Appendix A

Mission and Operational Areas of the Federal Reserve System

The Federal Reserve Banks and the Board of Governors have established four major operational areas to account for their activities: monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, and services to the U.S. Treasury and other government agencies.[1] This appendix describes each of these areas in detail.

Monetary and Economic Policy

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through its ability to influence money and credit in the economy. The System has several tools to affect the availability and cost of the nation's money and credit: setting reserve requirements; setting the discount rate (which affects the cost of borrowing); and the primary tool of monetary policy, open market operations.

The seven-member Board of Governors sets reserve requirements, and it acts on requests from the Federal Reserve Banks to adjust the discount rate. The Federal Open Market Committee (FOMC) meets in Washington eight times per year, usually twice each business quarter, to set policies for System open market operations; it comprises the Board, the President of the Federal Reserve Bank of New York, and, on a rotating basis, the presidents of four other Reserve Banks.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public in weekly and monthly statistical releases in such areas as the monetary aggregates, interest rates, bank credit, and exchange rates. The research staffs at the Board and the Reserve Banks use this information, along with data collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background for the Board and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. In addition, they conduct longer-run economic studies of issues at the regional, national, and international levels.

Supervision and Regulation

Under the authority of the Federal Reserve Act and the Bank Holding Company Act, the Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. Under the Bank Holding Company Act, the Board is responsible for assuring that all activities of bank holding companies are "closely related to banking and a proper incident thereto." The Board of Governors adopts regulations to carry out statutory directives and

1. Services to the U.S. Treasury and other government agencies is an operational area unique to the Federal Reserve Banks. The fourth operational area for the Board of Governors, System policy direction and oversight, provides resources for the supervision of Board and Bank programs and is discussed in chap. 2.

establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies; review applications for mergers, acquisitions, and changes in control from banks and bank holding companies; and take formal supervisory actions. The System makes available to the public nonidentifying information it periodically collects on the condition and income of banks and bank holding companies.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

In January the Board issued risk-based capital guidelines for state member banks and bank holding companies. The Basle Committee on Banking Regulations and Supervisory Practices, supervisory authorities from twelve major industrial countries, built the framework for the Board's requirements. The guidelines make regulatory capital requirements more sensitive to the risk profiles of banking organizations; take off-balance-sheet exposures into explicit account in assessing capital adequacy; and minimize disincentives to holding liquid, low-risk assets. The work of the Basle Committee acknowledges the growing internationalization of major banking and financial markets. The harmonization and strengthening of capital standards worldwide should contribute to a more stable and resilient international banking system and help mitigate the competitive inequality for international banks stemming from differences in national supervisory requirements.

During 1989 the System maintained the intensified supervision program for state member banks and bank holding companies that was implemented two years ago as a result of the increase in the number of bank failures and problem banks. In 1989 the Board and the Reserve Banks examined approximately 870 state member banks, inspected approximately 2,700 bank holding companies and their subsidiaries, and reviewed approximately 2,257 international and domestic applications. The System also examined 50 distressed savings and loan associations early in the year.

The Board enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1989 the System conducted examinations for such compliance at about 640 banks.

The Board's supervisory responsibilities also extend to foreign operations of U.S. banks and, under the International Banking Act, to U.S. operations of foreign banks.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which consists of many independent systems designed to move funds among financial institutions across the country. The Federal Reserve distributes currency and coin, processes checks for collection, operates electronic funds transfer networks, and provides for transfers of securities and for coupon collection.

Ensuring that the supply of currency and coin meets the public's demand for cash is the responsibility of the Federal Reserve. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions. The Banks use highly sophisticated equip-

ment to count cash, identify counterfeits, and destroy currency that is unfit for circulation. In 1989 the Reserve Banks paid out $254.4 billion in currency and $4.8 billion in coin and destroyed $59.8 billion of unfit currency.

The Reserve Banks collect and clear checks under the specific authority of the Federal Reserve Act of 1913. The Banks, Branches, and regional check-processing centers currently clear approximately 16 billion checks each year with an average daily value of more than $42 billion. Most checks deposited with the Federal Reserve by financial institutions are collected on the day they are deposited or on the next business day.

The Federal Reserve also plays a central role in the nation's payments mechanism through its electronic wire transfer system, Fedwire. Depository institutions can draw on their reserves or clearing accounts at the Reserve Banks through Fedwire and transfer funds anywhere in the country within minutes. Approximately 6,377 depository institutions use Fedwire through direct computer connections with Federal Reserve Banks, and another 4,193 institutions use Fedwire through off-line means such as telephone and telex. During 1989, approximately 59 million transfers valued at about $181 trillion were sent over Fedwire, an average of $3.1 million per transfer and $722 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing-account balances. Users of this net settlement service include local check clearinghouse associations, credit card processors, automated teller machine networks, and national and regional funds transfer networks. In 1989, approximately 767,000 net settlement entries were processed by the Reserve Banks.

Approximately 33,390 offices of depository institutions use the Federal Reserve's automated clearinghouse (ACH), which makes recurring payments electronically instead of by check. The depository institutions use the ACH for credit transactions, primarily to pay salaries and pensions, and for debit transactions such as preauthorized bill payments. Of the approximately 16,600 institutions receiving ACH transactions, 4,047 have electronic connections with the Federal Reserve; the others receive payment data via machine-readable magnetic tapes or paper registers. In 1989 the Reserve Banks processed more than 1.1 billion ACH transactions valued at about $5.1 trillion; one-third of the transactions were for the federal government, and the rest were commercial.

The securities services provided by the Reserve Banks cover the handling of book-entry securities and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of government agency securities to transfer them to other institutions throughout the country. The Reserve Banks maintained approximately 28,341 book-entry accounts in 1989 and processed approximately 10.9 million securities transfers.

In the definitive securities service, the Banks store physical securities ineligible for maintenance on the book-entry system. The Federal Reserve held approximately $22.3 billion of such securities at the end of 1989.

In its noncash collection service, the Federal Reserve processes coupons, bonds, and miscellaneous items such as bankers acceptances and certain checks and drafts. Coupon collection, which accounts for approximately 95 percent of the transactions in this service, amounted to about 3.4 million coupon envelopes in

1988 and 3.3 million coupon envelopes in 1989.

Services to the U.S. Treasury and Other Government Agencies

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Federal Reserve Banks, the government issues its checks and payments and collects its receipts. The Reserve Banks also process wire transfers of funds and automated clearinghouse payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Federal Reserve Banks provide several unique services to the government. They monitor the tax receipts deposited in the 14,670 tax and loan accounts maintained by depository institutions designated by the Treasury to perform this function, they hold the collateral that those institutions pledge to support those deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all Treasury savings bonds and retirement plan bonds. In another unique fiscal service, the Reserve Banks redeem food coupons for the Department of Agriculture and destroy them. ■

Appendix A

Mission and Operational Areas of the Federal Reserve System

The Federal Reserve Banks and the Board of Governors have established four major operational areas to account for their activities: monetary and economic policy, supervision and regulation of financial institutions, services to financial institutions and the public, and services to the U.S. Treasury and other government agencies.[1] This appendix describes each of these areas in detail.

Monetary and Economic Policy

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through its ability to influence money and credit in the economy. The System has several tools to affect the availability and cost of the nation's money and credit: setting reserve requirements; setting the discount rate (which affects the cost of borrowing); and the primary tool of monetary policy, open market operations.

The seven-member Board of Governors sets reserve requirements, and it acts on requests from the Federal Reserve Banks to adjust the discount rate. The Federal Open Market Committee (FOMC) meets in Washington eight times per year, usually twice each business quarter, to set policies for System open market operations; it comprises the Board, the President of the Federal Reserve Bank of New York, and, on a rotating basis, the presidents of four other Reserve Banks.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public in weekly and monthly statistical releases in such areas as the monetary aggregates, interest rates, bank credit, and exchange rates. The research staffs at the Board and the Reserve Banks use this information, along with data collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background for the Board and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. In addition, they conduct longer-run economic studies of issues at the regional, national, and international levels.

Services to the U.S. Treasury and Other Government Agencies

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Federal Reserve Banks, the government issues its checks and payments and collects its receipts. The Reserve Banks also process wire transfers of funds and automated clearinghouse payments and give the Treasury daily statements of account activity.

Beyond these typical depository activities, the Federal Reserve Banks provide

1. Services to the U.S. Treasury and other government agencies is an operational area unique to the Federal Reserve Banks. The fourth operational area for the Board of Governors, System policy direction and oversight, provides resources for the supervision of Board and Bank programs and is discussed in chap. 2.

several unique services to the government. They monitor the tax receipts deposited in the 12,833 tax and loan accounts maintained by depository institutions designated to perform this function, they hold the collateral that those institutions pledge to support those and other government deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all U.S. savings and retirement plan bonds. In another unique fiscal service, the Reserve Banks redeem food coupons for the Department of Agriculture and destroy them.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which consists of many independent systems designed to move funds among financial institutions across the country. The Federal Reserve distributes currency and coin, processes checks for collection, operates electronic funds transfer networks, and provides for transfers of securities and for coupon collection.

Ensuring that the supply of currency and coin meets the public's demand for cash is the responsibility of the Federal Reserve. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions. The Banks use highly sophisticated equipment to count cash, identify counterfeits, and destroy currency that is unfit for circulation. In 1990 the Reserve Banks paid out $277.8 billion in currency and $4.4 billion in coin and destroyed $65.9 billion of unfit currency.

The Reserve Banks collect and clear checks under the specific authority of the Federal Reserve Act of 1913. The Banks, Branches, and regional check-processing centers currently clear approximately 18.5 billion checks each year with an average daily value of more than $50 billion. Most checks deposited with the Federal Reserve by financial institutions are collected on the day they are deposited or on the next business day.

The Federal Reserve also plays a central role in the nation's payments mechanism through its wire transfer system, Fedwire. Depository institutions can draw on their reserves or clearing accounts at the Reserve Banks through Fedwire and transfer funds anywhere in the country. Approximately 6,653 depository institutions use Fedwire through direct computer connections with Federal Reserve Banks, and another 4,696 institutions use Fedwire through off-line means such as telephone. During 1990, approximately 64 million transfers valued at about $199 trillion were sent over Fedwire, an average of $3.1 million per transfer and $793 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing-account balances. Users of net settlement service include local check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds and securities transfer networks. In 1990, approximately 850,000 net settlement entries were processed by the Reserve Banks.

Approximately 29,700 depository institutions participate in the Federal Reserve's ACH service, which makes one-time and recurring payments electronically instead of by check. The depository institutions use the ACH for credit transactions, primarily to pay

salaries and pensions, and for debit transactions such as preauthorized bill payments and cash concentration debits. Of the approximately 12,300 ACH endpoints, 2,600 have electronic connections with the Federal Reserve; the others receive payment data via magnetic tapes or paper registers. In 1990 the Reserve Banks processed more than 1.3 billion ACH transactions valued at about $4.3 trillion; thirty-seven percent of the transactions were for the federal government, and the rest were commercial.

The securities services provided by the Reserve Banks cover the handling of book-entry securities and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of government agency securities to transfer them electronically to other institutions throughout the country. The Reserve Banks maintained approximately 15,600 book-entry accounts in 1990 and processed approximately 10.9 million securities transfers.

In the definitive securities service, the Banks store physical securities ineligible for maintenance on the Federal Reserve's book-entry system. The Federal Reserve held about $18.4 billion of such securities in priced accounts at the end of 1990.

In its noncash collection service, the Federal Reserve presents coupons, bonds, and miscellaneous items, such as bankers acceptances and certain checks and drafts, for collection. Coupon collection, which accounts for approximately 98 percent of the transactions in this service, amounted to 3.2 million coupon envelopes in 1989 and about 2.9 million coupon envelopes in 1990.

Supervision and Regulation

Under the authority of the Federal Reserve Act and the Bank Holding Company Act, the Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. Under the Bank Holding Company Act, the Board is responsible for ensuring that all activities of bank holding companies are "closely related to banking and a proper incident thereto." The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies; review applications for mergers, acquisitions, and changes in control from banks and bank holding companies; and take formal supervisory actions. The System makes available to the public nonidentifying information it periodically collects on the condition and income of banks and bank holding companies.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

During 1990 the System maintained the intensified supervision program for state member banks and bank holding companies that was implemented five years ago as a result of the increase in the number of bank failures and problem banks. In 1990 the Board and the Reserve Banks examined approximately 764 state member banks, inspected approximately 2,173 bank holding companies and their subsidiaries, and reviewed approximately 2,676 international and domestic applications.

The Board enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1990 the System con-

ducted approximately 550 compliance examinations.

The Board's supervisory responsibilities also extend to foreign operations of U.S. banks and, under the International Banking Act, to U.S. operations of foreign banks. ■

Appendix A

Mission and Operational Areas of the Federal Reserve System

The Federal Reserve Banks and the Board of Governors have established four major operational areas to account for their activities: monetary and economic policy, services to the U.S. Treasury and other government agencies, services to financial institutions and the public, and supervision and regulation of financial institutions.[1] This appendix describes each of these areas in detail.

Monetary and Economic Policy

The Federal Reserve contributes to the attainment of the nation's economic and financial goals through actions to influence money and credit in the economy. The System has several tools to affect the availability and cost of the nation's money and credit: setting reserve requirements; setting the discount rate (which affects the cost of borrowing); and open market operations, the primary tool of monetary policy.

The seven-member Board of Governors sets reserve requirements and acts on requests from the Federal Reserve Banks to adjust the discount rate. The Federal Open Market Committee (FOMC) meets in Washington eight times a year, usually twice each business quarter, to set policies for System open market operations; it comprises the Board, the president of the Federal Reserve Bank of New York, and, on a rotating basis, the presidents of four other Reserve Banks.

A vast amount of banking and financial data flows through the Reserve Banks to the Board, where it is compiled and made available to the public in weekly and monthly statistical releases on such topics as the monetary aggregates, interest rates, bank credit, and exchange rates. The research staffs at the Board and the Reserve Banks use this information, along with data collected by other public and private institutions, to assess the state of the economy and the relationships between the financial markets and economic activity. Staff members provide background for the Board and for each meeting of the FOMC by preparing detailed economic and financial analyses and projections for the domestic economy and international markets. In addition, they conduct longer-run economic studies of issues at the regional, national, and international levels.

Services to the U.S. Treasury and Other Government Agencies

The U.S. government uses the Federal Reserve as its bank. Through deposit accounts at the Federal Reserve Banks, the government issues its checks and payments and collects its receipts. The Reserve Banks also process wire transfers of funds and automated clearinghouse payments and give the Treasury daily statements of account activity.

1. Services to the U.S. Treasury and other government agencies is an operational area unique to the Federal Reserve Banks. The fourth operational area for the Board of Governors, System policy direction and oversight, provides resources for the supervision of Board and Bank programs and is discussed in chapter 2.

Beyond these typical depository activities, the Federal Reserve Banks provide several unique services to the government. They monitor the tax receipts deposited in the 13,026 tax and loan accounts maintained by depository institutions designated to perform this function, they hold the collateral that those institutions pledge to support those and other government deposits, and they transfer funds to the Treasury's account at its request. The Reserve Banks assist the Treasury in its financing of the public debt by issuing, servicing, and redeeming all marketable Treasury securities as well as all U.S. savings and retirement plan bonds. In another unique fiscal service, the Reserve Banks redeem food coupons for the U.S. Department of Agriculture and destroy them.

Services to Financial Institutions and the Public

The Federal Reserve System plays a central role in the nation's payments mechanism, which consists of many independent systems designed to move funds among financial institutions across the country. The Federal Reserve distributes currency and coin, processes checks for collection, operates electronic funds transfer networks, and provides for transfers of securities and for coupon collection.

Ensuring that the supply of currency and coin meets the public's demand for cash is the responsibility of the Federal Reserve. The Reserve Banks obtain currency and coin from the Bureau of Engraving and Printing and from the Mint and distribute it to the public through depository institutions. The Banks use highly sophisticated equipment to count cash, identify counterfeits, and destroy currency that is unfit for circulation. In 1991 the Reserve Banks paid out $285.2 billion in currency and $4.8 billion in coin and destroyed $73.8 billion of unfit currency.

The Reserve Banks collect and clear checks under the specific authority of the Federal Reserve Act of 1913. The Banks, Branches, and regional check-processing centers currently clear approximately 18.5 billion checks each year with an average daily value of more than $50 billion. Most checks deposited with the Federal Reserve by financial institutions are collected on the day they are deposited or on the next business day.

The Federal Reserve also plays a central role in the nation's payments mechanism through its wire transfer system, Fedwire. Depository institutions can draw on their reserves or clearing accounts at the Reserve Banks through Fedwire and transfer funds anywhere in the country. Approximately 6,969 depository institutions use Fedwire through direct computer connections with Federal Reserve Banks, and another 4,399 institutions use Fedwire through off-line means such as telephone. In 1991, approximately 64 million transfers valued at about $191 trillion were sent over Fedwire, an average of $3.0 million per transfer and $761 billion per day.

The Federal Reserve allows participants in private clearing arrangements to exchange and settle transactions on a net basis through reserve or clearing-account balances. Users of net settlement services include local check clearinghouse associations, automated clearinghouse (ACH) networks, credit card processors, automated teller machine networks, and national and regional funds and securities transfer networks. In 1991, approximately 770,000 net settlement entries were processed by the Reserve Banks.

Approximately 29,000 depository institutions participate in the Federal Reserve's ACH service, which makes one-time and recurring payments electronically instead of by check. The depository institutions use the ACH service for credit transactions, primarily to pay salaries and pensions, and for debit transactions such as preauthorized bill payments and cash concentration debits. Of the approximately 11,100 ACH endpoints, 3,700 have electronic connections with the Federal Reserve; the others receive payment data via magnetic tapes or paper registers. In 1991 the Reserve Banks processed more than 1.6 billion ACH transactions valued at about $6.7 trillion; 32 percent of the transactions were for the federal government, and the rest were commercial.

The securities services provided by the Reserve Banks cover the handling of book-entry securities and definitive securities and the collection of coupons and miscellaneous items. The book-entry service, begun in 1968, enables holders of government agency securities to transfer them electronically to other institutions throughout the country. The Reserve Banks maintained approximately 14,372 book-entry accounts in 1991 and processed approximately 11.2 million securities transfers.

In the definitive securities service, the Banks store physical securities ineligible for maintenance on the Federal Reserve's book-entry system. The Federal Reserve held about $15.1 billion of such securities in priced accounts at the end of 1991.

In its noncash collection service, the Federal Reserve presents coupons, bonds, and miscellaneous items, such as bankers acceptances and certain checks and drafts, for collection. Coupon collection, which accounts for approximately 98 percent of the transactions in this service, amounted to 2.9 million coupon envelopes in 1990 and about 2.2 million coupon envelopes in 1991.

Supervision and Regulation

Under the authority of the Federal Reserve Act and the Bank Holding Company Act, the Federal Reserve System plays a major role in the supervision and regulation of banks and bank holding companies. Under the Bank Holding Company Act, the Board is responsible for ensuring that all activities of bank holding companies are "closely related to banking and a proper incident thereto." The Board of Governors adopts regulations to carry out statutory directives and establishes System supervisory and regulatory policies; the Reserve Banks conduct on-site examinations and inspections of state member banks and bank holding companies, review applications for mergers, acquisitions, and changes in control from banks and bank holding companies, and take formal supervisory actions. The System makes available to the public nonidentifying information it periodically collects on the condition and income of banks and bank holding companies.

Beyond these activities, the Federal Reserve maintains continuous oversight of the banking industry to ensure the overall safety and soundness of the financial system. This broader responsibility is reflected in the System's presence in financial markets, through open market operations, and in the Federal Reserve's role as lender of last resort.

In 1991 the System maintained the intensified supervision program for state member banks and bank holding companies that was implemented five years ago as a result of the increase in the number of bank failures and problem banks. In 1991 the Board and the Reserve

Banks examined approximately 790 state member banks, inspected approximately 2,254 bank holding companies and their subsidiaries, and acted on a total of 3,083 international and domestic applications.

The Board enforces compliance by state member banks with the federal laws protecting consumers in their use of credit. In 1991 the System conducted approximately 591 compliance examinations.

The Board's supervisory responsibilities also extend to foreign operations of U.S. banks and, under the International Banking Act, to U.S. operations of foreign banks. ■