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Federal Reserve: Oversight and Disclosure Issues

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Summary

Critics of the Federal Reserve (Fed) have long argued for more oversight, transparency, and disclosure. Criticism intensified following the extensive assistance the Fed provided to financial firms during the financial crisis. Some critics downplay the degree of Fed oversight and disclosure that already takes place.

For oversight, the Fed is required to provide a written report to and testify before the committees of jurisdiction semi-annually. In addition, these committees periodically hold more focused hearings on Fed topics. Critics have sought a Government Accountability Office (GAO) audit of the Fed. The Fed's financial statements are annually audited by private-sector auditors. Contrary to popular belief, GAO has periodically conducted Fed audits since 1978, subject to statutory restrictions, and a GAO audit would not, under current law, release any confidential information identifying institutions that have borrowed from the Fed or the details of other transactions. The Dodd-Frank Act (P.L. 111-203) resulted in an audit of the Fed's emergency activities during the financial crisis and an audit of Fed governance. GAO can currently audit Fed activities for waste, fraud, and abuse. Effectively, the remaining statutory restrictions prevent GAO from evaluating the economic merits of Fed policy decisions. H.R. 3189, passed by the House, would require annual GAO audits that would not be subject to statutory restrictions. H.R. 24, S. 264, and S. 2232 would also require a GAO audit that would not be subject to statutory restrictions. On January 12, 2016, the Senate voted not to invoke cloture on S. 2232.

For disclosure, the Fed has publicly released extensive information on its operations, mostly on a voluntary basis. It is statutorily required to release an annual report and a weekly summary of its balance sheet. In December 2010, the Dodd-Frank Act required the Fed to release individual lending records for emergency facilities created during the financial crisis, revealing borrowers' identities and loans' terms. Going forward, individual records for discount window and open market operation transactions have been released with a two-year lag. More recently, congressional attention has shifted to disclosure related to Fed regulation. H.R. 3189 would require the Fed to conduct quantitative cost-benefit analysis on its rulemaking and disclose more information related to regulation (including international agreements), and salary and financial information about Fed officials and employees. H.R. 3189 and S. 1484/S. 1910 would require the Fed to compare its monetary policy to a rule and release transcripts of its policy deliberations.

Although oversight and disclosure are often lumped together, they are separate issues. Oversight entails independent evaluation of the Fed; disclosure is an issue of what internal information the Fed releases to the public. A potential consequence of greater oversight is that it could undermine the Fed's political independence. Most economists contend that the Fed's political independence leads to better policy outcomes and makes policy more effective by enhancing the Fed's credibility in the eyes of market participants. Chair Yellen believes that the GAO audit provision in H.R. 3189 "would politicize monetary policy and bring short-term political pressures into the deliberations of the FOMC by putting into place real-time second guessing of policy decisions." Disclosure helps Congress and the public better understand the Fed's actions. Up to a point, this makes monetary and regulatory policy more effective, but too much disclosure could make both less effective because they rely on confidential information. The challenge for Congress is to strike the right balance between a desire for the Fed to be responsive to Congress and for the Fed's decisions to be immune from short-term political calculations. A potential drawback to greater disclosure is that publicizing the names of borrowers could potentially stigmatize them in a way that causes runs on those borrowers or causes them to shun access to needed liquidity. Either outcome could result in a less stable financial system. A potential benefit of publicizing borrowers is to safeguard against favoritism or other conflicts of interest.

Contents

Contacts

Introduction

Congress has delegated monetary policy duties to the Federal Reserve (Fed), but retains oversight responsibilities. The Fed enjoys an unusual degree of independence from Congress and the President compared with other government agencies.[1] Proponents of these arrangements argue that this independence results in good, non-political policymaking and a high degree of credibility with financial markets.[2] Critics of the Fed argue that it performs essential government functions with political implications, yet is more opaque and unaccountable than other government agencies. Following the financial crisis, they assailed the Fed's decision to extend more than $1 trillion of assistance to the financial sector—exceeding the amount extended by the Troubled Asset Relief Program (TARP)—without any congressional input.[3] Much of this assistance was authorized by broad, seldom-used emergency powers found in Section 13(3) of the Federal Reserve Act.[4] These critics call for more oversight, transparency, and disclosure for the Fed.[5] More specifically, critics have focused on Government Accountability Office (GAO) audits of the Fed and the disclosure of details on the identities of borrowers and terms of loans.

Some of these critics downplay the degree of Fed oversight and disclosure that already takes place, which is outlined in this report. Contrary to popular belief, GAO has conducted frequent audits of the Fed since 1978, subject to statutory restrictions discussed below. In addition, the Fed's annual financial statements are audited by private-sector auditors. The Wall Street Reform and Consumer Protection Act of 2010 (hereinafter, the Dodd-Frank Act; P.L. 111-203) resulted in an audit of the Fed's emergency activities during the financial crisis, released in July 2011, and an audit of Fed governance, released in October 2011.

The Fed discloses extensive information about its operations voluntarily or as required by statute. In December 2010, as a result of the Dodd-Frank Act, the Fed released individual lending records for emergency facilities, revealing borrowers' identities for the first time. Going forward, the act requires individual records for discount window and open market operation transactions to be released with a two-year lag;[6] the Fed began releasing those records in the third quarter of 2012.

Although oversight and disclosure are often lumped together, they are separate issues and need not go together. Oversight entails independent evaluation of the Fed; disclosure concerns what internal information the Fed releases to the public. Contrary to a common misperception, a GAO audit would not, under current law, result in the release of any confidential information

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[1] For more information, see CRS Report R43391, *Independence of Federal Financial Regulators*, by Henry B. Hogue, Marc Labonte, and Baird Webel.

[2] See, for example, Frederic Mishkin, "Politicians Are Threatening the Fed's Independence," *Wall Street Journal*, September 29, 2011, http://online.wsj.com/article/SB10001424052970204831304576597200646525870.html. Economist William Poole makes the case that the Fed's independence is valuable, but that its role in the crisis has undermined its independence. See William Poole, "The Bernanke Question," July 28, 2009, http://www.cato.org/pub_display.php?pub_id=10388. For a review of the economic literature on whether independence promotes better policy, see CRS Report RL31955, *Central Bank Independence and Economic Performance: What Does the Evidence Show?*, by Marc Labonte and Gail E. Makinen.

[3] For details of the Fed's and TARP actions during the financial crisis, see CRS Report R43413, *Costs of Government Interventions in Response to the Financial Crisis: A Retrospective*, by Baird Webel and Marc Labonte.

[4] 12 U.S.C. §343. For more information, see CRS Report R44185, *Federal Reserve: Emergency Lending*, by Marc Labonte.

[5] See, for example, Mark Calabria, Testimony before U.S. House of Representatives, Committee on Financial Services, October 4, 2011, http://financialservices.house.gov/UploadedFiles/100411calabria.pdf.

[6] The discount window is how banks traditionally borrow from the Fed. Open market transactions are how the Fed implements monetary policy.

identifying institutions that have borrowed from the Fed or the details of other transactions. This report will consider the two issues separately.

In the 114th Congress, S. 2232 would require a one-time GAO audit of the Fed that is not subject to statutory restrictions. On January 12, 2016, the Senate voted not to invoke cloture on a motion to proceed to debate on S. 2232. The Fed Oversight Reform and Modernization Act (H.R. 3189) was ordered to be reported by the House Financial Services Committee on July 29, 2015, and passed the House on November 19, 2015. It would require annual audits of the Fed that are not subject to statutory restrictions, while making a number of other changes increasing Fed oversight and disclosure. The Centennial Monetary Commission Act (H.R. 2912) was added to H.R. 3189 before the latter passed the House. S. 1484, legislation that would make wide-ranging changes to financial regulation, was reported on June 2, 2015, by the Senate Committee on Banking, Housing, and Urban Affairs. Title 5 includes provisions related to Fed oversight and disclosure. S. 1484 was then included in the FY2016 Financial Services and General Government Appropriations Act (S. 1910), which was reported by the Senate Appropriations Committee on July 30, 2015.[7]

This report provides an overview of existing Fed oversight and disclosure practices, highlighting recent legislative changes and proposals. It also considers the potential impact of greater oversight and disclosure on the Fed's independence and its ability to achieve its macroeconomic and financial stability goals.

Oversight of Federal Reserve Activities

Before the recent financial crisis, oversight of the Fed already occurred in a number of forms. Regular congressional oversight of the Fed was, and still is, done through statutorily required semi-annual hearings with and written reports to the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee,[8] as well as ad hoc hearings on more focused topics, such as the Fed's response to the financial crisis.[9] Indeed, the House Financial Services Committee has a subcommittee dedicated primarily to monetary policy issues, the Subcommittee on Monetary Policy and Trade.

The terms of the chairman and vice-chairmen of the Federal Reserve Board of Governors last for four years and are subject to presidential nomination and Senate confirmation. This gives the Senate a chance to review and weigh in on the Fed's performance every four years. Governors are also subject to presidential nomination and Senate confirmation, but can serve only one full term, so it is rare for the Senate to evaluate a sitting governor. The Fed's regional bank presidents, who vote with the governors on monetary policy decisions, and regional bank directors are not subject to Senate confirmation, but are chosen in part by the Board of Governors.

[7] For an overview of all provisions of these bills related to the Fed, see CRS Report R44273, *Federal Reserve: Legislation in the 114th Congress*, by Marc Labonte.

[8] §2B of the Federal Reserve Act (12 U.S.C. §225b). These hearings and reporting requirements were established by the Full Employment Act of 1978 (P.L. 95-523, 92 Stat 1897), also known as the Humphrey-Hawkins Act, and renewed in the American Homeownership and Economic Opportunity Act of 2000 (P.L. 106-569). Since 2000, the Fed chairman has not been required to testify before both committees semi-annually, but has continued to do so.

[9] In response to the financial crisis, Congress also created a special legislative branch committee, the Congressional Oversight Panel (COP), and an executive branch inspector general, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) tasked with providing oversight of TARP for Congress. Both were focused on TARP and both occasionally analyzed the Fed's emergency operations, particularly those that overlapped with TARP. COP ceased operations in 2011.

One notable difference between the Fed and most other government agencies is that there is no congressional budgetary oversight of the Fed—the Fed is self-financing and its budget is not subject to the appropriations or authorization process. Thus, there is no regular avenue for Congress to ensure that the Fed is devoting resources to congressional priorities, or to use congressional control over resources as leverage to achieve its goals.

Within the Federal Reserve System, there is an Office of Inspector General (OIG) that regularly issues reports stemming from its investigations. It also issues semiannual reports to Congress that provide an overview of its activities. The Fed's OIG "promotes integrity, economy, efficiency, and effectiveness; helps prevent and detect fraud, waste, and abuse; and strengthens the agencies' accountability to Congress and the public";[10] it does not perform policy or economic evaluations. Examples of OIG reviews include the Fed's emergency lending facilities[11] and the Board's implementation of the Dodd-Frank Act.[12]

In its rule-making, the Fed follows the standard notice and comment process, which provides some transparency to the Fed's decision-making process and gives the public a chance to weigh in on regulatory proposals. However, as an independent agency, the Fed's rulemaking is not subject to executive review by the Office of Information and Regulatory Affairs and cost-benefit analysis requirements under Executive Order 12866.[13] The Fed has an ombudsman and an appeals process for its supervisory decisions, such as exam results. The Dodd-Frank Act also created a Federal Reserve vice chairman for Supervision and required the vice chairman to appear before the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee semi-annually regarding the Fed's financial supervisory powers.[14]

Effective congressional oversight is complicated by the complex, technical nature of monetary policymaking. There is no group with monetary policy expertise tasked by Congress with evaluating the Fed's actions. Congress could create specific oversight boards or bodies composed of outside experts that focus on the Federal Reserve. Congress could also rely on GAO audits for enhanced oversight. The congressional debate has focused on GAO audits, which are discussed in the next section.

GAO Audits

GAO is described as the "congressional watchdog," and GAO's mission is "to support the Congress in meeting its constitutional responsibilities and to help improve the performance and ensure the accountability of the federal government for the benefit of the American people."[15] Balancing Congress's need for GAO's support in fulfilling its oversight role with the

[10] Federal Reserve, Office of Inspector General's Mission Statement, July 19, 2011, http://www.federalreserve.gov/oig/mission.htm.

[11] Office of the Inspector General, *The Federal Reserve's Section 13(3) Lending Facilities to Support Overall Market Liquidity*, November 2010, http://www.federalreserve.gov/oig/files/FRS_Lending_Facilities_Report_final-11-23-10_web.pdf.

[12] Office of the Inspector General, *Audit of the Board's Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, September 2011, http://www.federalreserve.gov/oig/files/Dodd_Frank_09.28.2011.pdf.

[13] For more information, see CRS Report R41974, *Cost-Benefit and Other Analysis Requirements in the Rulemaking Process*, coordinated by Maeve P. Carey.

[14] §10(12) of the Federal Reserve Act (12 U.S.C. §247b). Before the Dodd-Frank Act, there was only one vice chairman of the Board of Governors with general responsibilities.

[15] See http://www.gao.gov/about/index.html. GAO was formerly known as the General Accounting Office.

congressional desire to maintain the Fed's independence has led Congress to debate the utility of GAO audits of the Fed for decades.

Contrary to popular belief, GAO has conducted numerous Fed-related audits since 1978.[16] GAO audits are initiated through legislation or at the request of a Member or committee of Congress, and the subject of the audit is determined by the legislation or requester. Thus, the amount of attention devoted by GAO to the Fed over time depends on congressional priorities. GAO typically completes and initiates multiple audits related to the Fed each year.[17] Federal statute limited the scope of these audits, however.

GAO was not permitted to audit the Fed between 1933 and 1978.[18] The Federal Banking Agency Audit Act of 1978 (31 U.S.C. §714) gave GAO authority to audit the Fed's non-monetary policy functions, such as its regulatory duties and role in the payment system. It prohibited GAO from auditing Fed activities related to

> (1) transactions for or with a foreign central bank, government of a foreign country, or non-private international financing organization;
>
> (2) deliberations, decisions, or actions on monetary policy matters, including discount window operations, reserves of member banks, securities credit, interest on deposits, and open market operations;
>
> (3) transactions made under the direction of the Federal Open Market Committee; or
>
> (4) a part of a discussion or communication among or between members of the Board and officers and employees of the Federal Reserve System related to clauses (1)-(3) of this subsection.[19]

Although the act does not specifically mention activities taken under the Fed's emergency authority, which was widely used during the financial crisis, those activities were interpreted as falling under the act's restrictions. The 1978 act also included restrictions on GAO disclosure of confidential information about the financial firms subject to the Fed's policies and provided GAO access to relevant confidential information.

These 1978 provisions are still in effect today, but significant additions in more recent acts discussed in the next section have greatly expanded the scope of GAO's audits.

The Helping Families Save Their Homes Act (P.L. 111-22)

An amendment to the Helping Families Save Their Homes Act of 2009 (P.L. 111-22) includes a provision that allows GAO audits of "any action taken by the Board under ... Section 13(3) of the Federal Reserve Act with respect to a single and specific partnership or corporation." This

[16] The Government Accountability Office (GAO) draws the following distinction between its activities: "*auditing* agency operations to determine whether federal funds are being spent efficiently and effectively; *investigating* allegations of illegal and improper activities; [and] *reporting* on how well government programs and policies are meeting their objectives ... " [italics added] Source: http://www.gao.gov/about/index.html. Because the term *audit* is broadly defined in the Federal Reserve debate, the terms GAO audit, investigation, and report will be used interchangeably for purposes of this report. Technically, existing statutory restrictions are relevant for GAO's ability to conduct reports, not audits or investigations.

[17] GAO audits of the Fed are listed in the Fed's Annual Report each year, which can be accessed at http://www.federalreserve.gov/publications/annual-report/default.htm.

[18] General Accounting Office, "Federal Reserve System Audits," Testimony by Charles Bowsher before the House Committee on Banking, Finance, and Urban Affairs, GAO-GGD-94-44, October 27, 1993. Before 1978, GAO could only audit the Fed in its role as fiscal agent of the U.S. Treasury.

[19] 31 U.S.C. §714(b).

allowed GAO audits of the Maiden Lane facilities and the asset guarantees of Citigroup and Bank of America, but maintained audit restrictions on non-emergency activities and broadly accessed emergency lending facilities, such as the Primary Dealer Credit Facility or the commercial paper facilities.[20] In performing the audit under P.L. 111-22, GAO must maintain the confidentiality of the private documents it accesses, but cannot withhold any information requested by Members of Congress on the committees of jurisdiction. The Fed has not taken any action under Section 13(3) since the financial crisis.

The Dodd-Frank Act (P.L. 111-203)

Title XI of the Dodd-Frank Act included provisions that allow GAO for the first time to audit open market operations, discount window lending, actions taken under emergency authority (§13(3) of the Federal Reserve Act), and programs created in response to the financial crisis[21] for

> (A) the operational integrity, accounting, financial reporting, and internal controls governing the credit facility or covered transaction;
>
> (B) the effectiveness of the security and collateral policies established for the facility or covered transaction in mitigating risk to the relevant Federal reserve bank and taxpayers;
>
> (C) whether the credit facility or the conduct of a covered transaction inappropriately favors one or more specific participants over other institutions eligible to utilize the facility; and
>
> (D) the policies governing the use, selection, or payment of third-party contractors by or for any credit facility or to conduct any covered transaction.[22]

Although the legislation authorized GAO audits on these grounds, it did not authorize GAO to conduct policy or economic evaluations of the Fed's monetary actions. In addition, GAO may not disclose confidential information in its reports or to Congress until that information is made public by the Fed, with the exception of the Fed's Maiden Lane facilities. Thus, a GAO audit would not result in the disclosure of any confidential information, such as who has borrowed from the Fed. These statutory changes were added to—as opposed to replacing—the existing statutory restrictions.

The Dodd-Frank Act mandated that GAO audit the Fed's response to the recent crisis within a year of enactment. This audit was completed in July 2011.[23] The legislation also called for a separate GAO audit of Federal Reserve bank governance to assess whether it produces potential or actual conflicts of interest; whether the existing system of selecting regional Federal Reserve bank directors results in directors who represent "the public without discrimination on the basis of race, creed, color, sex, or national origin, and with due but not exclusive consideration to the

[20] For a description of these programs, see CRS Report R43413, *Costs of Government Interventions in Response to the Financial Crisis: A Retrospective*, by Baird Webel and Marc Labonte.

[21] The Dodd-Frank Act required a one-time audit of all programs created during the financial crisis. Going forward, the Dodd-Frank Act allows future audits of open market operations, discount window lending, and actions taken under emergency authority. It appears that this authority for future audits would not cover programs that do not fall under one of those three categories, such as the Fed's central bank liquidity swaps, which are still in operation. (The audit of crisis programs included central bank liquidity swaps.)

[22] P.L. 111-203 §(b)(2).

[23] U.S. Government Accountability Office (GAO), *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, GAO-11-696, Jul 21, 2011, http://www.gao.gov/new.items/d11696.pdf.

interests of agriculture, commerce, industry, services, labor, and consumers";[24] the role regional banks played in the Fed's response to the crisis; and to propose reforms to regional bank governance. This audit was completed in October 2011.[25]

A brief evaluation of the July 2011 audit may provide evidence to help answer the questions of whether these enhanced audit powers have increased the effectiveness of congressional oversight and whether removing all audit restrictions in the future would be useful. Most of the information covered in the GAO audit had already been publicly released by the Fed, so there was very little that could be learned from the audit that could not have been learned elsewhere. Some of the information was summarized in a more convenient form for a lay reader, however, whereas use of the raw data would, in some cases, have required time-consuming and complex calculations to reproduce their findings. By contrast, the presentation of some of the information was arguably sensationalized in a way that exaggerated the size and scope of the Fed's actions. For instance, GAO produced a table widely cited in the press that made it appear as if the Fed had lent $16 trillion during the crisis, although total lending from the Fed by the broadest measure never exceeded $1.6 trillion.[26] GAO generated this total by summing up all loans made by the Fed over the course of the crisis, whether their term was one day or one year. This is not a standard accounting method because it makes 365 one-day loans that are rolled over each day appear 365 times larger than a one-year loan of the same amount, even though the amount extended by the Fed is the same in both cases. GAO also made some specific recommendations for the Fed to strengthen internal controls and increase disclosure.

Recent Legislation on Oversight

112th Congress

In the 112th Congress, Representative Ron Paul sponsored H.R. 459, entitled the Federal Reserve Transparency Act. This bill, as passed, would have required a one-time GAO audit of the Fed within 12 months of enactment that is not subject to statutory restrictions. The House Committee on Oversight and Government Reform marked up H.R. 459 on June 27, 2012, amending the original legislation. An amendment adopted at the markup required GAO to conduct an audit of loan files in foreclosure in 2009 and 2010 required as part of enforcement actions taken by the Fed against financial institutions it supervised. H.R. 459 was reported from committee as amended and passed by the House on July 25, 2012.

113th Congress

On September 17, 2014, the House passed H.R. 24. This bill, as passed, would have required a one-time GAO audit of the Fed within 12 months of enactment that is not subject to statutory restrictions. A section of H.R. 24 requiring an audit of foreclosure files in 2009 and 2010 was struck in committee markup.

H.R. 5018, among other things, would have required the Fed to formulate a mathematical rule that would direct it how to set monetary policy (e.g., prescribe the current level of the federal

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[24] P.L. 111-203, §1109(b) quoting 12 U.S.C. §302.

[25] GAO, *Federal Reserve Bank Governance: Opportunities Exist to Broaden Director Recruitment Efforts and Increase Transparency*, GAO-12-18, October 19, 2011, http://www.gao.gov/new.items/d1218.pdf.

[26] GAO, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, GAO-11-696, July 21, 2011, Table 8, p. 131, http://www.gao.gov/new.items/d11696.pdf.

funds rate). It would also have required the Fed to calculate a standard Taylor Rule (called the "Reference Policy Rule" in the bill), a mathematical policy rule that prescribes a federal funds rate based on inflation and output.[27] Within 48 hours of a policy decision, the Fed would have been required to submit the prescription of its rule to GAO and the committees of jurisdiction. If the Fed changed its rule or did not follow its rule, it would have triggered a GAO audit that was not subject to the statutory restrictions described above and testimony by the Fed chair before the committees of jurisdiction. It would also have increased the frequency of required congressional testimony by the chair, from semi-annually to quarterly. It would have required semi-annual congressional testimony on supervision to take place even if the position of vice chair of Supervision is unfilled. It would have required a written report on ongoing rulemaking to accompany that testimony.

114th Congress

H.R. 3189, among other things, has a number of provisions related to congressional oversight of the Fed. H.R. 3189 would require annual audits of the Fed that are not subject to the statutory restrictions described above. It would require the Fed to formulate a mathematical rule that would direct how it is to set monetary policy (e.g., prescribe the current level of the federal funds rate). It would also require the Fed to calculate a standard Taylor Rule (called the "Reference Policy Rule" in the bill), a mathematical policy rule that prescribes a federal funds rate based on inflation and output.[28] Within 48 hours of a policy decision, the Fed would be required to submit the prescription of its rule to GAO and the committees of jurisdiction. If the Fed deviates from its rule, it would trigger a GAO audit not subject to the remaining statutory restrictions and testimony by the Fed chair before the committees of jurisdiction. It would also increase the frequency of required congressional testimony by the chair, from semi-annually to quarterly.

The Dodd-Frank Act created the position of vice chair of Supervision, requiring the vice chair to testify on Fed supervision semi-annually. H.R. 3189 would require semi-annual congressional testimony on supervision to take place even if the position of vice chair is unfilled, which it has been since its creation in 2010. It would require a written report on ongoing rulemaking to accompany that testimony.

H.R. 2912, which was included in the version of H.R. 3189 that passed the House, would create a commission containing 12 voting members: 4 Members from the House majority party, 2 Members from the House minority party, 4 Members from the Senate majority party, and 2 Members from the Senate minority party. The commission would examine and make recommendations on monetary policy, the dual mandate,[29] macroprudential regulation, and lender of last resort functions. The commission is authorized to be funded through appropriations.[30]

Among provisions related to Fed oversight, S. 1484/S. 1910 would increase the frequency of the Fed's required reports to Congress on monetary policy from semi-annually to quarterly. It adds three economic variables—inflation expectations, credit conditions, and interest rates—and economic and monetary policy projections to the list of items that the Fed should discuss in the report. It also requires the Fed to include a discussion of any mathematical rules or other strategies it uses in monetary policy deliberations and how policy has deviated from those rules

[27] For more information, see CRS In Focus IF10207, *Monetary Policy and the Taylor Rule*, by Marc Labonte.

[28] For more information, see CRS In Focus IF10207, *Monetary Policy and the Taylor Rule*, by Marc Labonte.

[29] 12 U.S.C. §225a.

[30] S. 1484/S. 1910 would also create a congressional commission, but that commission was tasked with studying "whether it is appropriate to restructure the Federal Reserve districts…."

and strategies. The Taylor rule is a prominent example of such a rule.[31] It would allow members of the FOMC to include a statement of dissent in the report to Congress.

S. 1484/S. 1910 would require when the position of vice chair is vacant, the Fed chair to testify instead. S. 1484/S. 1910 would also require a one-time GAO study and a report by the Fed to Congress every 2 years for the next 10 years on the Fed's enhanced prudential regulation of banks with more than $50 billion in assets and nonbank financial institutions designated as systemically important (SIFIs).[32] The bill requires GAO to evaluate whether there are conflicts of interest between the Fed and the large institutions it regulates.

H.R. 24, S. 264, and S. 2232 in the 114th Congress would require a one-time GAO audit of the Fed that is not subject to statutory restrictions, similar to H.R. 459 in the 112th Congress and H.R. 24 in the 113th Congress. H.R. 24 and S. 2232 do not include the provision requiring an audit of 2009 and 2010 foreclosures, whereas S. 264 does. On January 12, 2016, the Senate voted not to invoke cloture on a motion to proceed to debate on S. 2232.

For the provisions of these bills related to disclosure, see the "114th Congress" section below in "Disclosure of Federal Reserve Activities."

Disclosure of Federal Reserve Activities

Until the financial crisis, statutory requirements for Fed disclosure were limited to its overall activities and finances. The Fed is statutorily required to "annually make a full report of its operations" to Congress that includes a full account of open market operations and "publish once each week a statement showing the condition of each Federal Reserve bank and a consolidated statement for all Federal Reserve banks" showing in detail the system's assets and liabilities.[33] This Annual Report is made available to the public and includes votes taken on monetary and regulatory decisions, as well as a summary of major actions taken.[34] The Fed is statutorily required to have its financial statements annually audited by an independent auditor.[35] This audit is published in the Fed's Annual Report. Congress also requires the Fed to produce reports on other miscellaneous topics.[36]

Despite the limited scope of statutory requirements, particularly related to monetary policy, the Fed has publicly disclosed extensive information on its operations on a voluntarily basis. Furthermore, the amount of disclosure has increased over time. Until 1993, the Fed did not publicly announce its monetary policy decisions (e.g., interest rate changes). The Fed has released minutes from its monetary policy deliberations (FOMC meetings) with a three-week lag since 1993 and transcripts of those deliberations with a five-year lag since 1995.[37] The Fed's monetary

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[31] For more information, see CRS In Focus IF10207, *Monetary Policy and the Taylor Rule*, by Marc Labonte.

[32] For more information on enhanced prudential regulation, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

[33] §10(7), §10(10), and §11(a)(1) of the Federal Reserve Act (12 U.S.C. §247, 12 U.S.C. §247a, and 12 U.S.C. §248(a), respectively).

[34] Annual reports can be accessed at http://www.federalreserve.gov/publications/annual-report/default.htm.

[35] §11B of the Federal Reserve Act (12 U.S.C. §248b). Since 2012, the Fed has voluntarily released unaudited financial statements quarterly as well. Those statements can be found at http://www.federalreserve.gov/monetarypolicy/bst_fedfinancials.htm#quarterly.

[36] Other Fed reports to Congress can be accessed at http://www.federalreserve.gov/publications/other-reports/default.htm.

[37] From 1970 to 1993, the Fed released other information on Federal Open Market Committee (FOMC) meetings. See David Lindsey, *A Modern History of FOMC Communication*, manuscript, June 2003, available at
(continued...)

policy has also become more transparent in recent years—a move endorsed by Chair Janet Yellen—with a more detailed description of the rationale for current and future policy decisions provided to the public.[38] In 2009, the Fed began releasing the economic projections of Fed officials. In 2011, the chairman began holding quarterly press conferences following FOMC announcements. In 2012, it announced a "longer-run goal" of 2% inflation for monetary policy. The Fed also releases information on its rulemaking, policies, and enforcement actions on its website. The Fed is subject to the Freedom of Information Act (FOIA), although it sometimes invokes exemptions provided in that act to deny FOIA requests.[39] Two studies found the Fed to rank as one of the more transparent central banks in the world.[40]

Before 2007, Fed lending to the financial system was minimal and monetary policy was limited to the buying and selling of U.S. Treasury securities. Public and congressional interest in Fed disclosure increased in response to the significant financial assistance the Fed provided the financial sector during the financial crisis. As the crisis unfolded, the Fed publicly released a significant amount of information on its emergency actions. The Fed voluntarily provided detailed information to the public on the general terms and eligibility of its borrowers and collateral by class for each crisis-response program.[41] It also provided a rationale for why each crisis program was created and an explanation of the goals the program aimed to accomplish. Beginning in June 2009, the Fed began releasing a monthly report that listed the number of and concentration among borrowers by type, the value and credit-worthiness of collateral held by type, and the interest income earned for each of its facilities.[42] Contracts with private vendors to purchase or manage assets for the facilities are also posted on the New York Fed's website.[43]

Prior to the Dodd-Frank Act, the Fed had kept confidential the identity of the borrowers from its facilities, the collateral posted in specific transactions, the terms of specific transactions, and the results of specific transactions (i.e., whether they resulted in profits or losses). As historical precedent, the Fed has had a long-standing policy of keeping confidential the identity of banks that borrow from its discount window.

(...continued)

http://fraser.stlouisfed.org/docs/publications/books/20030624_lindsey_modhistfomc.pdf.

[38] See Janet Yellen, "Communication in Monetary Policy," speech, Washington, DC, April 4, 2013, available at http://www.federalreserve.gov/newsevents/speech/yellen20130404a.htm. For an analysis of the effects of monetary policy transparency on economic outcomes, see William English et al., "The Federal Reserve's Framework for Monetary Policy," working paper presented at the International Monetary Fund, November 2013.

[39] The nine FOIA exemptions and their relevance to the Fed are detailed at http://www.federalreserve.gov/generalinfo/foia/exemptions.cfm. For background on FOIA, see CRS Report R41933, *The Freedom of Information Act (FOIA): Background, Legislation, and Policy Issues*, by Wendy Ginsberg.

[40] N. Nergiz Dincer and Barry Eichengreen, "Central Bank Transparency and Independence," *International Journal of Central Banking*, March 2014. This study finds an increase in Fed transparency between 1998 and 2010. Christopher Crowe and Ellen Meade, "Central Bank Independence and Transparency," *European Journal of Political Economy*, December 2008, vol. 24, no. 4, p. 763. This study finds a slight decline in Fed transparency between 1998 and 2006. It appears that the authors rate the Fed as less transparent in 2006 than 1998 because the Fed discontinued its release of money growth targets between those dates.

[41] All of the information outlined in this paragraph can be accessed at the Fed's website at http://www.federalreserve.gov/monetarypolicy/bst.htm.

[42] Federal Reserve Board of Governors, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, available at http://www.federalreserve.gov/monetarypolicy/bst_reports.htm. The report is now issued quarterly.

[43] Contracts are available at http://www.newyorkfed.org/aboutthefed/vendor_information.html.

The Emergency Economic Stabilization Act (P.L. 110-343)

For any action taken under the Fed's emergency authority (§13(3) of the Federal Reserve Act), the Emergency Economic Stabilization Act (P.L. 110-343) required the Fed to report to the House Financial Services Committee and the Senate Banking, Housing, and Urban Affairs Committee on its justification for exercising Section 13(3), the terms of the assistance provided, and regular updates on the status of the assistance. It did not require the Fed to release information on borrowers' identities or specific transactions.

The Dodd-Frank Act (P.L. 111-203)

For actions taken under Section 13(3) of the Federal Reserve Act, Title XI of the Dodd-Frank Act included a provision that requires the Fed to provide the congressional committees of jurisdiction details on the rationale for assistance; the identity of the recipient; the date, amount, and form of assistance; collateral pledged; the material terms of the assistance; and the expected cost to the taxpayer. This information is to be provided within 7 days, with updates every 30 days following. The Fed can request that this information be kept confidential and limited to the chairmen and ranking Members of the committees.

The act also called, for the first time, for public disclosure of the identities of borrowers, amount borrowed, rate charged, and collateral pledged or assets transferred. For Fed programs created during the crisis, this information had to be publicly disclosed by December 1, 2010. The information was released on that date.[44] The December 2010 data release covered all facilities created during the crisis, but did not cover the discount window or open market operations. Going forward, this information is to be disclosed quarterly within one year after a credit facility is terminated and within two years after the transaction for discount window loans or open market operations. The requirement for future transactions to be disclosed covers the discount window, open market operations, and any facility created under the Fed's emergency authority (§13(3) of the Federal Reserve Act). Discount window transactions and open market operations are available every quarter beginning in the third quarter of 2012.[45] To date, no emergency actions have been taken since enactment of the Dodd-Frank Act that would trigger a report. It appears that this requirement would not cover programs that do not fall under one of those three categories, such as the Fed's central bank liquidity swaps, which are still in operation. However, the 2010 data release and its quarterly report on the balance sheet disclose which central banks used the liquidity swaps.[46] Foreign central banks are under no obligation to disclose what they did with funds, however.

In addition, Title XI requires the Fed to create a page on its website entitled "Audit," linking to GAO reports, its financial statements, and the reports required under the Emergency Economic Stabilization Act (described above).[47]

Title XI also requires the Fed's Inspector General to conduct a study on the impact of exemptions from the Freedom of Information Act on the ability of the public to access information on the

[44] It can be accessed at http://www.federalreserve.gov/newsevents/reform_transaction.htm.

[45] Available at http://www.federalreserve.gov/newsevents/reform_quarterly_transaction.htm.

[46] Federal Reserve Board of Governors, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet,* available at http://www.federalreserve.gov/monetarypolicy/bst_reports.htm.

[47] The page can be accessed at http://www.federalreserve.gov/newsevents/reform_audit.htm.

Fed's emergency facilities, discount window, and open market operations within 30 months of enactment. The report was released in January 2013.[48]

Recent Legislation on Disclosure

113th Congress

In the 113th Congress, H.R. 5018, among other things, would have mandated a blackout period lasting from one week before to one day after a FOMC, where monetary policy decisions are made.[49] It would have required the Fed to determine its stress test scenarios through the public rulemaking process and provide those scenarios to GAO and CBO's Panel of Economic Advisers. It would have required the Fed to publicly disclose the total number of supervisory letters sent to bank holding companies with more than $50 billion in assets or nonbanks designated as systemically important. Currently, the scenarios are not disclosed to the banks or the public. It would have required the Fed's public rulemaking to include quantitative and qualitative cost-benefit analysis. It would have required the Fed to notify the committees of jurisdiction and the public and solicit public comment at least 90 days before it enters into or completes international negotiations. It would have required salary and personal investments for all Fed members, officers, and employees of the Federal Reserve System with a salary above GS-15 on the government scale to be publicly disclosed.

114th Congress

H.R. 3189 has a number of provisions requiring the Fed to publicly disclose additional information. It would require the Fed to

- determine its stress test scenarios through the public rulemaking process and provide those scenarios to GAO and CBO's Panel of Economic Advisers. Currently, the scenarios are not disclosed to the banks or the public, but the stress test process was publicly described through the standard rule making process.
- publicly disclose the total number of supervisory letters sent to bank holding companies with more than $50 billion in assets or non-banks designated as SIFIs.
- include in its public rulemaking quantitative and qualitative cost-benefit analysis and a post-adoption impact assessment.
- notify the committees of jurisdiction and the public and solicit public comment at least 30 days before it enters into and at least 90 days before it completes international negotiations on financial standards.[50]
- publicly disclose salary and personal investments for all Fed members, officers, and employees of the Federal Reserve Board of Governors with a salary above GS-15 on the government scale.

[48] Office of Inspector General, Federal Reserve, *No Changes Recommended to Freedom of Information Act Exemption*, January 2013, available at http://www.federalreserve.gov/oig/oig_rpt_2013.htm.

[49] The Fed has voluntarily adopted a similar policy. See http://www.federalreserve.gov/monetarypolicy/files/FOMC_ExtCommunicationStaff.pdf.

[50] This section also applies to the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

In addition, amendments added to H.R. 3189 as passed by the House would require the Fed to include an estimate of the impact of the Export-Import Bank and foreign export credit agencies on the Industrial Production Index in that release, which is prepared monthly by the Fed.

Currently, the Fed voluntarily releases FOMC transcripts to the public with a five-year lag. H.R. 3189 would require the Fed to publicly release FOMC transcripts. S. 1484/S. 1910 would require the lagged release of FOMC transcripts after three years. It would also require a publicly recorded vote by the Board on bank enforcement actions exceeding $1 million.[51]

For the provisions of these bills related to oversight, see the "114th Congress" section in the section "Oversight of Federal Reserve Activities."

Freedom of Information Act Lawsuits

The December 2010 release did not include information on discount window transactions. Separately, Bloomberg and Fox News Network sued the Federal Reserve under the Freedom of Information Act for the release of internal records pertaining to lending activities, including the discount window, for the period of August 2007 to March 2010. The Fed initially denied their requests based on the exemptions provided in the FOIA, but, as a result of the court ruling, the Fed released this information on March 31, 2011.[52]

Arguments For and Against Greater Oversight and Disclosure

Calls for greater Fed transparency can be placed into two categories: (1) more disclosure of its policy decisionmaking and (2) more disclosure of its borrowers and counterparties. There is some evidence that more transparency on decisionmaking can help market participants better predict the Fed's actions; some economists believe predictability makes monetary policy more effective.[53] Others worry that too much transparency risks hindering frank debate among policymakers or making monetary policy more political.[54]

The Fed has argued that allowing the public to know which firms are accessing its facilities could undermine investor confidence in the institutions receiving aid because of a perception that recipients are weak or unsound. A loss of investor confidence could potentially lead to destabilizing runs on the institution's deposits, debt, or equity. If institutions feared that this would occur, the Fed argues, the institutions would be wary of participating in the Fed's programs. A delayed release of information mitigates, but does not eliminate, these concerns. Some critics would view less Fed lending as a positive outcome, but if the premise that the Fed's

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[51] For information on enforcement actions, see http://www.federalreserve.gov/apps/enforcementactions/default.aspx.

[52] Bloomberg LP v. Board of Governors of the Federal Reserve System, U.S. District Court, Southern District of New York (Manhattan), No. 08-9595.

[53] See, for example, Christopher Crowe and Ellen Meade, "Central Bank Independence and Transparency: Evolution and Effectiveness," International Monetary Fund, working paper WP/08/119, May 2008. A recent Dallas Fed article establishes a correlation between central banks with greater transparency and more anchored inflation expectations among the public. See J Scott Davis, Adrienne Mack, and Mark Wynne, "Central Bank Transparency Anchors Inflation Expectations," Federal Reserve Bank of Dallas, *Economic Letter*, vol. 9, no. 4, April 2014.

[54] For an empirical analysis of the effects of releasing FOMC transcripts on debate at FOMC meetings, see Stephen Hansen, Michael McMahon, and Andrea Prat, "Transparency and Deliberation Within the FOMC," CEPR, discussion paper 9994, May 2014.

lender of last resort role helps prevent financial crises by maintaining the liquidity of the financial system is accepted, then an unwillingness by institutions to access Fed facilities makes the system less safe.

Whether investors are less willing to borrow as a result of the disclosure of identities will not be apparent until the next liquidity crunch. A historical example supporting the Fed's argument would be the experience with the Reconstruction Finance Corporation (RFC) in the Great Depression. When the RFC publicized to which banks it had given loans, those banks typically experienced depositor runs.[55] A more recent example—disclosure of TARP fund recipients—provides mixed evidence. At first, TARP funds were widely disbursed, and recipients included all the major banks. At that point, there was no perceived stigma to TARP participation. Subsequently, many banks repaid TARP shares at the first opportunity, and several remaining participants have expressed concern that if they did not repay soon, investors would perceive them as weak.

The granularity of information to be disclosed is a policy issue. Aggregate information about programs and activities that does not require the identification of borrowers tends to be more useful for broad policy purposes, while current information on specific transactions within the programs is of interest to investors. The Fed voluntarily released the former, but only reluctantly released the latter when compelled to by legislation and lawsuits. For oversight purposes, the former would suffice for answering most questions about taxpayer risk exposure, expected profits or losses, potential subsidies, economic effects, and evaluating the state of the financial system. The latter would be necessary for transparency around issues such as favoritism (certain firms receiving preferential treatment over similar firms).[56] Although preventing favoritism is a valid policy goal, releasing the identities of borrowers to "name and shame" them is more questionable, especially if one believes that these programs were helpful for providing liquidity and maintaining financial stability. Naming and shaming is likely to result in less uptake of the programs in the future. If one believes that these lending programs are not helpful, eliminating the programs would be more effective than undermining their effectiveness by stigmatizing recipients.

Greater disclosure and outside evaluation could potentially help Congress perform its oversight duties more effectively. An argument against increasing Fed oversight would be that it could be perceived as reducing the Fed's operational independence. Ben Bernanke, Fed chairman at the time, argued that "the general repeal of (the audit) exemption would serve only to increase the perceived influence of Congress on monetary policy decisions, which would undermine the confidence the public and the markets have in the Fed."[57] Most economists believe that the Fed's independence to carry out day-to-day decisions about monetary policy, unburdened by short-term political considerations, strengthens the Fed's credibility in the eyes of the private sector that it will achieve its mandated goal of price stability. Greater credibility is perceived to strengthen the effectiveness of monetary policy on the economy. This independence is seen as consistent with the democratic process because the Fed's mandate to pursue price and economic stability has

[55] James Butkiewicz, "The Reconstruction Finance Corporation, the Gold Standard, and the Banking Panic of 1933," *Southern Economic Journal*, vol. 66, no. 2, October 1999, p. 271.

[56] Another option for addressing these types of questions would be to allow GAO, the Fed's Inspector General, or some other outside group to investigate confidential material without releasing it to the public.

[57] Ben Bernanke, "Don't Strip the Fed of Supervisory Power," *Valley News*, December 1, 2009, p. A6. See also Donald Kohn, "Federal Reserve Independence," Testimony before the Subcommittee on Domestic Monetary Policy and Technology, House Financial Services Committee, July 9, 2009.

been given to it by Congress, and the use of policy instruments to achieve these goals is viewed as relatively technocratic in nature.[58]

The Fed's unprecedented response to the financial crisis moved it into new policy areas involving decisions that were arguably more political in nature, such as deciding which financial actors should be eligible to access Fed credit. New policy instruments were also potentially riskier than the discount window, and, unlike the discount window, were not explicitly endorsed by legislation at the time (many were authorized under its broad emergency authority). At this point, the emergency programs are winding down, lending is low, and Fed activities have shifted back to the traditional buying and selling of U.S. Treasury securities. As a result, some rationales raised during the crisis for greater oversight and disclosure are waning. Were another crisis to occur, Fed lending could potentially scale up quickly again, however.

Although few policymakers argue for total independence or total disclosure and oversight, the policy challenge is to strike the right balance between Fed independence and Fed accountability.

Federal Reserve Views on Oversight Reform Proposals

In February 2010 testimony, then-Chairman Bernanke advocated reforms that, in his view, would maintain a balance between independence and accountability:

> [W]e understand that the unusual nature of (the emergency credit and liquidity) facilities creates a special obligation to assure the Congress and the public of the integrity of their operation. Accordingly, we would welcome a review by the GAO of the Federal Reserve's management of all facilities created under emergency authorities. In particular, we would support legislation authorizing the GAO to audit the operational integrity, collateral policies, use of third-party contractors, accounting, financial reporting, and internal controls of these special credit and liquidity facilities…. We are also prepared to support legislation that would require the release of the identities of the firms that participated in each special facility after an appropriate delay. It is important that the release occur after a lag that is sufficiently long that investors will not view an institution's use of one of the facilities as a possible indication of ongoing financial problems, thereby undermining market confidence in the institution or discouraging use of any future facility that might become necessary to protect the U.S. economy.[59]

The Fed has opposed legislation subsequent to the Dodd-Frank Act that would remove remaining GAO audit restrictions, however. In July 2012, then-Chairman Bernanke testified,

> I want to agree with the basic premise that the Federal Reserve should be thoroughly transparent, thoroughly accountable. I will work with everyone here to make sure that that's the case. But I do feel it's a mistake to eliminate the exemption from monetary policy and deliberations which would effectively, at least to some extent, create a political influence or a political dampening effect on the Federal Reserve's policy decisions….
>
> The one thing which I consider to be absolutely critical, though, about the bill is that it would eliminate the exemption from monetary policy in deliberations. And the nightmare scenario I have is one in which some future Fed chairman would decide and say to raise the federal funds rate by 25 basis point, and somebody in this room would say I don't like that decision, I want the GAO to go in and get all of the records, get all the transcripts,

[58] See CRS Report RL31056, *Economics of Federal Reserve Independence*, by Marc Labonte.

[59] Ben S. Bernanke, *Semiannual Monetary Policy Report to the Congress*, Testimony Before the Committee on Financial Services, U.S. House of Representatives, Washington, DC, 111th Cong., 2nd sess., February 24, 2010.

> get all the preparatory materials and give us an independent opinion whether or not that was the right decision. And I think that would have a chilling effect and would prevent the Fed from operating on the apolitical independent basis that is so important in which experience shows is likely to lead to a low inflation healthy currency kind of economy.[60]

In a letter to Congress,[61] Chair Yellen opposed H.R. 3189. She stated that its policy rule provision

> would effectively put the Congress and the GAO squarely in the role of reviewing short-run monetary policy decisions and in a position to, in real time, influence the monetary policy deliberations leading to those decisions.

With regard to its GAO audit provision, she stated that the bill

> would politicize monetary policy and bring short-term political pressures into the deliberations of the FOMC by putting into place real-time second guessing of policy decisions…. The provision is based on a false premise—that the Fed is not subject to an audit.

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[60] Ben Bernanke, *Semiannual Monetary Policy Report to the Congress*, Testimony Before the Committee on Financial Services, U.S. House of Representatives, 112th Cong., 2nd sess., July 18, 2012.

[61] Chair Janet Yellen, *Letter to Honorable Paul Ryan and Honorable Nancy Pelosi*, November 16, 2015, http://www.http://www.federalreserve.gov/foia/files/ryan-pelosi-letter-20151116.pdf.