The Hats The Federal Reserve Wears

The Federal Reserve

is a central bank. It's not like any other bank you know; it won't make you a loan or even accept your deposits. Yet the Federal Reserve can have an important effect on you and the value of your money.

As the nation's central bank, the Federal Reserve wears a number of hats; that is, it does several quite different and important jobs:

- Provides bank-like services including collecting checks, wiring money, securities and information, and supplying cash
- Serves as the government's bank
- Supervises depository institutions
- Makes loans
- Serves the consumer and the community
- Manages the nation's money supply

PROVIDES BANK-LIKE SERVICES

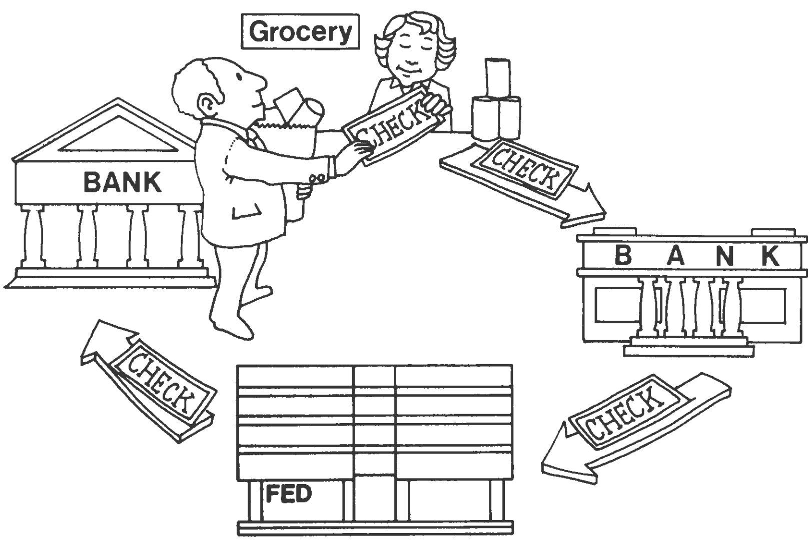
Many of the bank-like services and information provided to financial institutions are similar to the services performed by some of these institutions—banks, thrifts, and credit unions—for you and your family.

The Monetary Control Act of 1980 required the Federal Reserve to charge fees for some of its services, such as processing checks, wiring money, safekeeping of securities, and the transporting of cash. Other services provided are a part of our central banking responsibilities and are not subject to fees. Let's take a closer look at the Fed services that are subject to fees.

The Fed Collects Checks

Your bank or thrift institution receives thousands of checks every day. It must give depositors credit for them and naturally wants to get paid in return. This means sending the checks to the institutions on which they are drawn for payment.

The Federal Reserve helps financial institutions collect the checks they receive. It says in effect, "Bundle up your checks and send them to us. We will sort them and present them for payment, and we will pay you."



Travels of a Check

This saves your bank or thrift the trouble and expense of sorting the checks and mailing them individually. It also cuts the time for the checks to clear. Thus you may get credit faster when you make a deposit.

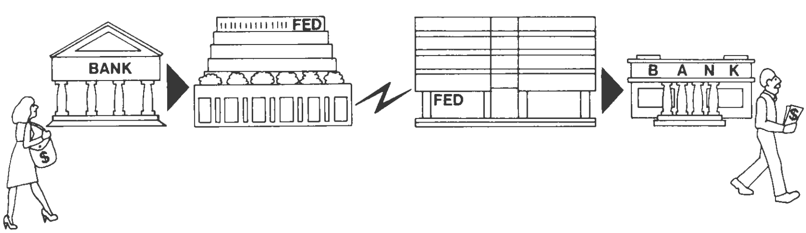
The Federal Reserve System handles so many checks each day that taped end to end, they would reach from New York to Alaska.

The Federal Reserve has helped create and operate an automated clearinghouse (ACH) system to handle electronic payments instead of paper. Financial institutions, businesses, and the U.S. Treasury now can cut down on paper work by offering consumers such services as automatic direct deposit and bill payment. The number of ACH transactions now totals many hundreds of millions in a year, and rapid growth continues.

The Fed computes the fees for its check and ACH services by figuring what they cost to produce and then adding a special factor to compensate for profits and other costs that private institutions incur.

The Fed Wires Money, Securities and Information

Our "Fedwire" is a state-of-the-art communications network that transfers information, funds, and securities throughout the country. Over 4,500 depository institutions nationwide now access the network's computerized facilities.



Wiring Money

Let's suppose a business executive in San Francisco needs a large sum of money from the home office across the country in Philadelphia in order to close an important deal.

The home office's bank simply calls the Philadelphia Federal Reserve Bank, which wires the money to the San Francisco Reserve Bank, which in turn wires the funds to a local bank where the executive is waiting. Nearly a hundred trillion dollars are transferred over the Fedwire network yearly.

The Fed Supplies Cash

When a financial institution needs more coin and currency to meet its customers' demands, it can order the cash from a Federal Reserve Bank or branch, which ships the money out by armored car or registered mail. To do this job the Federal Reserve must keep a large supply of coin and currency in its vaults. This cash comes from the Bureau of Engraving and Printing, which produces the paper money, and a United States Mint, which produces the coin.

Federal Reserve notes are the only kind of paper money that is issued today. Faith in the strength, soundness, and stability of the American economy is the real backing for our money.

Although the processing of cash is free of charge, financial institutions are charged for its transportation.

Now let's look at the other hats the Federal Reserve wears as it fulfills its function as central banker.

SERVES AS THE GOVERNMENT'S BANK

The federal government spends more and owes more than anybody else in the world. The Federal Reserve assists the government by keeping its checking accounts and helping to handle its IOUs.

When you pay federal taxes, your money doesn't necessarily go off to Washington. It may wind up as a deposit in the government's checking account at the nearest Federal Reserve Bank. As the government spends money to build dams, pay soldiers, or whatever, it writes checks on its accounts with the Federal

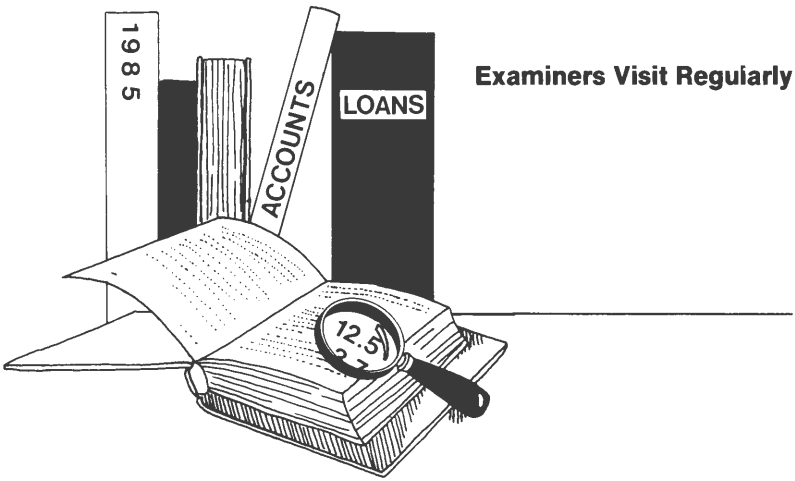
Reserve, which keeps records and sends regular statements just as your bank does for you.

When the government borrows money, it gives the lender an IOU in the form of a certificate or more recently, an entry in a special account. The Federal Reserve handles much of the paperwork resulting from these transactions. Except for Savings Bonds, all U.S. government securities will be in book entry form after July 1986.

This means your investment is represented by a special account on the books of a Federal Reserve Bank instead of an engraved piece of paper that could be lost or stolen.

SUPERVISES DEPOSITORY INSTITUTIONS

For the Federal Reserve, supervising means first, issuing regulations about what institutions may or may not do and second, examining certain ones to make sure they are safe and sound. We have a staff of examiners, and they visit state member banks as well as bank holding companies. The remainder of the country's banks and thrifts are examined by other agencies.



Examiners Visit Regularly

When a bank is examined, the quality of its deposits and loans, the amount of its capital and the quality of its management are carefully reviewed.

MAKES LOANS

Sometimes financial institutions require extra money, usually when their customers want to borrow or withdraw unexpectedly large amounts or to meet other temporary and often unexpected needs. The Fed can make loans to cover such situations. Of course, the borrower must meet the Fed's requirements, which include paying a level of interest called the discount rate and pledging security.

SERVES THE CONSUMER AND THE COMMUNITY

In the 1960s and the 1970s, Congress passed a number of consumer protection laws and directed the Federal Reserve to draw up the detailed regulations necessary to put them into effect. For example, Truth in Lending ensures information on the cost of credit, Equal Credit Opportunity prohibits discrimination when applying for credit, and Electronic Fund Transfer provides protection when moving funds electronically.

The Fed helps to enforce consumer and community reinvestment rights.

These and other consumer regulations apply to all lenders but they are enforced by different government agencies. The Federal Reserve itself is responsible for state member banks.

The Federal Reserve wants as many consumers as possible to know about their credit rights and how to exercise them, so it has an ongoing educational campaign. Pamphlets, films, and speaking engagements are featured.

In addition, the Federal Reserve receives and tries to resolve consumer complaints against depository institutions. Some involve problems with credit regulations, and others stem from everyday transactions such as making deposits or loan repayments. If you have any questions, write to your district Federal Reserve Bank.

The Federal Reserve also has a community affairs responsibility and informs the public and lending institutions about programs for community reinvestment, small business lending and economic development. The Federal Reserve also helps enforce the Community Reinvestment Act, which provides ways groups may protest when they think an institution is not meeting a community's credit needs.

MANAGES MONEY

Money, it is said, is much like fire. Under control, both are very useful, but running wild, both can do great harm. The Federal Reserve has the job of keeping the nation's supply of money under control.

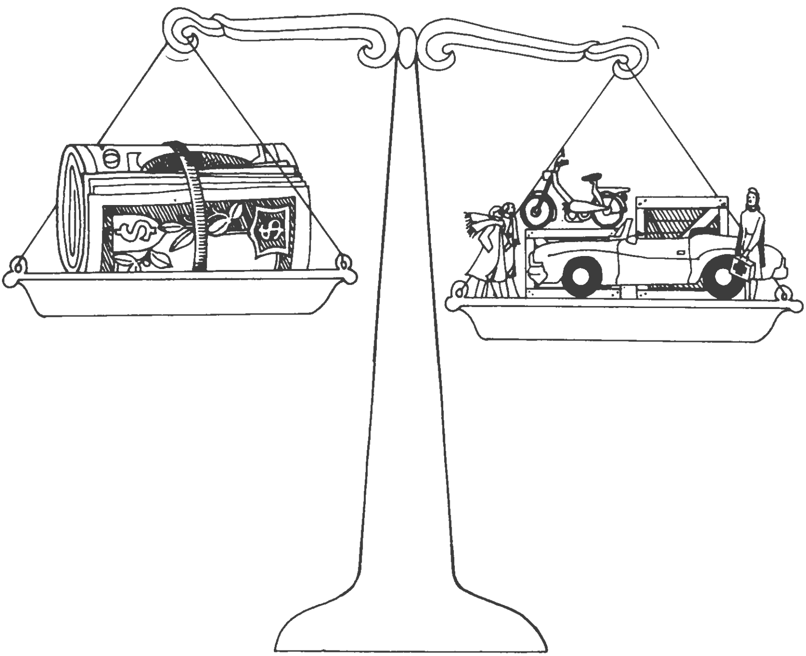
The Federal Reserve is not directly concerned with who gets money or how it is spent. The free enterprise system, with millions of people making their own decisions, determines these things.

The Federal Reserve deals in totals only. It tries to make sure the total amount of money in circulation is about right; not too much, not too little. Too much money can make prices rise on the things you buy. This is inflation. Too little money can cause recession and unemployment.

A Delicate Balance

To prevent inflation or recession, the Federal Reserve tries to keep the flow of spending in line with the near-capacity production of goods and services. Or, if inflation or recession happens, it tries to get spending and production back in balance at a level that keeps most workers and factories busy.

Since the Federal Reserve has no control over production, it works with spending. It does this by influencing the amount of money available for consumers, businessmen, and governments to spend.



The Fed tries to keep spending in line with the near capacity production of goods and services . . .

There are three basic ways to get spending money: earn it, take it out of savings, or borrow it. The Federal Reserve works primarily through borrowed money.

Money for loans comes from two sources: first, from people who have saved and are willing to lend their savings; and second, from institutions such as banks, which have the power, within limits, to create money in checking-type accounts when they make loans.

The Federal Reserve doesn't have a great influence over the level of savings, but it can affect the amount of money that is created.

When the prices of goods and services begin to rise, the Federal Reserve might decide to throttle down on credit. This should slow spending with borrowed money, which could help bring total spending back in line with production of goods and services. Other things being equal, prices should then start to stabilize.

When the country is in a recession and unemployment is rising, the Federal Reserve is likely to make it possible for financial institutions to increase their lending. This will help stimulate spending with borrowed money, which should increase total spending, which, in turn, should increase production. As production rises, unemployed workers and factories will be called back on the job.

A balance of spending and production at high levels is what the Federal Reserve is after, and influencing the amount of credit is how it goes about it.

You could say that minimizing inflation and maximizing employment in a growing economy are overall objectives of the Federal Reserve System. Besides the supply of money, many other factors, both foreign and domestic, affect prices and jobs. The Federal Reserve is only one member, although an important one, of the team that is trying to improve the nation's economic well-being.

WHO RUNS THE FEDERAL RESERVE?

Congress created the Federal Reserve back in 1913, but Congress doesn't run its operations. Neither does the President of the United States. The Fed is a fairly independent organization within the government. The purpose of this arrangement is to keep the job of managing the nation's money supply insulated from short-run political pressures.

The Federal Reserve has a seven-member Board of Governors, and its headquarters is in Washington, D.C.The President of the United States appoints the members of the Board of Governors with the consent of the U.S. Senate.

There are 12 Federal Reserve Banks scattered around the country, and most of these banks have branches. Each Reserve Bank has its own president and board of directors.

The relationship between the Board of Governors and the 12 Reserve Banks is not unlike the one between the federal government and the various state governments. Like the federal government, the Board usually concentrates on matters of national importance. Like the states, the 12 Banks tend to specialize on matters within their districts.

But it is important to know about local conditions when making national decisions, so the Reserve Banks have their say. A good example is open market operations, the main way the Federal Reserve affects the amount of bank credit available. They are run by the Federal Open Market Committee, which is made up of the seven members of the Board of Governors plus the presidents of five Reserve Banks.

Most presidents take turns serving, and they attend meetings even when they are not on the Committee.

When the Federal Reserve was created, its stock was sold to the member banks. As stockholders, they elect a majority of the directors of the 12 Federal Reserve Banks. The other directors are appointed by the Board of Governors. The directors and the officers they approve run the Federal Reserve Banks and their employees, who are not under civil service.

The Federal Reserve earns interest on the government securities it owns. Out of this income it pays all operating expenses and dividends to stockholders. Most of what's left goes to the U.S. Treasury. In recent years, this has come to many billions of dollars annually.

This pamphlet was written by Lawrence C. Murdoch, Jr., Vice President and Secretary of the Federal Reserve Bank of Philadelphia.

4/86

For additional copies of this pamphlet or for a list of other available publications, write to:

Federal Reserve Bank of Philadelphia
Public Services Department
P.O. Box 66
Philadelphia, Pennsylvania 19105-0066

FEDERAL
RESERVE BANK OF
PHILADELPHIA

Ten Independence Mall, Philadelphia, PA 19106-1574