



The Federal Reserve Accountability and Transparency Act*

Jim Sivon
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In late July, after a year-long review of the Federal Reserve System, the House Financial Services Committee passed the Federal Reserve Accountability and Transparency Act (H.R. 5018). Financial services firms should take note of this bill since it not only raises fundamental policy questions related to the conduct of monetary policy and the independence of the Federal Reserve, but it also includes several provisions related to the Federal Reserve Board's role as a supervisor and regulator.

Monetary Policy

The centerpiece of the Federal Reserve Accountability and Transparency Act is a requirement that the Federal Reserve Board follow a "rules-based" approach to monetary policy. Monetary policy rules have been the subject of extensive discussion and debate within economic circles for decades. In the 1960s, for example, Milton Friedman advocated that monetary policy be linked to a constant rate of growth in the money supply. More recently, John Taylor, a professor of economics at Stanford, has advocated a rule that adjusts interest rates based upon the rate of inflation and other economic conditions (the Taylor rule). H.R. 5018 would give the Federal Reserve Board some discretion in the design of the rule, but would require that any rule provide for adjustments in interest rates selected by the Board (e.g., fed funds rate) based upon changes in inflation and other economic conditions (e.g., GDP).

H.R. 5018 also includes several provisions aimed at transparency and compliance with the rule. After it adopts a rule, the Federal Reserve must provide the rule to the House Financial Services Committee and Senate Banking Committee and must identify the members of the Federal Open Market Committee that voted in favor of the rule. The General Accountability Office (GAO) is required to monitor the rule and inform these Congressional committees of any material changes in the rule or noncompliance with the rule. If GAO finds that the Federal Reserve has not complied with the rule, either of the Congressional committees may request that GAO conduct an audit of the Federal Reserve's conduct of monetary policy.

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Provisions Related to Supervision and Regulation

The regulatory and supervisory provisions contained in the bill include the following:

- **Supervisory Policy Statements During Blackout Periods** — The bill provides that Federal Reserve officials may discuss prudential or supervisory functions of the Board during the blackout periods surrounding meetings of the Federal Open Market Committee.
- **Stress Tests** — The bill directs the Board to amend its regulations governing stress testing to address the methodologies and models used in the tests.
- **Supervisory Letters and Matters Requiring Attention** — The bill directs the Board to disclose publicly the aggregate number of supervisory letters sent to large bank holding companies and designated nonbanks since enactment of the Dodd-Frank Act in 2010, including the aggregate number of such letters designated as “Matters Requiring Attention” or “Matters Requiring Immediate Attention.”
- **Testimony on Regulatory and Supervisory Policies** — The bill calls for the Chair of the Federal Reserve Board to testify before Congress on a quarterly basis, rather than the current semi-annual basis, and requires a separate testimony on the Board’s regulatory and supervisory activities by either the Vice Chairman for Supervision or the Vice Chairman of the Board.
- **Cost Benefit Analysis of Regulations** — The bill requires the Board to conduct a cost and benefit analysis of proposed regulations, including “secondary costs” such as the effect of the regulation on economic growth, the availability of credit, and the safety and soundness of the banking system. The bill also requires the Board to conduct a post-adoption assessment of the impact of regulations.
- **International Supervisory Negotiations** — The bill requires the Board, the Federal Deposit Insurance Corporation, and the Treasury Department to notify the House Financial Services Committee and Senate Banking Committee in advance of international negotiations on supervisory matters and to seek input from the public and the Committees on the topics and goals of the negotiations. Final agreements also are subject to public disclosure and consultation requirements.

Looking Ahead

It is widely anticipated that, if the Republicans gain control of the Senate, Congress will seek to revisit some features of the Dodd-Frank Act. Should that occur, it would not be surprising to see some of the supervisory and regulatory provisions of H.R. 5018 thrown into the legislative mix. Indeed, there may be many financial firms that would favor such an outcome.

The larger question for the financial services industry is how to respond to the provisions in H.R. 5018 that relate to the Board’s monetary policy function. There is a good case to be made for the certainty associated with a monetary policy rule. In fact, some believe that the Federal Reserve adhered to a rule during the Greenspan era. At the same time, GAO oversight and audits of the Federal Reserve’s monetary policy function may jeopardize the independence of the Federal Reserve. Possibly, some unilateral initiatives by the Federal Reserve Board, both in connection with its monetary policy function and its regulatory and supervisory functions, could diminish this risk. The better answer, however, may be to transfer the regulatory and supervisory functions of the Federal Reserve to another federal agency (or agencies) and let the Board concentrate on monetary policy.

*Jim Sivon is a partner with the law firm of **Barnett Sivon & Natter, P.C.***