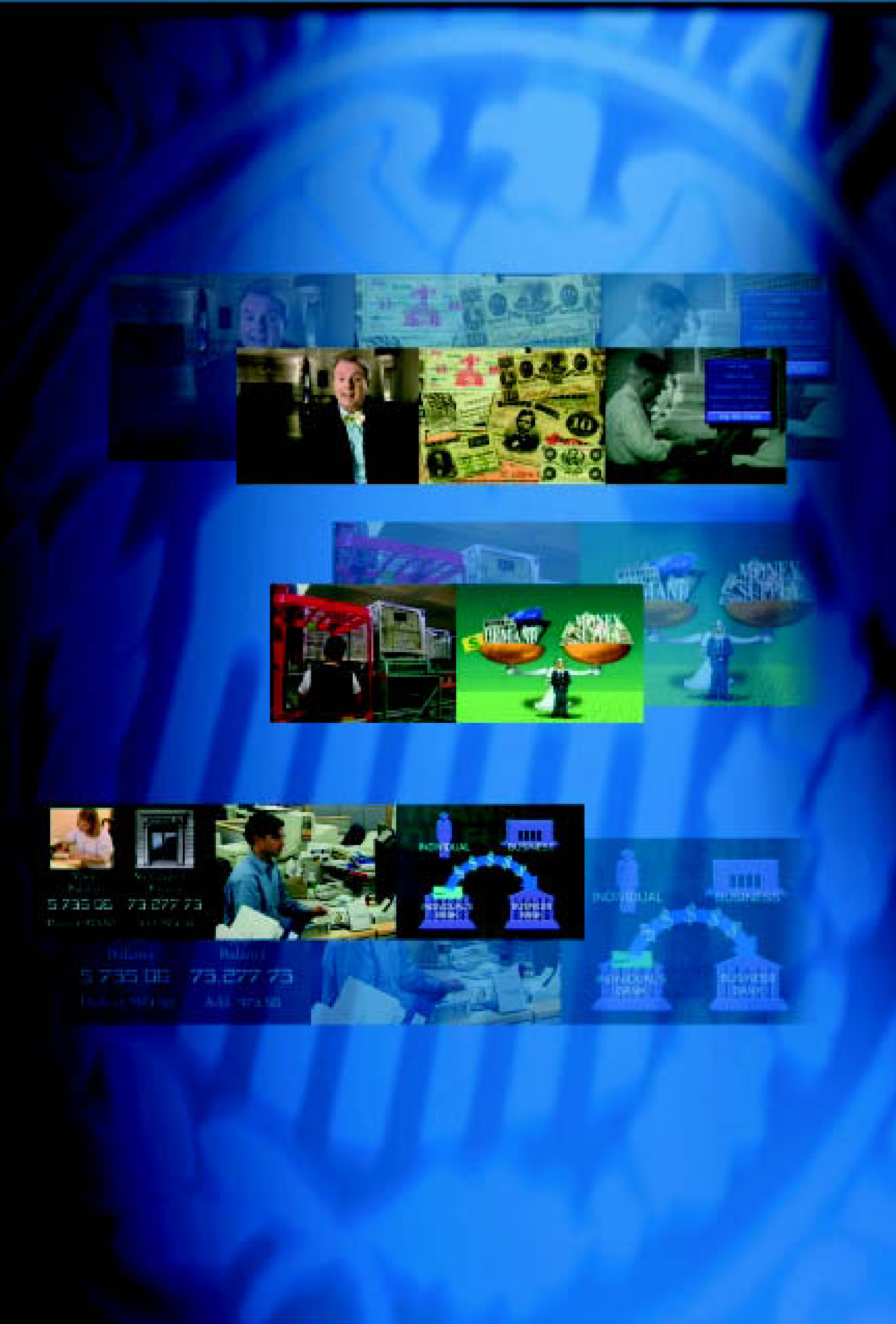
THE FED TODAY

History, Structure, Monetary Policy, Banking Supervision, Financial Services and More!

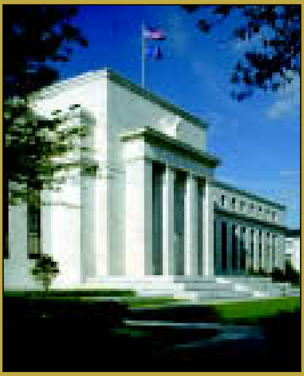


The Fed Today

The Federal Reserve System, or “the Fed” for short, is our nation’s central bank. Since its beginnings in 1913, the Fed’s main mission has always been to establish and maintain the public’s confidence in the monetary and banking system of the United States.

But the confidence that exists today wasn’t always there during much of our country’s early history. At one time, the nation had more than 30,000 types of currency, which almost any organization—even drugstores—could issue. The confusion was compounded because people could redeem some currencies for gold and silver, while government bonds backed other types of currency. To make matters worse, many banks often didn’t have enough money on hand to pay their depositors.

Something had to be done.



The Eccles Building in Washington, D.C., houses the Board of Governors of the Federal Reserve System.

President Woodrow Wilson signed the Federal Reserve Act in December 1913.

History

Congress drafted the Federal Reserve Act in 1913, creating the Federal Reserve System to establish order and confidence in the country’s monetary and banking system.

The act had its beginning in 1908, when Congress set up the National Monetary Commission to pinpoint weaknesses in the nation’s financial system.

The commission found that the United States lacked a reliable method to provide liquidity to the money supply. The country needed an “elastic currency,” which means we needed to be able to increase or decrease the growth of the money supply when necessary.

President Woodrow Wilson signed the Federal Reserve Act into law on Dec. 23, 1913, giving the Fed the responsibility of providing the country with a safer and more flexible financial system.

Since the act was signed, the Fed's original mission has expanded to include helping maintain a stable, healthy and growing economy.

Structure

The Fed is a "decentralized central bank"—a distinctively American version of a central bank, with a unique public/private structure. The Fed is governed by a seven-member Board of Governors appointed by the president and confirmed by the Senate. The Board represents the public sector, or governmental side, of the Fed.

The Fed also includes 12 regional Reserve Banks. Each regional Fed has a board of directors consisting of local citizens who represent the private sector. These directors come from all walks of life: bankers, business owners, educators, farmers and other professionals. This decentralized structure provides accountability but avoids centralized governmental control of the country's banking and monetary policy. By working in the communities, economic experts at the Reserve Banks are able to give Fed leaders in Washington regional perspectives that are blended into a national economic picture.

The Fed receives no government funding, paying instead for its activities with interest earned from investments in government securities, loans to banks and charges for services provided to financial institutions.

The 12 Federal Reserve Districts

Each year the Fed generates enough revenue to cover its costs and turns all excess income over to the U.S. Treasury.

The Fed operates independently *within* the government. As in any corporation, the Fed has stockholders. All nationally chartered banks hold stock in the Federal Reserve. State-chartered banks may choose to join the Fed and likewise own stock. Unlike stockholders in a public company, banks cannot sell or trade their Fed stock. They also do not control the Fed; however, they elect six of the nine board members of the Reserve Bank in their district.

Today's regional Reserve Banks work with the Board of Governors to establish and implement monetary policy and are responsible for supervising banks and bank holding companies. The regional Feds also provide a variety of financial services to banks and other deposit-taking financial institutions.

Monetary Policy

The Fed's foundation rests upon developing and implementing a sound monetary policy whose primary focus is price stability.

The Federal Open Market Committee (FOMC) is the group that establishes monetary policy. The committee comprises the seven governors and the 12 Reserve Bank presidents. The Fed chairman, who reports regularly to Congress, heads the committee. Five of the 12 Reserve Bank presidents have voting authority. The president of the New York Fed is a permanent voting member and serves as the FOMC's vice chairman. The other four votes rotate every year among the other 11 presidents.

The committee makes decisions that affect the amount of available money and credit. For example, if the FOMC sees signs of inflationary pressures that may affect price stability, the committee may move to slow the growth of the money supply.

Meeting room of FOMC in Washington, D.C.

As the money supply grows, so does the demand for goods and services. When more money is available, people tend to spend more. However, when the production of goods and services can't keep up with the growth in demand, prices usually begin to rise—that is, *inflation* occurs.

If there is an indication that inflation is threatening purchasing power, the Fed may need to slow the growth of the money supply. It does this by using three tools—the discount rate, the reserve requirement and, most important, open market operations.

Conversely, if the money supply and the demand for goods decrease, people buy less; prices could fall and businesses would produce fewer goods. In this case, we could have an economic slowdown—or, worse, a *recession*.

The Discount Rate

The discount rate is the interest rate the Fed charges financial institutions for short-term loans of reserves. Changing the discount rate can inhibit or encourage a financial institution's lending and investment activities by sending a signal about the Fed's goals and by indirectly influencing the interest rates banks pay depositors and at which they offer loans.

The Reserve Requirement

The reserve requirement is the percentage of checking account deposits that financial institutions must set aside in reserve. If the Fed raises the reserve requirement, banks have less money to lend, which restrains growth of the money supply. If the Fed lowers the reserve requirement, banks have more money to lend and the money supply increases.

The Fed rarely changes the reserve requirement. In fact, it is the least used monetary policy tool because changes in the reserve requirement significantly affect the way financial institutions operate. Reserve requirement changes are seen as a sign that monetary policy has swung strongly in a new direction.

Open Market Operations

The Fed's primary tool for fighting inflation and recession is open market operations. Acting through banks and government securities dealers, the Fed buys and sells U.S. government securities on the open market to influence short-term interest rates and the growth of money and credit.

When the Fed determines that too much money and credit are available in the market and inflationary pressures are rising, the Fed will sell securities to banks and dealers. As a result, banks have less money to loan to the public. With excess money and credit taken out of the financial system, inflationary pressures are reduced, thus stabilizing the economy.

If too little money is available in the financial system, which could lead to an economic slowdown or recession, the Fed buys securities. The funds the Fed uses to purchase the securities will eventually arrive at local banks, which then have more money to lend. This process moves money into the financial system and stabilizes the economy.

Through both the selling and buying of securities, the goal is a stable economy with higher employment and production, steady growth and overall stable prices.

Banking Supervision

Prior to the Fed's creation, the United States had neither a uniform currency nor a way to ensure that banks and other financial institutions stayed solvent. Throughout the 1800s and early 1900s, banks found themselves in precarious situations when many customers showed up on the banks' doorsteps demanding their money.

Today Congress establishes rules that govern the supervision and regulation of banks that operate in the United States.

The Fed works with other government agencies to make sure banks follow the rules and laws. This hands-on experience provides the Fed with essential knowledge for setting monetary policy and forestalling or managing financial crises.

The Fed monitors banks, bank holding companies and U.S. operations of foreign banks to ensure their safety and soundness so that the public's confidence remains high. Examiners based in the regional Reserve Banks periodically study a bank's records to determine the bank's financial condition and whether it is following appropriate laws and regulations. The Fed will require the bank to correct any problems.

Today's examinations are part of an ongoing process in which examiners perform their duties either from their own offices with the latest in automation or by going directly to the banks.

Financial Services

The Fed is referred to as the "banker's bank" because it provides essentially the same services to banks that banks provide to their customers. For example, regional Feds can loan money to banks and charge them an interest rate, just like banks loan money to their customers.

Through the Fed's discount and credit operations, Reserve Banks provide cash to banks to meet short-term needs stemming from seasonal fluctuations in deposits or unexpected withdrawals. The Fed also provides cash to banks for longer-term solutions in exceptional circumstances. When lending money to banks, the Fed charges a discount rate, much as a bank charges an interest rate for a house or car loan.

These services contribute to an effective functioning of the banking system, alleviate pressure in the reserve market and reduce unexpected movements in interest rates. Moreover, adjustments to the basic discount rate can be an important indicator of impending monetary policy shifts.

The Fed is not only the banker's bank, it's also the U.S. government's bank, maintaining accounts and providing services for the Treasury Department. Federal taxes are deposited at the Fed. The Reserve Banks also handle the sale and redemption of government securities to help the Treasury finance the national debt. These Treasury bills, notes and bonds are sold to the public and financial institutions.

Every day, Reserve Banks process billions of dollars in currency, checks and electronic payments. As a result, the Fed plays a vital role in the nation's payment system.

It's up to the Fed to make sure there's always enough money in circulation. This means issuing currency and coin to banks and ensuring that currency is in good condition. The Fed removes and destroys damaged, counterfeit or worn-out currency and coins.

One of the Fed's busiest operations is check clearing—an around-the-clock operation. Millions of checks are sorted, tabulated and credited or debited daily to financial institution accounts .

Conclusion

The Fed is a uniquely American version of a central bank, fulfilling major responsibilities important to the nation's well-being—fighting inflation, setting monetary policy, serving as the banker's bank and supervising financial institutions. In fact, emerging democracies around the globe use the Fed as a model to develop their own monetary policies.

These countries look to the Fed's success at instilling confidence in our nation's money and its success at achieving price stability—the foundation for a stable and growing economy and better living standards for its citizens.

"To keep prices steady,

keep jobs and production both coming,

the job of the Fed,

when all's done and said,

is to keep the economy humming."

— Charles Osgood
Radio and Television Commentator
Narrator, The Fed Today *video*

Federal Reserve Districts and Branches

1A
Boston

2B
New York
- Buffalo

3C
Philadelphia

4D
Cleveland
- Cincinnati
- Pittsburgh

5E
Richmond
- Baltimore
- Charlotte

6F
Atlanta
- Birmingham
- Jacksonville
- Miami
- Nashville
- New Orleans

7G
Chicago
- Detroit

8H
St. Louis
- Little Rock
- Louisville
- Memphis

9I
Minneapolis
- Helena

10J
Kansas City
- Denver
- Oklahoma City
- Omaha

11K
Dallas
- El Paso
- Houston
- San Antonio

12L
San Francisco
- Los Angeles
- Portland
- Salt Lake City
- Seattle