



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

October 12, 2011

BEN S. BERNANKE  
CHAIRMAN

Ms. Orice Williams Brown  
Managing Director  
Financial Markets and Community Investment  
Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Ms. Brown:

Thank you for the opportunity to respond to the GAO's draft report on Federal Reserve Bank Governance (GAO-12-18). The Federal Reserve Board and Reserve Banks appreciate the hard work and completeness of the review by the GAO of Federal Reserve Bank governance.

The Federal Reserve System has a unique structure and governance framework that was established by Congress in 1913. In creating a central bank for the United States nearly a century ago, Congress determined in the Federal Reserve Act to blend a policy-making government agency with 12 banks in regions across the nation that had strong and direct ties to their respective regions. By adopting a structure that provides representatives from all parts of the nation a direct voice in the development and implementation of monetary policy, Congress hoped to encourage the development of national policies that are informed by information and insights about local economies and businesses throughout the United States rather than by the needs or opinions of only a single region. Moreover, by establishing the Reserve Banks as government chartered entities with private shareholders and corporate boards of directors that include bankers, Congress also was able to fund the Federal Reserve without reliance on taxpayer money and to provide that the banking operations of each regional Reserve Bank would be overseen by a board of directors that includes some directors with banking expertise.

That model continues to have benefits today. The GAO report recognizes that the members of the boards of directors of the Reserve Banks provide a unique and valuable perspective on the economic and business environment in each local region that is factored into the development of monetary policy. The report also confirms that the Federal Reserve Board and Reserve Banks have in place a number of policies and procedures to address both potential and perceived conflicts of interest associated with a governance structure that includes bankers on the boards of Reserve Banks. In particular, the report describes the policies and practices adopted by the Federal Reserve Board and Reserve Banks that prevent Reserve Bank directors from being involved in any supervisory matters, including examinations, supervisory ratings, applications for System approval of transaction, or development and implementation of supervisory policy, and from being involved in discount window lending decisions or decisions regarding emergency lending facilities.

Importantly, the report finds that there was no special treatment of firms with director representation in any discount window lending decision or decision regarding the emergency lending facilities established by the Federal Reserve during the financial crisis. Moreover, the report found no instance where a Reserve Bank director was involved in any supervisory matter involving an institution with which the director was affiliated.

We appreciate that the GAO report also recognizes the significant efforts the Federal Reserve Board and Reserve Banks have made to increase transparency regarding the decisions, operations and transactions involving the Federal Reserve. We also appreciate the GAO's finding that the Federal Reserve Board and the Federal Reserve Banks are audited every year by an independent public accounting firm, as well as subject to review by the GAO and by an independent inspector general.

The GAO report contains four recommendations. The Federal Reserve believes all have merit and will work to implement each of them.

First, the GAO recommends that the Federal Reserve Board encourage the Reserve Banks to consider ways to broaden their pools of potential candidates for directors. The Federal Reserve Board and the Reserve Banks take seriously the importance of ensuring that members of the Reserve Bank boards of directors are chosen, as required by the Federal

Reserve Act, without discrimination on the basis of race, creed, color, sex or national origin, and that the Class B and Class C directors are chosen with due consideration to the interests of agriculture, commerce, industry, services, labor and consumers. As noted in the GAO report, the Federal Reserve Board has made it a priority to encourage selection of directors that represent broad and diverse perspectives. Indeed, the Federal Reserve Board in selecting Class C directors and several of the Reserve Banks in identifying candidates for Class A and B directors have already broadened the pool of candidates for these positions to consider qualified candidates who are not chief executives, as the GAO recommends. We will continue to explore ways that the Federal Reserve can broaden the pool of potential candidates for directors to increase diversity on Reserve Bank boards.

Second, the GAO recommends that the bylaws of each Reserve Bank clearly document the roles and responsibilities of the Reserve Bank directors. To date, as noted in the report, these roles and responsibilities have been explained in training sessions, Reserve Bank materials and Federal Reserve Board policies. We will work with the Reserve Banks to consider ways to amend the Reserve Bank bylaws to clearly explain the roles of Reserve Bank directors. In addition, we have already made a number of revisions to Federal Reserve Board policies governing the selection and eligibility of directors (the "Eligibility Policy") and the conduct of directors (the "Guide to Conduct") to make clearer the policies governing director selection, affiliations and activities. The System will continue to take steps to ensure that Reserve Bank directors are fully aware of their roles and the policies that govern their positions on the boards of the Reserve Banks.

Third, the GAO recommends that the Federal Reserve adopt a process for Reserve Banks to request waivers from the Eligibility Policy, which governs affiliations by Class B directors and shareholding and affiliations by Class C directors among other things. In 2009, the Federal Reserve Board took this step and established a process governing waiver requests by Reserve Banks to the Eligibility Policy and will consider adopting a process for waivers to the Guide to Conduct as well. While we expect waivers to be very rare and limited to unique circumstances, the Federal Reserve will also consider making public any waivers granted, with due regard for protecting personal privacy.

The final recommendation by GAO is that the Reserve Banks publish their key governance documents and policies. The Federal Reserve Board agrees that publication of its Eligibility Policy as well as the Guide to Conduct would help directors, potential candidates and the public understand the duties and expectations placed on Reserve Bank directors. Consequently, the Federal Reserve Board will post these policies on our public website. We will also work with the Reserve Banks to make available to the public other relevant governance documents and information, such as Reserve Bank bylaws, general information about the director appointment and election processes, and information about the identity of directors and their terms of office.

The unique nature and structure of the Federal Reserve System raises important issues of governance for the Federal Reserve. We appreciate the attention of the GAO to this matter and are committed to continuing to act within the framework of the Federal Reserve Act to improve governance throughout the Federal Reserve System.

Sincerely,

A handwritten signature in black ink, appearing to be 'A. P.', written in a cursive style.