A5)



(a) By distance from a FSB branch (opened pre-1870)

(b) By distance from a *planned* FSB branch

Figure 3: Black Americans' employment by distance from a FSB branch (from Stein and Yannelis, 2020, Figure A6)

Other research has shown that the children of Bank depositors had approximately 33% higher literacy rates than non-depositors' children in 1880 and 1900, and suggests this may partly be because many teachers worked as bank cashiers and "were able to inform depositors of schooling opportunities for their children, and encouraged them to invest more in their children's human capital" (Fu, 2021b).

2 *The Bank's collapse*[*]

[*] This section draws heavily on Todd (2019).

Although federally chartered, the Freedman's Savings Bank was legally a *private* organization run by a 50-member Board of Trustees (all of whom were white men). However, there seems to have been some confusion about whether the Bank had a government guarantee, and how it was connected to the similarly-named "Freedmen's Bureau," a government agency created by legislation signed by Lincoln on the same day as the Bank's charter. Bank trustees and executives were also involved with the Freedmen's Bureau, exacerbating (arguably intentionally) their conflation.

In addition, "Bureau offices were used without charge by savings bank personnel wearing government-issued uniforms and some Bureau employees actively solicited savings bank deposits," and "there were reports that [Bank cofounder] Alvord explained the savings bank to some black soldiers not as an optional institution where they *could* deposit savings, but as a direct [military] order... that they *had to* make deposits" (Todd, 2019, p.26).

In 1869, the Bank constructed a luxurious new headquarters building (Figure 4), which cofounder Anson Sperry later described as

> "an illegal and unjustifiable extravagance.... In other words, I damned it from its foundation stone up. I have nothing to say of the motives of the men who built it. I date from that the decadence of the Bank." (Todd, 2019, p.35)

Figure 4: Freedman's Savings Bank Headquarters c. 1890, Washington, D.C.

Ultimately, true control of the Bank was captured by a small number of trustees, and in particular Henry D. Cooke, who was also a partner in his brother's investment bank, Jay Cooke & Co.; president of First National Bank; and eventually the governor of Washington, D.C.

Cooke and his supporters successfully lobbied Congress to change the Bank's charter and loosen restrictions on how the Bank could invest depositors' money. Over the next few years, Freedman's Savings Bank deposits were used to bail out unsuccessful investments and loans made by Jay Cooke & Co. and First National. Todd (2019, p.37) notes that

> "the savings bank was generally uninterested in lending deposits in the black community. Instead, it provided loans for a number of high-risk

> schemes, often related to the business interests of its trustees.... There were also loans to individual savings bank officials and other complex personal arrangements."

In 1873, Jay Cooke & Co. collapsed. The firm had made huge investments in railroad companies alongside European investors, and a financial panic in Europe caused a crash in U.S. railroads that took down Jay Cooke and First National. The Freedman's Savings Bank imposed 60-day waiting periods on withdrawals, but given the fact that it had bought some of the Cookes' worst investments (and made bad bets of its own), it ultimately failed in June 1874. Of course, the Bank had no government guarantee, and federal deposit insurance (e.g., the FDIC) would not be created for 60 more years.

The Bank's collapse took a year, and some depositors got their money out in time. But as information about impending failure spread, it reached African American depositors particularly slowly, and they were especially likely to suffer losses (Traweek and Wardlaw, 2022). Perhaps as much as a quarter to a half of accumulated Southern African American wealth was destroyed (Todd, 2019; Baradaran, 2017).

3 *The Bank's legacy*

In the decade after the Bank's collapse, the federal government did make partial reimbursements of some lost deposits. However, this involved delay and paperwork, with even the largest recoveries covering 62% of losses; more than half of depositors received nothing. The impacts were more than financial; Todd (2019, p.46–47) argues that

> "As an institution for newly freed slaves, Freedman's Savings & Trust was often responsible for the first money any of its depositors had earned in exchange for labor in their entire lives. Thus, while the amounts might have been small from an economic perspective, the value to the account holders was likely far greater than the amount of goods or services that could be purchased with those dollars."

This echoes the famous observation of scholar and civil rights activist W. E. B. Du Bois that

> "With the prestige of the government back of it, and a directing board of unusual respectability and national reputation, this banking institution had made a remarkable start in the development of that thrift among black folk which slavery had kept them from knowing. Then in one sad day came the crash—all the hard-earned dollars of the freedmen disappeared; but that was the least of the loss—all the faith in saving went too, and much of the faith in men; and that was a loss

> that a Nation which today sneers at Negro shiftlessness has never yet made good. Not even ten additional years of slavery could have done so much to throttle the thrift of the freedmen as the mismanagement and bankruptcy of the series of savings banks chartered by the Nation for their especial aid." (Du Bois, 1903)

Historians have long argued that the collapse of the Freedman's Savings Bank led to a lack of trust in financial institutions by African Americans that may explain—at least in part—the persistently high rates at which African Americans are "unbanked" or "underbanked." Indeed, according to the FDIC National Survey of Unbanked and Underbanked Households, Black Americans today are particularly unlikely to have bank accounts, especially among those with incomes below $30,000 per year (see Figure 5).

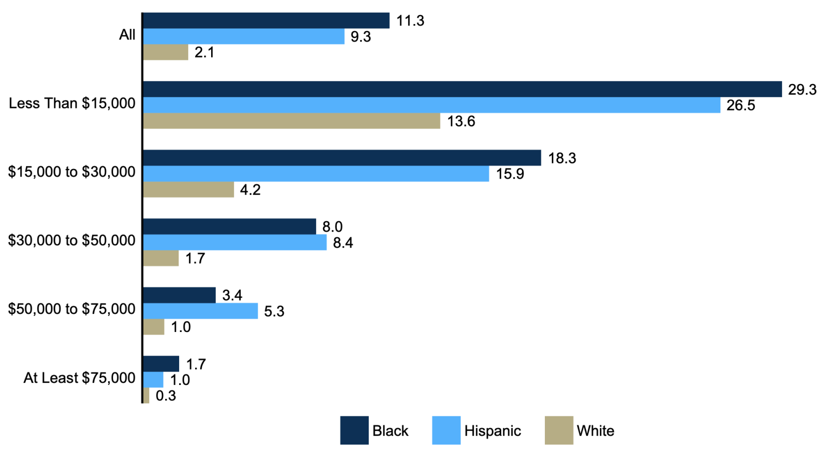


Figure 5: Unbanked rates by household income level and race/ethnicity (from Federal Deposit Insurance Corporation, 2022, Figure 3.2)

The FDIC surveys also ask the unbanked *why* they do not have a bank account; you will have a chance to investigate some of this data in Section 5.

Research shows that African Americans are especially likely to be unbanked and to report a lack of trust in the financial system today in places where there were Freedman's Savings Bank branches 150 years ago (Fu, 2021a; Stein and Yannelis, 2020).* The memory of families and communities can be much longer than any single lifetime.

Aside from trust, another key reported reason for lack of engagement with the formal financial system is "not having enough money to keep in an account." Since banks can help with wealth accumulation, this can drive a self-reinforcing cycle with a Black–White wealth gap that has persisted through centuries of anti-Black racism. As Baradaran (2017) argues,

> "What [high rates of Black un/underbanking] means is that blacks disproportionately rely on fringe banks, leading to a debt trap. Blacks

* The long-term effects of the Bank's collapse on trust exist for African Americans, but not among members of other racial groups. Fu (2021a) also shows that heightened mistrust exists not only in Southern counties where the Bank had branches, but also in Northern areas connected along train lines that helped facilitated the Great Migration.

> pay higher interest on mortgages and small loans. They pay more fees on basic services than similarly situated whites and they are taken to court disproportionately by creditors for very small debts. All of this both due to and contributes to the wealth gap. Without a cushion of wealth, black families pay more for credit and financial services and fall harder when they hit a bump. Wealth provides a layer of financial security, and this shock absorber is missing for many black families."

THE COLLAPSE OF THE FREEDMAN'S SAVINGS BANK deprived African Americans of a significant fraction of their accumulated wealth. It deprived African Americans of trust—across generations—in a system of financial institutions that can help accumulate generational wealth. The collapse also caused a crisis of trust in *Black* banks, starting in the decades when they were just getting off the ground.

At the 1906 meeting of the National Negro Business League, William R. Pettiford explained that "Many of the young men born since the failure of the Freedman's (Bank) in Washington would tell us... that Negroes could not run banks, and they gave as their reason the failure of that bank"; of course this reflected the "young men's" misunderstanding about who was responsible. As R.T. Hill argued at the meeting,

> "No doubt there lingers in the minds of some that the Freedman's Bank was of Negro origin, officered and managed solely by Negroes, and thus managed, they were responsible for its failure.... This impression (I) wish to correct. Colored men were not elected to any important positions until failure was undermining its very foundations." Todd (2019, p.106)

The role of "Black banks" has evolved over the course of American history. The FDIC now maintains a "Minority Depository Institutions" (MDI) Program that considers minority ownership, minority management, and service of minority communities. The 2021 merger of Broadway Federal and City First Banks created the first Black/African American MDI with over $1 billion in assets; when the merger was announced, there were more than 700 non-MDI billion-dollar banks (Todd, 2022, p. 214). Tim Todd suggests that this merger

> "raises a question of racial dynamics that is often a part of 'Black bank' discussions: Is majority Black ownership necessary for a bank serving the Black community? For much of American history, the answer to that question was very much 'yes.' Strictly enforced segregation left Black depositors and would-be borrowers cut off from America's mainstream financial system in all but relatively few instances. While desegregation was a long overdue step and expanded economic opportunities, it did not eliminate racism nor the challenges facing bank customers." Todd (2022, p. 215)

The headquarters building from which the Freedman's Savings Bank was managed and mismanaged—an "illegal and unjustifiable extravagance"—is long gone. Demolished in 1899, its site was a vacant lot for two decades before being replaced in 1919 by the U.S. Treasury Department's Annex building (Figure 6).

In 2016, the Treasury Annex was renamed the Freedman's Bank Building. Announcing the change 150 years after the Bank's establishment, Treasury Secretary Jacob Lew aimed to "recognize an institution that symbolized a new future for African-Americans," but noted that "The legacy of Freedman's Bank also serves as a reminder that we must continue striving for greater financial inclusion for all Americans—particularly those in underserved and minority communities—so that they can share in the benefits of our growing economy."[*]

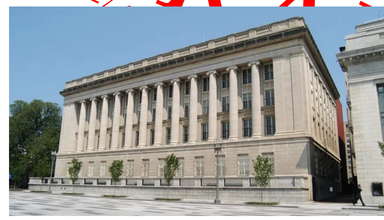


Figure 6: Freedman's Bank Building, formerly the U.S. Treasury Annex, 2016, Washington, D.C. (photo from U.S. Treasury Department)

[*] home.treasury.gov/news/press-releases/jl0294

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4 *Reflection/discussion questions*

1. Banks (and financial services firms more generally) offer a number of products to serve their customers and communities in different ways. What needs can banks help meet, and what products do they use to meet them?
2. If you can't, won't, or don't access financial services through the banking system, how else can you meet some of the same needs?
3. While it was operating, what products did the Freedman's Savings Bank offer its customers? What did the Bank fail to offer?
4. How can regulators and policymakers help prevent bank failures? In the period before deposit insurance (e.g., the FDIC), how might they have helped protect banks' most vulnerable customers when banks *did* fail? How can they help when banks *do* fail now?
5. What kinds of policies—if any—could we use now to support the strength of "Minority Depository Institutions" (MDI)?
6. What kinds of policies—if any—could we use now to help reduce the rate of un/underbanking?

5 *Empirical exercise*

We will be working with a simplified set of survey response data from Federal Deposit Insurance Corporation (2022). While the underlying data is publicly available from the FDIC website, the files are large and perhaps unwieldy; `fdic_survey.csv` contains a restricted set of observations and variables in "comma-separated values" format, which should be straightforward to import into a variety of spreadsheet programs, statistical analysis packages, or general-purpose programming environments.

The dataset comprises 30,434 observations, each of which represents a household that responded to the survey. The variables are described in Table 1.

Variable name	Variable description	Values and meanings
household_identifier	Household identifier	Unique numbers
unbanked	Unbanked status	0 = Banked, 1 = Unbanked
Reported reason for being unbanked		0 = Not reported, 1 = Reported
unbanked_reason1	"Bank locations are inconvenient"	
unbanked_reason2	"Bank account fees are too high"	
unbanked_reason3	"Bank account fees are too unpredictable"	
unbanked_reason4	"Banks do not offer needed products and services"	
unbanked_reason5	"Do not trust banks"	
unbanked_reason6	"Do not have enough money to meet minimum balance requirements"	
unbanked_reason7	"Avoiding a bank gives more privacy"	
unbanked_reason8	"Do not have personal identification required to open an account"	
unbanked_reason9	"Problems with past banking or credit history"	
unbanked_reason10	Other reason	
unbanked_reason98	Did not select a reason	
unbanked_reasonmain	Main reason for being unbanked	1–10 or 98 (see unbanked_reason*)
state	State of residence	Postal abbreviation
raceethnicity	Race/ethnicity	Classification per FDIC
household_type	Marital/family status	Classification per FDIC
household_income	Household income category	Classification per FDIC
household_sampleweight	Sample weight	Households represented (1000s)

Table 1: fdic_survey.csv variable names and descriptions

Open the data file in your preferred analytics environment and confirm that you have 30,434 observations and 19 variables. Note that not all variables are available for every observation; in particular, the "reported reasons for being unbanked" variables (unbanked_reason*) are blank for every respondent who is not unbanked (unbanked is 0).

Note that since some types of households were harder to successfully survey, the FDIC has provided survey weights in the household_sampleweight variable. Working with weighted statistics can be tricky, so you may wish to conduct your analyses ignoring them, and treating every observation in the data set equally. Doing so will of course give you results that diverge slightly from those in the FDIC's published analyses.*

* On average, each observation in the dataset "represents" approximately 4,354 households, so the 30,434 observations aim to capture approximately 133M total U.S. households. However, average weights differ across demographic and other characteristics; for example, the average household_sampleweight for Black, Hispanic, and white respondents are 5.7, 5.8, and 3.9, respectively. This suggests that it may have been harder to successfully survey Black and Hispanic Americans, such that each respondent "represents" a larger number of members of the target population.

Analytics hints

Some of the relevant outcomes we might be interested in studying are *binary* variables; that is, they can only take on two values. For example, households in the sample are either *unbanked* or *not*. Also, every unbanked household either *did* or *did not* report each possible "reason for being unbanked." In our dataset, these binary variables are coded as zero or one. A convenient thing about coding variables this way is that the average (mean) value of a binary variable will tell you what fraction of a sample is coded one. So for example, you can look at the average of the `unbanked` variable to see what fraction of households are unbanked, which is our first empirical question, below.

Another convenient thing about coding binary variables as 0/1 is that taking the sum of a variable within a sample tells you the number of observations that are coded as one. So for example, you can look at the sum of the `unbanked_reason5` variable to see how many respondents report lack of trust as a reason for being unbanked, which is empirical question 5.

Empirical questions

1. What fraction of households are unbanked overall?

2. How does the unbanked rate vary by race/ethnicity?

3. Among the unbanked, what is the most commonly reported "main reason for being unbanked" (`unbanked_reasonmain`)? What is the second most common? Do the answers depend on how we treat responses 10 and 98 ("other reason" and "did not select a reason")?

4. How does the most commonly reported "main reason for being unbanked" vary by race/ethnicity? Are there any reasons that are particularly common among Black-coded respondents?

5. How many survey respondents report lack of trust as a reason for being unbanked (`unbanked_reason5`)?

6. Among the unbanked, how common is it to report lack of trust as a reason for being unbanked? How does this vary by race/ethnicity?

7. Approximately how many Black/African Americans live in New Mexico? (This will probably require you to do research from outside sources.) Estimate the number of unbanked Black/African Americans living in New Mexico. What challenges does this estimation exercise present, and what assumptions could you make to help overcome these challenges?