

16th Edition

THE FEDERAL RESERVE TODAY



TABLE OF CONTENTS

Foreword	1
The Structure and Organization of the System.....	2
System Functions and Objectives	9
Monetary Policy and Economic Activity	11
Financial Supervision and Regulation.....	19
Payments Services for Financial Institutions	24
Banking Services for the U.S. Treasury	27
Consumer Protection and Education.....	31
Glossary	35

Foreword

The Federal Reserve System, often called the Fed, is the central bank of the United States. As the nation's central bank, the Fed has three well-known responsibilities: conducting monetary policy, supervising and regulating financial institutions, and providing services to financial institutions. In addition to these functions, the Fed also acts as the fiscal agent for the U.S. Treasury and is engaged in consumer protection activities.

The actions of the Federal Reserve System affect everyone. Economic conditions in the United States and worldwide are impacted by how well the Fed does its job. Promoting the integrity of our financial institutions, the efficiency of our payments systems, the adequacy of our money and credit, and the purchasing power of our dollar are all responsibilities of the Fed.

The Fed's principal goal of economic stability has not changed since its creation in 1913 with the passage of the Federal Reserve Act. Its role, however, has grown a great deal. Just in the past decade, Fed functions changed and expanded to deal with dramatic transformations in financial institutions, payments processes and markets.

As the reprint of this publication goes to press, the Fed finds itself in another time of great change. In response to the financial crisis that peaked in late 2008, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) of 2010. The Dodd-Frank Act established new responsibilities for the Fed and other financial regulators, placed new limits on the permissible activities of financial firms and called for the creation of new agencies, including the Consumer Financial Protection Bureau. With hundreds of elements of the Dodd-Frank Act connected to or directly affecting the Federal Reserve, interpretation, rule-writing and implementation will take time.

Still, the Fed's primary objectives discussed in this 16th edition of *The Federal Reserve Today* remain as relevant to our daily lives as they have ever been. More than 40 years have passed since Robert P. Black, then an economist and later president of the Federal Reserve Bank of Richmond, wrote the text for the first edition of this publication. This 16th edition is the story of the Fed today — its structure, its objectives and its actions.

The Fed and You

*Throughout this edition of *The Federal Reserve Today*, look for boxes marked "The Fed and You," for highlights of how the Fed's actions impact you.*



The Structure and Organization of the System

The Fed's actions affect the economy and therefore affect you. To ensure that the Fed remains accountable and free from political pressure, the Federal Reserve System is composed of public and private elements. The Board of Governors of the Federal Reserve System provides oversight to the 12 Reserve Banks and their branches. The Federal Open Market Committee (FOMC), the Fed's monetary policymaking body, is made up of the members of the Board of Governors and presidents of the Reserve Banks. The Reserve Banks interact with more than 16,000 depository institutions that provide financial services to the public.



Board of Governors

The seven members of the Board are appointed by the president of the United States and confirmed by the U.S. Senate. The full term of a Board member is 14 years, and members who have served a full term may not be reappointed.

The president also appoints the chairman and vice chairman of the Board from among the seven Board members. The chairman and vice chairman serve four-year terms and may be reappointed to these positions. The Board's seven governors serve as members of the Federal Open Market Committee.

Three advisory councils – the Federal Advisory Council, the Consumer Advisory Council and the Thrift Institutions Advisory Council – inform the Board on matters of current interest. These councils, whose members are drawn from each of the 12 Federal Reserve Districts, meet three to four times a year.



The Federal Open Market Committee

The Federal Open Market Committee (FOMC) can affect overall economic activity through monetary policy. The FOMC sets monetary policy by establishing a target for the federal funds rate (the interest rate banks charge for overnight loans between banks). While all seven members of the Board of Governors and all 12 presidents of the Reserve Banks participate in each FOMC meeting, voting rights rotate among some participants. The seven members of the Board of Governors, the president of the New York Reserve Bank and the presidents of four other Reserve Banks, who serve one-year rotations, vote on monetary policy decisions.

The Fed and You

Every day people make economic decisions. Deciding what to purchase, how much to save and whether to attend college will impact your life and the larger economy. The Fed's actions can affect the economic environment in which you make these decisions. Therefore the Fed's actions, your decisions and the economy are interconnected.

Reserve Banks

The 12 Reserve Banks are named after the locations of their headquarters – Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, San Francisco and St. Louis. Each Bank is assigned a number and a corresponding letter. As the map on pages 6 and 7 shows, the naming convention begins with the Boston Fed, 1A, in the Northeast and continues south and west across the country to the San Francisco Fed, 12L.

The Reserve Banks are quasi-governmental, or legally private but functionally public, corporations. Reserve Banks are “owned” by commercial banks in their region (that is, banks hold stock in their Federal Reserve Bank) but serve public goals and are overseen by the Board of Governors, a government entity. While these member banks are considered “owners” of the Fed, they do not have many of the usual rights of stockholders. For example, although 6 percent of their capital is invested in the Reserve Banks, their dividend return on this investment is fixed at 6 percent by law. The purpose of this quasi-governmental arrangement is to ensure a central bank that is both accountable to the American people and insulated from political pressure.

The Reserve Banks carry out a number of important functions. Bank presidents contribute to the monetary policy discussion and vote on the direction of monetary policy during FOMC meetings. While each president brings his or her own unique views on the national economy to these meetings, one of the specific roles of Reserve Banks is to reach out to local communities within each District to gather information about the regional economy.

One channel through which Reserve Banks interact with the public and the banking industry is the Reserve Bank’s own Board of Directors. Each Reserve Bank is governed by a Board that represents both member banks and the nonbank public. These nine directors oversee Bank operations and provide Fed officials with considerable “grassroots” information on business and financial conditions. While the member banks elect the Board of Directors, the Directors’ decisions are subject to review by the Board of Governors.



**There are
12 Reserve Banks.**

The entrepreneurs and leaders who sit on the Reserve Banks' advisory committees also provide vital community-level input on the economy. These committees provide information on matters pertaining to small business, agriculture, labor, community development and payments. Members of advisory committees represent a diverse range of industries and interests in their Districts.

Reserve Banks also engage with the banking industry through supervisory activities and by providing payments services to depository institutions. The Reserve Banks support a number of community development and economic and financial education programs for the public. The Banks also work directly with the U.S. Treasury as its fiscal agent.



Member Banks

Approximately 34 percent of the commercial banks in the United States are members of the Federal Reserve System. Nationally chartered banks are required to be members of the Federal Reserve System and state chartered banks may choose to become members. Member banks are required to hold 6 percent of their capital as stock in their Reserve Bank.



Other Depository Institutions

In addition to member banks, about 13,700 other **depository institutions** provide checkable deposits and other banking services to the American people. These include state-chartered commercial banks, savings banks, savings and loan associations and credit unions. Although not formally part of the Federal Reserve System, these institutions have access to Fed financial services and are subject to System regulations.



American People

The American people play an integral role in the Federal Reserve System. Voters elect the leaders who appoint members to the Board of Governors. Local business people serve on advisory councils and committees. While the actions of the Federal Reserve System impact the public, Federal Reserve policymakers rely on information from a myriad of individuals to make policy decisions. These decisions impact the economy in which we live, work and make our own economic decisions.

A Summary of the Components of the Federal Reserve System



Board of Governors

- Consists of seven members, appointed by the president and confirmed by the U.S. Senate
- Provides leadership to and exercises general supervisory power over Reserve Banks
- Informed by advisory councils
- Members serve on the Federal Open Market Committee



Federal Open Market Committee (FOMC)

- Includes seven members of the Board of Governors, the president of the New York Reserve Bank and the presidents of four other Reserve Banks who vote on a rotating basis
- Sets monetary policy



Reserve Banks

- Represent 12 diverse geographic Districts
- Supervise and regulate financial institutions
- Provide services to financial institutions and the federal government
- Presidents serve on FOMC



Member Banks

- Approximately 2,400 national and state-chartered banks
- Provide banking services to the public
- Hold stock in their Reserve Bank



Other Depository Institutions

- 13,700 state-chartered banks, savings and loan associations and credit unions
- Provide banking services to the public
- Subject to Federal Reserve regulations and have access to Fed payments services

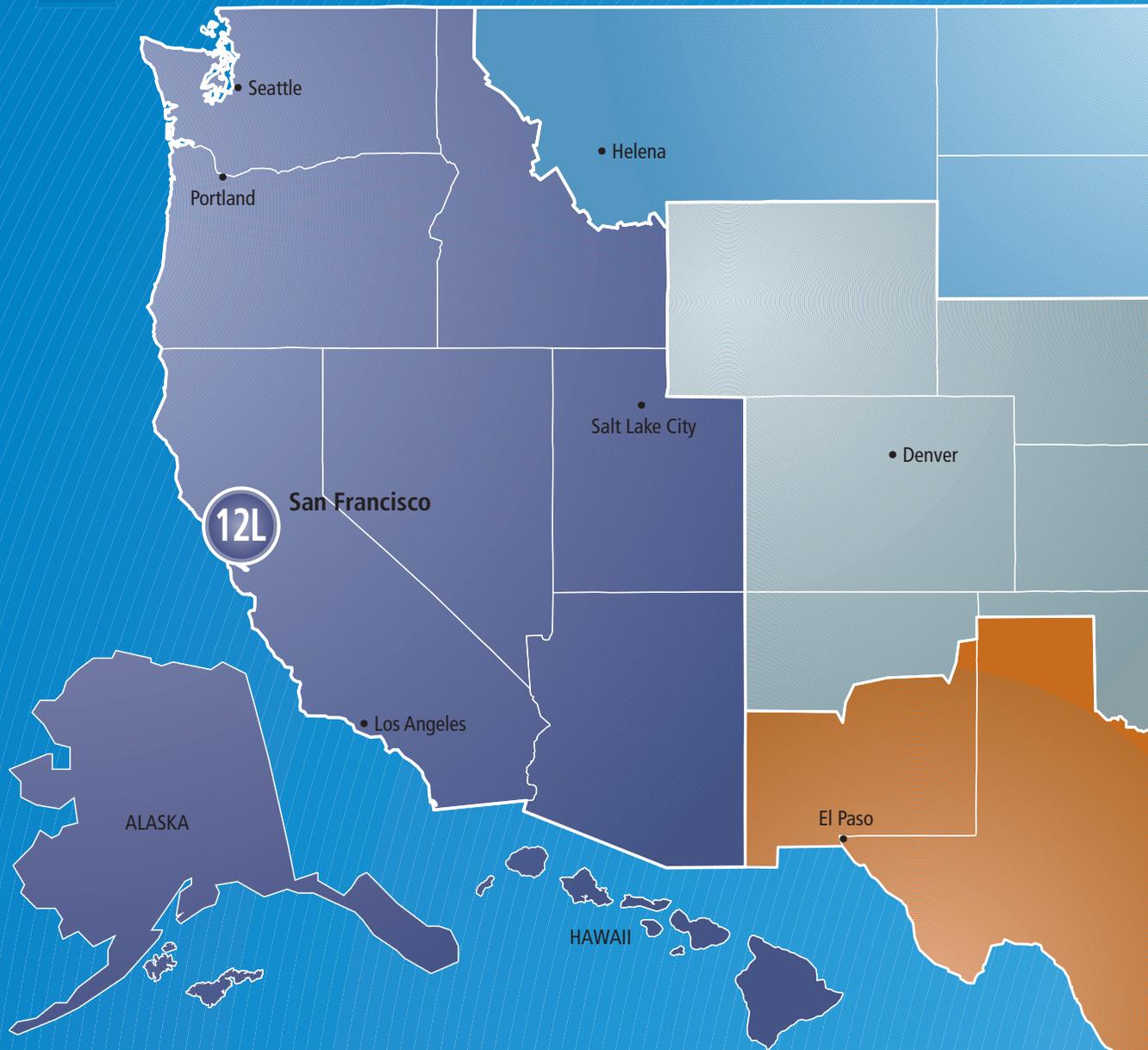


American People

- Elect leaders who appoint members to the Board of Governors
- Serve on advisory councils and committees and Boards of Directors
- Affected by the actions of the Federal Reserve System

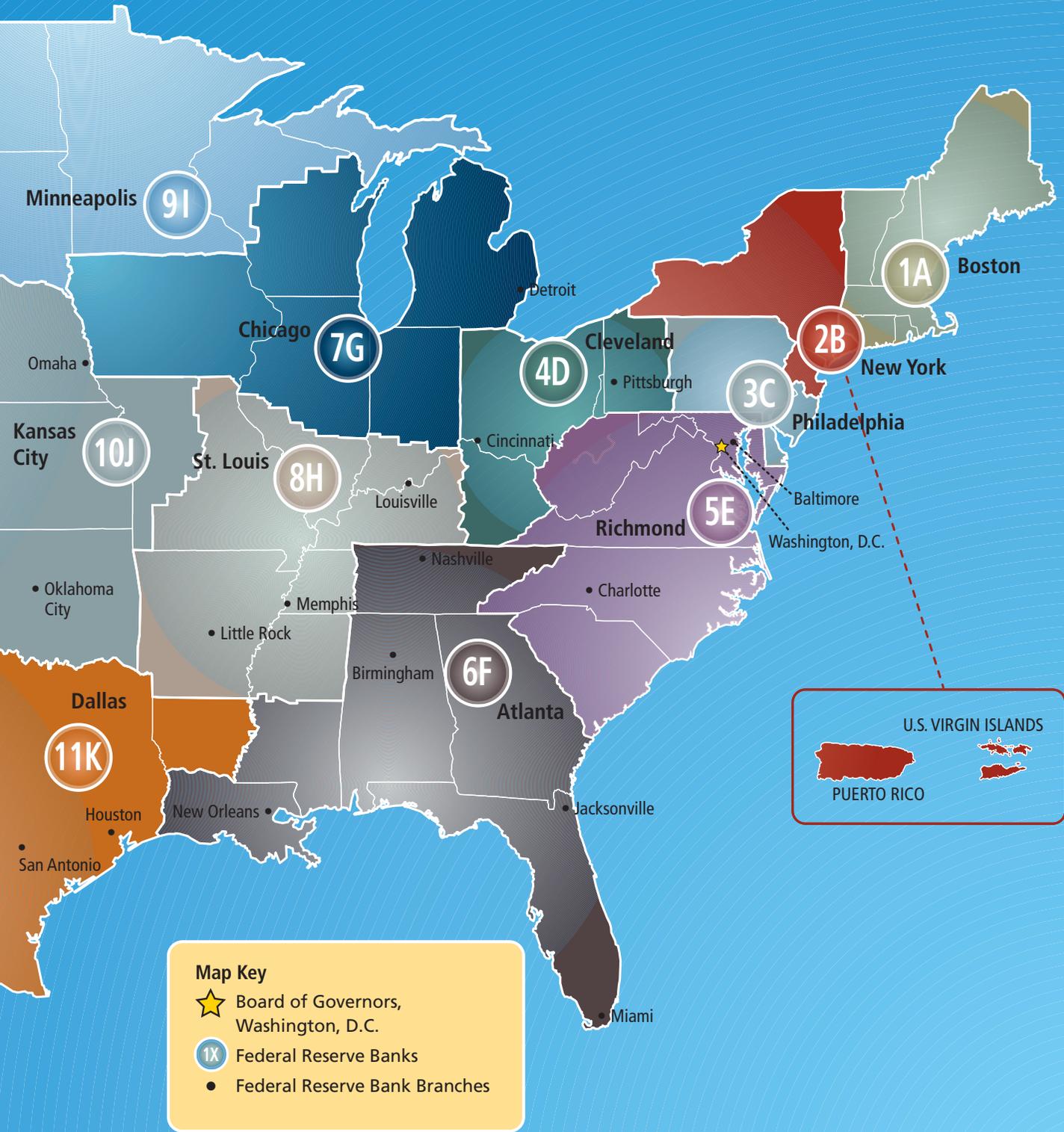


The Federal Reserve System



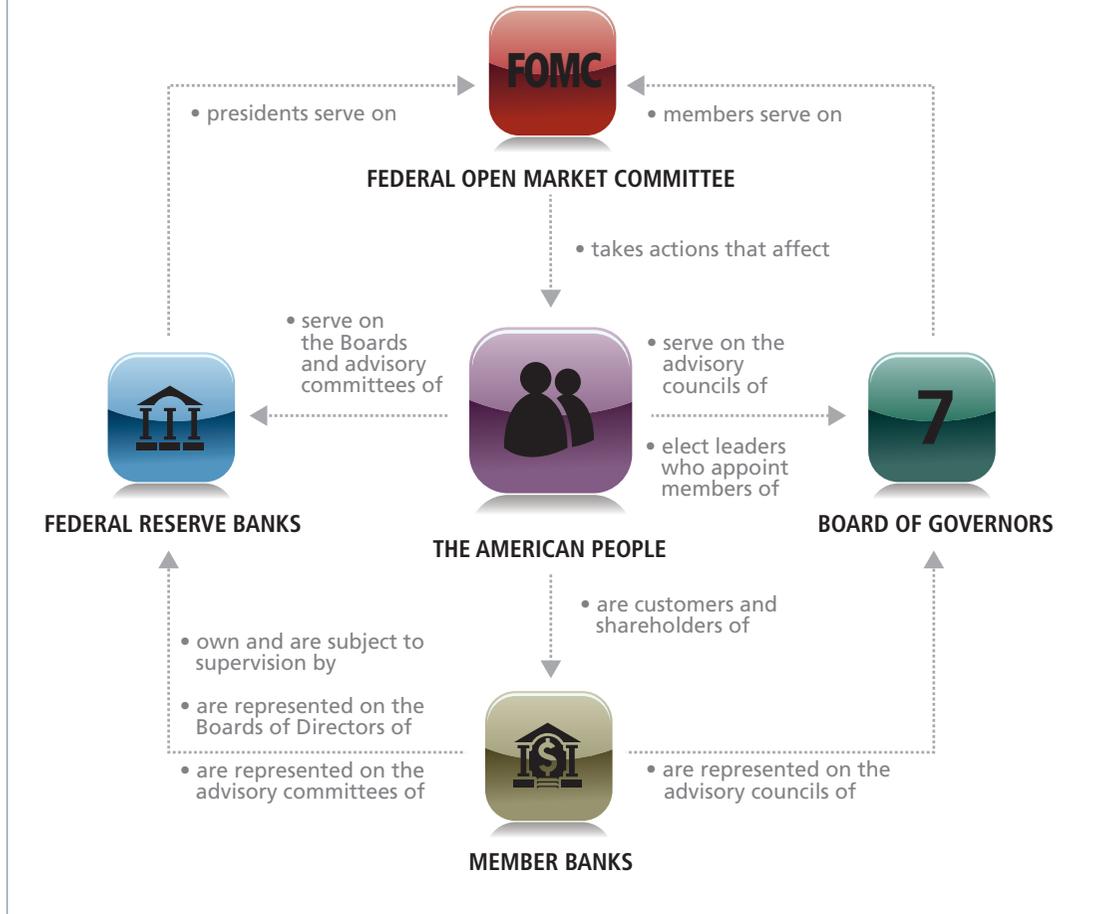
Why Are the Districts Different Sizes?

In 1914, an organizing committee determined the boundaries for the 12 Federal Reserve Districts. The committee located most of the Districts in the East because, at the time, most people lived in the eastern part of the country. Instead of following state lines, boundaries ran along county lines to fit the needs of the banks in the area. For example, although most of West Virginia is located in the Richmond District, the northern panhandle of West Virginia is part of the Cleveland District because of its close proximity to the Cleveland District branch in Pittsburgh, Pa.



The American People and The Federal Reserve System

Follow the arrows from any box in this graphic for the relationships between the American people and the Federal Reserve System.



Are Reserve Banks Supported by Tax Dollars?

Yes and no. Reserve Banks are not directly supported by tax dollars. They are mainly financed by interest earned on the Fed's portfolio of income-producing government securities and interest earned on loans to depository institutions. However, Reserve Banks are required to transfer excess earnings to the U.S. Treasury. Reserve Banks are indirectly supported by tax dollars because earnings returned to the U.S. Treasury reduce the portion of government spending that taxpayers finance. During 2008, the income of Reserve Banks totaled approximately \$35.5 billion of which \$31.7 billion, or 89 percent, was transferred to the U.S. Treasury.

System Functions and Objectives



System Functions and Objectives

The Federal Reserve System performs three traditional functions:

1. Conducting monetary policy

The Federal Reserve System's primary function is to conduct monetary policy. Monetary policy is used to support the Fed's primary economic goals of maximum employment, price stability and moderate long-term interest rates.

2. Supervising and regulating financial institutions

The Federal Reserve System is charged with helping to protect the integrity of the nation's financial institutions. The Fed examines and regulates depository institutions in order to help ensure the safety and soundness of the financial system, to promote stability in financial markets and to promote compliance with applicable laws. By doing this, the Fed reinforces the public's confidence in the banking system.

3. Providing payments services to financial institutions

The Federal Reserve System provides services to depository institutions and the federal government. Just as your bank holds cash and processes checks and electronic payments for you, the Fed holds cash reserves and processes check and electronic payments for depository institutions.

The Federal Reserve acts as a fiscal agent for the federal government, which is sometimes considered a fourth function of the Fed. As part of this role, the Fed provides banking and securities services to the U.S. Treasury and issues currency and coin.

Though not usually considered one of its three traditional functions, the Federal Reserve System plays an important role in consumer protection. Activities include writing and enforcing the regulations consumers rely on to protect them from fraud and unfair lending practices, promoting fair and impartial access to credit, and educating people about the role of the Federal Reserve in the economy.

Monetary Policy and Economic Activity



Monetary Policy and Economic Activity

What Is Monetary Policy?

Monetary policy is the Fed's behavior in pursuit of price stability, moderate long-term interest rates and maximum employment.

Under normal economic conditions, the **Federal Open Market Committee (FOMC)** sets monetary policy by choosing an interest rate. That interest rate is important since it is the cost — to a bank — of holding **reserves**. In recent years, the Fed has set a target, or target range, for the **federal funds rate** — the interest rate for overnight loans between banks. The Open Market Desk at the Federal Reserve Bank of New York then conducts open market operations, the buying or selling of U.S. **Treasury securities**, to change the amount of reserves in the banking system to adjust the federal funds rate. Since the federal funds rate is the price of borrowing reserves, open market operations bring the actual federal funds rate in line with the FOMC's target. In summary, **monetary policy** can be defined as the Fed's strategy to vary the quantity or the price of reserves in the banking system.

The FOMC has eight scheduled meetings a year to determine if an adjustment to the federal funds rate target is needed. Between regularly scheduled meetings, the FOMC can change the federal funds rate target by conference call — an infrequently used option. The FOMC uses its control of the federal funds rate “to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates” as mandated in the **Federal Reserve Act**.

The Fed's Mandate

How can control of the federal funds rate give the Fed the ability to achieve its broad legislative mandate?

Price Stability

The classic definition of **inflation** is too much **money** chasing too few goods. Price stability therefore requires a limit on the amount of money in the economy. Because the amount of reserves in the banking system helps to determine the supply of money, the Fed has to consider how changes in the amount of reserves will affect the future course of inflation.

Moderate Long-Term Interest Rates

Financial institutions compare the federal funds rate with other short-term interest rates. Competition to borrow at the lowest rate available and lend at the highest rate available brings



The Fed does not actually print money. Economists sometimes say “the Fed created money” rather than saying “the Fed increased the supply of reserves.”

interest rates on other short-term instruments in line with the federal funds rate. In addition, changes in the federal funds rate affect long-term rates as well, since a long-term interest rate is basically an average of short-term rates over time.

The rate of inflation expected by the public helps form interest-rate expectations over the long run. Inflation reduces the purchasing power of money over time, and therefore will erode the value of payments made on a loan. If both lender and borrower expect high inflation, then they will agree on an interest rate that is high enough to compensate for the reduction of purchasing power caused by inflation over the life of the loan. As people build inflationary expectations into contracts, long-term interest rates rise or fall accordingly. The Fed must take actions that lead to low inflation and instill public confidence that inflation will remain low over time in order to achieve moderate long-term interest rates.

Maximum Employment

The connection between monetary policy and the Fed's other mandated goal, maximum employment, is more subtle.



The three goals of monetary policy are:

- **Price stability**
- **Moderate long-term interest rates**
- **Maximum employment**

The Federal Funds Rate Target and Open Market Operations

Suppose that the FOMC lowers the federal funds rate target. The Open Market Desk then conducts open market operations by purchasing Treasury securities from commercial banks. The Fed pays for the securities by depositing funds into the accounts that commercial banks hold with the Fed. The additional reserves in the system tend to lower the federal funds rate. Banks generally do not let these reserves remain idle because they can earn interest by lending them. The additional lending tends to lower other interest rates in the economy.

If, on the other hand, the FOMC raises its target, the process begins with the Open Market Desk selling Treasury securities. Buyers pay for the securities with funds held in accounts at commercial banks. This lowers the amount of reserves available for lending by commercial banks and pushes interest rates higher.

Most of the time, the Open Market Desk maintains the federal funds rate at a target level. However, maintaining the rate at a target can also involve significant open market activity. Private sector activity can affect the amount of bank reserves in the system, which puts pressure on the federal funds rate. The Open Market Desk must conduct open market operations that offset this activity to keep the funds rate at the target level.

The level of employment is closely related to the level of overall economic activity; thus policies that promote economic growth also promote rising employment.

In the short run, monetary policy has definite effects on economic activity. Low interest rates, especially long-term rates, tend to stimulate spending, production and employment. Conversely, high rates can dampen spending, production and employment. Given the mandate for maximum employment, why not just set the federal funds rate target as low as possible? The answer illustrates the tension that exists among the goals of monetary policy.

To maintain a very low funds rate, the Fed would need to add large amounts of reserves to the banking system, which would lead to rising inflation and inflationary expectations over time. This would cause higher long-term interest rates that would eventually restrain economic activity. Any temporary benefit from an excessively low federal funds rate today would be lost in the long run, leading to higher inflation in the future.

In the long run, higher output can be gained through the use of additional inputs in the production process (primarily labor and capital) and through increases in the productivity of these inputs (for example, better educated workers). These long-run determinants of output growth are largely independent of monetary policy, although notably bad monetary policy could disrupt economic activity and reduce growth.



The “Three Tools of Monetary Policy” Reconsidered

A staple of monetary policy discussions has been the three tools of monetary policy: open market operations, discount window lending and changes in reserve requirements. When the FOMC uses the federal funds rate as its monetary policy instrument, two of the three tools lose significance for monetary policy.

Routinely, the Fed uses open market operations to offset changes in the volume of discount window lending so that the amount of reserves outstanding and the federal funds rate remain unchanged. Similarly, any changes in reserve requirements would be easily offset with open market operations. When such changes are offset, discount lending and reserve requirements become just two of many factors that determine the daily volume of open market operations needed to hit the FOMC’s target for the federal funds rate.

The ideal situation is to keep inflation expectations firmly anchored at a low level. If output and employment happen to fall below their long-run trends, well-anchored expectations would allow the Fed to temporarily lower its federal funds rate target without risking rising inflation and long-term interest rates.

Expectations of Inflation and Interest Rates

People form expectations based on their understanding of how the economy functions, the Fed's strategy for achieving its goals and the types of disturbances likely to affect economic activity over time. The Fed, like any central bank, has considerable influence over the public's expectations of inflation and interest rates. Consistent behavior over time is the foundation for public understanding of Fed strategy. In addition, regular and clear communication can improve the public's understanding of what the Fed is doing and the reasons for those actions.

In recent years, the Fed has provided more timely information to the public. In 1994, the FOMC began announcing its target for the federal funds rate immediately after each meeting. Later, the Fed added its views of recent developments in the economy, including information related to the likely path of the federal funds rate over time. Public statements by the Federal Reserve Board chairman and members of the FOMC and minutes from FOMC meetings also provide information to inform the public about the Fed's views on the state of the economy and the strategy of monetary policy. In late 2007, the FOMC began releasing quarterly forecasts of inflation and economic activity over three-year horizons to better inform the public.

Financial Stability

An implicit goal of every central bank is to promote orderly financial markets. As Fed Board Chairman Ben Bernanke put it in 2007, "Well-functioning financial markets are essential for a prosperous economy. As the nation's central bank, the Federal Reserve seeks to promote general financial stability." While monetary policy can take into account the likely effects of financial market disturbances on output, employment and inflation, the Fed can also respond to financial market disruptions with **credit policy**. Monetary policy affects the size of the Fed's **balance sheet**, or its **assets** and **liabilities**, while credit policy affects the supply of credit to individual firms without changing the size of the Fed's balance sheet.

One example of a credit policy action is **discount window** lending, or the arrangements made for depository institutions to borrow from Reserve Banks. Borrowers at the discount window post collateral for the loans and pay an interest rate that is above the target federal funds rate. The discount window is important because it can provide ready access to **liquidity**

The Fed and You

When there is inflation in the economy, you pay more for the goods and services you purchase. The Fed uses monetary policy to keep average prices stable.



If people expect higher inflation in the future, long-term interest rates will rise.



Monetary policy affects the size of the Fed's balance sheet; credit policy does not.



The Fed is responsible for monetary policy. Fiscal policy, such as changes in taxing and spending that affect the economy, is the responsibility of government policymakers.

to particular financial institutions during unusual circumstances. It does not, however, add liquidity to the broad market because the Fed uses open market operations to offset the impact of discount window transactions on the federal funds rate. Because such “sterilized” discount window lending does not typically change the size of the Fed’s balance sheet, it is not a monetary policy action.

It should also be emphasized that the Fed routinely accommodates changes in private sector demands for liquidity through its policy of federal funds rate targeting. Private sector activity can increase the demand for reserves, which would tend to push up the federal funds rate. However, the Open Market Desk can purchase U.S. Treasury securities to add additional reserves to the system to keep the federal funds rate at the target level. On occasion, these purchases can be substantial. For instance, on Aug. 10, 2007, the Open Market Desk made purchases at three different times totaling \$38 billion to bring the funds rate in closer alignment with the target. This one-day total was more than four times the daily average during the first half of that year.

A Typical FOMC Statement

The Federal Open Market Committee decided today to keep its target for the federal funds rate at 5-1/4 percent.

Recent indicators have suggested somewhat firmer economic growth, and some tentative signs of stabilization have appeared in the housing market. Overall, the economy seems likely to expand at a moderate pace over coming quarters.

Readings on core inflation have improved modestly in recent months, and inflation pressures seem likely to moderate over time. However, the high level of resource utilization has the potential to sustain inflation pressures.

The Committee judges that some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Thomas M. Hoenig; Donald L. Kohn; Randall S. Kroszner; Cathy E. Minehan; Fred-eric S. Mishkin; Michael H. Moskow; William Poole; and Kevin M. Warsh.

FOMC Statement, January 31, 2007

Dissecting an FOMC Statement

The results of a typical FOMC meeting are summarized in the press release issued less than an hour after the meeting ends. A statement is reproduced on page 16.

The first sentence states that the federal funds rate target was not changed at this meeting. The next two brief paragraphs mention the FOMC's view of recent developments affecting the outlook for economic activity and inflation. The fourth paragraph is a statement of the FOMC's view of the key risks. In this case, one risk mentioned is that inflation will fail to decline as expected. The implication is that if the risk were to materialize, the FOMC would need to reconsider its target for the federal funds rate. This statement could have significant effects on the public's expectations of both inflation and the trajectory of the federal funds rate. It states the FOMC's dissatisfaction with the rate of inflation that prevailed at that time and suggests the committee's willingness to raise the federal funds rate trajectory, if needed, to improve the inflation outlook.

Policy in a Period of Financial Turmoil

During times of financial turmoil, policy may evolve to meet the immediate liquidity needs of the economy. However, the goals of the Fed remain the same and the Fed continues to operate within the confines of the Federal Reserve Act.

An example is the Fed's response to the financial turmoil that began in 2007 and intensified in 2008. By many measures this downturn was much worse than any other since the Great Depression. In this highly unusual recession, the Fed responded in a variety of ways. Its initial monetary policy response was straightforward. The FOMC lowered its target for the federal funds rate. It is quite normal for the FOMC to reduce the funds rate in response to a weakening economy and easing inflationary pressures.

In late 2008, after the FOMC had lowered the federal funds rate to effectively zero, the Fed changed its monetary policy strategy. Discount window lending was expanded and left unsterilized. The Fed made funds available in a number of ways in order to address symptoms of stress in different areas of financial markets. It also purchased financial assets other than short-term Treasury securities, announced that it would purchase mortgage-backed securities from government-sponsored housing agencies, and purchased long-term Treasury securities. These efforts resulted in a 250 percent expansion in the size of the Fed's balance sheet.

Also in late 2008 the Fed began, for the first time, to pay interest on reserves held by financial institutions.

These actions, though many are not typical of the Fed during times of normal economic fluctuations, are in keeping with the Fed's mandate and overall mission to promote economic and financial stability. As the economic turmoil resolves, some changes, like paying interest on reserves held by financial institutions, will become permanent additions to Fed policy. However, the Fed can reduce the scope of other non-traditional activities and return to implementing monetary policy through interest rate targeting.

An Example of Monetary Policy and Inflation Control



Signs of building inflationary pressure emerge. For example, consumers could see long-term interest rates or prices of commodities, like crude oil, rise.



The FOMC raises the funds rate target.



The Open Market Desk sells Treasury securities, which lowers bank reserve holdings and raises the federal funds rate. A higher funds rate, in turn, leads to higher interest rates for other forms of lending.



Consumers and firms face a greater reward for saving and a higher cost for spending. Some interest-sensitive spending is deferred.



Seeing the Fed responding to building inflationary pressures, firms and consumers make price and wage decisions based on the expectation that the Fed will keep inflation under control.



Prices remain stable.

Financial Supervision and Regulation



Financial Supervision and Regulation

Regulations are the written rules and guidelines that define acceptable behavior for financial institutions. Supervision refers to the oversight and enforcement of these regulations to ensure safe and sound behavior. The Fed's supervision and regulation actions help to foster peoples' confidence in the banking system. Protecting the integrity of the nation's financial institutions, fostering stability in financial markets, ensuring compliance with applicable laws and regulations, and encouraging banking institutions to responsibly meet the financial needs of their communities are all important in maintaining financial stability.

The Fed supervises and regulates **state member banks** (state chartered banks that have chosen to become members of the Fed) and **bank and financial holding companies** (companies that own banks). The Fed also supervises overseas and international operations of regulated financial institutions. Foreign banks with U.S. branches, agencies and nonbank operations are also subject to Fed supervision. Other financial institutions, such as nationally chartered banks, are supervised by other entities, such as the Office of the Comptroller of the Currency. The Fed's Banking Supervision and Regulation units work closely with other regulators and authorities to ensure that regulations are uniformly applied and consistently enforced throughout the banking system.

The Fed fulfills its supervisory responsibilities through a wide range of activities, including:

- Distributing supervisory and regulatory guidance documents to financial institutions' management and directors;
- Reviewing and approving applications for new member banks, bank mergers and other organizational changes;

What happens if a financial institution breaks the law or acts irresponsibly?

Enforcement actions are sometimes necessary for violations of laws, unsafe or unsound practices, breaches of fiduciary duty and violations of final orders. Actions can be assessed against any entity the Fed has authority to supervise, including its officers, directors and employees. Formal enforcement actions include written agreements, cease and desist orders and orders assessing civil money penalties.



- Conducting on-site examinations and inspections of state member banks, foreign banking organizations, and bank and financial holding companies
- Meeting with management and directors of financial organizations
- Monitoring and surveillance of bank performance and activities
- Tracking conditions in the banking sector of the national economy
- Identifying specific areas of emerging risks
- Initiating enforcement actions, when warranted

Safety and Soundness Examinations

Federal Reserve examiners conduct commercial bank examinations and bank and financial holding company inspections on a regular basis. Not only do examiners evaluate the soundness of the institutions' assets, but they also look at the effectiveness of internal operations, policies, management and risk management practices. They assess the institutions' sensitivity to market risks, or risks that come from changes in the economy. Examiners assess financial institutions' internal risk management processes and compliance with applicable banking laws and regulations. Information technology examiners evaluate the quality and reliability of financial institutions' computer systems and networks. These examiners also conduct reviews of application software shared by the financial services industry.

Analysts routinely review monitoring reports to track the overall condition of institutions and identify exceptions to established standards. Those institutions that do not meet these standards are scheduled for additional review.

Consumer Affairs Examinations

The Fed has broad powers to write, interpret and enforce laws that protect consumers in lending and deposit transactions. Consumer Affairs examiners evaluate a bank's compliance with these consumer protection laws and regulations to ensure that consumers receive comprehensive information and fair treatment. They also conduct reviews to determine compliance with the Community Reinvestment Act of 1977, which stipulates that a bank must meet the credit needs of its entire community — including low- and moderate-income neighborhoods.

The Fed and You

You can be sure your bank deposits are safe because of the actions of the Fed and other government agencies. The Federal Reserve is responsible for promoting a safe and sound banking system because stability of our financial system is important for consumer confidence and the growth of our economy.

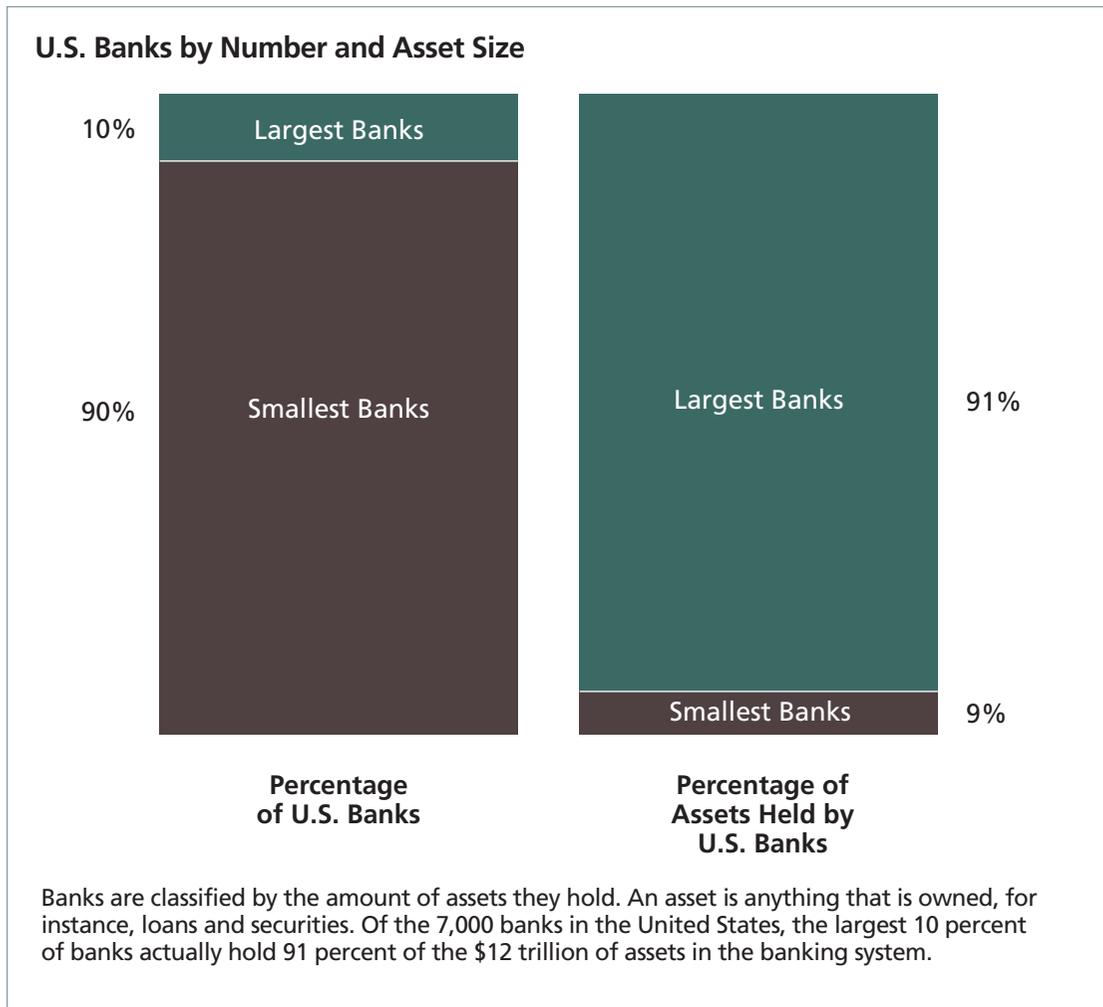


State member banks are state chartered banks that are members of the Fed.

The Federal Reserve System has a full range of enforcement actions available to ensure compliance with consumer protection laws and regulations. In addition, the Fed maintains a System-wide consumer complaints hotline and Web site to respond to inquiries and concerns raised by the public about consumer protection issues.

Targeted Exams

Targeted exams may be performed on specific areas of any supervised bank, bank holding company or financial holding company. Targeted reviews are generally performed on larger or more complex banking organizations as part of the continuous supervision process. These exams focus on a company's principal risks, and internal systems for managing those risks, and are incorporated into an overall assessment of the institution.



Supervisory & Policy Studies

Each Reserve Bank tracks banking and economic trends and conditions in its region to support the supervisory process. Specific emphasis is placed on emerging risks and the potential impact of banking policy issues on supervised institutions. The Fed promotes development of expertise in capital markets, credit, liquidity and operational risk.

Meeting the Needs of a Changing Economy

The effects of the financial turmoil that began in 2007 and intensified in 2008 will be felt in the economy for some time. Since the founding of the Federal Reserve System, the regulatory function has adapted in response to an evolving financial system. Elected officials are again considering strategies to improve the supervision and regulation of banking-related industries to prevent another experience like the financial turmoil of 2007 and 2008. In the coming years, the Fed's supervision and regulation role will evolve to meet the needs of a changing economy.

Monitoring and Surveillance of Banking Activities: Anti-Money Laundering

Money laundering is the criminal practice of processing ill-gotten gains or "dirty" money. The objective of money laundering is to "clean" the money so that it appears to be proceeds from legal activities. Money laundering can be used to further a criminal enterprise, evade taxes or conduct other unlawful activity.

Congress passed The Bank Secrecy Act (BSA) in 1970 to aid in the detection and identification of money laundering. BSA records are used by law enforcement agencies to identify the source, volume and movement of currency into and out of the United States. The USA PATRIOT Act of 2001, signed into law after the attacks of Sept. 11, 2001, expanded the focus of the BSA to detect and deter terrorist financing.

The Federal Reserve provides guidance to financial institutions on identifying and controlling risks associated with money laundering and terrorist financing. In addition, the Federal Reserve monitors compliance with the BSA and other anti-money laundering laws. BSA program reviews are conducted as part of the safety and soundness or compliance examination process.



Payments Services for Financial Institutions

As a “banker’s bank,” the Federal Reserve System provides **payments services** to commercial banks and other depository institutions similar to those provided by depository institutions for their customers. These services include processing checks and electronic payments.

Check Processing

The Fed operates a nationwide check clearing system. Traditionally, depository institutions sent the actual checks they received to Reserve Banks to be processed and routed to the originating depository institution for collection. **Settlement** was accomplished through the Federal Reserve accounts of these institutions. An increasing number of institutions now use electronic check clearing options made possible under the Check Clearing for the 21st Century Act. Also known as “Check 21,” the act enabled Reserve Banks to employ electronic image-based solutions for the rapid exchange of check data between depository institutions. Ongoing industry advances continue to revolutionize the traditional process of check clearing and the Fed’s role in that process.

Electronic Payments

The Fed provides two types of electronic payments services: fund transfers (Fedwire) and the Automated Clearinghouse (ACH). Fedwire processes payments of all sizes up to a maximum of just less than \$10 billion. ACH is used mostly for recurring payments, such as business payrolls, consumer insurance payments, and the U.S. government’s military and civilian payrolls and Social Security benefits.

The Fedwire system is an electronic network that processes and transmits messages nationwide. For example, suppose a corporation headquartered in Richmond, Va., needed to transfer funds to a corporation in San Francisco. The financial institution of the Richmond corporation originates the transfer and the Richmond Reserve Bank deducts the funds from the reserve account of the financial institution. The San Francisco Reserve Bank adds the funds to the reserve account of the San Francisco financial institution. The San Francisco financial institution then credits the account of the firm. The Reserve Banks settle by means of accounting entries on their books.

The ACH system processes and transmits “batches” of payment transactions, such as corporate payroll payments. When a corporation's depository institution originates payroll payments



Settlement occurs by debiting the accounts of depository institutions making payments and simultaneously crediting the accounts of depository institutions receiving payments.



The Fed and You

When you pay bills online, your payment is likely to have been processed through the Federal Reserve System.

through the Fed's ACH system, the system routes individual payments within the batch to employee accounts at depository institutions. The Fed settles payments with the corporation's originating depository institution and each receiving depository institution.

In recent years, the ACH system and traditional paper check-writing practices have converged to create a category of ACH activity often referred to as e-check payments. The two most common e-check payments are Accounts Receivable Conversion (ARC) payments and Point of Purchase (POP) payments. ARC is very common among utility companies, where paper checks used for bill payment are converted to an electronic payment or debit transaction by the company and the paper check is destroyed. POP payments are very common among major national retailers, where paper checks written at the point of sale are immediately converted to an electronic payment and returned to the customer.

How a Check is Typically Cleared



You write a \$10 check from your checking account and send it to your cousin.



Your cousin deposits the check at her bank, which credits her account \$10.



Your cousin's bank chooses to clear the check through the Federal Reserve System. (Clearing this transaction through the Fed is just one of many possible methods by which your cousin's bank might choose to clear your \$10 check.) The bank has three options for sending the item to the Fed – it can send the original check, a substitute of the original check or an image of the original check.



Once the check – usually in electronic form – is received at the Fed, the Fed credits your cousin's bank \$10 and debits your bank \$10.



The Fed then sends an image of the \$10 check and the electronic data on the check to your bank via an electronic transmission. Your bank uses this transmission to debit your account \$10. Your original check is retained at your cousin's bank, and ultimately destroyed.

A Cross-Country Electronic Payment



You direct your bank in Sacramento, Calif., to wire your credit card payment from your account to your credit card company in Wilmington, Del.



Your bank debits your account and uses its online computer link with ACH to credit your credit card company's bank.



Your credit card company's bank deposits the payment in your credit card company's account.

Banking Services for the U.S. Treasury





Banking Services for the U.S. Treasury

As banker and fiscal agent for the U.S. Treasury, the Federal Reserve System provides services for the government, primarily through depository institutions.

Government Banker

Reserve Banks provide the U.S. Treasury with a checking account. When the government makes a payment by check or electronically, that payment is usually cashed by or deposited in a commercial bank or similar institution. The Fed processes the payment almost immediately and deducts the amount from the Treasury's account. Although the Treasury usually keeps the money received from tax payments on deposit at commercial banks, it transfers funds to a Reserve Bank when needed to make payments.

Increasingly, the federal government has saved money and improved its service to the public by using the Federal Reserve System's electronic payments network. Most regular federal government payments, such as Social Security benefits and the government payroll, are direct deposits made through the Fed's automated clearinghouse service.

The Journey of a \$20 Bill



A \$20 bill is printed at the Bureau of Engraving and Printing in Washington, D.C., or Fort Worth, Texas.



The \$20 bill is sent to a Federal Reserve Bank.



Your bank is running low on cash for its ATM, so it orders some from its account at the Fed. An armored truck brings the \$20 bill, along with others, from the Fed to your bank, where it is loaded into an ATM.



You use your debit card to get \$20 from the ATM.

The Fed and You

The currency and coin you carry was issued by a Federal Reserve Bank.

U.S. Fiscal Agent

Acting as the U.S. fiscal agent, Reserve Banks sell, transfer and redeem government securities, make interest payments on these securities and assist the Treasury and other federal government agencies with their securities in many other ways. This is done electronically through a system called “**Treasury Direct.**” The Treasury and federal agencies reimburse the Reserve Banks for expenses associated with these fiscal agency functions.

Supplying Paper Money and Coin

The Reserve Banks provide a vital part of the machinery through which most currency moves into and out of circulation. As the public demands currency from the banking system, depository institutions draw down their accounts at Federal Reserve Banks in exchange for additional currency. Similarly, when currency from the public flows back into depository institutions, those institutions deposit the surplus in their Reserve Banks.

The Treasury is responsible for the design and production of U.S. paper money and coin. Paper money is produced at Bureau of Engraving and Printing facilities in Washington, D.C., and Fort Worth, Texas. Coins are produced at U.S. Mint facilities in Philadelphia and Denver. While the Treasury produces currency, Reserve Banks are responsible for putting the newly produced money into circulation to meet public needs. The Fed also is responsible for destroying money that is no longer fit



The Reserve Banks do not print money. They issue money printed by the Bureau of Engraving and Printing to depository institutions.



You spend the \$20 at a bookstore.

The bookstore deposits the bill in its account at its bank. The bookstore's bank either distributes the \$20 to another customer or sends the \$20 bill with its shipment of excess cash to a Federal Reserve Bank for processing.

Back at the Federal Reserve Bank, a machine determines whether the \$20 bill is “fit,” or in good condition, for circulation. If the \$20 is fit for circulation, it will be repackaged and paid to another bank and the process will continue until the \$20 becomes “unfit,” or too worn out, for further circulation. Unfit bills are shredded at the Federal Reserve Bank.

for circulation. By crediting the government's account, Reserve Banks "buy" new paper money and coin from the Treasury to replace the unfit notes they destroy and coin they return to the Mint.

Note Issue

All bills issued today are Federal Reserve notes. These notes are liabilities of the 12 Reserve Banks and are backed by the Federal Reserve System.

Average Life Span of Coin and Currency (May 2009)

\$ 1	22 months
\$ 5	16 months
\$ 10	18 months
\$ 20	24 months
\$ 50	55 months
\$ 100	89 months
coins	25 years



Consumer Protection and Education



Consumer Protection and Education

The Federal Reserve System has a number of consumer protection responsibilities. The Consumer Compliance function writes consumer protection regulations for the financial industry, and it enforces consumer protection and civil rights laws and regulations at the banks the Fed supervises. Community Affairs offices across the Federal Reserve System promote community development and fair and impartial access to credit. Economic Education offices in each Federal Reserve District work to advance the public's knowledge of the Federal Reserve's role in the economy.

Consumer Compliance

Congress has assigned responsibility to the Federal Reserve Board of Governors for implementing certain laws pertaining to a wide range of banking and financial activities. The Board implements those laws in part through its authority to write consumer protection regulations that cover many aspects of an institution's lending and deposit functions. For instance, laws and regulations govern what disclosures an institution must provide for consumers obtaining loans and for consumers opening deposit accounts. Other consumer protection laws prohibit institutions from discriminating in the lending process. Still others ensure that mortgage borrowers receive detailed information about their real estate loan transactions. Consumer Compliance examiners review for compliance with such laws and regulations at the banks the Fed supervises. Examiners prepare confidential reports of their examination findings and issue them to bank management. Banks are required to respond to these reports and, as necessary, to take actions to prevent or correct violations of consumer protection and civil rights laws and regulations.

Consumer Compliance examiners conduct a separate review under the Community Reinvestment Act (CRA) to determine how well a bank is meeting the credit needs of its entire community – in particular, the credit needs of low- and moderate-income neighborhoods – without compromising the safety and soundness of the bank's operations. They prepare an evaluation document that discloses the bank's CRA rating and performance. Upon request, banks must make this evaluation available to the public. CRA ratings and public evaluations for banks supervised by the Fed are also available on the Internet at www.federalreserve.gov/dcca/cra.

The Fed also handles certain consumer complaints. A consumer may file a complaint against a bank or financial institution either online (www.federalreserveconsumerhelp.gov) or via



The Fed engages in consumer protection and education activities to support its economic growth objectives and promote a stable financial system.

phone, fax or mail. Although the Fed looks into every complaint that involves the banks it regulates, the Fed does not have the authority to resolve every type of problem. For example:

- It is unable to resolve contract disputes or undocumented factual disputes between a customer and a bank. In these cases, it is suggested that the customer contact an attorney.
- It cannot investigate matters that are the subject of a pending lawsuit.
- It is unable to resolve complaints about customer service or disagreements over specific bank policies and procedures not addressed by federal law or regulation.

In addition to providing detailed information on how to file a complaint, the Federal Reserve's consumer help website contains a wide variety of information for consumers about banking, including useful information on mortgages, deposit accounts, consumer credit and other banking topics.

Community Affairs

The Community Affairs function of the Federal Reserve System was created after the passage of the Community Reinvestment Act (CRA) in 1977. CRA encouraged banks and financial service institutions to serve all communities within their service areas. As a result, Community Affairs supports the Federal Reserve System's economic growth objectives by promoting fair and impartial access to credit and sustainable community development efforts. These efforts help in the revitalization of low-income communities.

The Community Affairs program uses various methods of engaging partners, including:

- Providing technical assistance to depository institutions and other community development stakeholders to develop effective community development programs
- Providing financial education information on personal finance issues that better prepares consumers for complex financial decisions
- Participating and exchanging information with community development industry partners to develop sustainable business practices and outcomes
- Developing research and analysis on emerging community development trends and their impact on communities

While all of the 12 Reserve Banks work within the framework of a shared mission and goals, each establishes its own programs that address local needs. Community Affairs encourages cooperation among financial institutions, community-based organizations, government entities and the public to share information and resources that support economic growth objectives and consumer protection responsibilities. For more information, visit <http://www.federalreserve.gov/communitydev/default.htm>.

Economic Education

The Federal Reserve's mission of maintaining a stable financial system depends on the participation and support of an educated public. Economic Education offices of the Federal Reserve System primarily work with K-12 and undergraduate college students and teachers to educate the public about the Federal Reserve. Offices typically offer teacher training opportunities, educational materials and programs for students. To learn more about products and programs offered by the Economic Education offices of the Federal Reserve System, visit www.federalreserveeducation.org.

Glossary



Glossary

Asset is anything of value that is owned. For banks, this includes loans. For the Fed, this includes Treasury securities.

Balance sheet is a record of an individual's or a firm's assets and liabilities.

Bank holding company is any company that has control over or owns a bank.

Board of Governors is an agency located in Washington, D.C. that provides leadership for the Federal Reserve System. It consists of seven members appointed by the president and approved by the Senate.

Central bank is a bank that oversees monetary policy and financial markets for a nation.

Credit policy includes Federal Reserve actions, such as discount window lending, that affect the supply of credit to individual firms. Credit policy does not usually affect the size of the Fed's balance sheet.

Depository institutions are organizations that accept deposits and make loans. These include commercial banks, savings banks, savings and loan associations and credit unions.

Discount window is the Fed's mechanism for lending funds to depository institutions.

Federal funds rate is the interest rate commercial banks charge each other to borrow reserves for short periods. Monetary policy is formulated as a target or target range for the federal funds rate.

Federal Open Market Committee (FOMC) is a part of the Federal Reserve System. Made up of the Board of Governors and Federal Reserve Bank Presidents, the FOMC sets monetary policy.

Federal Reserve Act is the 1913 law that created the Federal Reserve System.

Financial holding company is a bank holding company that engages in a broad range of banking-related activities, such as insurance and securities underwriting.

Inflation is a sustained increase in the level of prices in the economy.

Liability is anything that is owed. For banks, this includes customers' deposits. For the Fed, this includes bank reserves and currency in circulation.

Liquidity is a measure of the ability to turn an asset quickly into cash, without significant penalty.

Monetary policy is the Fed's strategy to vary the quantity or the price of reserves furnished to the banking system to achieve its mandate of price stability, moderate long-term interest rates and maximum employment.

Money is anything generally accepted in payment for goods and services.

Money supply is, in general, the amount of currency, coins and checking account deposits available in the economy.

Open market operations are the transactions in government securities in the conduct of monetary policy.

Payments services are check processing and electronic fund transfers provided by the Federal Reserve Banks.

Reserves are funds held by depository institutions as cash in their vaults or as deposits with their regional Reserve Bank.

Reserve requirement is the minimum percentage of deposits that the Fed requires banks to hold as cash in their vaults or on deposit at the Fed.

Settlement occurs by debiting the accounts of depository institutions making payments and simultaneously crediting the accounts of depository institutions receiving payments.

State member bank is a state chartered bank that is a member of the Federal Reserve System. State member banks are regulated by the Fed.

Treasury Direct is the system through which the Federal Reserve services securities on behalf of the U.S. Treasury.

Treasury securities are interest-bearing debt obligations (e.g. Treasury Notes and Treasury Bonds) issued by the U.S. Treasury in order to finance the federal debt.

