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Statement of

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Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

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Chairman Frank, Ranking Member Bachus, and other members of the Committee, I appreciate the opportunity to testify on H.R. 1207, the Federal Reserve Transparency Act of 2009. The Federal Reserve is accountable to the Congress and the public. To inform the Congress and the American people about our actions and accommodate appropriate oversight of those actions, the Federal Reserve has further strengthened its ongoing commitment to transparency. We provide substantial information to the Congress and the public on the policies, actions, and operations of the Federal Reserve; routinely testify before this and other congressional oversight committees on all areas of our responsibilities; and publish the results of annual audits of the Federal Reserve's financial statements by an independent accounting firm. Importantly, the Federal Reserve also is subject under current law to, and cooperates with, the Government Accountability Office (GAO) in its audits of nearly all of the functions and actions of the Federal Reserve.

In my testimony, I will discuss the various ways that the Federal Reserve is both accountable and transparent to the Congress and the public, including the wide range of Federal Reserve policies and functions that currently are subject to GAO audit. I also will discuss the substantial steps that we have taken to promote understanding of our actions during the financial crisis to foster financial and economic stability, to promote the availability of credit to businesses and consumers, and to restore economic growth. In addition, I will discuss the public benefits of ensuring that the Federal Reserve maintains independence in the conduct of monetary policy, and why granting the GAO broad new authority to audit the monetary policy and related activities of the Federal Reserve would be contrary to the public interest.

**Accountability and Oversight**

The Federal Reserve is subject to oversight through a variety of mechanisms. Importantly, the Federal Reserve regularly reports to the Congress and provides both the Congress and the public a full range of detailed information concerning its policy actions, operations, and financial accounts. Indeed, our goal is to be as transparent as possible about our policies and operations without undermining our ability to effectively fulfill our monetary policy and other responsibilities.

For example, the Chairman of the Federal Reserve Board testifies and provides a report to the Congress semiannually on the state of the economy and on the Federal Reserve's actions to carry out the monetary policy objectives that the Congress has established.[1] In addition, Federal Reserve officials frequently testify before the Congress on all aspects of the Federal Reserve's responsibilities and operations, including economic and financial conditions, monetary policy, the supervision and regulation of banking organizations, consumer protection in financial services, payments system and clearing matters, and cash and check services provided by the Federal Reserve. In fact, since the beginning of 2007, Board members and other officials have testified before the Congress more than 80 times, including 28 times so far this year.

An independent public accounting firm that is selected and retained by the Board's Inspector General annually audits the financial statements for the Federal Reserve System, including the Reserve Banks. The Federal Reserve makes these audited financial statements available to the public and submits them to the Congress with detailed annual reports of our activities. These annual reports review the Federal Reserve's policy actions and operations during the year across the full range of our monetary policy, bank supervision, payments system,

[1] For our most recent report, see Board of Governors of the Federal Reserve System (2009), *Monetary Policy Report to the Congress* (Washington: Board of Governors, July 21), www.federalreserve.gov/monetarypolicy/files/20090721_mprfullreport.pdf.

and consumer protection functions.[2] In addition, the Board annually provides the Congress with a separate report that provides detail on the budgets, budget process, income, and expenses of the Board and the Reserve Banks.[3]

With respect to monetary policy, the Federal Open Market Committee (FOMC) releases a statement describing its monetary policy decisions immediately after each regularly scheduled meeting and publishes detailed minutes of each meeting three weeks later. We also publish summaries of the economic forecasts of FOMC participants four times a year and release full transcripts of FOMC meetings with a five-year lag.

During the financial crisis of the past two years, the Federal Reserve has instituted a number of important programs--using both open market operations and discount window lending--to promote financial stability and the monetary policy goals of maximum employment and stable prices. As Chairman Bernanke has noted, many of the recent improvements in financial conditions can be traced, in part, to the policy actions taken by the Federal Reserve.

We recognize that these programs must be accompanied by additional transparency so that the Congress and the public can be assured that we are exercising the best possible stewardship of the resources and responsibilities that have been entrusted to us. For these reasons, we have substantially increased both the type and amount of information that we disclose concerning our liquidity and asset purchase programs. Since the System began operations in 1914, the Federal Reserve has published its balance sheet every week, showing the assets and liabilities of the Reserve Banks, both individually and on a consolidated basis.[4]

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[2] See Board of Governors of the Federal Reserve System (2009), *95th Annual Report, 2008* (Washington: Board of Governors), www.federalreserve.gov/boarddocs/rptcongress/annual08/default.htm.
[3] See Board of Governors of the Federal Reserve System (2009), *Annual Report: Budget Review, 2009* (Washington: Board of Governors), www.federalreserve.gov/boarddocs/rptcongress/budgetrev/br09.pdf.
[4] These balance sheets are made available each Thursday, for the week ending the preceding Wednesday, through the Federal Reserve's H.4.1 Statistical Release. The release for the week ending September 23, 2009, is available at www.federalreserve.gov/releases/h41.

During the crisis, we have added significant new information to these weekly balance sheets, including information about the amount of credit outstanding under each of our credit facilities.

The Board also recently created a section of its website that offers considerable new and detailed information about our policy programs and financial activities.[5] Earlier this year, we initiated a detailed monthly report on the Federal Reserve's liquidity programs and balance sheet that provides the Congress and the public more detailed and timely information on our lending, the associated collateral, and other facets of programs established to fight the financial crisis. Importantly, these monthly reports provide the number and distribution of borrowers under each facility; the value, type, and quality of the collateral that secures advances under each facility, including the loans to the Maiden Lane entities formed to help prevent the disorderly failure of Bear Stearns and American International Group (AIG); and trends in borrowing under the facilities. The Board also files a report with the Congress every 60 days on each outstanding liquidity facility authorized under section 13(3) of the Federal Reserve Act.[6] Moreover, the Federal Reserve has made public the significant contracts that we have entered into with private-sector vendors to assist in the management and administration of the special liquidity and asset purchase programs established to combat the financial crisis and restore economic growth.

We have taken these steps with the objective of increasing the information publicly available about the Federal Reserve and our programs so that the Congress and the public can more effectively assess our efforts in pursuit of financial stability and our monetary policy objectives. Altogether, we now provide more information about our operations than ever before,

[5] See "Credit and Liquidity Programs and the Balance Sheet" on the Board's website, available at www.federalreserve.gov/monetarypolicy/bst_reportsresources.htm.
[6] The Federal Reserve's monthly reports and 60-day reports are available on the "Credit and Liquidity Programs and the Balance Sheet" section of the Board's website..

and we continue to explore whether additional information can be provided without jeopardizing the effectiveness of our efforts.

**Existing GAO Audit Authority**

There appears to be a widespread misconception about the role the GAO already plays in oversight of the Federal Reserve. We are subject to audits by the GAO across a wide range of our responsibilities. For example, all of our supervisory and regulatory functions are subject to audit by the GAO to the same extent as the supervisory and regulatory functions of the other federal banking agencies. Indeed, the GAO in recent years has conducted dozens of audits of the policies and practices of the Federal Reserve in its supervision and regulation of bank holding companies, state member banks, and other banking organizations. These audits have included assessments of our capital standards, a review of our consolidated supervision function, and audits of our actions in connection with troubled banking organizations.

In addition, the GAO has conducted audits of the Federal Reserve in a wide range of other areas, including our oversight and operation of payment systems; our implementation and enforcement of consumer protection laws; our policies on the acquisition of U.S. banking organizations by sovereign wealth funds; our efforts to address cyber security; and the need for financial regulatory reform. So far in 2009, the GAO has completed 14 engagements involving the Federal Reserve, and another 14 engagements are in process.

The Congress also recently granted the GAO the authority to audit the credit facilities extended by the Federal Reserve to "single and specific" companies under section 13(3) of the Federal Reserve Act. This authority allows the GAO to audit the loan facilities the Federal Reserve has created for AIG, Bear Stearns, Citigroup, and Bank of America. In addition, the Congress clarified the GAO's authority to audit the Term Asset-Backed Securities Loan Facility

(TALF), a joint Treasury-Federal Reserve initiative, in conjunction with the GAO's reviews of the performance of the Treasury's Troubled Asset Relief Program. We have been cooperating closely with the GAO--as we have in the past--to assist their reviews under all of these authorities.

**H.R. 1207 and Monetary Policy Independence**

The Congress purposefully--and for good reason--chose to exclude from GAO review only two highly sensitive areas: one is monetary policy deliberations, decisions, and actions, including open market and discount window operations; and the other is Federal Reserve transactions for or with foreign central banks, foreign governments, and public international financing organizations. The limited exceptions for monetary policy and discount window operations were adopted to ensure that the Federal Reserve could "independently conduct the Nation's monetary policy."[7]

Considerable experience shows that monetary policy independence--within a framework of legislatively established objectives and public accountability--tends to yield a monetary policy that best promotes price stability and economic growth. Monetary policy independence prevents governments from succumbing to the temptation to use the central bank to fund budget deficits. It also enables policymakers to look beyond the short term as they weigh the effects of their monetary policy actions on price stability and employment. And it reinforces public confidence that monetary policy will be guided solely by the objectives laid out in the Federal Reserve Act. Thus, the Congress has sought to maintain an independent monetary policy not because it benefits the Federal Reserve, but because of the important public benefits it provides.

Through its investigations and audits, the GAO typically makes its own judgments about policy actions and the manner in which they are implemented and makes recommendations to the

[7] See S. Rep. 95-723, at 2 (1978).

audited agency and to the Congress for policy changes or future policy actions. Accordingly, financial markets likely would see the grant of audit authority to the GAO with respect to monetary policy as undermining the Federal Reserve's independence in this crucial area, particularly because GAO audits or the threat of a GAO audit could be used both to second-guess the Federal Reserve's monetary policy judgments and to try to influence subsequent monetary policy decisions.

Permitting GAO audits of monetary policy also would likely cast a chill on monetary policy deliberations if policymakers believed that GAO audits would result in early publication and analyses of their policy discussions. Unfettered and wide-ranging internal debates are essential to identifying the best possible policy options for achieving maximum employment and stable prices in light of data that may be conflicting or, at best, ambiguous as to the optimum policy path.

Moreover, publication of the results of GAO audits related to monetary policy actions and deliberations would complicate and interfere with the FOMC's communications to the markets and the public about current economic conditions and the appropriate stance of monetary policy. Households, businesses, and financial market participants would understandably be uncertain about the implications of the GAO's findings for future decisions of the FOMC, thereby increasing market volatility and weakening the ability of monetary policy actions to achieve their desired effects.

The exception from GAO audit for monetary policy matters rightfully extends to the Federal Reserve's use of market credit and liquidity programs to support the functioning of financial markets, stimulate the economy, and unfreeze credit markets. During the crisis, as use of the federal funds rate and discount rate to achieve policy objectives became constrained by the zero bound, the Federal Reserve established several broadly available market credit facilities.[8] These broad-based facilities are fundamentally different from the institution-specific loans that the Federal Reserve has made and that are already subject to GAO audit. These broader market facilities are designed to unfreeze credit markets and lower interest rate spreads and are a natural extension of the traditional central bank responsibility to serve as a backup source of liquidity during periods of financial strain.[9] In this way, these facilities represent an essential part of the Federal Reserve's efforts to promote financial stability and its monetary policy objectives.

Permitting GAO audits of discount window lending and the broad liquidity facilities that the Federal Reserve uses to affect credit conditions generally could reduce the effectiveness of these facilities in promoting financial stability, maximum employment, and price stability. Experience, including during the current financial crisis, shows that banks' unwillingness to use the discount window can result in high and volatile short-term interest rates and greatly limit the effectiveness of the discount window as a tool to enhance financial stability. Indeed, one of the important difficulties that hampered the effectiveness of the Federal Reserve's early response to the crisis was the unwillingness of many banks to draw discount window credit because of concerns about stigma; institutions were concerned that, if their discount window borrowing from the Federal Reserve became known, they would be subject to adverse reactions from the market or other sources. Authorizing the GAO to audit the discount window and other broad-based lending programs could significantly increase potential borrowers' fears of stigma and adverse reactions.

[8] Examples of market credit facilities established by the Federal Reserve include the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, and the TALF.

[9] The GAO's limited authority to conduct audits of the TALF does not directly implicate the independence of monetary policy, as the GAO may conduct audits of the TALF solely to assess the performance of Treasury's Troubled Asset Relief Program. Accordingly, as part of these audits, the GAO does not audit the Federal Reserve's decision to participate in the TALF in order to help achieve the Federal Reserve's monetary policy and financial stability objectives, or the effect of the TALF on the Federal Reserve's balance sheet or conduct of monetary policy.

H.R. 1207 would completely remove the exceptions from GAO audit in current law for monetary policy and discount window deliberations and operations, thereby allowing frequent and ongoing audits in these areas. Financial market participants likely would see passage of H.R. 1207 as a substantial erosion of the Federal Reserve's monetary policy independence. Accordingly, enactment of the bill would tend to undermine public and investor confidence in monetary policy by raising concerns that monetary policy judgments in pursuit of our legislated objectives would become subject to political considerations.

These concerns likely would increase inflation fears and market interest rates and, ultimately, damage economic stability and job creation. Indeed, the bond rating agencies view operational independence of a country's central bank as an important factor in determining sovereign credit ratings.[10] Actions that weaken monetary policy independence thus could raise the Treasury's cost of borrowing. Higher long-term interest rates would further increase the burden of the national debt on current and future generations.

Adoption of H.R. 1207 also could disrupt the nation's relationships with foreign central banks and governments, relationships which are helpful in supporting the Federal Reserve's efforts to fulfill its statutory missions, and erect barriers to official cooperation among central banks and governments. Foreign central banks and governments likely would be less willing to engage in financial transactions with the Federal Reserve if these transactions were subject to policy review by the GAO, as H.R. 1207 would allow. These transactions, such as the deposit of international reserves and bilateral currency swap arrangements, help support the role of the dollar as a worldwide reserve currency and alleviate stresses in U.S. financial markets. For

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[10] See Standard & Poor's (2004), "Sovereign Credit Ratings: A Primer," March 15, www2.standardandpoors.com/spf/pdf/products/SovRatingsPrimer_sov.pdf.

example, the temporary liquidity swaps entered into by the Federal Reserve with other central banks are designed to improve liquidity conditions in both domestic and international financial markets, guard against the spillover of volatility in foreign trading to U.S. money markets, and thereby reduce funding pressures in U.S. financial markets.

The modifications proposed by H.R. 1207 are not needed to allow the GAO to audit the Federal Reserve's supervisory and regulatory programs for banking organizations, its consumer protection functions, or the many other aspects of the Federal Reserve's responsibilities that are not related to monetary policy or transactions with foreign authorities.  As I noted earlier, the GAO already has and exercises authority to conduct audits in these areas, and the Federal Reserve cooperates fully with the GAO on these reviews.

The Federal Reserve recognizes that there may be ways to further enhance the review of the operational integrity of our market credit facilities without endangering our ability to independently determine and implement monetary policy.  We have worked and will continue to work with this Committee and the Congress to ensure that our credit facilities are operated in a way that promotes the highest standards of accountability, stewardship, and policy effectiveness.

Thank you for inviting me to present the Board's views on this very important subject.  I look forward to answering any questions you may have.