Board of Governors of the Federal Reserve System

Government Performance and Results Act
Strategic Planning Document
2001-2005

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INTRODUCTION

The Board of Governors of the Federal Reserve ("the Board") is one component of the nation's central bank. See Appendix 1 for a complete description of the Federal Reserve System.

MISSION

The mission of the Board is to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems so as to promote optimal macroeconomic performance.

VALUES

The values of the Board, which guide its organizational decisions and its employees' actions, include:

- **Commitment to the public interest** -- The Board endeavors to provide service to the public, the U.S. government, and the financial community that is consistent with its mandate. It expects to be held accountable to the public it serves.

- **Integrity** -- The Board seeks to adhere to the highest standards of honesty, fairness, and discretion in its dealings with the public, the financial community, and its employees.

- **Quality and excellence** -- The Board strives for excellence, embracing prudent change and innovation.

- **Independence of views and careful analysis** -- The Board values the regional nature of the System as well as the diversity of its employees; input from a variety of sources; independent professional judgment; thorough and careful analysis; and the integration of these components through teamwork into coherent, effective policies.

GOALS

The Board has three primary goals with interrelated and mutually reinforcing elements:

1. To conduct monetary policy that promotes the achievement of maximum sustainable long-term growth; price stability fosters that goal.

2. To promote a safe, sound, competitive, and accessible banking system and stable financial markets.

3. To provide high-quality professional oversight of Reserve Bank operations and to foster the integrity, efficiency, and accessibility of U.S. payment and settlement systems.

ACHIEVEMENT OF GOALS AND OBJECTIVES

The Board employs a comprehensive planning, budget formulation, and budget execution process to ensure the identification, prioritization, and accomplishment of goals and objectives. Planning is coordinated throughout the System by the *Strategic Framework* (discussed below) and by committees responsible for information technology and supervision and regulation. Monetary policy work is coordinated through the structure of the Federal Open Market Committee. The budget and accounting systems are closely linked to ensure that expenses can be compared with plans. This process integrates strategic planning, allocation of resources among competing priorities, performance measurement, and ongoing review of the need for existing programs.

Background

In the face of accelerating change in the economy and banking system brought about by numerous factors--including globalization, technology, evolution of payment systems, and bank consolidation--the Federal Reserve recognized the need for a more comprehensive planning framework. In 1995, a System Strategic Planning Coordinating Group was appointed, consisting of Board members, Reserve Bank Presidents, and senior managers, representing the full range of the Federal Reserve's activities. This group produced an "umbrella" strategic framework under which the Board, the Reserve Banks, and the product offices produce their own more-detailed plans and decision documents. This framework was the basis for the Board's first Government Performance and Results Act (GPRA) Planning Document, setting forth the mission, values, and goals of the System. This has remained essentially unchanged and is incorporated in this plan. Key assumptions and external and internal factors that could affect the achievement of those goals and objectives were reviewed and updated in 2001 as part of the biennial planning process and are discussed in the following section.

The Board's strategic planning efforts recognize key differences between government and private sector strategic planning and results measurement. Private planning can use measures of costs and revenue derived from prices determined in competitive markets; the results of that planning are reflected in the ability of the private entity to prosper over time. The government does not have direct competition in certain areas and has a monopoly in others (monetary policy, for example) and establishing a proxy for costs and prices is extraordinarily difficult. Moreover, the results are judged relative to public policy objectives embodied in law, which often are not readily measurable. Nonetheless, the government should try to effectively accomplish its mission while creating the efficiencies that come from strategic planning, recognizing that analogies are just that. Thus, the Board's central planning objective is oriented toward achieving effectiveness and efficiency specific to the functions we serve.

In monetary policy, for example, the Federal Reserve exerts only partial and indirect influence on the economy. Because the Federal Reserve's performance therefore cannot be measured solely in terms of economic outcomes, the appropriate judgment must be whether our research technology is successful in anticipating problems and changes in the economy. In the bank supervision function, the mission of contributing to a viable, competitive, efficient banking system demands a sharing of risks between the central bank and private banks, which serve the crucial function of managing the risk of investing in illiquid loans. As a regulator, our job is to ensure that banks are allowed to take on appropriate degrees of risk in fulfilling their function in the economy, but not to the point that they impose risks to the financial system in general. Measures of our success would include whether the banking system is performing its functions and whether systemic risk is appropriately contained during periods of challenge to individual institutions or groups of institutions. In financial services, where direct competition exists, the Federal Reserve is able to more directly measure its performance. Unlike its competitors, however, the appropriate goal is not to maximize profits, but to enhance the efficiency and integrity of the nation's payment systems while recovering costs, both actual and imputed. A delicate balancing of marketplace performance and public policy is required.

PLANNING CONSIDERATIONS

Strategic Planning and the Budgeting Process

In order to enhance the focus on strategic priorities, in 1997 the Board restructured its budget and planning process to lengthen the planning and budgeting horizons and involve the Board itself more heavily in setting priorities. The Board adopted a four-year planning horizon and a two-year budget.

In developing plans and budgets under the strategic framework, the director of each Board division updates division-wide plans, coordinating efforts with other directors and Reserve Banks as necessary. These plans and resulting resource requests are reviewed by the Committee on Board Affairs to make recommendations to the full Board. A Staff Planning Group and the Board's Program Analysis and Budget Section provide support to the Committee during the planning process by identifying issues and providing analysis of the Board's budget options.

The Reserve Bank planning and budget process provides a similar level of review and oversight for the Reserve Banks. On an annual basis, the Reserve Bank budgets are considered by the Board following review by the Committee on Federal Reserve Bank Affairs. .Staff of the Division of Reserve Bank Operations and Payment Systems support the Committee.

Planning Background

In 2001, working with the management of each division, the Staff Planning Group identified several ongoing trends that are reflected in this strategic plan:

1. consolidation, deregulation, and globalization trends, as well as creation of large complex banking organizations and financial institutions, and their impact on safety and soundness, consumer protection, and the stability of payment systems
2. increased attention required for countries with economies formerly thought to be too small to affect our economic well-being
3. advances in automation and telecommunication technologies that will
   - reduce reaction time to deal with systemic issues
   - change the complexity of financial products
   - enhance systems for identifying, measuring, and pricing risk
   - improve capabilities to gather, analyze, and share data

- increase centralization of System supervision and regulation automation tools and databases
4. expanded focus on minimizing reputational risk to the Federal Reserve System
5. the need for actions and policies to attract and maintain a highly motivated, properly trained, and fairly compensated professional workforce and to enhance management skills

OVERARCHING ISSUES

In consultation with senior managers throughout the Board, six overarching issues affecting planning were identified.

1. Human Resources and Board Organization

   In the next few years, there may be major turnover in the senior management ranks of the Board. Numerous mid-level managers will also be eligible to retire. Additional emphasis on management succession planning is essential.

   Maintaining the quality of staff needed to manage the increasingly complex and technical work of the Board will be a challenge. Establishing appropriate salaries and retention incentives in highly competitive and specialized fields will be required. In addition to salary, other incentives, including improved benefits and workplace flexibility such as alternative work schedules and job-sharing should be considered to help attract and retain staff with critical skills. Improved training and development programs will also be necessary.

   As the type of work conducted by the Board changes, the skill sets of some employees will need to adapt. Opportunities to retrain existing staff for new work should be considered when appropriate. Technical positions in divisions throughout the Board are susceptible to this problem.

2. Financial Modernization and Reform

   The trend toward large financial institutions is affecting our role as a supervisor. Multinational and highly complex mergers, creation of large financial conglomerates, the volume and complexity of OTC derivatives, the growth of hedge funds, and declining banking conditions are resulting in markets that are stretching the capacity of conventional supervisory programs. A System committee is dealing with many of these issues, and the findings of the group, along with other Federal Reserve staff and Basel Committee efforts, may have a significant effect on the supervision and research divisions.

   For example, to deal with some of the new large complex banking organizations, the Federal Reserve will need to acquire or build some necessary expertise in the insurance industry. Greater and timelier sharing of information with other regulators, domestic and foreign, will be required in this environment. Additional investment in information systems-based analytical tools will also be required to support the supervisory process.

   Recognition that financial markets are becoming increasingly complex and that conventional supervisory approaches may be limited is causing the Board to consider alternatives such as market-based supervision. This approach, however, will require greater coordination between the microeconomic and supervisory programs of the Board and possibly a reallocation of resources.

As new forms of supervision are developed, and Federal Reserve staff relies on functional regulation to a greater extent, the Board needs to determine what current activities should be revised or eliminated. To appropriately limit the costs of supervision, we need to identify unnecessary duplication in System supervisory activities as well as identify the need for new and enhanced activities. Failure to be a prudent supervisor could result in unintended consequences or adjustments in responsibilities.

3. Assistance and Support to Foreign Governments, Central Banks, and International Organizations

The Board is often asked to assist foreign governments and central banks to improve their operations and help create effective bank supervision programs. These efforts, which are expanding, are frequently performed under the auspices of the World Bank, Agency for International Development, State Department, Treasury, and similar organizations. Funding for this support and the allocation of staff resources competes with other priorities, causing difficulties for some Board divisions. In order to continue providing appropriate and quality assistance and support, coordination and decisionmaking regarding overseas support should be improved.

4. Technology

Just as technological advances, especially in computers and telecommunications, have changed the nature of the U.S. economy, they are playing a critical role in the Board. The Board will continue to make changes to its technology infrastructure to enable it to meet business needs and to manage costs. The Board will also be challenged to balance the pace of technological innovation with prudent risk management and to measure the costs and benefits of our technological investments.

The volume of data gathered, stored, and analyzed has been growing in recent years. Improved access to data and the complexity of issues facing the Board are combining to increase demand for analysis and forecasts. Managing the Board's data and records in a timely and efficient manner will require increased investment in technology.

Lessons learned in dealing with Year 2000 issues will be used going forward to improve technical cooperation and coordination with other financial regulators, government agencies, and depository institutions.

5. Communications

The Board traditionally has taken a conservative approach to public affairs activities. This is changing, as there is a growing perception that more can be done to explain the role of the

System and the value that the public receives from our efforts. The Internet offers an opportunity to provide services and information to the public at a reduced cost. The focus on using the Internet as a primary channel to make information available to the public in a timely fashion should continue.

6. Facilities

Maintaining adequate and secure facilities will be a challenge during the planning period. The Eccles Building renovation will continue to result in the temporary displacement, on a phased basis, of all staff in that building. Notwithstanding the Eccles Building issue, there is already little space available. As part of its long-term space planning strategy the Board has acquired a new facility which will significantly reduce the net expense of office space. Security improvements and other actions needed to ensure employee safety at all of the Board's facilities will continue to require management attention. .

MONETARY POLICY FUNCTION

Goal

Conduct monetary policy that promotes the achievement of maximum sustainable long-term growth; price stability fosters that goal.

This goal will be attained through the following objectives:

1. Stay abreast of recent developments and prospects in the U.S. economy and financial markets and in those abroad, so that monetary policy decisions will be well informed.
2. Enhance our knowledge of the structural and behavioral relationships in the macroeconomic and financial markets and improve the quality of the data used to gauge economic performance, through developmental research activities.
3. Implement monetary policy effectively in rapidly changing economic circumstances and in an evolving financial market structure.
4. Contribute to the development of U.S. international policies and procedures, in cooperation with the Department of the Treasury and other agencies.
5. Promote understanding of Federal Reserve policy among other government policy officials and the general public.

Objective 1

Staying abreast of recent and prospective developments.

This objective will be pursued in part through the following activities:

- Staff will provide periodic briefings and written reports to policymakers, analyzing incoming economic data. Staff also will prepare ad hoc analyses, as needed, to address special questions.

- Staff will regularly provide formal, quantitative forecasts for use by policymakers.

- Policymakers and staff will utilize extensive contacts in the private sector to obtain timely information about tendencies in the economy and financial markets. The *Beige Book*, summaries of economic and financial developments in each Federal Reserve District, prepared by Reserve Bank staff, will be one source of such information.

- Policymakers and staff will maintain close contacts with officials in international organizations and at foreign official institutions to remain current on economic developments and policies abroad.

Objective 2

Enhancing knowledge of macroeconomic and financial relationships.

This objective will be pursued in part through the following activities:

- The staff will undertake research into the broad range of topics relevant to the conduct of monetary policy. In the period ahead, this research will focus on the consequences for the behavior of wages and prices (especially as they may be influenced by changing labor market practices and low unemployment), asset market behavior and its implications for monetary policy, measurement of structural improvements in productivity, advancing technology, financial market innovation and deregulation, and globalization.

- The staff will work to improve the quality of statistics relating to output, inflation, and finance. Efforts will focus on, among other things, the measurement of output, especially in the high technology sector, and a more complete accounting of flows of funds in financial markets.

Objective 3

Implementing monetary policy effectively.

This objective will be pursued in part through the following activities:

- The FOMC will seek, through the operations of the Trading Desk at the New York Bank, to effect changes in money market conditions consistent with the longer-term objectives of policy.

- In view of the declining quantity of Treasury debt outstanding, the staff will analyze alternative means to implement monetary policy.

Objective 4

Contributing to international policy.

This objective will be pursued in part through the following activities:

- The Board will seek to reduce risks to the U.S. economy and financial system from external shocks and to improve stability in domestic and international financial markets.

- The Board will provide leadership in the evolution of international institutions and arrangements in response to the changing shape of the world economy.

- Staff research will contribute to international efforts to understand the origins and consequences of, and to develop effective responses to, international economic and financial disruptions.

Objective 5

Ensuring understanding of Federal Reserve policy.

This objective will be pursued in part through the following activities:

- The Board will report formally to the Congress on its monetary policy plans twice yearly. The Board will also seek to improve public understanding of economic developments and policy through congressional testimony, speeches, and other means.

- The Board will publish data on monetary and financial market developments and on industrial production and capacity utilization, to inform the public about the environment in which the Federal Reserve is operating.

External Factors:

- *Independence* – The Federal Reserve's independence within the government, a key element of which is its lack of dependence on the appropriations process, is critical in terms of its ability to formulate and implement monetary policy. Preserving this independence will be crucial to the proper discharge of its central banking responsibilities in the future. This independence depends importantly on responsible management of the resources used. Along these lines, the Board will continue to operate under both internal and external pressures for budget restraint, even as it performs its current and any expanded future responsibilities.

- *Data Access* – The nation's financial system is growing more complex at an accelerating pace. The quantity of data, much of which is available over the Internet, is also growing. Investments in automation and security to enhance timely access to data will be critical during the planning period. Continued investment in efforts to maintain the quality of data will be required given innovations in financial markets and growth of activity outside of regulated sectors where data are provided on a consistent basis. Experiments utilizing data purchased from credit bureaus to analyze issues related to consumer and mortgage debt growth, debt service, delinquency, and bankruptcy will continue.

- *Economic and financial globalization* – Individual economies are becoming more open and links among the world's financial markets are becoming closer. These forces heighten the potential for economic shocks and systemic problems to move across national borders, in some circumstances, with great speed. As a result, there will be pressure for greater international consistency of policies, regulations, guidelines, and supervisory procedures.

Legislative Changes:

- Authorization by the Congress to pay interest on reserve balances and explicit interest on contractual clearing balances would help ensure that the level of such balances remains adequate, thereby promoting the continued smooth implementation of monetary policy. Also, coupled with legislation to permit increased flexibility in setting required reserve ratios, interest on reserves and clearing balances might permit reductions in reserve requirements and, possibly, their eventual elimination. These measures would help to increase efficiency in the financial system by largely removing the incentives for depository institutions to expend resources to avoid reserve requirements.

Performance Measures:

- It is recognized that monetary policy has only a partial and indirect influence on economic performance and the Congress has not chosen to establish quantitative objectives for monetary policy in statute. The performance of monetary policy in relation to evolving economic and financial circumstances will continue to be reviewed by the Congress in the context of the Board's semiannual monetary policy report and the accompanying testimony.

BANKING SUPERVISION AND REGULATION FUNCTION

Goal

Promote a safe, sound, competitive, and accessible banking system and stable financial markets.

This goal will be attained through the following objectives.

1. Provide comprehensive and effective supervision of U.S. banks, bank and financial holding companies, U.S. operations of foreign banking organizations, and related entities.
2. Promote overall financial stability, manage and contain systemic risk, and ensure that emerging financial crises are identified early and successfully resolved.
3. Improve efficiency and effectiveness and reduce burden on supervised institutions.
4. Promote equal access to banking services.
5. Administer and ensure compliance with consumer protection statutes relating to consumer financial transactions.

Objective 1

Provide comprehensive and effective supervision of U.S. banks, bank and financial holding companies, U.S. operations of foreign banking organizations, and related entities.

Discussion

As described in the Federal Reserve Act, a fundamental responsibility of the central bank is to establish more effective supervision of banking in the United States. Supervisors may undertake many preventative measures during stable periods of economic expansion to ensure the safety and soundness of the banking system. However, to measure the effectiveness of past and current supervisory practices, the performance and stability of the banking system should be evaluated over a full economic cycle that reveals its soundness and resiliency under stressful conditions.

One of the Federal Reserve's key strategies for maintaining effective supervision under both favorable and unfavorable banking conditions has been to focus supervision on areas of highest risk to individual organizations and the financial system as a whole. The risk-focused approach emphasizes pre-examination planning and prioritizes examination resources based on an organization's risk profile. Significantly, this approach also places greater emphasis on evaluating the integrity of an institution's own ongoing system for managing risk, rather than point-in-time transaction testing. The process promotes sound practices for managing risk at banking organizations by checking for strong internal controls, active boards of directors, and senior management oversight and accountability. Focusing resources on the areas of highest risk as well as testing an appropriate level of transactions to verify critical controls and processes makes this approach more effective and less burdensome, while accomplishing the secondary goal of reducing costs for the financial institution and the Federal Reserve. In addition, the pre-examination planning is more comprehensive by integrating information from various functions of the Federal Reserve. The risk-focused approach has been coordinated with other banking regulators. Coordination is also being effected with other regulators to ensure that the Federal Reserve properly fulfills its role as an umbrella supervisor for each component of financial holding companies.

This objective requires that the supervision staff understand and accommodate the effects of financial innovation and technology on the operations and risk profile of banking organizations and the payment system. Supervision staff must also ensure that supervisory programs accommodate prudent advances that benefit consumers and businesses or improve risk management. New technologies and financial innovation have changed the nature of banking products and services and opened advanced electronic delivery mechanisms that raise many important issues for supervisors. Devising appropriate supervisory responses in terms of sound practice guidance, interpretations, or new rulemakings to safeguard banks and payment systems has become more challenging. At the same time, regulators must ensure that supervisory responses provide a balance between allowing prudent risk taking by banking organizations and safeguarding against excessive practices or deteriorating credit conditions.

As part of this objective, the System must help improve international banking by refining and strengthening supervisory policies and practices and foreign banking organizations (FBOs) programs. The Federal Reserve continues to work with other supervisors through the Basel Supervisors Committee to promote standards and core principles for consolidated supervision. To this end the System will provide education, training, and other resources to international supervisors who play a significant role in the U.S. or global economies. In regard to FBOs, the System will develop a process for coordinating supervisory processes more closely with the home country; focus on methods to better track and evaluate increasing exposures from non-G-10 countries; and develop supervisory strategies to address problem credit concentrations.

Objective 2

Promote overall financial stability, manage and contain systemic risk, and ensure that emerging financial crises are identified early and successfully resolved.

Discussion

Recognizing that capital requirements cannot substitute for effective risk management and internal controls in financial institutions, the Federal Reserve, along with other international and domestic supervisors, has placed increasing emphasis on risk- management practices. This focus has resulted in a series of instructions, policy statements, and examination manuals that stress the importance of managing all risks inherent in the business of banking, including market and credit risks, and liquidity, legal, international, and operational risks.

At the core of this focus are four basic elements of sound risk management: 1) active oversight roles by bank boards of directors and senior management; 2) adequate policies, limits, and procedures; 3) adequate risk measurement, monitoring, and management information systems;

and, 4) adequate internal controls and audits. Internal controls are receiving increased attention because breakdowns, or absences, of controls have been key to most of the recent financial problems encountered by large financial institutions.

In recent years, sound practice guidance for examiners and financial institutions has covered trading activities, non-trading securities and derivative end-user activities, interest rate risk, private banking, and secondary market credit activities, among others. The dissemination of this guidance has clarified our expectations for the institutions we supervise, improved the quality of examinations in these areas, and led to improved practices by many institutions.

Objective 3

Improve efficiency and effectiveness and reduce burden on supervised institutions.

Discussion

The Federal Reserve will conduct seamless supervision of state member banks, financial and bank holding companies, and foreign banking organizations (FBOs) through ongoing and improved coordination with state, federal, and foreign bank supervisors and appropriate state and federal functional supervisors. Planning for all aspects of supervising institutions is coordinated with the appropriate state bank supervisors, functional regulators, and the FDIC and OCC as necessary. Such efforts ensure that state banking organizations with operations that cross state boundaries involving multiple regulators are not disadvantaged compared with nationally chartered banks.

Efforts to remove unnecessary banking restrictions consistent with safety, soundness, and consumer protection will continue. Procedures or regulations that initially serve an important safety and soundness or consumer safeguard purpose may become outmoded. The rate of obsolescence has increased in recent years as the industry has reacted to rapid changes in the financial marketplace and as recent financial modernization legislation has been passed.

It is critical that the System harnesses the benefits of technology in carrying out responsibilities to improve supervisory efficiency and consistency. Technological advances in developing and maintaining databases, in processing information, and in telecommunication have brought continued improvements to the process of bank supervision. By developing a comprehensive common approach for developing and utilizing information systems and automated examination tools, the System can lower supervisory costs, improve consistency, and reduce the burden on banking organizations. To help accomplish this work we will continue to develop and improve the National Information Center as a central source of regulatory data. Investments to improve the access and ease of use of database-driven tools, such as the National Examination Data System and Banking Organization National Desktop (BOND), will continue and access will be provided to other federal and state regulators. Automating examination efforts should assist in the Federal Reserve’s efforts to be less intrusive while improving effectiveness by reducing the time and effort spent on-site collecting and analyzing examination data. It will also speed the documentation of work and the production of examination reports. Using statistical techniques for sampling loan portfolios should reduce burden on the institutions while improving the effectiveness of the loan review. The workstations will also allow for a more sophisticated review of the risk profile of the institution using both regulatory and internal data from the institution.

Changes in the financial services industry and, more recently, the Gramm-Leach-Bliley legislation will continue to require changes in the System's organizational structure so that it is sufficiently flexible to allocate well-trained resources in response to identified risk. A review of various options for reallocating functions or responsibilities in the System that might improve the effectiveness and efficiency of supervision is currently under way and will be completed within this planning period. Finally, a set of qualitative performance measures or benchmarks that identify how efficiently resources are being allocated and employed throughout the System is being developed.

Objective 4

Promote equal access to banking services.

Discussion

In its examination of state member banks, the Federal Reserve administers and enforces the regulations that apply to all lenders subject to the Equal Credit Opportunity and Home Mortgage Disclosure Acts, as well as the Fair Housing Act and Community Reinvestment Act (CRA). Industry-wide consolidation makes fulfillment of these responsibilities more complicated and has required more effective use of automation to analyze available data in a manner that ensures sound policy decisions. In addition to investigations of consumer complaints alleging discrimination, the Federal Reserve provides training, communication, and outreach programs as part of a wide range of activities designed to prompt banks to engage in community development lending.

The System will promote greater understanding and compliance by state member banks of consumer regulatory issues. Outreach efforts will focus on methods to encourage compliance with consumer protection laws and regulations. The basic premise is that the more informed state member banks become about the regulatory environment in which they operate, the more they will achieve compliance on their own, which benefits the consumer in the long run.

In addition, compliance with CRA will be encouraged by examinations that focus on the performance of financial institutions in meeting community needs and through applications analyses that focus on CRA records.

Objective 5

Administer and ensure compliance with consumer protection statutes relating to consumer financial transactions (Truth in Lending, Truth in Savings, Consumer Leasing, and Electronic Funds Transfer) to carry out congressional intent, striking the proper balance between protection of consumers and burden to the industry.

Discussion

The Federal Reserve is charged with writing the regulations implementing a wide range of consumer protections for financial transactions, including borrowing and savings disclosures, limits on liability for lost or stolen credit and debit cards, resolving errors in credit and debit transactions, and protections against abusive practices. These rules apply to all institutions serving customers, whether banks, finance companies, mortgage brokers, retailers, or others. To be effective, the rules must be updated and interpreted to take account of changing business practices and augmented by effective consumer education.

External Factors:

- *Economic performance* – During periodic downturns, the number of financial institutions requiring close supervision will increase. Systemic risk will increase resulting in more frequent monitoring of those institutions for which the Federal Reserve has responsibility.

- *Legislative and statutory initiatives* – Recent legislation removing artificial barriers between commercial and investment banking or the limitations on commercial banking activities will have a profound impact on supervision and regulation activities. Passage of the financial modernization bill in late 1999 significantly affected the work of the Federal Reserve, requiring additional training, interagency coordination, and automation activity.

- *Industry consolidation* – Continued integration of U.S. financial market sectors, accompanied by the introduction of new financial products and means for their delivery, is further blurring lines between banks and non-banks. Securities firms, insurance companies, financial companies, and even many prominent industrial companies -- as well as commercial banks -- are exploiting technological and financial innovations to seek to capture larger shares of the financial services market. Industry consolidation will affect the way the Board operates to ensure safety and soundness and limit systemic risk.

- *Technology* – The rapid pace of technological innovation, especially in telecommunications and electronic data processing, is having a profound effect on the economy and on U.S. financial services. The harnessing of technology will be central in the development of new financial services and channels of distribution in the private sector. Technology will likely pose challenges in all of the Federal Reserve's policy areas, including banking supervision and regulation and consumer protections. Technological innovation will also create opportunities by providing tools to improve the Board’s efficiency across organizational units and functions.

- *Risk* – Dramatic advances in information and telecommunication technologies have allowed banks to develop new and improved products and services and to deliver them over a broader geographic area with greater efficiency. Such innovations, by the banking industry and by financial markets in general, have increased the sophistication and complexity of bank lending, investing, trading, and funding. They have propelled growth in less traditional or newer fee-oriented banking activities, and in the process, altered the risk profiles of many banking organizations in fundamental ways. Coupled with deterioration in credit and banking conditions, this situation requires increased vigilance.

- *Privatization and demographic changes* – In an era of shrinking government – with the emphasis on cost reduction and privatization of public functions – the traditional government "safety net" will not always be available. But the underlying social problems will remain. Pressure will be increased on acceptance of "social responsibility" by the private sector, including banks. Changing demographics could further heighten interest in civil rights and fair lending matters.

- *Economic and financial globalization* – Individual economies are becoming more open and links among the world's financial markets are becoming closer. These forces heighten the potential for economic shocks and systemic problems to move across national borders, in some circumstances with great speed. As a result, pressure for greater international consistency of policies, regulations, guidelines, and supervisory procedures is increasing.

- *Pressure to reduce regulatory burden* – There will be continuing pressure on the Board from markets, banking and other financial institutions, the general public, and the Congress, to reduce regulatory burden and improve efficiency. This has and will continue to require streamlining of regulations and automating and standardizing examination processes.

Program Changes:

- In late 2000, the Board approved a major realignment of supervision staff to fulfill better the Federal Reserve's chief supervisory responsibilities. The changes in the organizational structure improve coordination and consistency of supervision, particularly in regard to policy development, coordination of System automation projects, and supervision of global financial institutions. Further anticipated organizational changes should enhance important policymaking activity needed to ensure that the System as a whole is prepared to deal with changes in the industry and the recent financial modernization legislation. Realignments will also improve utilization of information technology by better planning and coordinating actions throughout the system.

Performance Measures:

1. All financial institution examinations completed as required by statute and current risk portfolios actively reviewed and updated.

2. Net losses to the Bank Insurance Fund (BIF) from state member banks consistent with economic conditions but, at a minimum, less than the amount that would have been charged for premiums if the cap had not been reached on the FDIC fund.

3. Extent to which the Federal Reserve, working alone or in cooperation with other authorities, is successful in identifying supervisory and/or financial problems in a timely manner and resolving them in a way that minimizes disruptions to the financial and payment systems and the economy more generally.

4. Consumer affairs examinations conducted to ensure compliance with consumer protection laws and regulations.

5. Guidance needed to ensure compliance with consumer protection laws issued on a timely basis to reflect industry changes and legislation.

PAYMENT SYSTEM POLICY AND OVERSIGHT FUNCTION

Goal

Effectively oversee Reserve Bank operations and foster the integrity, efficiency, and accessibility of U.S. payment and settlement systems.

This goal will be attained through the following three objectives.

1. Develop sound, effective policies and regulations that foster payment system integrity, efficiency, and accessibility.
2. Produce high-quality assessments of Federal Reserve Bank operations, projects, and initiatives that assist Federal Reserve management in fostering and strengthening sound internal control systems and efficient and effective performance.
3. Conduct research and analysis that contributes to policy development and/or increases the Board's and others' understanding of payment system dynamics and risk.

Objective 1

Develop sound, effective policies and regulations that foster payment system integrity, efficiency, and accessibility.

This objective will be pursued in part through the following initiatives:

- *Fundamental review of the Board's payment system risk policy.* Federal Reserve staff is evaluating the effectiveness of the Board's payment system risk policy and considering modifications that may improve its effectiveness and continue to promote payment system stability. Specifically, the staff is examining a range of policy options and assessing whether they foster a more efficient balance of the risks, costs, and benefits to the public and private sectors associated with intraday credit. The Board adopted several of staff's recommendations and requested public comment on other near-term policy actions. Staff plans to recommend final action on these policy changes by year-end 2001, with analysis of the longer-term strategic direction continuing into 2002.

- *Check Truncation Act.* Staff is working collaboratively with representatives of the banking industry, business and consumer users of checks, payments law experts, the Treasury, and others to draft a law for congressional consideration that would remove legal impediments to check truncation. The objective of this effort is to foster innovation and enhances the overall efficiency of the nation's payment systems without mandating the receipt of checks in electronic form. Under the draft Check Truncation Act, a bank could, if it so chose, truncate some or all checks and collect or return them electronically by agreement, as they can do today, or by substituting machine-readable copies of checks for the original checks.

- *Post-September 11 assessment.* Staff is working closely with the Reserve Banks in conducting a post-September 11 assessment, with a focus on further improving the robustness and resiliency of critical Federal Reserve functions and of critical elements in the financial markets.

Objective 2

Produce high-quality assessments of Federal Reserve Bank operations, projects, and initiatives that assist Federal Reserve management in fostering and strengthening sound internal control systems and efficient and effective performance.

The Division of Reserve Bank Operations and Payment Systems is reengineering its approach to Reserve Bank oversight by integrating various division processes, strengthening its monitoring capabilities, increasing reliance on Reserve Bank audit departments, and focusing more on strategic initiatives and key processes across Reserve Banks.

This objective will be pursued in part through the following initiatives:

- *Development of enhanced on-site examination process*. Board staff is developing and implementing integrated, risk-based techniques to streamline and better target on-site examinations of Reserve Banks and reviews of strategic Reserve Bank initiatives and key System processes.

- *Development of enhanced monitoring capabilities.* Board staff is developing and implementing user-friendly automation tools to facilitate off-site surveillance and analysis of Reserve Bank payment, fiscal agency, and key support operations.

- *Oversight of strategic infrastructure projects, including Reserve Bank check modernization, cash distribution, web-based application development, and network modernization.* Board staff is monitoring the major technology overhaul of Reserve Bank check-processing operations, assessing how to most efficiently distribute and process cash within the economy, and overseeing the development of web-based applications to support the delivery of Reserve Bank financial services. Staff also is overseeing the Reserve Banks' conversion of certain depository institution connections and connections between Reserve Banks to a public network based on frame relay communications protocol.

- *Oversight of implementation of cost accounting modifications. S*taff is closely monitoring the Reserve Banks' compliance with cost accounting changes that became effective in 2001.The Reserve Banks adopted fundamental changes in cost allocation methodologies to support management accountability and decisionmaking, and eliminated the practice of sharing certain project costs among the Banks.

Objective 3

Conduct research and analysis that contributes to policy development and/or increases the Board's and others' understanding of payment system dynamics and risk.

This objective will be pursued in part through the following initiatives:

- *Retail payments research project.* Staff is overseeing the Reserve Banks' research efforts to improve the financial industry's, the public's, and the Federal Reserve System's understanding of the U.S. retail payments system. As part of this research, three surveys have just been completed that provided estimates of the volume and value of checks written in the United States, the use of checks by broad categories of payment types, and estimates of the volume and value of various non-cash retail electronic payments. Federal Reserve analyses of these data are ongoing. These data will help provide a basis for improving strategic planning, regulatory and policy analysis, and longer-term research by academics, the Federal Reserve, the financial industry, and other interested parties. Additional future retail payments research about consumer and business payment behavior is planned in addition to replicating the study to estimate the volume and value of check payments in the U.S.

- *G-10 central bank retail payments project.* Staff is working collaboratively with representatives from other central banks under the auspices of the Bank for International Settlements' Committee on Payment and Settlement Systems to further the understanding of retail payment instruments and policy issues.

External Factors:

- *Technology* – The cost of technology will continue to decrease and the rate of technological change will continue to increase. In particular, the reliability and security of web-based applications and open architectures will continue to improve. System architectures and applications will comprise multiple hardware and software products, and the inter-operation of these products will become increasingly complex to manage and operate.

- *Industry consolidation and integration* – The banking industry will continue to consolidate. The Federal Reserve Banks' customer base will increasingly consist of very large financial institutions with nationwide and global presence and smaller community banks and credit unions. In addition, there will be continued integration of domestic and international financial markets.

- *Electronic payment alternatives* – In addition to existing electronic payment alternatives, continued market innovation will result in new electronic payment methods, which will further influence the shift from paper to electronic payments.

Internal Factors:

- *Staffing* – The division must attract and retain qualified professional staff with complex analytical skills and leading-edge technological skills in order to accomplish its oversight, policy development, and research-related activities. The division also must explore creative training and development opportunities to better position staff to perform the complex quantitative and qualitative analyses required of them.

Performance Measures:

1. All Reserve Banks are examined annually and an external audit of Reserve Bank financial statements is ordered annually, as required by the Federal Reserve Act.

2. Extent to which the Board, working alone or in cooperation with other organizations, identifies significant operational or financial problems affecting the flow of large-value payments or book-entry securities transfers and resolves them in a way that minimizes disruption to the financial and payment systems, specifically, and the economy more generally.

BOARD SUPPORT FUNCTION

Goal

Foster the integrity, efficiency, and effectiveness of Board programs.

This goal will be attained through the following six objectives.

1. Oversee a planning and budget process that clearly identifies the Board's mission, results in concise plans for the effective accomplishment of operations, transmits to the staff the information needed to attain objectives efficiently, and provides the public the capability to measure our accomplishments.
2. Develop appropriate policies, oversight mechanisms, and measurement criteria to ensure that the recruiting, training, and retention of staff meet Board needs.
3. Establish, encourage, and enforce a climate of fair and equitable treatment for all employees regardless of race, creed, color, national origin, age, or sex.
4. Provide financial management support needed for sound business decisions.
5. Provide cost-effective information resources management services to Board divisions, support divisional distributed processing requirements, and provide analysis on information technology issues to the Board, Reserve Banks, other financial regulatory institutions and central banks.
6. Efficiently provide modern, safe, secure facilities and necessary support activities conducive to efficient and effective Board operations.

Objective 1

Oversee a planning and budget process that clearly identifies the Board's mission, results in concise plans for the effective accomplishment of operations, transmits to the staff the information needed to attain objectives efficiently, and provides the public the capability to measure our accomplishments.

Discussion

Unlike most other government agencies, the Board budget is not subject to the congressional appropriations process or to review by the Administration through the Office of Management and Budget. Rather, the Board establishes its budget formulation procedures, conducts strategic planning to identify the proper amount and allocation of resources, approves its budget, and provides various reports and budget testimony to the Congress.

The Board, like the framers of the Federal Reserve Act, considers the continuance of its budgetary independence as directly relevant to the Board's independence in managing monetary policy. To maintain budgetary independence, the Board believes that it must demonstrate effective and efficient use of its financial resources. Resource management begins with a clear mission statement, identification of goals, a review of factors that might affect the long-term attainment of the goals and possible responses to those factors. With the establishment of objectives to attain those goals and identification of the resources needed to accomplish them, the Board develops the budget necessary to implement the strategic plan.

Objective 2

Develop appropriate policies, oversight mechanisms, and measurement criteria to ensure that the recruiting, training, and retention of staff meet Board needs.

Discussion

Management of human resources will be one of the most essential tasks facing the Board through the planning period. Changing requirements associated with technology, communications, demographics, employee needs and expectations, and market rates of pay are among the factors that will cause the Board to focus more carefully on steps to attract, retain, and train staff to meet increasingly complex requirements.

New forms of pay and benefits will have to be reviewed, particularly concepts such as variable pay that are more sensitive to changing market conditions. Methods to assist managers in assessing, reporting, and improving employee performance will gain importance. Inclusion of all Board staff in advances made possible by technology and organizational realignment will be important and will require management training and support for senior staff and functional and technical training for staff.

Objective 3

Establish, encourage, and enforce a climate of fair and equitable treatment for all employees regardless of race, creed, color, national origin, age, or sex.

Discussion

The Board of Governors is committed to the hiring, development, compensation, and promotion of staff based on an individual's qualifications, abilities, and job performance. The policy of the Board is to promote equal opportunity in every aspect of employment.

The Board's policies and practices address the issue of equal treatment in employment practices and hiring initiatives for all employees, and include targeted initiatives for women, people of color, and those with disabilities. The Board's view emphasizes that equal employment opportunity is part of effective management, as well as a legal requirement, because it focuses on using the talents of all human capital. The Board's EEO Program Director continuously reviews the success criteria for accomplishing the Board's EEO objectives; validates Board practices, programs, and procedures against those objectives; and continuously monitors results and discusses issues with employees in order to establish and maintain an equitable and fair environment in which all employees can attain their full potential.

Objective 4

Provide financial management support needed for sound business decisions.

Discussion

The Board's financial management system must continue to provide high-quality, timely data that managers need in order to make decisions between competing priorities, operational procedures, and investments. The current budget and accounting systems are closely linked to one another and to the human resource (payroll and benefits), information technology, and procurement systems that generate critical data. The data must be timely and easily available to all managers. The data must also provide information about the costs of major Board programs, such as monetary policy, for decisions by the Board as well as for performance measurement. The Management Division provides regular analyses of the information to the Board and its managers.

Objective 5

Provide cost-effective secure information resources and technology management services to Board divisions, support divisional distributed processing requirements, and provide analysis on information technology issues to the Board, Reserve Banks, other financial regulatory institutions, and central banks.

Discussion

Changes in technology have significantly altered the issues facing the Board in the monetary policy and supervision and regulation areas. Fortunately, the very advances in technology that have caused these adjustments have also enhanced our capacity for real-time surveillance. Nevertheless, to obtain the required benefits from technology requires continuous investment in a mix of mainframe and distributed processing equipment, communications capability, including appropriate bandwidth, and a well-trained and motivated staff. Investments in human capital and technology must be made carefully to ensure that the results are timely and effective. The infrastructure for maintaining these investments must be efficient and effective in meeting the diverse needs of the organization. The infrastructure must provide security for data, software, and communications, and redundancy needed for rapid recovery of operations at other facilities. Finally, the work at the Board must be carefully synchronized and coordinated with that at the Reserve Banks, particularly in support of large databases and software required for the supervision and regulation function.

Objective 6

Efficiently provide modern, safe, secure facilities and necessary support activities conducive to efficient and effective Board operations.

Discussion

The Board will upgrade the infrastructure (including electrical work, plumbing, safety, and asbestos removal) of its current facilities. The capital plan to replace and upgrade equipment in the physical plant will be updated and current projects will be completed. Emergency planning, including work to provide backup electrical power will continue. Actions to evaluate and, where necessary, enhance the security of facilities to provide for the safety of employees and continuity of operations are a priority.

External Factors:

- *Staffing* – At a time when a significant portion of the Board staff is, or will soon be, eligible to retire, outside compensation issues are making it more difficult to recruit. Limits on salary are adding to pressure for better benefits. Technology is changing and with it the requirements and job content of many positions which is resulting in increasing needs for staff training. Increased costs for salaries and benefits are only partially offset by improved productivity resulting from automation. This is resulting in continuous pressure to find more efficient ways to perform operations and to eliminate lower priority work. At the Board, nearly 75 percent of expense is associated with staffing; thus, the requirement to be more efficient is generally translated into staff reductions in lower priority work.

- *Security* – The Board takes the safety and security of its staff and facilities extremely seriously. It is likely that actions necessary to mitigate security threats will require more resources than in the past.

Performance Measures:

1. a) The Board's Biennial Performance Plan, which meets the intent of the Government Performance and Results Act, is prepared on a timely basis and used in developing the Board's budget.
   b) The Board's Biennial Performance Report, which meets the intent of the Government Performance and Results Act, is prepared on a timely basis and used in evaluating program and financial performance.

2. Staff who are trained both functionally and technically fill at least 90 percent of the positions.

3. At least 90 percent of managers are satisfied with the financial data available to them for managing their resources and making decisions.

4. Managers choose to purchase services from the Board IT organization rather than hire their own staff or contract for outside sources.

5. a) Facilities are conducive to productive staff work as reported by division directors.
   b) The cost of acquiring office space is reduced by $1 million during the planning period.
   c) Safety is improved by bringing the Eccles Building up to current building code standards during the planning period.
   d) Security operations and continuity of operations plans are tested and found effective.

DISSEMINATING GOALS AND OBJECTIVES AND HOLDING MANAGERS ACCOUNTABLE FOR RESULTS

Five standing committees, each comprising up to three governors, administer the activities of the Federal Reserve Board. These committees include: the Committee on Consumer and Community Affairs, the Committee on Economic Affairs, the Committee on Federal Reserve Bank Affairs, the Committee on Supervisory and Regulatory Affairs, and the Committee on Board Affairs. The standing committees, in conjunction with the division directors, determine any adjustments to strategic goals and review and adjust priorities to help establish resource levels. The Committee on Board Affairs oversees the planning and budget process, which includes preparation of the Board's GPRA materials.

The Board's goals and objectives are communicated to staff by division directors and by the strategic plan. Managers and staff are held accountable for meeting objectives which support these goals through the Board's performance management program, which ties base compensation and a modest amount of variable pay to achievement of specific objectives. The Board's goals and objectives are also shown on the Board's web site where the Strategic Plan is posted for employees.

The Board maintains a vigorous Public Affairs Program and Publications Program to assist the public in understanding the actions, regulations, and rules of the Board. In addition, an extensive collection of educational materials, many dealing with consumer affairs issues, is created to assist the public. Electronic distribution of these materials, using the Board's public web site, helps to ensure the efficient dissemination, on a timely basis, of this information to the public.

PROGRAM EVALUATIONS

The activities of the Board are critical to the economic well-being of the country. The Federal Reserve affects the lives of American citizens through its monetary policy actions, supervision and regulation activities, and payment systems policies and oversight activities. These effects are significant, ongoing, and highly visible. It is essential that the analyses performed by staff to influence policy decisions be reviewed at later dates to determine whether the desired effect was achieved and if the benefits of the activity outweighed its costs. The effectiveness of Board programs is subject to review by the Office of the Inspector General, which provides copies of its reports to Congress. Many functions of the Board are also subject to review by the General Accounting Office.

Monetary Policy

The Federal Reserve's conduct of monetary policy is evaluated frequently through a number of vehicles. First, the Federal Reserve Act, as amended, requires the Board of Governors to report to the Congress semiannually on the conduct of monetary policy. The Chairman of the Board of Governors presents testimony to Senate and House committees on these reports. More generally, Federal Reserve policymakers testify frequently before congressional committees on monetary policy and other Federal Reserve responsibilities, and from time to time congressional hearings include evaluations of monetary policy by academic and other experts from outside the Federal Reserve. As a matter of critical national importance, national and business newspapers and magazines report on and analyze monetary policy decisions and their effects on a daily basis.

Banking Supervision and Regulation

As part of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the Inspector General of the Federal Reserve is required to review any failure of a state member bank that results in a material loss to the Bank Insurance Fund (BIF). The purpose of this review is to identify the cause of the failure, determine whether supervision was in accordance with policy standards, and, if so, whether policies and standards are in need of revision. There have been no such material loss reviews required in the past four years.

Payment System Policy and Oversight Function

The effectiveness of the Payment System Policy and Oversight Function is subject to review by the Office of the Inspector General and the General Accounting Office. In addition, the effectiveness of this function is evaluated based on feedback received from the Reserve Banks, financial industry, Congress, and others, and the extent to which staff's research is accepted and cited by others. Another factor in evaluating the effectiveness of this function is the extent to which staff brings to the attention of the governors issues that may hamper the Reserve Banks' ability to comply with the Monetary Control Act.

Board Support

The effectiveness of Board support programs is subject to review from various management sources. Financial operations are reviewed annually by an outside independent auditor. Information technology activities are subject to competitive pressures because operating divisions may use allocated resources to purchase support from the Division of Information Technology or outside vendors, or provide the support themselves. The human resource operations are evaluated by management based on the ability of the operating divisions to attract and retain the high quality staff required for Board operations. All of these activities are subject to review by the Office of the Inspector General.

INTERAGENCY COOPERATION AND CROSS CUTTING ISSUES

While many aspects of the Board's mission is unique to the organization, the Board does not operate in a vacuum. To coordinate its activities, the staff works closely with a broad variety of organizations and individuals on a daily basis. Regular meetings with senior officials from the Department of the Treasury, regulatory agencies such as the Securities and Exchange Commission (SEC), and other executive branch agencies help ensure consistency of purpose and coordination of actions. One area of the Board's mission, supervision and regulation of financial institutions, is shared with other regulatory agencies. We work closely with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, and state banking regulatory agencies to ensure the safety and soundness of the nation's financial institutions and to enforce consumer safeguards. The primary mechanism to ensure coordinated and non-duplicative activity is the Federal Financial Institutions Examination Council (FFIEC), established by the Congress in 1979. The Board and other federal and state financial regulatory agencies are represented on the council. Major regulatory policy actions, data collection, and other activities are coordinated through that body to ensure efficiency and minimize regulatory burden consistent with safety and soundness and fair treatment of consumers. A second source of coordination is active participation in the GPRA working group. This group includes representatives from all of the financial regulators, Treasury, SEC, and Office of Federal Housing Enterprise Oversight (OFHEO). This group shares planning data, coordinates cross cutting issues, and reviews best practices in planning and in developing GPRA documentation.

STAKEHOLDER CONSULTATIONS

The goals and objectives of the Board have been developed keeping in mind feedback regularly received from the public, the Congress, industry groups, federal and state regulators, academics, and others. The Board relies heavily on advisory and working committees to provide input on a wide variety of issues. These committees include: the Federal Advisory Council, which provides input on economic and banking matters; the Consumer Advisory Council, which provides input on consumer protection matters; the Thrift Institutions Advisory Council, which provides input on the needs and problems of thrift institutions; and Federal Reserve Bank advisory committees, which provide advice to Reserve Banks on agriculture and small business matters. The Board also consults regularly with a broad variety of banking and financial service industry groups. Strategic initiatives are developed and carried out in close coordination with other federal and state banking regulatory agencies through participation in the Federal Financial Institutions Examinations Council and with state banking regulators through regular consultations.

APPENDIX 1

The Federal Reserve: The Nation's Central Bank

The Federal Reserve System is the central bank of the United States. It was founded by the Congress 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.

Today the Federal Reserve's duties fall into three general areas:

- Conducting the nation's monetary policy by influencing money and credit conditions in the economy in pursuit of maximum employment and stable prices.

- Supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking system, maintaining the stability of the financial system and containing systemic risk that may arise in financial markets, protecting the credit rights of consumers, and encouraging banks to meet the credit needs of consumers, including those in low and moderate income neighborhoods.

- 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 payment systems.

The Federal Reserve System was created by passage of 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 the Banking Act of 1935; the Employment Act of 1946; the 1970 amendments to the Bank Holding Company Act; the International Banking Act of 1978; the Full Employment and Balanced Growth Act of 1978; the Depository Institutions Deregulation and Monetary Control Act of 1980; the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; the Federal Deposit Insurance Corporation Improvement Act of 1991; and the Gramm-Leach-Bliley Act of 1999. The Congress defined the primary objectives of national economic policy in the Employment Act of 1946 and in an amendment to the Federal Reserve Act in 1977. These objectives include economic growth in line with the economy's potential to expand; a high level of employment; stable prices (that is, stability in the purchasing power of the dollar); and moderate long-term interest rates. Major financial services reform legislation, incorporated in the Gramm-Leach-Bliley Act, reflects changes in the nature of the industry and the economy in general. Both the legislation and the underlying changes that had been occurring will have a significant affect on the operations and workload of the Federal Reserve.

Since the late 1960s, the number of federal laws intended to protect consumers in credit and other financial transactions has been growing. The Congress has assigned the Federal Reserve the duty of implementing these laws to ensure that consumers receive comprehensive information and fair treatment. Thus, consumer protection laws such as the 1968 Truth in Lending Act, the Community Reinvestment Act of 1977, the Expedited Funds Availability Act of 1987, the Truth in Savings Act of 1991 and others have given the Federal Reserve rule-writing, compliance and consumer education responsibilities.

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 the Congress the power to coin money and set its value -- a power that, in the 1913 act, the Congress itself delegated to the Federal Reserve. The Federal Reserve works within the framework of the overall objectives of economic policy established by the government, and thus the description of the System as “independent within the government” is more accurate.

Board of Governors

The Board of Governors of the Federal Reserve System was established as a federal government agency. It is made up of seven members appointed by the President of the United States and confirmed by the U.S. Senate. The full term of a Board member is fourteen years; the appointments are staggered so that one term expires on January 31 of each even numbered year. The Chairman and the Vice Chairman of the Board are also appointed by the President and confirmed by the Senate. The nominees to these posts must already be members of the Board or must be simultaneously appointed to the Board. The terms for these positions are four years.

Structure of the System

The Federal Reserve System has a structure designed by the 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 Federal 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. While the regional structure is not changing in regard to the monetary policy function, consolidation and the creation of large complex banking organizations is causing a shift from largely regional oversight to a more functional approach within both the supervision and regulation and payment systems areas.

A major component of the System is the Federal Open Market Committee (FOMC), which is made up of the seven members 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 is charged under law with overseeing open market operations, the principal tool of national monetary policy. The FOMC also directs operations undertaken by the Federal Reserve in foreign exchange markets.

APPENDIX 2

MANAGEMENT ISSUES

The latest strategic planning exercise did not identify material changes in the mission or goals of the Board. There were adjustments to remove completed objectives, particularly the successful completion of the Century Date Change Project, changes in the methods for dealing with large complex banking organizations, a strengthening of programs to manage and develop human capital, and increased emphasis on information and physical security.

Because of the complexity, scope and volume of its responsibilities, a highly qualified and trained staff is necessary to carry out the Board's mission. The Board has developed programs to provide the salary and benefits needed to compete in the market for a diverse, highly skilled workforce and training programs to maintain required skills in a dynamic financial and regulatory environment. The Board also requires the ability to gather, store, retrieve, and analyze large quantities of complex economic and financial data. This requires modern automation and telecommunications capabilities and a supporting infrastructure. The Board emphasizes the need to ensure that appropriate resources are devoted to maintain this infrastructure.

The Board is organized along division lines with specific functions. The divisions conducting the basic programs and activities of the Board are described below:

Monetary Policy Function

The Division of Research and Statistics

- develops and presents economic and financial data to the Board, the FOMC, and other System officials as background for the formulation and conduct of monetary, regulatory, and supervisory policies
- fosters a broader understanding of issues relating to economic policy by providing leadership in economic and statistical research and by supplying data and analyses for public release.

The Division of Monetary Affairs

- supports the Board and the FOMC in the formulation of monetary policy and its implementation through open market operations, the discount window, and reserve requirements.

The Division of International Finance

- provides the Board, the FOMC, and other System officials with assessments of current and prospective international economic and financial developments
- evaluates and forecasts major economic and financial developments abroad, developments in foreign exchange and other international asset markets, and U.S., international transactions
- prepares economic data and analyses for public release.

Supervision and Regulation Function

The Division of Banking Supervision and Regulation

- informs the Board of current and prospective developments in bank supervision and banking structure
- coordinates the System's bank supervision and examination activities
- processes applications required to form or expand bank holding companies or make other changes in banking structure
- administers certain regulations.

The Division of Consumer and Community Affairs

- provides support needed for the Board to carry out its federal consumer protection responsibilities.

The Legal Division

- provides legal advice and services to the Board to meet its responsibilities under bank supervisory statutes and regulations.

Payment System Policy and Oversight Function

The Division of Reserve Bank Operations and Payment Systems

- oversees the efficiency and effectiveness of, and adequacy of controls over, Reserve Bank financial services, fiscal agency services, and certain significant Reserve Bank support functions, such as information technology, human resources, financial and cost accounting, operating and capital budgets, facilities management, and internal audit.
- develops and recommends to the Board policies and regulations that foster the efficiency and integrity of the U.S. payment system, and works collaboratively with other central banks and international organizations to improve the payment system more broadly.