# Accountability and Governance of the Federal Reserve

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Under the Federal Reserve Act of 1913, the Federal Reserve structure incorporates elements of the public and private sector in a design reflective of the value Americans place on the importance of checks and balances.

## A Critical Balance of Power: The Accountability and Governance of the Federal Reserve

Congress created the Federal Reserve with a governance structure that places the central bank firmly under government oversight, but with protections designed to mitigate the risk of political manipulation. This resulting system engages the private sector to act as a partial check against the abuse of central bank policies for solely political purposes.

The 12 regional Federal Reserve Banks are sometimes referred to as the operating arms of the nation's central bank. The Board of Governors, a government agency based in Washington, D.C. is a governmental agency with broad oversight for the entire Federal Reserve System, while each of the 12 regional Reserve Banks operate under the control of a local board of directors composed of individuals engaged in community development, business, banking and labor.

The design engages a broad spectrum of individuals from across the nation in oversight of the nation's central bank and creates a forum for contributions to the Fed's policy deliberations. As designed, it was also intended in part to prevent too close of a connection between our nation's fiscal policies, as directed by the administration and Congress, and monetary policies, directed by the central bank.

You can learn more about the structure in the paper **"Structure, Governance, Representation: Federal Reserve Member Banks and Federal Reserve Bank Stock."** This document was prepared at a time when there were a couple of different initiatives underway related to the role of bankers in the Fed's structure. In addition to a Government Accountability Office (GAO) review about the requirement that member banks hold stock in their regional Reserve Bank, there had also been an unprecedented decision by Congress to divert some of the Federal Reserve dividends as a funding source for the Fixing American's Surface Transportation (FAST) Act. While these events occurred a few years ago, the involvement of banks within the Fed's structure is an issue that can be poorly understood and something that has emerged over time as a point of contention by the Fed's critics. This paper explains the history of the Fed's structure and provides insight on the role of important role of America's banks within it.

## Federal Reserve System Governance Structure FAQs

The Federal Reserve System is a public-private, decentralized institution designed nearly 100 years ago by Congress after six years of public debate. The public component is the government agency, the Board of Governors in Washington, D.C. The private component is the 12 regional Reserve Banks and their Branches located throughout the country and overseen by private citizens who serve as directors.

The separation of the authority over spending (Congress) from authority to regulate the money supply (Federal Reserve) is essential to insulate policy decisions from short-term political pressures related to election cycles and maintain the focus on long-term stability. Congress created the Fed as an independent institution that is accountable to Congress. Governors of the Federal Reserve System are appointed by the President and confirmed by the Senate to serve 14-year terms. The Board of Governors has broad oversight of the regional Reserve Banks.

## Board of Directors FAQs

The Boards of Directors oversee operations and policies and confer on economic and banking developments at each of the 12 Federal Reserve Banks.

Reserve Bank directors come from every region of the country and every sector of the economy. They meet legal requirements and practices that guide their eligibility and conduct, and are held accountable by law.

Through the Federal Reserve Act, Congress put in place long-time provisions governing director eligibility and selection, in addition to requirements that dictate the makeup of regional Reserve Bank boards. The Federal Reserve Board recently strengthened its rules to address Reserve Bank director eligibility in light of recent changes in status of affiliated financial firms.

Each Reserve Bank has nine directors:

- Three directors, including the chair and deputy chair of each Reserve Bank board are appointed by the Board of Governors, the government agency. These directors are prohibited from any involvement in banking.
- Three directors, who are similarly restricted and may not be bankers, are elected by bankers from within their respective Federal Reserve district. These directors have no reporting responsibilities to any banks.
- Three directors are bankers who are elected by their peers. Regulations mandate that smaller banks must hold two of these seats.

Reserve Bank directors have important oversight responsibilities for the operation of their respective Reserve Bank. However, they have absolutely no role in banking supervision. By law, the Board of Governors is responsible for the supervision of banks and any information or discussion related to supervisory issues moves directly between a regional Reserve Bank's staff and the Board in Washington, D.C. In regard to the Fed's important discount lending activity involving financial institutions, directors are provided only aggregate information to ensure adequate knowledge of the Reserve Bank's balance sheet and to meet their oversight responsibilities.

The Federal Reserve supervises all bank holding companies, so directors can't put their own firm under Fed supervision for favorable treatment. If a bank director does want to convert their firm to Fed membership or take any other actions that would involve Fed approval, the Board of Governors in Washington is the entity that must act on the proposal.

Bankers are desirable directors because they are leaders in their communities and provide the Fed with valuable information on the economy, banking conditions and stress in the financial system. In addition, because the Reserve Banks provide financial services and products to facilitate and backstop the nation's payments system, bankers provide valuable expertise for the Fed's work in this area.

The Class B and Class C Reserve Bank board members select the Reserve Bank president, but the selection must be approved by the Board of Governors in Washington, D.C., which holds veto authority.

Like the rest of the Fed's structure, the process of selecting a president involves important checks and balances. The structure of the Federal Reserve is a product of the populist movement—citizens wanted direct input and representation to counterbalance the powerful influence that Wall Street and Washington could have on the financial system. In this regard, Congress clearly supported the need to protect individuals who hold these posts from political concerns related to election or political appointment.

## Related Research

- See historical publications from the Kansas City Fed.
- The Federal Reserve System's decentralized structure is designed to ensure representation and operational effectiveness. Learn about the System Structure.