

Purpose

Overview of the Federal Reserve System

The Federal Reserve performs five key functions in the public interest to promote the health of the U.S. economy and the stability of the U.S. financial system.

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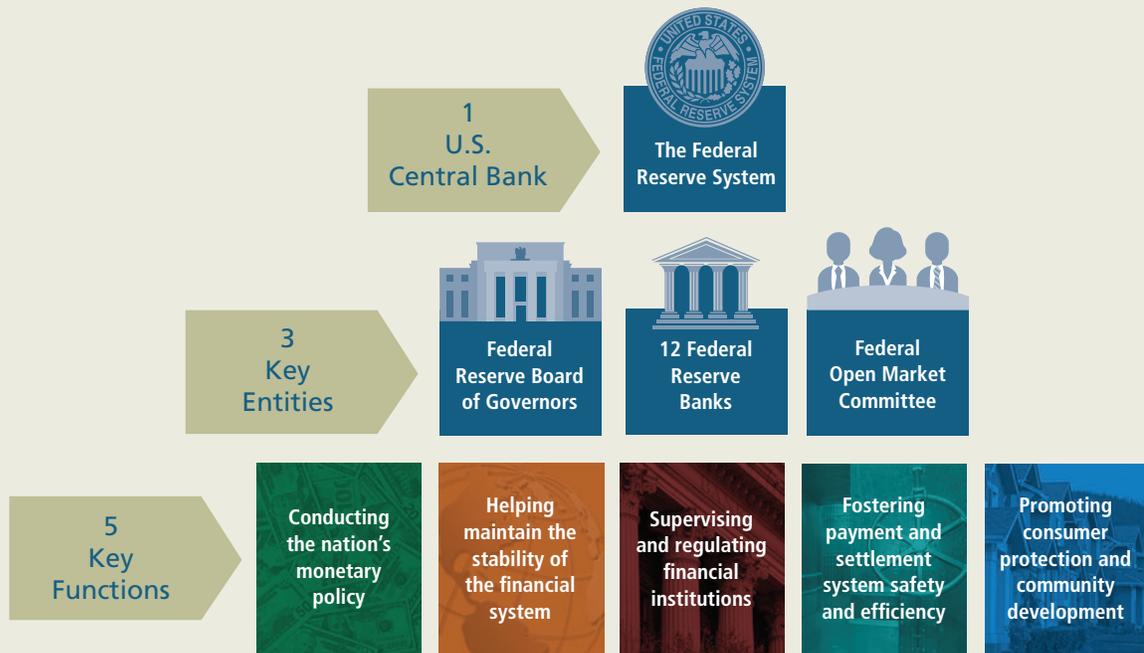
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The Federal Reserve System is the central bank of the United States. It performs five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest. The Federal Reserve

- **conducts the nation’s monetary policy** to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy;
- **promotes the stability of the financial system** and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad;
- **promotes the safety and soundness of individual financial institutions** and monitors their impact on the financial system as a whole;

Figure 1.1. The Federal Reserve System

The Federal Reserve is unique among central banks. By statute, Congress provided for a central banking system with public and private characteristics. The System performs five functions in the public interest.



- **fosters payment and settlement system safety and efficiency** through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments; and
- **promotes consumer protection and community development** through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.

The Federal Reserve was established to serve the public interest.

The U.S. Approach to Central Banking

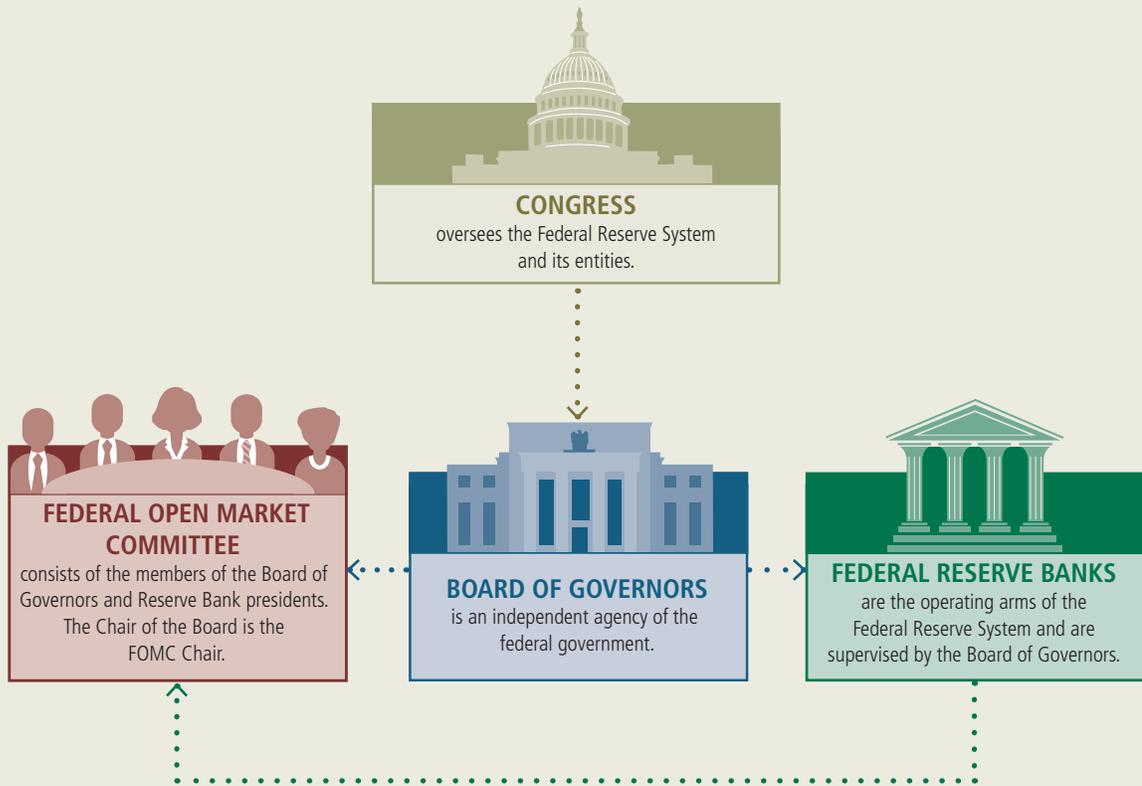
The framers of the Federal Reserve Act purposely rejected the concept of a single central bank. Instead, they provided for a central banking “system” with three salient features: (1) a central governing Board, (2) a decentralized operating structure of 12 Reserve Banks, and (3) a combination of public and private characteristics.

Although parts of the Federal Reserve System share some characteristics with private-sector entities, the Federal Reserve was established to serve the public interest.

There are [three key entities in the Federal Reserve System](#): the Board of Governors, the Federal Reserve Banks (Reserve Banks), and the Federal Open Market Committee (FOMC). The Board of Governors, an agency of the federal government that reports to and is directly accountable to Congress ([figure 1.2](#)), provides general guidance for the System and oversees the 12 Reserve Banks.

Figure 1.2. Three key entities, serving the public interest

The framers of the Federal Reserve Act developed a central banking system that would broadly represent the public interest.



Within the System, certain responsibilities are shared between the Board of Governors in Washington, D.C., whose members are appointed by the President with the advice and consent of the Senate, and the Federal Reserve Banks and Branches, which constitute the System's operating presence around the country. While the Federal Reserve has frequent communication with executive branch and congressional officials, its decisions are made independently.

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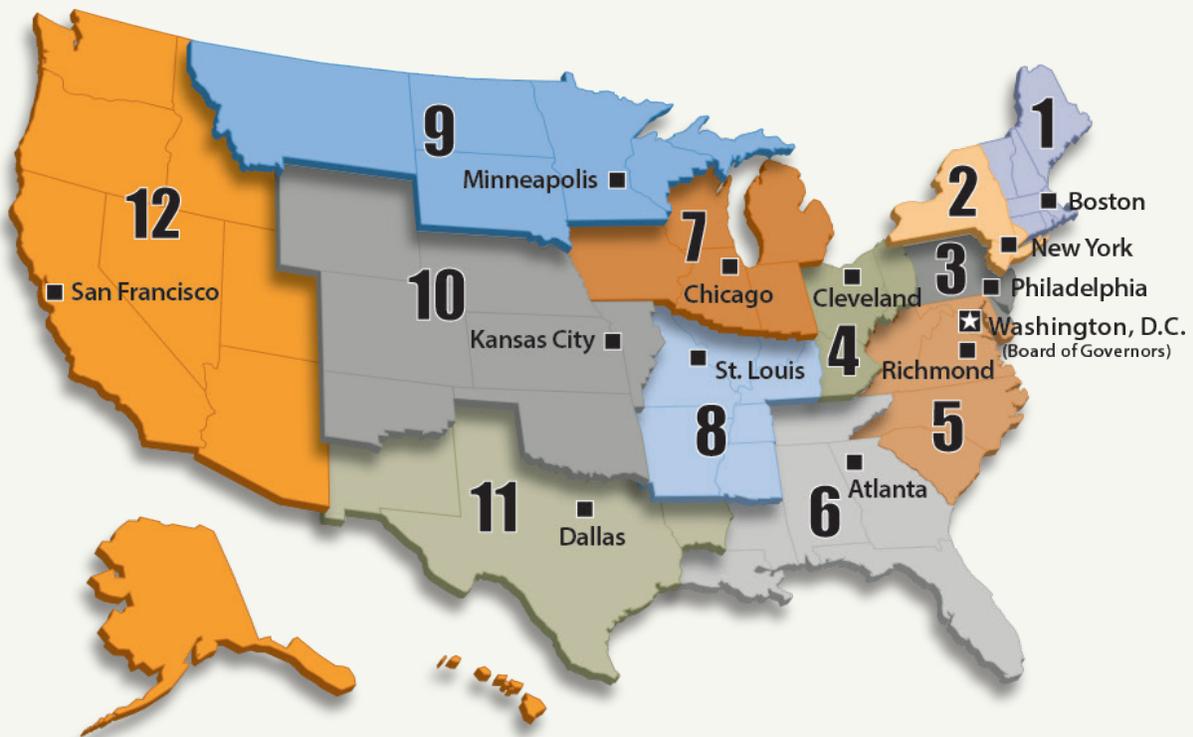
The Decentralized System Structure and Its Philosophy

In establishing the Federal Reserve System, the United States was divided geographically into 12 Districts, each with a separately incorporated Reserve Bank. District boundaries were based on prevailing trade regions that existed in 1913 and related economic considerations, so they do not necessarily coincide with state lines (figure 1.3).

As originally envisioned, each of the 12 Reserve Banks was intended to operate independently from the other Reserve Banks. Variation was expected in discount rates—the interest rate that commercial banks

Figure 1.3. Twelve Federal Reserve Districts operate independently but with supervision

Federal Reserve District boundaries are based on economic considerations; the Districts operate independently but under the supervision of the Federal Reserve Board of Governors.



Revisions to the Federal Reserve Act in 1933 and 1935 created the modern-day Federal Open Market Committee.

were charged for borrowing funds from a Reserve Bank. The setting of a separately determined discount rate appropriate to each District was considered the most important tool of monetary policy at that time. The concept of national economic policymaking was not well developed, and the impact of open market operations—purchases and sales of U.S. government securities—on policymaking was less significant.

As the nation's economy became more integrated and more complex, through advances in technology, communications, transportation, and financial services, the effective conduct of monetary policy began to require increased collaboration and coordination throughout the System. This was accomplished in part through revisions to the Federal Reserve Act in 1933 and 1935 that together created the modern-day FOMC.

The Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act) introduced an even greater degree of coordination among Reserve Banks with respect to the pricing of financial services offered to depository institutions. There has also been a trend among Reserve Banks to centralize or consolidate many of their financial services and support functions and to standardize others. Reserve Banks have become more efficient by entering into intra-System service agreements that allocate responsibilities for services and functions that are national in scope among each of the 12 Reserve Banks.



The Reserve Banks: A Blend of Private and Governmental Characteristics

Pursuant to the Federal Reserve Act, each of the 12 Reserve Banks is separately incorporated and has a nine-member board of directors.

Commercial banks that are members of the Federal Reserve System hold stock in their District's Reserve Bank and elect six of the Reserve Bank's directors; three remaining directors are appointed by the Board of Governors. Most Reserve Banks have at least one Branch, and each Branch has its own board of directors. Branch directors are appointed by either the Reserve Bank or the Board of Governors.

Directors serve as a link between the Federal Reserve and the private sector. As a group, directors bring to their duties a wide variety of experiences in the private sector, which gives them invaluable insight into the economic conditions of their respective Federal Reserve Districts. Reserve Bank head-office and Branch directors contribute to the System's overall understanding of the economy.

The Federal Reserve is not funded by congressional appropriations. Its operations are financed primarily from the interest earned on the securities it owns—securities acquired in the course of the Federal Reserve's open market operations. The fees received for priced services provided to depository institutions—such as check clearing, funds transfers, and automated clearinghouse operations—are another source of income; this income is used to cover the cost of those services. After payment of expenses and transfers to surplus (limited to an aggregate of \$10 billion), all the net earnings of the Federal Reserve Banks are transferred to the U.S. Treasury ([figure 1.4](#)).

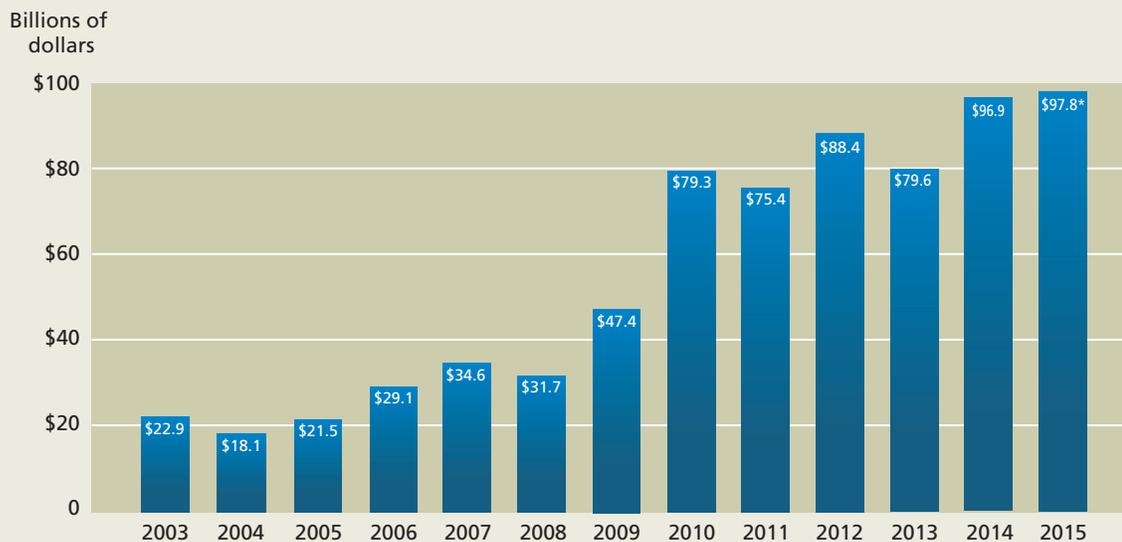
Is Reserve Bank stock like regular corporate stock?

The 12 regional Federal Reserve Banks issue shares of stock to member banks. Owning Reserve Bank stock is, however, quite different from owning stock in a private company. The Reserve Banks are not operated for profit, and ownership of a certain amount of stock is, by law, a condition of membership in the System. The stock may not be sold, traded, or pledged as security for a loan, and dividends are, by law, paid to member banks at a maximum rate of 6 percent, determined in part by each member bank's total assets.

Despite the need for coordination and consistency throughout the Federal Reserve System, geographic distinctions remain important. Effective monetary policymaking requires knowledge and input about regional differences. For example, two directors from the same industry may have different opinions regarding the strength or weakness of that sector, depending on their regional perspectives. The decentralized structure of the System and its blend of private and public characteristics, envisioned by the System’s creators, therefore, remain important features today.

Figure 1.4. Federal Reserve net earnings are paid to the U.S. Treasury

The Federal Reserve transfers its net earnings to the U.S. Treasury.



* Does not include \$19.3 billion also transferred to the U.S. Treasury from Reserve Bank capital surplus per the Fixing America’s Surface Transportation Act.

Source: Federal Reserve Board news release, January 10, 2013 (available in the News & Events section of the Federal Reserve Board’s website, www.federalreserve.gov).