

The Federal Reserve

The Federal Reserve System is the central bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system; over the years, its role in banking and the economy has expanded.

Overview of the Federal Reserve System

The Federal Reserve's duties fall into four general areas:

1. Conducting the nation's monetary policy by influencing the money and credit conditions in the economy in pursuit of full employment and stable prices
2. Supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers
3. Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
4. Providing certain financial services to the U.S. government, to the public, to financial institutions, and to foreign official institutions, including playing a major role in operating the nation's payments system.

PURPOSES & FUNCTIONS

Woodrow Wilson signed the Federal Reserve Act at 6:02 p.m. on December 23, 1913. A particularly severe crisis in 1907 prompted Congress to establish the National Monetary Commission, which put forth proposals to create an institution that would counter financial disruptions of these kinds. After considerable debate, Congress passed the Federal Reserve Act, which President Woodrow Wilson signed into law on December 23, 1913. The act stated that its purposes were "to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes." Soon after the creation of the Federal Reserve, it became clear that the act had broader implications for national economic and financial policy. As time has passed, further legislation has clarified and supplemented the original purposes.

Key laws affecting the Federal Reserve have been:

1. the Banking Act of 1935
2. the Employment Act of 1946
3. the 1970 amendments to the Bank Holding Company Act
4. the International Banking Act of 1978
5. the Full Employment and Balanced Growth Act of 1978
6. the Depository Institutions Deregulation and Monetary Control Act of 1980
7. the Financial Institutions Reform, Recovery, and Enforcement Act of 1989
8. the Federal Deposit Insurance Corporation Improvement Act of 1991

Congress defined the primary objectives of national economic policy in two of these acts:

1. Employment Act of 1946
2. Full Employment Balanced Growth Act of 1978 (sometimes called the Humphrey–Hawkins Act after its original sponsors).

The primary objectives of the Fed include:

1. economic growth in line with the economy's potential to expand
2. a high level of employment
3. stable prices (that is, stability in the purchasing power of the dollar)
4. moderate long-term interest rates.

OVERVIEW

The Federal Reserve System is considered to be an independent central bank. It is so, however, only in the sense that its decisions do not have to be ratified by the President or anyone else in the executive branch of government. The entire System is subject to oversight by the U.S. Congress because the Constitution gives to Congress the power to coin money and set its value - a power that, in the 1913 act, Congress itself delegated to the Federal Reserve.

The Federal Reserve must work within the framework of the overall objectives of economic and financial policy established by the government, and thus the description of the System as “independent within the government” is more accurate.

STRUCTURE OF THE SYSTEM

The Federal Reserve System has a structure designed by Congress to give it a broad perspective on the economy and on economic activity in all parts of the nation. It is a federal system, composed basically of a central, governmental agency—the Board of Governors— in Washington, D.C., and twelve regional Reserve Banks, located in major cities throughout the nation. These components share responsibility for supervising and regulating certain financial institutions and activities; for providing banking services to depository institutions and to the federal government; and for ensuring that consumers receive adequate information and fair treatment in their business with the banking system. A major component of the System is the Federal Open Market Committee (FOMC), which is made up of the Board of Governors, the president of the Federal Reserve Bank of New York, and presidents of four other Federal Reserve Banks, who serve on a rotating basis. The FOMC oversees open market operations, which is the main tool used by the Federal Reserve to influence money market conditions and the growth of money and credit. Two other groups play roles in the way the Federal Reserve System works: depository institutions, through which the tools of monetary policy operate, and advisory committees, which make recommendations to the Board of Governors and to the Reserve Banks regarding the System’s responsibilities.

The Federal Reserve System conducts monetary policy using three major tools:

1. Open market operations—the buying and selling of U.S. government (mainly Treasury) securities in the open market to influence the level of reserves in the depository system
2. Reserve requirements—requirements regarding the amount of funds that commercial banks and other depository institutions must hold in reserve against deposit
3. The discount rate—the interest rate charged commercial banks and other depository institutions when they borrow reserves from a regional Federal Reserve Bank.

Policy regarding open market operations is established by the FOMC. However, the Board of Governors has sole authority over changes in reserve requirements, and it must also approve any change in the discount rate initiated by a Federal Reserve Bank.

The Federal Reserve also plays a major role in the supervision and regulation of the U.S. banking system. Banking supervision—the examination of institutions for safety and soundness and for compliance with law—is shared with the Office of the Comptroller of the Currency, which supervises national banks, and the Federal Deposit Insurance Corporation, which supervises state banks that are not members of the Federal Reserve System. The Board's supervisory responsibilities extend to the roughly 1,000 state banks that are members of the Federal Reserve System, all bank holding companies, the foreign activities of member banks, the U.S. activities of foreign banks, and Edge Act and agreement corporations (institutions that engage in a foreign banking business).

Some regulations issued by the Board apply to the entire banking industry, whereas others apply only to member banks, that is, state banks that have chosen to join the Federal Reserve System and national banks, which by law are automatically members of the System. The Board also issues regulations to carry out major federal laws governing consumer credit protection, such as Truth in Lending, Equal Credit Opportunity, and Home Mortgage Disclosure; many of these regulations apply to various lenders outside the banking industry as well as to banks.

Members of the Board of Governors are in continual contact with other policymakers in government. They frequently testify before congressional committees on the economy, monetary policy, banking supervision and regulation, consumer credit protection, financial markets, and other matters. Under the Humphrey–Hawkins Act, the Board of Governors must submit a report on the economy and the conduct of monetary policy to Congress by February 20 and July 20 of each year. The Chairman of the Board of Governors is called to testify on the report before the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Banking, Finance and Urban Affairs.

The Board has regular contact with members of the President's Council of Economic Advisers and other key economic officials, and the Chairman meets from time to time with the President of the United States and has regular meetings with the Secretary of the Treasury.

The Board publishes detailed statistics and other information about the System's activities and the economy in publications such as the monthly Federal Reserve Bulletin, special announcements of Board actions, and separate statistical releases. Through the Federal Reserve Regulatory Service, it provides materials relating to its regulatory and supervisory functions. The Board is audited annually by a major public accounting firm, and the audit report is published in the Board's Annual Report. The General Accounting Office (GAO) also audits the Board. A complete list of audits or studies performed and under way by the GAO is available in the Board's annual Budget Review, which is sent to Congress during the first quarter of each calendar year. Monetary policy, which is exempt from audit by the GAO, is monitored directly by Congress through written reports, including the semiannual Humphrey–Hawkins reports, prepared by the Board of Governors.

Federal Reserve Banks

A network of twelve Federal Reserve Banks and their twenty-five Branches carries out a variety of System functions, including:

1. operating a nationwide payments system
2. distributing the nation's currency and coin
3. supervising and regulating member banks and bank holding companies
4. serving as banker for the U.S. Treasury.

All U.S. currency carries the letter and number designation of the Reserve Bank that first puts it into circulation. Besides carrying out functions for the System as a whole, such as administering nationwide banking and credit policies, each Reserve Bank acts as a depository for the banks in its own District and fulfills other District responsibilities. The Board of Governors exercises broad authority over the operations and activities of the Federal Reserve Banks and their Branches. This authority includes oversight of the Reserve Banks' services to banks and other depository institutions and of their examination and supervision of various banking institutions.

Federal Reserve District Banks and Branches

| Number | Letter | Bank | Branch |
|--------|--------|---------------|---|
| 1 | A | Boston | |
| 2 | B | New York | Buffalo, N.Y. |
| 3 | C | Philadelphia | |
| 4 | D | Cleveland | Cincinnati, Ohio Pittsburgh, Pa. |
| 5 | E | Richmond | Baltimore, Md. Charlotte, N.C. |
| 6 | F | Atlanta | Birmingham, Ala. Jacksonville, Fla. Miami, Fla. Nashville, Tenn. New Orleans, La. |
| 7 | G | Chicago | Detroit, Mich. |
| 8 | H | St. Louis | Little Rock, Ark. Louisville, Ky. Memphis, Tenn. |
| 9 | I | Minneapolis | Helena, Mont. |
| 10 | J | Kansas | City Denver, Colo. Oklahoma City, Okla. Omaha, Nebr. |
| 11 | K | Dallas | El Paso, Tex. Houston, Tex. San Antonio, Tex. |
| 12 | L | San Francisco | Los Angeles, Calif. Portland, Ore. Salt Lake City, Utah Seattle, Wash. |

Federal Open Market Committee

The FOMC is charged under law with overseeing open market operations, the principal tool of national monetary policy. These operations influence the amount of reserves available to depository institutions. The FOMC also sets ranges for the growth of the monetary aggregates and directs operations undertaken by the Federal Reserve in foreign exchange markets. The FOMC is composed of the seven members of the Board of Governors and five of the twelve Reserve Bank presidents. The president of the Federal Reserve Bank of New York is a permanent member; the other presidents serve one-year terms on a rotating basis. All the presidents participate in FOMC discussions, contributing to the Committee's assessment of the economy and of policy options, but only the five presidents who are members of the Committee vote on policy decisions. The FOMC under law determines its own internal organization and by tradition elects the Chairman of the Board of Governors as its chairman and the president of the Federal Reserve Bank of New York as its vice chairman. Formal meetings are held eight times each year in Washington, D.C. Telephone consultations and other meetings are held when needed.