Purpose

The Three Key System Entities

The Board of Governors, the Federal Reserve Banks, and the Federal Open Market Committee work together to promote the health of the U.S. economy and the stability of the U.S. financial system.

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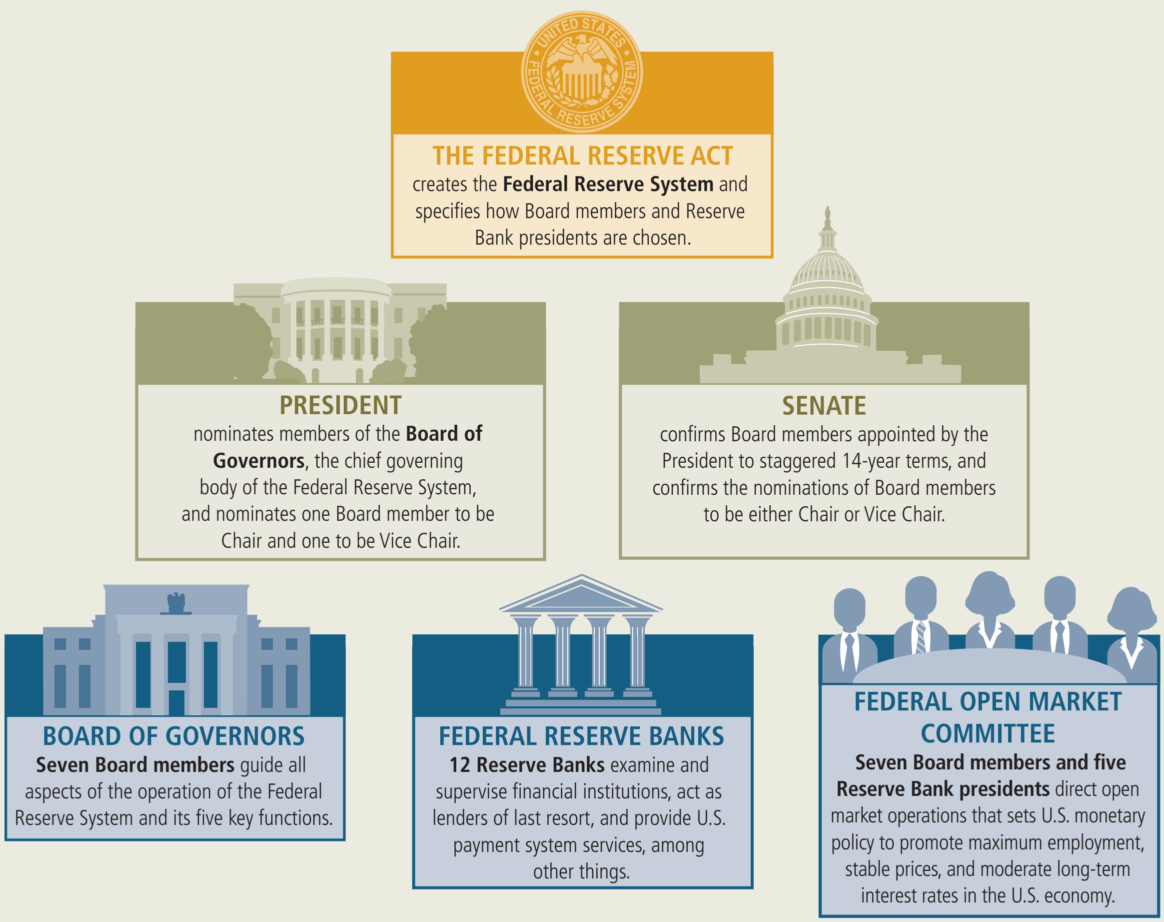
Three key Federal Reserve entities—the Federal Reserve Board of Governors (Board of Governors), the Federal Reserve Banks (Reserve Banks), and the Federal Open Market Committee (FOMC)—make decisions that help promote the health of the U.S. economy and the stability of the U.S. financial system.

Figure 2.1. How the Federal Reserve operates within the U.S. government framework

A statutory framework established by the U.S. Congress guides the operation of the Federal Reserve System.



The Federal Reserve Board: Selection and Function

The Board of Governors—located in Washington, D.C.—is the governing body of the Federal Reserve System. It is run by seven members, or "governors," who are nominated by the President of the United States and confirmed in their positions by the U.S. Senate. The Board of Governors guides the operation of the Federal Reserve System to promote the goals and fulfill the responsibilities given to the Federal Reserve by the Federal Reserve Act.

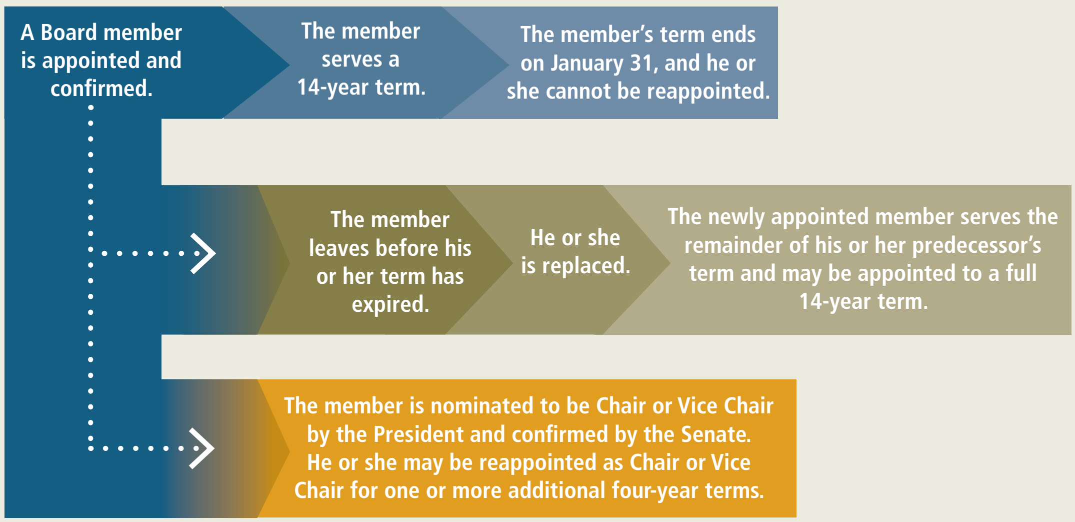
All of the members of the Board serve on the FOMC, which is the body within the Federal Reserve that sets monetary policy (see "The Federal Open Market Committee: Selection and Function" on page 15). Each member of the Board of Governors is appointed for a 14-year term; the terms are staggered so that one term expires on January 31 of each even-numbered year. After serving a full 14-year term, a Board member may not be reappointed. If a Board member leaves the Board before his or her term expires, however, the person nominated and confirmed to serve the remainder of the term may later be appointed to a full 14-year term (figure 2.2).

The Chair and Vice Chair of the Board are also appointed by the President and confirmed by the Senate, but serve only four-year terms. They may be reappointed to additional four-year terms. The nominees to these posts must already be members of the Board or must be simultaneously appointed to the Board.

The Board oversees the operations of the 12 Reserve Banks and shares with them the responsibility for supervising and regulating certain financial institutions and activities (see section 5, "Supervising and Regulating Financial Institutions and Activities," on page 72). The Board also provides general guidance, direction, and oversight when the Reserve Banks lend to depository institutions and when the Reserve

Figure 2.2. Serving on the Board of Governors

The Federal Reserve's governors serve staggered 14-year terms and may not be reappointed; all governors—including the Chair and Vice Chair—are appointed by the President and confirmed by the Senate.



Banks provide financial services to depository institutions and the federal government. The Board also has broad oversight responsibility for the operations and activities of the Federal Reserve Banks (see section 6, "Fostering Payment and Settlement System Safety and Efficiency," on page 118). This authority includes oversight of the Reserve Banks' services to depository institutions, and to the U.S. Treasury, and of the Reserve Banks' examination and supervision of various financial institutions. As part of this oversight, the Board reviews and approves the budgets of each of the Reserve Banks.

The Board also helps to ensure that the voices and concerns of consumers and communities are heard at the central bank by conducting consumer-focused supervision, research, and policy analysis, and, more generally, by promoting a fair and transparent consumer financial services market (see section 7, "Promoting Consumer Protection and Community Development," on page 152).

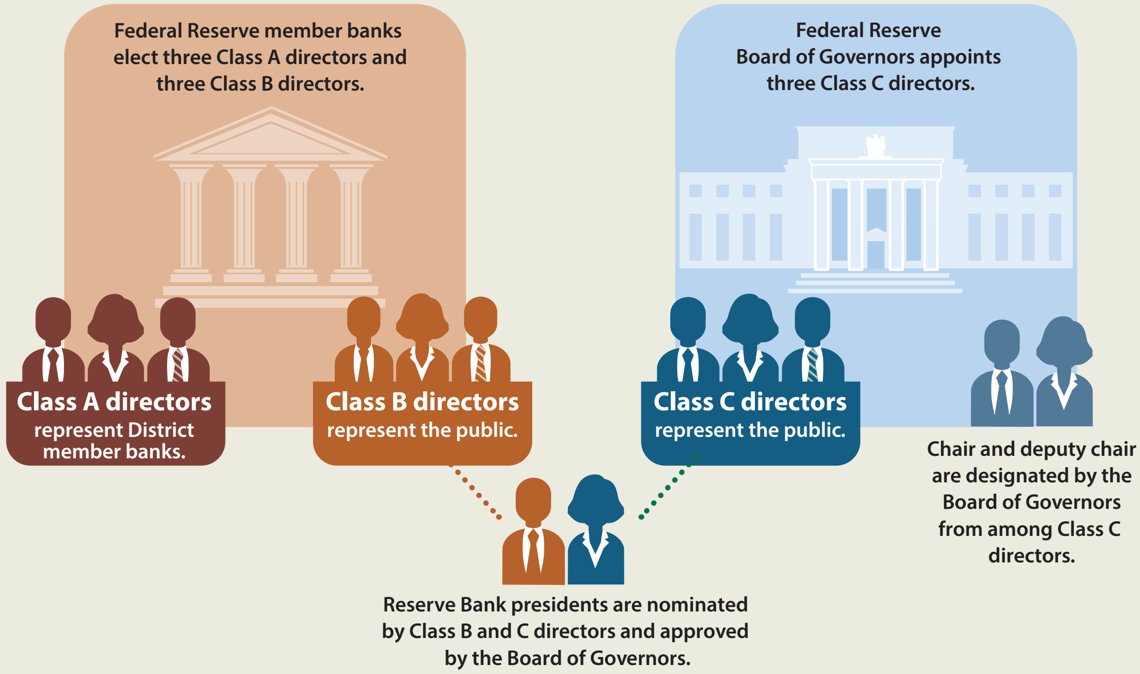
The Federal Reserve Banks: Structure and Function

The 12 Federal Reserve Banks and their 24 Branches are the operating arms of the Federal Reserve System. Each Reserve Bank operates within its own particular geographic area, or district, of the United States.

Each Reserve Bank gathers data and other information about the businesses and the needs of local communities in its region. That information is then factored into monetary policy decisions by the FOMC and other decisions made by the Board of Governors.

Figure 2.3. Composition of Federal Reserve Bank boards of directors and selection of Reserve Bank presidents

The boards of directors of the Reserve Banks represent a cross-section of banking, commercial, agricultural, and industrial interests. Six of the nine members of each board of directors are chosen to represent the public interest; those six board directors nominate their Bank's president.



Reserve Bank Leadership

Want to learn more about Reserve Bank directors?

Reserve Bank and Branch directors play a number of roles at their Banks. To learn more about director responsibilities and requirements, see *Roles and Responsibilities of Federal Reserve Directors* in the About the Fed section of the Board's website, www.federalreserve.gov/aboutthefed/directors/about.htm.

As set forth in the Federal Reserve Act, each Reserve Bank is subject to "the supervision and control of a board of directors." Much like the boards of directors of private corporations, Reserve Bank boards are responsible for overseeing their Bank's administration and governance, reviewing the Bank's budget and overall performance, overseeing the Bank's audit process, and developing broad strategic goals and directions. However, unlike private corporations, Reserve Banks are not operated in the interest of shareholders, but rather in the public interest.

Each year, the Board of Governors designates one chair and one deputy chair for each Reserve Bank board from among its Class C directors. The Federal Reserve Act requires that the chair of a Reserve Bank's board be a person of "tested banking experience," a term which has been interpreted as requiring familiarity with banking or financial services.

Each Reserve Bank board delegates responsibility for day-to-day operations to the president of that Reserve Bank and his or her staff. Reserve Bank presidents act as chief executive officers of their respective Banks and also serve, in rotation, as voting members of the FOMC. Presidents are nominated by a Bank's Class B and C directors and approved by the Board of Governors for five-year terms.

Reserve Bank Branches also have boards of directors. Pursuant to policy established by the Board of Governors, Branch boards must have either five or seven members. All Branch directors are appointed: the majority of directors on a Branch board are appointed by the Reserve Bank, and the remaining directors on the board are appointed by the Board of Governors. Each Branch board selects a chair from among those directors appointed by the Board of Governors. Unlike Reserve Bank directors, Branch directors are not divided into different classes. However, Branch directors must meet different eligibility requirements, depending on whether they are appointed by the Reserve Bank or the Board of Governors.

Reserve Bank and Branch directors are elected or appointed for staggered three-year terms. When a director does not serve a full term, his or her successor is elected or appointed to serve the unexpired portion of that term.

Reserve Bank Responsibilities

The Reserve Banks carry out Federal Reserve core functions by

1. **supervising and examining state member banks** (state-chartered banks that have chosen to become members of the Federal Reserve System), bank and thrift holding companies, and nonbank financial institutions that have been designated as systemically important under authority delegated to them by the Board;
2. **lending to depository institutions** to ensure liquidity in the financial system;
3. **providing key financial services** that undergird the nation's payment system, including distributing the nation's currency and coin to depository institutions, clearing checks, operating the FedWire and automated clearinghouse (ACH) systems, and serving as a bank for the U.S. Treasury; and
4. **examining certain financial institutions** to ensure and enforce compliance with federal consumer protection and fair lending laws, while also promoting local community development.

In its role providing key financial services, the Reserve Bank acts, essentially, as a financial institution for the banks, thrifts, and credit unions in its District—that is, each Reserve Bank acts as a "bank for banks." In that capacity, it offers (and charges for) services to these depository institutions similar to those that ordinary banks provide their individual and business customers: the equivalent of checking accounts; loans; coin and currency; safekeeping services; and payment services (such as the processing of checks and the making of recurring and nonrecurring small- and large-dollar payments) that help banks, and ultimately their customers, buy and sell goods, services, and securities.

In addition, through their leaders and their connections to, and interactions with, members of their local communities, Federal Reserve Banks provide the Federal Reserve System with a wealth of information on conditions in virtually every part of the nation—information that is vital to formulating a national monetary policy that will help to maintain the health of the economy and the stability of the nation's financial system.

Certain information gathered by the Reserve Banks from Reserve Bank directors and other sources is also shared with the public prior to each FOMC meeting in a report commonly known as the Beige Book. In addition, every two weeks, the board of each Reserve Bank recommends discount rates (interest rates to be charged for loans to depository institutions made through that Bank's discount window); these interest rate recommendations are subject to review and determination by the Board of Governors.

The Federal Open Market Committee: Selection and Function

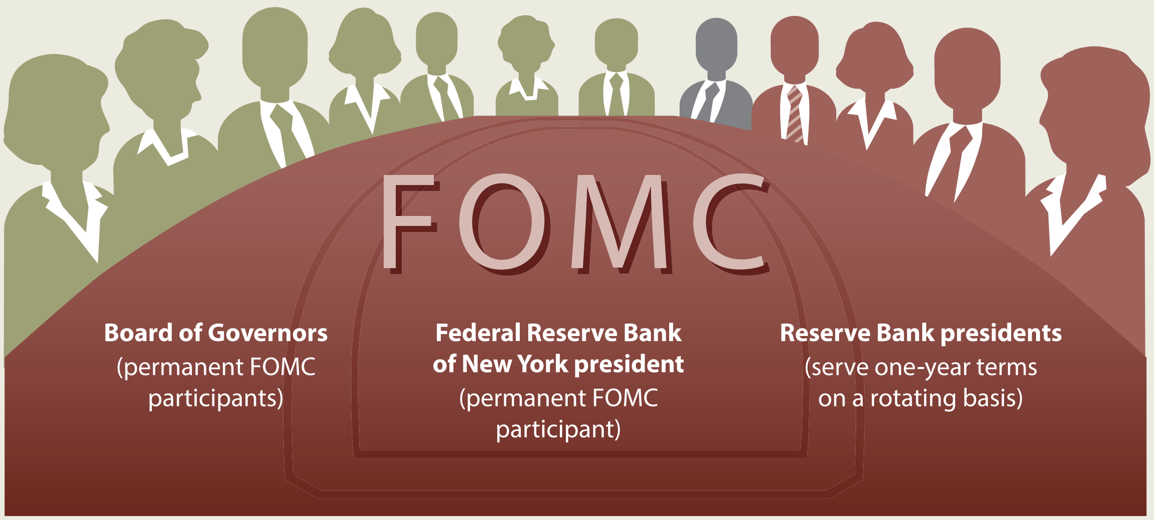
The FOMC is the body of the Federal Reserve System that sets national monetary policy (figure 2.4). The FOMC makes all decisions regarding the conduct of open market operations, which affect the federal funds rate (the rate at which depository institutions lend to each other), the size and composition of the Federal Reserve's asset holdings, and communications with the public about the likely future course of monetary policy. Congress enacted legislation that created the FOMC as part of the Federal Reserve System in 1933 and 1935.

FOMC Membership

The FOMC consists of 12 voting members—the 7 members of the Board of Governors; the president of the Federal Reserve Bank of New York; and 4 of the remaining 11 Reserve Bank presidents, who serve one-year terms on a rotating basis.

Figure 2.4. Composition of the Federal Open Market Committee

The Federal Open Market Committee's (FOMC) structure promotes the consideration of broad U.S. economic perspectives and the public interest in key monetary policy decisions made by the U.S. central bank.



All 12 of the Reserve Bank presidents attend FOMC meetings and participate in FOMC discussions, but only the presidents who are Committee members at the time may vote on policy decisions.

By law, the FOMC determines its own internal organization and, by tradition, the FOMC elects the Chair of the Board of Governors as its chair and the president of the Federal Reserve Bank of New York as its vice chair. FOMC meetings are typically held eight times each year in Washington, D.C., and at other times as needed.

Want to learn more about the FOMC?

For more information about the FOMC, visit the About the Fed section of the Board's website, www.federalreserve.gov/aboutthefed/structure-federal-open-market-committee.htm.

FOMC Responsibilities

The FOMC is charged with overseeing "open market operations," the principal tool by which the Federal Reserve executes U.S. monetary policy. These operations affect the federal funds rate, which in turn influence overall monetary and credit conditions, aggregate demand, and the entire economy (see section 3, "Conducting Monetary Policy," on page 20). The FOMC also directs operations undertaken by the Federal Reserve in foreign exchange markets and, in recent years, has authorized currency swap programs with foreign central banks.

Other Significant Entities Contributing to Federal Reserve Functions

Two other groups play important roles in the Federal Reserve System's core functions: (1) depository institutions—banks, thrifts, and credit unions; and (2) Federal Reserve System advisory committees, which make recommendations to the Board of Governors and to the Reserve Banks regarding the System's responsibilities.

Depository Institutions

Depository institutions offer transaction, or checking, accounts to the public and may maintain accounts of their own at their local Federal Reserve Banks. Depository institutions are required to meet reserve requirements—that is, to keep a certain amount of cash on hand or in an account at a Reserve Bank based on the total balances in the checking accounts they hold.

Depository institutions that have higher balances in their Reserve Bank accounts than they need to meet reserve requirements may lend to other depository institutions that need those funds to satisfy their own reserve requirements. This rate influences interest rates, asset prices and wealth, exchange rates, and, thereby, aggregate demand in the economy. The FOMC sets a target for the federal funds rate at its meetings and authorizes actions called open market operations to achieve that target (see section 3, "Conducting Monetary Policy," on page 20 for more information about the conduct of monetary policy).

Advisory Councils

Four advisory committees assist and advise the Board on matters of public policy.

1. **Federal Advisory Council (FAC).** This council, established by the Federal Reserve Act, comprises 12 representatives of the banking industry. The FAC ordinarily meets with the Board four times a year, as required by law. Annually, each Reserve Bank chooses one person to represent its District on the FAC. FAC members customarily serve three one-year terms and elect their own officers.
2. **Community Depository Institutions Advisory Council (CDIAC).** The CDIAC was originally established by the Board of Governors to obtain information and views from thrift institutions (savings and loan institutions and mutual savings banks) and credit unions. More recently, its membership has expanded to include community banks. Like the FAC, the CDIAC provides the Board of Governors with firsthand insight and information about the economy, lending conditions, and other issues.
3. **Model Validation Council.** This council was established by the Board of Governors in 2012 to provide expert and independent advice on its process to rigorously assess the models used in stress tests of banking institutions. Stress tests are required under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The council is intended to improve the quality of stress tests and thereby strengthen confidence in the stress-testing program. (For more information about stress tests, see "Capital Planning, Stress Testing, and Capital Distributions" on page 112.)
4. **Community Advisory Council (CAC).** This council was formed by the Federal Reserve Board in 2015 to offer diverse perspectives on the economic circumstances and financial services needs of consumers and communities, with a particular focus on the concerns of low- and moderate-income populations. The CAC complements the FAC and CDIAC, whose members represent depository institutions.

More on Federal Reserve Advisory Councils

For a current roster of Federal Reserve advisory council members, visit the About the Fed section of the Federal Reserve Board public website at www.federalreserve.gov/aboutthefed/advisorydefault.htm.

The CAC meets semiannually with members of the Board of Governors. The 15 CAC members serve staggered three-year terms and are selected by the Board through a public nomination process.

Federal Reserve Banks also have their own advisory committees. Perhaps the most important of these are committees that advise the Banks on agricultural, small business, and labor matters. The Federal Reserve Board solicits the views of each of these committees biannually.