The Federal Reserve System

The structure of the Federal Reserve System reflects a compromise between the 'States Rights View' and the 'Central Bank View'. U.S. citizens have long feared the existence of a central power responsible for vital economic functions. This view culminated in the well-known Anti-Trust laws that trim economic powers in the U.S. Therefore, at the moment of its inception, the Federal Reserve System had to overcome and compromise these views. How can one create a central economic power (central bank) and compromise at the same time the 'States Rights View'?

The solution to this problem is in the unique and clever structure of the Federal Reserve System. The system location and ownership reflect both views. The head office is located in Washington, D.C. There are 12 district banks and 24 branches of the system spread across the nation. The member banks technically own the Federal Reserve.

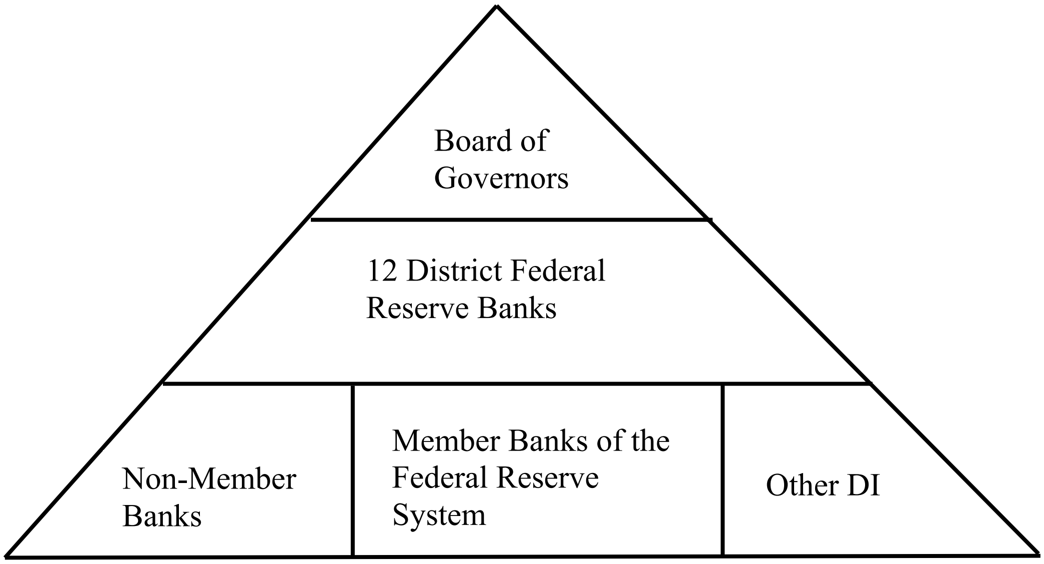
Congress made it crystal clear that the Federal Reserve is its own creature, and is not a part of the executive branch of the government (the Secretary of the Treasury represents the executive branch). The Federal Reserve is non-partisan.

Congress founded the Federal Reserve (central bank of the United States) in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system. Today the Federal Reserve's duties fall into four general areas,

(1) Conducting the nation's monetary policy;
(2) Supervising and regulating banking institutions and protecting the credit rights of consumers;
(3) Maintaining the stability of the financial system; and
(4) Providing certain financial services to the U.S. government, the public, financial institutions, and foreign official institutions.

The structure of the Federal Reserve System is made of

1. The Board of Governors
2. Member Banks
3. Non-Member Banks
4. District Federal Reserve Banks
5. Federal Advisory Council
6. Federal Open Market Committee



Source: Luckett (1984, p.302)

The Board of Governors

As of March 2005, the Board is compromised of

1. Alan Greenspan, *Chairman*
2. Roger W. Ferguson, Jr., *Vice Chairman*
3. Edward M. Gramlich
4. Susan Schmidt Bies
5. Mark W. Olson
6. Ben S. Bernanke
7. Donald L. Kohn

Past chairmen of the Board are, (in historical order) Mr. Marriner S. Eccles, Mr. William McChesney Martin Jr. (1951-1970), Mr. Arthur Burns (1970-1979) and Mr. Paul Volcker (1979-1987).

Alan Greenspan took office June 19, 2004, for a fifth term as Chairman of the Board of Governors of the Federal Reserve System. Dr. Greenspan also serves as Chairman of the Federal Open Market Committee, the System's principal monetary policymaking body. He originally took office as Chairman and to fill an unexpired term as a member of the Board on August 11, 1987. Dr. Greenspan was reappointed to the Board to a full 14-year term, which began February 1, 1992, and ends January 31, 2006. He has been designated Chairman by Presidents Reagan, Bush, Clinton, and Bush.

Assignment:

State the requirements for being a member of the Board of Governors at the Federal Reserve. In other words, how can you become member of the Board of Governors?

The seven members of the Board of Governors of the Federal Reserve System are nominated by the President and confirmed by the Senate (see list at left for current membership). A full term is fourteen years. One term begins every two years, on February 1 of even-numbered years. A member who serves a full term may not be re-appointed. A member who completes an un-expired portion of a term may be re-appointed. All terms end on their statutory date regardless of the date on which the member is sworn into office. The Chairman and the Vice-Chairman of the Board are named by the President from among the members and are confirmed by the Senate. They serve a term of four years. A member's term on the Board is not affected by his or her status as Chairman or Vice Chairman.

It is expected that once a new chairman is chosen, the defeated candidate will resign from the Board, even if he/she still have to serve for the remainder of the14 years.

The central authority of the Federal Reserve is the ‘Board of Governors’. The Board makes all administrative decisions. Although the President appoints members of the Board, they are not under the control of the President.

Under the provisions of the original Federal Reserve Act, the Federal Reserve Board was composed of seven members, including five appointive members, the Secretary of the Treasury, who was ex-officio chairman of the Board, and the Comptroller of the Currency. The original term of office was ten years, and the five original appointive members had terms of two, four, six, eight, and ten years respectively. In 1922 the number of appointive members was increased to six, and in 1933 the term of office was increased to twelve years.

The Banking Act of 1935, approved Aug. 23, 1935, changed the name of the Federal Reserve Board to the Board of Governors of the Federal Reserve System and provided that the Board should be composed of seven appointive members; that the Secretary of the Treasury and the Comptroller of the Currency should continue to serve as members until Feb. 1, 1936; that the appointive members in office on the date of that act should continue to serve until Feb. 1, 1936, or until their successors were appointed and had qualified; and that thereafter the terms of members should be fourteen years and that the designation of Chairman and Vice Chairman of the Board should be for a term of four years.

The Board functions are

1. To serve as majority on the Fed Open-Market-Operation Committee (FOMC)
2. To approve the discount rate
3. To set the reserve requirements for all deposit-taking financial institutions (DI)
4. To approve bank mergers and new banks

How are the Chairman and members of the Federal Reserve Board of Governors selected, and what is the term of office?

The seven members of the Board of Governors are nominated by the President of the United States and confirmed by the U.S. Senate. By law, the appointments must yield a "fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country," and no two Governors may come from the same Federal Reserve District.

The full term of a Governor is fourteen years; appointments are staggered so that one term expires on January 31 of each even-numbered year. A Governor who has served a full term may not be reappointed, but a Governor who was appointed to complete an unexpired term may be reappointed to a full fourteen-year term.

Once appointed, Governors may not be removed from office for their policy views. The lengthy terms and staggered appointments are intended to contribute to the insulation of the Board--and the Federal Reserve System as a whole--from day-to-day political pressures to which it might otherwise be subject. If all Governors serve full terms, a President would be able to appoint only two Governors during a four-year presidential term. Moreover, even a President reelected for a second term would not have appointed a majority of the Governors until late in the second term. In reality, many Governors do not complete their fourteen-year terms, and recent Presidents have averaged more than one appointment to the Board every two years.

As stipulated in the Banking Act of 1935, the Chairman and Vice Chairman of the Board are chosen by the President from among the sitting Governors and must be confirmed by the Senate. They serve terms of four years and may be reappointed as Chairman or Vice Chairman until their terms as Governors expire. The Chairman serves as public spokesperson and representative of the Board and manager of the Board's staff and presides at Board meetings. Affirming the apolitical nature of the Board, recent Presidents representing both major political parties have selected the same person as Board Chairman.

Who are the current Board members?

List of current Board members.

What are the salaries of the Board members?

Congress sets the salaries of the Board members. For 2005, the Chairman's annual salary is $180,000. The annual salary of the other Board members (including the Vice Chairman) is $162,100.

How can I request to have a Board member speak at an event?

Write directly to the Board member, addressing him or her as "The Honorable." Because the Board receives many requests, please allow at least ten business days for a response. Requests may be faxed to 202-452-3819 or mailed to the following address:

Federal Reserve Board
20th Street and Constitution Avenue, NW
Washington, DC 20551

How can I send comments, suggestions, or requests to a Board member by e-mail?

Because of the many requests and suggestions received from the public, we cannot provide the individual e-mail addresses of the Board members.

How many employees work at the Board?

About 1,700 people work at the Board of Governors in Washington, D.C. For more information, see the Board's *Annual Report: Budget Review* on the Board's web site.

Is it legal for Board employees to own stock or to trade in the market?

Yes, generally. Board employees, and their spouses and minor children, are allowed to own or trade stock, except the stock of depository institutions or affiliates of such institutions. Also, employees who have ongoing access to the most sensitive Federal Open Market Committee information, and their spouses and minor children, may not own stock in primary government securities dealers or their affiliates, and they are restricted as to when they may buy and sell securities.

The Federal Reserve Act provides that the president of a Federal Reserve Bank shall be the chief executive officer of the Bank, appointed by the board of directors of the Bank, with the approval of the Board of Governors of the Federal Reserve System, for a term of five years. The terms of all the presidents of the twelve District Banks run concurrently, ending on the last day of February of years numbered 6 and 1 (for example, 1991, 1996, and 2001). The appointment of a president who takes office after a term has begun ends upon the completion of that term. A president of a Reserve Bank may be re-appointed after serving a full term or an incomplete term.

On December 23, 1913, the Federal Reserve System, which serves as the nation's central bank, was created by an Act of Congress. The System consists of a seven member Board of Governors with headquarters in Washington, D.C., and twelve Reserve Banks located in major cities throughout the United States. Appointments to the Board The seven members of the Board of Governors are appointed by the President and confirmed by the Senate to serve 14-year terms of office. Members may serve only one full term, but a member who has been appointed to complete a non-expired term may be re-appointed to a full term. The President designates, and the Senate confirms, two members of the Board to be Chairman and Vice Chairman, for four-year terms.

Representation
Only one member of the Board may be selected from any one of the twelve Federal Reserve Districts. In making appointments, the President is directed by law to select a "fair representation of the financial, agricultural, industrial, and commercial interests and geographical divisions of the country." These aspects of selection are intended to ensure representation of regional interests and the interests of various sectors of the public.
Responsibilities

The primary responsibility of the Board members is the formulation of monetary policy. The seven Board members constitute a majority of the 12-member Federal Open Market Committee (FOMC), the group that makes the key decisions affecting the cost and availability of money and credit in the economy. The other five members of the FOMC are Reserve Bank presidents, one of whom is the president of the Federal Reserve Bank of New York. The other Bank presidents serve one-year terms on a rotating basis. By statute the FOMC determines its own organization, and by tradition it elects the Chairman of the Board of Governors as its Chairman and the President of the New York Bank as its Vice Chairman.

The Board sets reserve requirements and shares the responsibility with the Reserve Banks for discount rate policy. These two functions plus open market operations constitute the monetary policy tools of the Federal Reserve System. In addition to monetary policy responsibilities, the Federal Reserve Board has regulatory and supervisory responsibilities over banks that are members of the System, bank holding companies, international banking facilities in the United States, Edge Act and agreement corporations, foreign activities of member banks, and the U.S. activities of foreign-owned banks. The Board also sets margin requirements, which limit the use of credit for purchasing or carrying securities. In addition, the Board plays a key role in assuring the smooth functioning and continued development of the nation's vast payments system [see Fedwire and Payment System Risk Policy].

Another area of Board responsibility is the development and administration of regulations that implement major federal laws governing consumer credit such as the Truth in Lending Act, the Equal Credit Opportunity Act, the Home Mortgage Disclosure Act and the Truth in Savings Act [see Consumer Information and Community Affairs].

Meetings
The Board usually meets several times a week. Meetings are conducted in compliance with the Government in the Sunshine Act, and many meetings are open to the public. If the Board has convened to consider confidential financial information, however, the sessions are closed to public observation.

Contacts within Government
As they carry out their duties, members of the Board routinely confer with officials of other government agencies, representatives of banking industry groups, officials of the central banks of other countries, members of Congress and academicians. For example, they meet frequently with Treasury officials and the Council of Economic Advisers to help evaluate the economic climate and to discuss objectives for the nation's economy. Governors also discuss the international monetary system with central bankers of other countries and are in close contact with the heads of the U.S. agencies that make foreign loans and conduct foreign financial transactions.

The Member banks

The main reason for a bank to seek membership at the Federal Reserve System is to acquire a federal charter from OCC. By law, all national banks must be members at the Fed. State banks may join the Federal Reserve under certain requirements. Historically, only 10 percent of state banks joined the system.

Ownership of the Federal Reserve System
Technically, a member bank is part owner of the Federal Reserve System. When a bank joins the system, it is required to buy stocks in the system for the amount of 3 percent of the member' bank capital. Once a member, the Federal Reserve pays an annual 6 percent dividend to the bank on the stocks.
This stock ownership is strictly technical. It provides no control and no share of profits (except for the 6 percent).

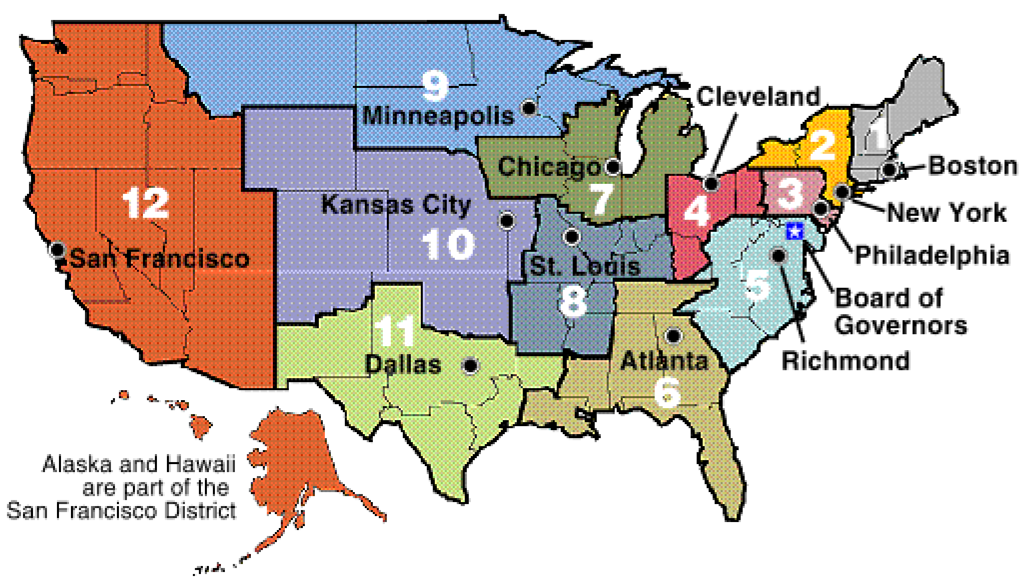
Assignment:
Can you explain why the ownership is strictly technical? What if it wasn't? Discuss.

Non-Member Banks

The DIDMCA Act of 1980 required all deposit-taking institutions to be subject to a uniform reserve' requirements. It also gave access to all DI to the discount window and to Federal Reserve services, such as the clearing system.

District Federal Reserve Banks

The Federal Reserve Act suggested dividing the country between 8 and 12 districts. The number 12 were chosen. There are 12 districts federal reserve banks across the United States. Each district bank is named after the city it is located in. These districts banks' jurisdictions do not follow state boundaries, but are to approximate homogenous economic conditions across the country.



The terms of all the presidents of the twelve District Banks run concurrently, ending on the last day of February of years numbered 6 and 1 (for example, 2001, 2006, and 2011). The appointment of a president who takes office after a term has begun ends upon the completion of that term. A president of a Reserve Bank may be reappointed after serving a full term or an incomplete term.

Reserve Bank presidents are subject to mandatory retirement upon becoming 65 years of age. However, presidents initially appointed after age 55 can, at the option of the board of directors, be permitted to serve until attaining ten years of service in the office or age 70, whichever comes first.

There are also cities that have Federal Reserve facilities. The following table reports these cities and their respective district bank.

Table 1: Cities that offer Federal Reserve facilities

Federal Reserve District Bank	District Number	Cities
New York	2	Buffalo
Cleveland	4	Pittsburgh
Richmond	5	Charlotte, Baltimore
Atlanta	6	Jacksonville, Miami, Birmingham, Nashville, New Orleans
Chicago	7	Detroit
St. Louis	8	Louisville, Memphis, Little Rock
Minneapolis	9	Helena
Kansas City	10	Denver, Omaha, Oklahoma City
Dallas	11	Houston, San Antonio, El Paso
San Francisco	12	Los Angeles, Salt Lake City, Portland, Seattle

The duties of the district banks are

1. To carry out Board' decisions at regional level, i.e., to channel out the Board of Governors rules on member banks
2. Intermediation function to member banks
3. Administrative purpose to the regions
4. Sets the regional discount rate
5. Issue currency
6. Clear and collect checks

    The clearing and collection of checks is a system wherein reciprocal amounts of checks are offset against one another (cleared) and where the net differences are paid (collected).
7. Withdraw damaged currency from circulation
8. Evaluate mergers and new banks' applications
9. Administer and make discount loans within the district
10. Examine Bank Holding Companies (BHC) and State Chartered member banks
11. Collect data on local business

12. Conduct monetary policy and economic research

The largest districts in size are New York, Chicago and San Francisco. All three account for at least 50 percent of total assets held by the Federal Reserve System. The Federal Reserve Bank of New York has one quarter of the total assets.

Originally, district banks have autonomous decision-making. However, this self-ruling property ceased by the Banking Act of 1935.

Structure:
Each district bank has nine members' board of directors. The member banks in the district elect six of the nine. Of which, three must be bankers, three must have no banking connection and the Board of Governors appoints three. The latter non-elected members are supposed to represent public interests. The board of directors appoints a president and a vice president for the district bank. The Board of Governors must approve this appointment.

Five of the twelve district presidents are voting members of the Federal Open Market Committee (FOMC). The rest seven attend the meetings and participate in the discussions.

The Federal Advisory Council

The council has no power. Its main duty is to advise the Board of Governors on current monetary policies to undertake, banking matters and credit policies. Each board of directors of the district banks appoints one member to the advisory council. The council convenes at least four times a year.

The Federal Open Market Committee (FOMC)

The FOMC is the most important and powerful group at the Federal Reserve System. The group formulates monetary policy and convenes at least eight times every year (i.e., once every six weeks).
The Humphery-Hawkins Act of 1978 (known as the Full Employment and Balanced Growth Act) required the FOMC to submit a written report – at least four times a year - to Congress before taking actions. Prior to 1978, the FOMC was criticized for secrecy and leaving Congress in the dark. The rationale of secrecy was that the FOMC didn't want to give any tips to traders on future policies to avoid any harmful speculation.
The report must state the FOMC intended monetary policy measures.

Assignment:

Does Congress have to approve proposed monetary policy before implementation? What if Congress does not approve (like) the intended policy? What measures could be taken, if any?
(** The act does not require the FOMC to follow its own plan)

The FOMC is made of 12 members.

- The 7 members of the Board of Governors
- 5 of the presidents of the district banks
    - The president of the New York Federal Reserve Bank
    - The other 4 members are rotated annually as follows,
        - One from Cleveland or Chicago
        - One from Boston, Philadelphia, Richmond
        - One from Atlanta, Dallas, St. Louis
        - One from Minneapolis, Kansas City, San Francisco
- The other 7 presidents have no voting rights but can participate in the discussions.

The chairman of the FOMC is the chairman of the Board of Governors (Dr. Alan Greenspan). The president of the New York Federal Reserve Bank (referred to as King of the Kings) is always a voting member of the FOMC. The reason is that the New York Federal Reserve is a member of the Bank of International Settlements (BIS) and it houses $100 billion worth of the world gold.

The functions of the FOMC are,

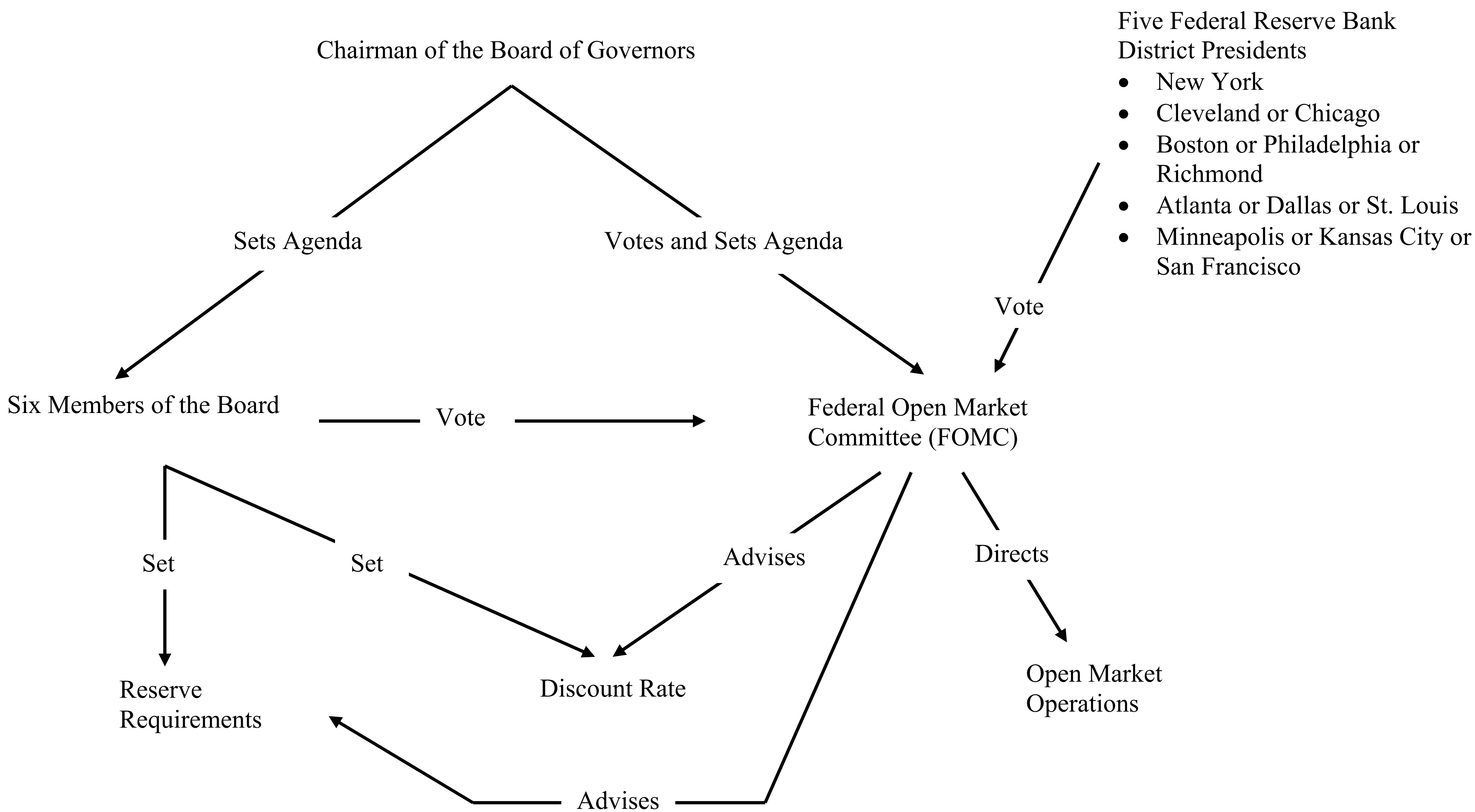
1. To supervise, to examine and to regulate member banks
2. Clearing and collection of checks (Nation-wide)

    Clearing functions are intra-district, inter-district and wire-transfer services.
3. Fiscal agent for the government
4. Economic research

    The staff numbers 1000 people. Half of which are economist, 250 at the Board of Governors, 100 at the NY Fed and 150 at other Fed district banks.

The Federal Reserve is a non-profit institution. However, the process of conducting monetary policy results in annual profits. Profits are the difference between expenses and income. Expenses include payment to employees, utilities and maintenance of facilities. Income is the dividends on holding the United States government securities. Legally, the Federal Reserve is the owner of these securities, and therefore entitled to the interest payments. Recent profits are valued at $14 billion.

In Summary, the functions of each division of the Federal Reserve System could be illustrated as follows,



ECO 3223 – Fall 2005
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Assignment:
What happens to the profits made by the Federal Reserve System?
(** transferred back to the United States Treasury)

Table 2: Addresses of Federal Reserve Banks

Board of Governors of the Federal Reserve System 20th and C Streets, N.W. Washington, DC 20551 (202) 452-3000	
Federal Reserve Bank of Boston 600 Atlantic Avenue Boston, MA 02106 (617) 973-3000	Federal Reserve Bank of Chicago 230 South LaSalle Street Chicago, IL 60604 (312) 322-5322
Federal Reserve Bank of New York 33 Liberty Street New York, NY 10045 (212) 720-5000	Federal Reserve Bank of St. Louis 411 Locust Street St. Louis, MO 63102 (314) 444-8444
Federal Reserve Bank of Philadelphia Ten Independence Mall Philadelphia, PA 19106 (215) 574-6000	Federal Reserve Bank of Kansas City 925 Grand Boulevard Kansas City, MO 64198 (816) 881-2000
Federal Reserve Bank of Minneapolis 90 Hennepin Avenue P.O. Box 291 Minneapolis, MN 55480-0291 (612) 204-5000	Federal Reserve Bank of Cleveland 1455 East Sixth Street Cleveland, OH 44114 (216) 579-2000
Federal Reserve Bank of Richmond 701 East Byrd Street Richmond, VA 23219 (804) 697-8000	Federal Reserve Bank of Dallas 2200 North Pearl Street Dallas, TX 75201 (214) 922-6000
Federal Reserve Bank of Atlanta 104 Marietta Street, N.W. Atlanta, GA 30303 (404) 521-8500	Federal Reserve Bank of San Francisco 101 Market Street San Francisco, CA 94105 (415) 974-2000