

Federal Reserve Bank of New York. - Speeches
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TESTIMONY BY

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BEFORE THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

OCTOBER 27, 1993

I welcome the opportunity to appear before the Committee today to provide my views on the provisions of H.R. 28, the Federal Reserve System Accountability Act of 1993, which relate to the audit of Reserve Banks by the Government Accounting Office. H.R. 28 would eliminate the exemptions in the Federal Banking Agency Audit Act for foreign central banks and government transactions, monetary policy deliberations, decisions, and actions, and Federal Open Market Committee transactions. Governor Angell will be addressing the concerns of the Board of Governors on this legislative proposal. I will focus on the implications of the proposal for the actions taken by the Federal Reserve Bank of New York in implementing FOMC decisions and carrying out activities for our foreign accounts.

I want to comment on the scope of the current exemption and to make clear to the Committee my appreciation and respect for the audit process. Also, I would like to take this opportunity to note steps that can be taken to ensure further the effectiveness of GAO audits of the Bank, within the GAO's current authority. In my opinion, that authority provides sufficient scope to address many of the concerns you have asked me to discuss today.

I believe that the elimination of the current exemption would interfere with the Fed's ability to formulate and execute an optimal monetary policy. It would introduce the unmistakable potential for political influence; every movement and nuance of policy would then have to be examined in light of that potential. At the core of my concern is the fact that the process by which

we implement monetary policy is inextricably entwined with the policy itself. For example, questions regarding the volume of open market operations on the surface may appear to be questions of efficiency. In fact, they relate to the policy intent to avoid undue volatility in the markets. The idea that the process of executing open market operations may be audited without imposing judgments about the policy itself is simply not realistic.

Simply put, optimum monetary policy is achieved only when the public and the markets perceive no short-term political influence. This is not a new issue, nor a new conclusion on my part. I have had plenty of opportunity to consider the import of the exclusion of the GAO from auditing monetary policy in my former role as manager of both the domestic and foreign open market accounts. I have no doubt that the potential for damage to a credible and effective monetary policy would be very real if the exclusion were to be lifted. This potential for damage clearly would outweigh any possible benefit to the public from GAO audits of monetary policy operations.

I feel equally strongly about the impairment of our policy implementation if the exclusion were to be lifted on the foreign side. Foreign exchange intervention is conducted not only in conjunction with the Treasury, through the Exchange Stabilization Fund which is exempt from GAO audit, but also frequently with or on behalf of foreign central banks and monetary authorities.

We hold a very large amount -- over \$300 billion at present -- of marketable U.S. Government securities, representing dollar reserves of these official foreign entities. I cannot presume to gauge the response of all of these central bank governors and finance ministers, but I can tell you with absolute certainty that there is some number of them, and perhaps a large number, who would question the appropriateness of their reserve activity being scrutinized by the GAO and the Congress. This would almost certainly be damaging to the relationships that are so central to international monetary cooperation and, perhaps, to the role of the dollar. Certainly, it would impair the ability of the U.S. monetary authorities to conduct their foreign exchange intervention policies on a coordinated basis with the same effectiveness and efficiency we enjoy today.

Having said that, I want to reiterate that I do not have some sort of reflexive distaste for auditors or the audit process. To the contrary, as someone who has had managerial responsibility for large organizations in both the public and private sectors, I have a keen appreciation for the role of auditors and the improvements they bring to the table in the form of operational quality and effectiveness.

I view auditors as an important asset for management. There is a long tradition at the Fed of recognizing the value of independent oversight. Indeed, I believe we subject ourselves to an extraordinarily rigorous series of performance and operational appraisals. Within each Reserve Bank there is an independent

audit function that reports directly to the board of directors and performs comprehensive audits of all aspects of that Bank's work.

At the New York Fed, we have had a constructive and positive relationship with the GAO for almost 15 years. We supply the GAO permanent space in the Bank and have assigned staff as liaison in order to assist them in the orderly completion of their tasks. In addition, we take seriously their findings and are responsive to their suggestions for improvements. While I do not want to wax too poetic and imply that we love the result of each and every audit, I do want to make clear that we have a great appreciation for the role of auditors.

The conduct of Bank personnel with responsibility for monetary policy matters is subject to the Bank's rules of conduct, stringent standards regarding outside financial interests and potential conflicts stemming from family and other personal relationships. The GAO always has had full audit authority over Reserve Banks' personnel policies and practices, disclosure statements, and the like, and, thus, has been able to assure itself and Congress of the ethical standards and practices of all our employees.

We are not, however, resting on our laurels. There are always ways to enhance the effectiveness of operations, and audits by GAO can contribute significantly to that process. I plan to call Comptroller General Bowsher from time to time to

offer suggestions as to how the GAO might be even more useful to the Bank.

I now would like to respond to matters raised in Chairman Gonzalez' October 21 letter to me regarding our policy on meals and entertainment and our ethics officer. As I have noted, there is no limitation on the GAO that prevents its looking at our meals and entertainment practices or policy. Moreover, we do not impart information on monetary policy or our foreign account relationships to any outsiders, at luncheons or elsewhere. To the contrary, we use meetings with knowledgeable people to gain information about market conditions that is helpful in our monetary policy deliberations.

The Chairman asked a question regarding the cost of meals at expensive restaurants hosted by regulated institutions. Because others paid for these approximately two dozen meals that were identified as having occurred over a period of a year and a half, we do not have that cost information. We are however, very sensitive to the appearances of such things, and our internal rules specifically caution against accepting inappropriate entertainment, lavish meals or frequent meals from a particular institution. Further, we concluded that we do not have an adequate audit trail. Therefore, we are about to issue a policy requiring that all business meals paid by regulated institutions or vendors be documented as to restaurant, purpose, and attendees, to provide an audit trail for us, the Board of Governors, and the GAO going forward.

Finally, as the Chairman noted, we recently named an ethics officer. That does not mean this role was not being performed previously within the Bank. That function was fulfilled by the Bank's First Vice President, its General Counsel and the Personnel officers. We concluded that we would focus those responsibilities in a single individual, a senior vice president of the Bank. Since his appointment as ethics officer, he has responded to inquiries from members of the Bank's staff regarding ethics and conflict of interest questions. He also has participated in redrafting our rules of conduct, which should be concluded by year end, and other documents which will be helpful to the Bank's staff in their compliance with these rules. We regard his efforts as a continuation and refinement of the policies we have already put in place. As far as I am concerned, GAO staff has access to those policies and procedures, and I look forward to receiving GAO's input on them.

I appreciate this opportunity to participate in this hearing and look forward to answering any further questions the Committee members may have.

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