

24.2: The Federal Reserve System's Structure

Learning Objectives

- What is the structure of the Federal Reserve system?

The Federal Reserve is composed of twelve numbered districts, each with its own Federal Reserve Bank: Boston (1), New York (2), Philadelphia (3), Cleveland (4), Richmond (5), Atlanta (6), Chicago (7), St. Louis (8), Minneapolis (9), Kansas City (10), Dallas (11), and San Francisco (12). Except for regions 1 and 3, each of those **district banks** also operates one or more branches. For example, the Federal Reserve Bank of New York (FRBNY) maintains a branch in Buffalo; the Atlanta Fed has branches in Nashville, Birmingham, New Orleans, Jacksonville, and Miami. The Fed's headquarters is located in Washington, DC. For an interactive map of the system, browse www.federalreserve.gov/otherfrb.htm.

Missouri is the only state with two federal reserve district banks. This was thought necessary to secure the votes of Missouri congressional representatives for the bill. (So much for public interest!) *The districts don't seem to be evenly balanced economically.* They were, more or less, when the legislation was passed before World War I, but since then, the West Coast, Southwest, and Southeast (Sunbelt) have grown in economic importance relative to the Northeast and old Midwest (Rustbelt). (District 3 encompasses only southern New Jersey and eastern Pennsylvania, an area that is no longer the economic powerhouse it once was.) Rather than redistrict, the Fed has simply shifted resources over the years toward the larger and economically more potent districts.

Each Federal Reserve bank is owned (but not entirely controlled) by the commercial banks in its district, and they are members of the system. Those banks, which include all nationally chartered banks and any state banks that choose to join, own restricted The Fed's stock is not traded in public markets and pays an annual dividend no higher than 6 percent. shares in the Fed, which they use to elect six district bank directors, three of whom have to be professional bankers and three of whom have to be nonbank business leaders. The Board of Governors in Washington selects another three directors, who are supposed to represent the public interest and are not allowed to work for or own stock in any bank. The nine directors, with the consent of the board, then appoint a president.

The twelve district banks do mostly grunt work:

- Issue new Federal Reserve notes (FRNs) in place of worn currency
- Clear checks
- Lend to banks within their districts
- Act as a liaison between the Fed and the business community
- Collect data on regional business and economic conditions
- Conduct monetary policy research
- Evaluate bank merger and new activities applications
- Examine bank holding companies and state-chartered member banks. The Comptroller of the Currency is the primary regulator of federally chartered banks. State regulators and the FDIC regulate state banks that are not members of the Federal Reserve system.

The FRBNY is the most important of the district banks because, in addition to the tasks listed above, it also conducts so-called open market operations, buying and selling government bonds (and occasionally other assets) on behalf of the Federal Reserve system and at the behest of headquarters in Washington. Moreover, the FRBNY is a member of the Bank for International Settlements (BIS) www.bis.org and safeguards over \$100 billion in gold owned by the world's major central banks. Finally, the FRBNY's president is the only permanent member of the Federal Open Market Committee (FOMC).

The FOMC is composed of the seven members of the Board of Governors, the president of the FRBNY, and the presidents of the other district banks, though only four of the last-mentioned group can vote (on a rotating basis). The FOMC meets every six weeks or so to decide on monetary policy, specifically on the rate of growth of the money supply or the federal funds target rate, an important interest rate, both of which are controlled via so-called open market operations. Until recently, the Fed had only two other tools for implementing monetary policy, the discount rate at which district banks lend directly to member banks and reserve requirements. Prior to the crisis of 2007–2008, neither was an effective tool for a long time, so the market and the media naturally concentrated on the FOMC and have even taken to calling it “the Fed,” although technically it is only one part of the central bank. *The head of the Fed is the Board of Governors, which is composed of a chairperson, currently Ben Bernanke, and six governors.*

www.federalreserve.gov/aboutthefed/bios/board/bernanke.htm All seven are appointed by the president of the United States and confirmed by the U.S. Senate. The governors must come from different Federal Reserve districts and serve a single fourteen-year term. The chairperson is selected from among the governors and serves a four-year, renewable term. The chairperson is the most powerful member of the Fed because he or she controls the board, which controls the FOMC, which controls the FRBNY's open market operations, which influences the money supply or a key interest rate. The chairperson also effectively controls reserve requirements and the discount rate. He (so far no women) is also the Fed's public face and its major liaison to the national government. Although de jure power within the Fed is diffused by the checks and balances discussed above, today de facto power is concentrated in the chairperson. That allows the Fed to be effective but ensures that a rogue chairperson cannot abuse his power.

Historically, some chairpersons have made nebbishes look effective, while others, including most recently Alan Greenspan, have been considered, if not infallible demigods, then at least erudite gurus. *Neither extreme view is accurate because all chairpersons have relied heavily on the advice and consent of the other governors, the district banks' presidents, and the Fed's research staff of economists, which is the world's largest.* The researchers provide the chairperson and the entire FOMC with new data, qualitative assessments of economic trends, and quantitative output from the latest and greatest macroeconomic models. They also examine the global economy and analyze the foreign exchange market, on the lookout for possible shocks from abroad. Fed economists also help the district banks to do their jobs by investigating market and competition conditions and engaging in educational and other public outreach programs.

KEY TAKEAWAYS

- The Fed is composed of a Washington-based headquarters and twelve district banks and their branches.
- The district banks, which are owned by the member banks, fulfill the Fed's quotidian duties like clearing checks and conducting economic research.
- The most important of the district banks is the Federal Reserve Bank of New York (FRBNY), which conducts open market operations, the buying and selling of bonds that influences the money supply and interest rates.
- It also safeguards much of the world's gold and has a permanent seat on the Federal Open Market Committee (FOMC), the Fed's most important policymaking body.
- Composed of the Board of Governors and the presidents of the district banks, the FOMC meets every six weeks or so to decide whether monetary policy should be tightened (interest rates increased), loosened (interest rates decreased), or maintained.
- The Fed is full of checks and balances, but is clearly led by the chairperson of the Board of Governors.
- The chairperson often personifies the Fed as he (to date it's been a male) is the bank's public face.
- Nevertheless, a large number of people, from common businesspeople to the Fed's research economists, influence his decisions through the data, opinions, and analysis they present.

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