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An Expanded Role For The Federal Reserve Bank

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ABSTRACT

On June 17, 2009 the Obama Administration released an 85-page white paper on federal regulatory reform. The corner stone of the proposed plan is an expanded role for the Federal Reserve Bank. The Federal Reserve Bank is an independent private bank created by Congress in 1913. This paper will present a critical review of the proposed expanded powers for the Federal Reserve Bank.

Keywords: Expanded Role Federal Reserve

1 INTRODUCTION

The Federal Reserve Bank is the Central Bank of the United States. It was founded by Congress in 1913 to provide the nation with a safer, more flexible and more stable monetary and financial system."1

Presently, the Federal Reserve duties fall into four general areas. Firstly, the Federal Reserve is responsible for monetary policy. It is mandated with influencing the monetary and credit conditions in the United States in pursuit of maximum employment, stable prices and moderate long-term interest rates. Secondly, the Federal Reserve is mandated with supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers. Thirdly, the Federal Reserve is mandated with maintaining the stability of the financial system and containing systematic risk that may arise in the financial markets. Fourthly, the Federal Reserve is mandated with providing financial services to depository institutions, the U.S. government and foreign official institutions, including playing a major role in operating the nation's payments systems.2

The Federal Reserve is an independent central bank, as its decisions do not have to be ratified by the President or anyone else in the executive branch of government. The Federal Reserve is subject to oversight by Congress. "The Federal Reserve must work within the framework of the overall objectives of the economic and financial policy established by the government" 3

The Federal Reserve is a profit making institution. However, after it pays its expenses it turns the rest of its earnings over to the Treasury. "About 95 percent of the Federal Reserve Banks' net earnings have been paid into the Treasury since the Federal Reserve began operations in 1914. In 2003, the Federal Reserve paid approximately $22 billion to the Treasury."4

The Board of Governors of the Federal Reserve contracts with an accounting firm each year to conduct an audit. The results of the audit are disclosed in an annual report. Additionally, the Government Accounting Office audits certain functions of the Federal Reserve. However, certain functions such as transactions with foreign central banks and open market operations are excluded from the Government Accounting Office's audit. 5

The Board of Governors of the Federal Reserve System supervises and regulates the operations of the Federal Reserve Bank, exercises broad responsibility in the nation's payments system and administers most of the nation's laws regarding consumer credit protection. The Board of Governors has sole authority over changes in reserve requirements and it must approve any changes in the discount rate initiated by a Federal Reserve Bank. 6

The Board is composed of seven members who are appointed by the President and confirmed by the Senate. The full term of a Board member is 14 years. The Chairman and Vice Chairman of the Board are also appointed by the President and confirmed by the Senate. The terms for these positions are four years.7

Members of the Board are in frequent contact with other policymakers in government. They are frequently called to testify in Congressional hearings. On or about each February and July 20th the Chairman of the Board of Governors testifies before the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services. "The Chairman's testimony addresses the efforts, activities, objectives and plans of the Board of Governors . . .with respect to the conduct of monetary policy as well as economic developments in the United States and prospects for the future." 8

2 PROPOSED CHANGES TO THE FEDERAL RESERVE BANK

On June 17, 2009, the Obama Administration released an 85-page white paper summarizing the administration's recommendations for financial regulatory reform. President Obama stated, "We must act now to restore confidence in the integrity of our financial system. The lasting economic damage to ordinary families and businesses is a constant reminder of the urgent need to act to reform our financial regulatory system and put our economy on track to a sustainable recovery. We must build a new foundation for financial regulation that is simpler and more effectively enforced, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market."9

The corner stone of the Obama administrations plan is an expanded role for the Federal Reserve Bank. "We propose . . . new authority for the Federal Reserve to supervise all firms that could pose a threat to financial stability, even those that do not own banks." 10 "We propose an evolution in the Federal Reserve's current supervisory authority for BHCs (Bank Holding Companies), to create a single point of accountability for the consolidated supervision of all companies that own a bank. **All large, interconnected firms whose failure could threaten the stability of the system should be subject to the consolidated supervision by the Federal Reserve, regardless of whether they own an insured depositary institution.** These firms should not be able to escape oversight of their risky activities by manipulating their legal structure."11

The Federal Reserve under the Obama plan would be given supervisory responsibility over large 'to big to fail', firms, regardless of whether they are in the banking industry or not. This is a huge expansion of the Federal Reserve's original mandate.

While the Obama administration's recommendation for financial regulatory reform expands the role of the Federal Reserve, it also limits and removes some of its present responsibilities. The proposal recommends the creation of the Financial Services Oversight Council. This council chaired by the Treasury, would . . . "help fill in gaps in supervision, facilitate coordination of policy and resolution of disputes and identify emerging risks in firms and market activities."12 Although, the administration states that the Federal Reserve will have the final say. This council overlaps with the Federal Reserve's existing broad authorities to intervene to prevent crises that could seriously hurt the markets and economy.

The administration also proposes the creation of a "Consumer Financial Protection Agency with the authority and accountability to make sure the consumer protection regulations are written fairly and enforced vigorously"13 Consumer protection laws and regulations are currently the province of the Federal Reserve. This new agency would remove one of the Federal Reserve's most important and visible responsibilities.

3 INITIAL REACTIONS TO PROPOSED CHANGES TO THE RESPONSIBILITIES OF THE FEDERAL RESERVE BANK

"One Federal Reserve to Rule Them All", "Federal Reserve to Gain Power Under Plan", Obama Takes on the Federal Reserve", are a few headlines which blazed across the business periodicals in the days and weeks following the release of the Administration's financial proposals.

Republican Senator Richard Shelby believes the reforms may overload the Federal Reserve Bank. He stated "I don't think we can expect the Fed or any other agency to play so many roles".14 Sheila Bair, Head of the Federal Deposit Insurance Company, criticized the Federal Reserve's proposed expanded powers. She commented, "There's a legitimate policy issue about what you want the appropriate separation of powers, the checks and balances to be." 15

Kevin Logan, senior US economist at Dresdner Kleinwort, summarized many economists fear of the expanded power of the Federal Reserve into the non-banking sector. He stated, "The suggestion that the retailer Target might have to become a bank holding company, governed by the same rules and searing degree of oversight as JP Morgan Chase, might seem laughable, but it is true. Target has a subsidiary that is classed as an 'industrial loan company', offering credit to customers who cannot afford to – or simply don't want to pay in full for their purchases at check-out."16 Others have commented that it does not make sense to give the Federal Reserve more power as they did not exercise their current power effectively in averting the current financial meltdown. Senator Jim Bunning of Kentucky said, " . . .if the Fed and other regulators had been doing their jobs and paying attention to what the banks and other firms were doing earlier this decade, they almost certainly could have prevented this mess. What makes you think the Fed will do better this time around."17

Peter Teuten, President of Keane Business Risk Management Services, thinks that the proposed plan has the role of the Federal Reserve about right. Mr. Teuten commented, "I think that the conception of the expansion is . . .essentially speaking much needed. There has to be central oversight and it may as well be the Fed as anybody else. They have the technical expertise. They generally have a much broader understanding of systematic risk. There is no addressing systematic risk thus far and that has to change."18

4 CONCLUSION

President Barak Obama has fired up the debate on financial regulatory reform. His administration's white paper leaves much of the current regulatory framework in place while dramatically expanding the role of the Federal Reserve, the Private bank whose functions are largely misunderstood by the public. On one side commentators and legislators support the Federal Reserve's expanded role and on the other side it is feared. Despite the disagreement over the proper remedy for the financial regulatory structure, there is one point that both sides agree on- failure is not an option. Perhaps Senator Mark Warner of West Virginia summarized this sentiment the best when he commented, "If we mess this up, the unintended consequences for not only our economic recovery but the overall long-term financial stability for the world is really at stake."19

AUTHOR INFORMATION

Corinne Crawford, MBA, CPA is an Assistant Accounting Professor at Borough of Manhattan Community College, CUNY, New York, New York. She spent 15 years in public accounting, Pricewaterhousecoopers and KPMG, before switching careers to teach full-time. Professor Crawford has been teaching at Borough of Manhattan Community College since 2009. Prior to teaching at BMCC, she was an accounting professor and coordinator of the Accounting Department at Marymount Manhattan College. Professor Crawford has published several articles in the CPA Journal.

END NOTES

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