AUDIT THE FED: DODD-FRANK, QE3, AND FEDERAL RESERVE TRANSPARENCY

HEARING

BEFORE THE

SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY
AND TECHNOLOGY

OF THE

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AUDIT THE FED: DODD-FRANK, QE3, AND FEDERAL RESERVE TRANSPARENCY

Tuesday, October 4, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MONETARY
POLICY AND TECHNOLOGY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Ron Paul [chairman of the subcommittee] presiding.

Members present: Representatives Paul, Luetkemeyer, Huizenga, Hayworth, Schweikert; and Peters.

Chairman PAUL. This hearing will come to order.

Without objection, all members' opening statements will be made a part of the record.

This morning, we are holding a hearing entitled, "Audit the Fed: Dodd-Frank, QE3, and Federal Reserve Transparency." I will yield myself 5 minutes for opening remarks.

Transparency of the Federal Reserve has been an issue that I have been working on for many years, and I consider it very, very important, and we have been making some progress on this. Back in the 1970s, there was a major effort made to get more transparency of the Fed, but unfortunately it actually backfired and gave more protection to the Fed from any inquiries made by the Congress.

One thing I would like to make clear is my efforts to have more transparency of the Fed aren't equated to that of wanting Congress to manage day-to-day operations of the monetary policy. Quite frankly, I think managing of the monetary policy should be more involved with a free market, free market of interest rates, rather than anybody believing they can manage that from a day-to-day viewpoint.

Frequently, it is said that the independence of the Fed must be protected at all costs. I usually think once there is an emphasis on independence of the Fed, it usually means the secrecy of the Fed, and it is quite a bit of a difference, but the Fed hides behind this independence so there is no political influence.

But I think more people now are starting to realize that the Fed isn't truly independent from political influence because indirectly, and sometimes more directly, it is involved in political decisions or at least private and secret decisions made to serve some political interest.

The Constitution is rather clear on if anybody is to have any oversight, it would be the Congress rather than the Executive Branch. The ability to do this, of course, has been hindered. The Congress created the Federal Reserve with the Federal Reserve Act of 1913, and therefore, obviously the Congress has something to say about it. Not only did they create the Fed, but they have changed the rules. Congress has passed laws giving instructions to the Federal Reserve, so clearly, Congress has the responsibility of oversight of the Federal Reserve.

I think it is very interesting that one of the arguments for independence is that we can't allow the people to know what is going on with the banks; that if all of the sudden, we knew that a bank was having a problem, this would be bad information for the people to know. And then that is used as an excuse to prop up certain banks and make sure bailouts occur and that there is a lender of last resort, and there is no confusion or, otherwise, no correction that might be necessary.

But in many ways, the Fed performs a function exactly opposite of what the SEC is supposed to do. The SEC is a regulator that is supposed to go in and look at the books and throw out some rules so that people know what is going on and get information out. It seems to me at least, that the Federal Reserve does exactly the opposite.

The significance of monetary policy is really the overriding issue about the Federal Reserve, and what has happened since 1913 and actually what is happening today, because we are in the midst of a major crisis, and there are many of us who have come to the conclusion that the business cycle is very much related to monetary policy. So, if the business cycle is related to monetary policy, this should be of vital interest to all of us. If we connect the two, the Federal Reserve and the business cycle, then we see that recessions and depressions are a result of the business cycle. First, you have the boom and you have to have the correction, so you have to have the bust.

The other important relationship of the Federal Reserve to what Congress does, and for too long, it has actually been symbiotic, the Congress has been negligent in oversight, but they have been very complacent about deficits being accommodated. If the Fed was not so accommodative and always buy the debt and keep interest rates artificially low, there would be a lot more restraints on the Congress. But as long as Congress wants to spend money and they don't want to raise taxes—that is not popular—and borrowing becomes difficult, then there is a better way from their viewpoint to do it, and that is just to allow the Fed to create money out of thin air, which for those of us who believe in less government is better than more government, whether it is warfare or welfare, we see that the Federal Reserve has a strong influence in allowing our government to grow.

So I am very pleased to chair this hearing today, and I am very pleased to know that we are making progress. We didn't get a full audit last year, but we did get an audit coming out of the Dodd-Frank Act. We did get a lot more information, and today we are going to receive more information, as well as the court cases that have come about. So compared to even 4 years ago, a lot of progress has been made in the right direction, but from my viewpoint, we have a long way to go.

I have concluded my opening statement.

Do any other members wish to make an opening statement?

Okay. We will then go ahead and start with our first panel. Our first panel consists of Ms. Orice Williams Brown, who has spent her 21-year career in civil service at the GAO office. She is currently the Managing Director of GAO's Financial Markets and Community Investment team. Her portfolio of work includes banking, securities futures, and insurance issues. Most recently, she has been responsible for leading much of GAO's work on the financial crisis, Treasury's Troubled Asset Relief Program, the Federal Reserve System and its emergency lending programs, and regulatory reform. Ms. Brown received her MBA with a concentration in finance from Virginia Tech. I now recognize Ms. Brown for her testimony.

STATEMENT OF ORICE WILLIAMS BROWN, MANAGING DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. BROWN. Thank you. Chairman Paul, members of the subcommittee, I am pleased to be here today to discuss our recent report on the Federal Reserve's emergency programs.

As you well know, the study was required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is the first comprehensive assessment of the Federal Reserve's use of emergency authority under section 13(3) of the Federal Reserve Act in response to the recent financial crisis. It also covers a number of programs that were carried out under sections 10(b) and 14 of the Federal Reserve Act.

This morning, I would like to briefly highlight a few of our findings.

First, we found that the Federal Reserve and its emergency programs were subject to a number of internal and external audits. None of these audits found material weaknesses, and when issues were uncovered, the reserve banks generally addressed the deficiency in a timely manner. However, we did find that some operational audits had not been completed until the emergency programs had been operational for over a year.

Second, the New York Fed was the primary player in executing most of the emergency programs authorized by the Board of Governors and the Open Market Committee. However, one program, the Term Auction Facility, was executed across all 12 Federal Reserve Banks through their discount window operations. To implement and operate the various programs, the New York Fed used over 100 vendors to provide a variety of services, ranging from legal services to asset management. We found that most of the contracts were awarded noncompetitively and they were not recompeted after the period of exigency had passed. For a significant portion of vendor fees, Reserve Banks were reimbursed by program recipients or fees were paid from program income.

Third, we found that while the Federal Reserve took steps to manage conflicts of interest, opportunities exist to strengthen its policies for employees, directors, and vendors. During the crisis, the

New York Fed expanded its guidance and monitoring for employee conflicts. However, while the crisis highlighted the potential for Reserve Banks to provide emergency assistance to a broad range of institutions, the New York Fed had not yet revised its conflict policies and procedures to more fully reflect potential conflicts that could arise with this new, expanded role.

Fourth, we looked at the Federal Reserve's risk management practices. We found that it took steps to mitigate the risk of loss, such as requiring collateral amounts beyond the loan exposure for the early programs, and accepting only highly rated assets as collateral for some of the latter, more novel, programs. For actions to assist individual institutions, it negotiated specific protections. Over time, the New York Fed expanded its risk management capabilities and strengthened its management of risks across all programs. However, we found that neither the Reserve Bank nor the Board of Governors tracked total potential loss exposures across all emergency programs.

Finally, we found that while the Board of Governors took steps to promote consistent treatment of participants, it lacked guidance and documentation for some decisions. For example, Reserve Banks lacked documented procedures to guide decisions about restricting or denying access to the programs. We made seven recommendations to the Board of Governors to strengthen policies for managing noncompetitive vendor selections, conflicts of interests, risks related to emergency lending, and documentation of emergency program decisions. In response, the Reserve Board indicated that it recognized the benefits of our recommendations and would strongly consider how best to respond.

In closing, I would also note that many of these programs were established at the height of the financial crisis, and little public information was provided initially. Over time, the Board of Governors and the New York Fed increased the amount of information provided to the public, and going forward, the Dodd-Frank Act requires even greater transparency and accountability for any future actions.

Mr. Chairman and members of the subcommittee, this concludes my oral statement, and I will be happy to answer any questions at this time. Thank you.

[The prepared statement of Ms. Williams Brown can be found on page 43 of the appendix.]

Chairman PAUL. Thank you very much.

I will yield 5 minutes to myself for questions.

Overall, having done this audit and been involved, was there any one thing that you were more frustrated with? Was there any obstacle or misunderstanding or the law was confusing? Or was this a pretty clear-cut responsibility and there weren't that many problems? How do you look at it in general?

Ms. BROWN. In general, I would say that the Act laid out a pretty clear level of expectation for us in terms of what was expected, the programs that we were to cover, and exactly what aspects of the program and the operations of the programs that we were supposed to cover. So I would say it was fairly straightforward.

Chairman PAUL. Okay. And this was a 1-year audit; you just have to perform this one time?

Ms. BROWN. Correct.

Chairman PAUL. Would there be much of a problem if we were doing this every year as far as accomplishing what you have done? What kind of a task is this?

Ms. BROWN. This particular audit, while it was fairly straightforward, was an enormous undertaking given the number of emergency programs involved. Going forward, if—one, we would have to keep in mind the current structure that we have around the future ability to perform perform audits. And Dodd-Frank includes in section 1102 some additional authority for us to look at any future credit facilities that the Fed may establish and also certain open market or monetary policy activities that are delineated in the Dodd-Frank Act. So if we were asked to audit those, we would look at any particular request in turn, and approach it very much the way we approach this.

Chairman PAUL. And from your own experience, you have not had to look into the Federal Reserve in the way you did this time? Is this something rather unique for your experience?

Ms. BROWN. Yes.

Chairman PAUL. Many say that it is unnecessary to audit the Fed because they are already audited annually by an independent auditor. These audits are of the Fed's financial statements and became a legal requirement in the late 1990s.

Can you describe to us the difference between these financial audits that they would like to say, well, they are all inclusive and we know everything, versus an audit conducted by the GAO—could you describe the difference between the two?

Ms. BROWN. Yes. GAO actually also does financial audits and we do performance evaluations, and the audit that we did and issued in July of 2011 falls under the program evaluation performance audit arena, and the biggest difference is that we in this were asked to look at specific operational issues. We were asked to look at the operational integrity issues like internal controls over the operations of the programs. We were also asked to look at how the programs were implemented and stood up.

Financial audits tend to focus on if—whether or not the financial statements are being fairly and accurately presented and the controls around the financial reporting. So it tends to be much broader and also more in-depth.

Chairman PAUL. Along that line, I want to follow up with a similar question. The Dodd-Frank GAO audit has been described as a procedural audit. It seems that most of the analysis was looking at the protocol and guidelines in place for the various emergency lending facilities. What do we know about individual transactions? How were they conducted, how was collateral evaluated, and who all had knowledge and access to the facilities and those things in general? Are they included in the GAO's audit or were they not part of the directives given by the Dodd-Frank Act, especially on the individual transactions, and who knew about them and why they occurred?

Ms. BROWN. We were specifically asked to look at the operational aspects of the program, but that includes looking at certain individual transactions, specifically when it came to assistance to individual institutions. But in terms of looking at the broad-based programs, we did look at eligibility requirements. We looked at who the largest users were of the particular programs, and we also looked at how the decision was made from the perspective of who approved the particular emergency program—was it the Board of Governors, was it the Open Market Committee—and then how the particular Reserve Bank implemented the action that had been authorized by the Board of Governors or the FOMC.

Chairman PAUL. Thank you. My 5 minutes has expired. So we will move on to the next member, the gentleman from Missouri, Blaine Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. One of the things that is concerning to me is the fact that all banks, credit unions, thrifts, what have you, they have some entity that provides oversight over them. And yet the Fed, which is the central bank basically, I guess you would say, of our country, has very little if any oversight over it, you know. And some of the things that you say here are the things that were not—because of the prohibitions—you were not able to go into. I think it is kind of interesting. Where do you think we need to draw the line on this?

Ms. BROWN. GAO's position is that this is a policy decision, and wherever the line is drawn and the bar is set for us to do whatever action, we will do what Congress asks us to do.

Mr. LUETKEMEYER. Okay. Along that line, with regard to the emergency loans that were done during the height of the situation we had in this country, you say in here that the Federal Reserve banks required borrowers in several programs to post collateral in excess of the loan amount, programs that do not require pledge assets with high ratings, etc., etc. Did you see in the way that they handled the loans, was it, in normal banking terms—in other words, did they have the normal set of requirements for collateral excess over the loan they made, normal repayment terms, or what did you see there?

Ms. BROWN. We did look at the security and collateral procedures around loans that were made and we evaluated the processes they had in place. And we found that they did have controls around those, that they did have requirements that certain loans be overcollateralized. And in other cases, there was a requirement that the collateral posted be highly rated. So there were certain controls that were built around the loans that were being made.

Mr. LUETKEMEYER. Did you see anything there that was of concern to you?

Ms. BROWN. We didn't see anything that raised a major concern. We did point out that some of the internal audits that had been done had raised some questions around increasing the controls around the collateral, and we did look at the extent to which those had been addressed, and we found that at some point when an issue was raised, the bank would take steps to improve the controls that were in place.

Mr. LUETKEMEYER. Have all of those loans been paid back?

Ms. BROWN. For many of the broad programs, they have been. There are outstanding loans for the three Maiden Lane LLCs related to the assistance to Bear Stearns and AIG.

Mr. LUETKEMEYER. Okay. The point I am going to try and get to here, though, is they haven't all been paid back?

Ms. BROWN. Correct.

Mr. LUETKEMEYER. Your audit authority is over with; is that correct?

Ms. BROWN. Correct.

Mr. LUETKEMEYER. Therefore, at this point, there is no audit authority on those loans that have been paid subsequent to your audit or those that are yet to be paid; is that correct?

Ms. BROWN. In all cases except for any that involve assistance to individual institutions.

Mr. LUETKEMEYER. Do you think it would be a good idea if we went back and had a requirement to audit those whenever they are all paid off to see if everything is done according to sound financial tenets?

Ms. BROWN. It is something that if we were asked to do, we would definitely do.

Mr. LUETKEMEYER. That is a policy decision, right?

Ms. BROWN. Yes.

Mr. LUETKEMEYER. Okay. With regard to the open market operations of the Fed, one of the things it says here is that they are not required to disclose their operations until 2 years after they take place. How do you get ahold of information that is pertinent, that is time-sensitive, that we can actually get a good job of seeing everything that is going on here? If we can't do it within a 2-year timeframe, that seems almost beyond the ability to implement any sort of controls or corrections.

Ms. BROWN. We would note that in the audit that we did that was issued in July, it was done in many cases less than a 2-year time period.

Mr. LUETKEMEYER. And one more quick question: With regard to the swap lines of things that they have with foreign banks, were you able to do anything at all with oversight of that? Were you able to look into any of the activities along those lines?

Ms. BROWN. That was one of the specific programs listed under our authority in Dodd-Frank.

Mr. LUETKEMEYER. What did you find?

Ms. BROWN. We basically looked at how they were structured. We found that the Fed had engaged in a number of swap line transactions with foreign central banks, and the biggest takeaway was that once the Fed engaged in the swap with the foreign central bank, any activity of the central bank—the foreign central bank was really, from the Fed's perspective, that was the central bank's responsibility, and the foreign central bank assumed any credit risk from the activities that it engaged in.

Mr. LUETKEMEYER. If the chairman will bear with me, just one more question. Do you see any risk to the Fed with the way it is structured right now?

Ms. BROWN. That is one program that remains open, and the authority for that program is open through August of 2012. It was one of the programs that had been extended, and as with swaps, there is currency risk associated with currency swap-type of transactions.

Mr. LUETKEMEYER. Okay. I see my time is up. Thank you, Mr. Chairman, for your indulgence.

Chairman PAUL. Thank you. I now yield 5 minutes to Congresswoman Hayworth from New York.

Dr. HAYWORTH. Thank you, Mr. Chairman, and thank you for conducting this hearing. Thank you, Ms. Williams Brown, for being with us.

There is a notable statement in the GAO report that some Federal Reserve Board decisions to extend credit to certain borrowers were not fully documented. And I was wondering if you could elaborate on that. What sort of documentation would you like to have seen? Was there an explanation as to why the documentation was lacking?

Ms. BROWN. In the area of documentation prior to Dodd-Frank, there wasn't an explicit requirement for the Fed to document its decisions. From an audit perspective, that often presents a challenge in determining exactly what happened. So that requires us to have a number of conversations with the relevant players.

But what we noted is, with the programs, there were generally broad eligibility requirements, and institutions that were generally considered to be in good financial condition were able to participate in a particular program. But to the extent that there were exceptions that didn't necessarily appear to coincide with the particular process in place, we had to have conversations to find out why things happened.

One example is with the commercial paper lending facility. An AIG subsidiary was allowed to continue to participate in the facility, even though they no longer met the new requirements—and that is, that they had been an active participant in the commercial paper market—but they were still allowed to participate in the facility.

Dr. HAYWORTH. Is there further work ongoing to determine why that was allowed to occur or—

Ms. BROWN. No.

Dr. HAYWORTH. So that now lies with us, I guess, here to—

Ms. BROWN. And we did make a recommendation to the Fed, going forward, that if they were to engage in credit facilities or any emergency lending in the future, that it is important to document decisions, and the Dodd-Frank Act now has a reporting requirement. So we pointed out that in order to fulfill that reporting requirement in the future, there is documentation that has to go along with the decision-making.

Dr. HAYWORTH. In order to encourage—

Ms. BROWN. Report it.

Dr. HAYWORTH. And presumably to encourage sound decision-making—

Ms. BROWN. Yes.

Dr. HAYWORTH. —so that we are not doing things that don't make sense fiscally.

Ms. BROWN. Yes, that. And to be able to then report to the Congress what was being done and why.

Dr. HAYWORTH. Thank you, Ms. Williams Brown, I appreciate that. Mr. Chairman, I yield back the remainder of my time.

Chairman PAUL. I now yield 5 minutes to the Congressman from Arizona, Mr. Schweikert.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Ms. Williams Brown, part of this is actually—and my good friend from New York was almost touching on parts of this. First of all, on the emergency facilities, were you able to take a look at how well documented the requests were, the systemization of the decision-making? And part of where I am leading on this is just your opinion, when you are playing auditor, if we were to have another hiccup, do they have mechanical rules and steps that are consistent? What did you see?

Ms. BROWN. In the retrospective audit, there weren't requirements for them to document specific decision points. So from that perspective, it required us to go back and attempt to reconstruct how decisions were made. Going forward, there are new requirements in terms of being able to report out that should help provide some additional structure around it, and that is one of the things that we also spoke to in some of our recommendations.

Mr. SCHWEIKERT. I heard some discussions about—even before—some of the new requirements. But do they seem to now have been adopted in the—if you and I were to lay out a flowchart and say, here is our decision-making process, with you and I also understanding this may be a process that sometimes has to be done very quickly.

Ms. BROWN. Correct.

Mr. SCHWEIKERT. But it also helps to know what checkboxes you are going through saying, okay, we have this, we have this, we have this. And from what you are seeing, have those documentation requirements, the new ones, been built into the system?

Ms. BROWN. I will say that since July, we haven't gone back to update the status of the recommendations that we made. So I can't say if they have addressed the recommendations that we made, for example, for a better documentation process. That is not something I am in a position today to say that they have or have not done those types of things.

Mr. SCHWEIKERT. Okay. Mr. Chairman, Ms. Williams Brown, with that—because where I am sort of hunting is, how did they document what assets were being pledged future forward, what was being swapped, and how well that was locked in, saying, yes, you are pledging this, and once you have pledged it, you can't go and touch it anywhere else, and we also have the proper mechanics telling us any exposure, like are there any sort of—where these assets may have also lent out their value to other pledges? I am just—I am trying to understand the decision tree, but also the quality of the documentation on assets pledged.

Ms. BROWN. In terms of pledging collateral and tracking that, we did look at the control process around the collateral process, and we did specific drilldowns on two of the facilities that the borrowers were able to pledge a wide variety of collateral for a single loan. And we did a drilldown to look at the collateral that was pledged, and we also did some independent evaluation and testing to make sure that those controls around those were operational. So there was a process around that.

Mr. SCHWEIKERT. When you were looking at some of that, did you find some of the assets didn't really—ultimately, the market value—add up to what they were put into the pledge?

Ms. BROWN. We looked at the pricing of the collateral, and we found in a small percent of cases, somewhere around 2 percent, that there was some discrepancy in the price of the particular collateral that we tracked versus what was included in the data that we had gotten from the Federal Reserve. But we did not find any type of systematic bias one way or the other in terms of how that collateral had been priced.

Mr. SCHWEIKERT. But only about 2 percent?

Ms. BROWN. It was a fairly small percentage.

Mr. SCHWEIKERT. I am surprised. And would some of that have been MBS, mortgage-backed securities, because of the way you would price it?

Ms. BROWN. Right. I think it cut across a variety of other types of collateral that had been posted.

Mr. SCHWEIKERT. Last one, and I am partially doing this from writing, and seeing if I can find it in my notes, and this one may be asking more of an opinion.

The Inspector General for the Fed, I think, has also been given additional duties for the Consumer Financial Protection Bureau; almost wearing two hats, even though they are now separated. Any opinion on whether that works?

Ms. BROWN. That is not something we have specifically looked at, so I am not in a position to offer an opinion.

Mr. SCHWEIKERT. Gosh darn on that one. Mr. Chairman, I yield back my time. Thank you.

Chairman PAUL. I thank the gentleman. I yield 5 minutes to the gentleman from Michigan, Mr. Huizenga.

Mr. HUIZENGA. Thank you, Mr. Chairman, and I just want to express my appreciation for you holding this hearing. I think this is very important. I appreciate your time coming in as well, and I won't plan on using this full 5 minutes.

But I am struck by the theme that we are hearing of a need for oversight, and I don't want to put words in your mouth, but that certainly is the tone that I am catching, that this is a good thing that we should—or that has happened. I think it is up to us, then, to decide whether this is something we should continue. It seems to me that we should.

I am curious a bit about if you could talk—and I apologize if you had—I had to step out for a phone call, but maybe you touched on this. I am wondering if you could talk a little bit about what some of the lending facilities were used by branches and subsidiaries of foreign banks, and were you really able to determine why several of those emergency lending facilities were primarily used by foreign institutions? I wonder if you could talk a little bit about that.

Ms. BROWN. We did look at the largest users across the facilities, and we did find that there are certain facilities that tended to be used by the branches and agencies of foreign banks. And in conversations and following up with the Federal Reserve about the reason for that, we found that usually the largest lenders of facilities were driven by the composition of the market. So if it is a market that there were major foreign banks that had branches and agencies in the United States, they would have been as likely as a U.S. bank to tap a particular facility.

Mr. HUIZENGA. And so that wasn't necessarily a region when you are saying that could be a product line or—

Ms. BROWN. Product line or a particular market that they were active in, because many of the broad-based programs were aimed at a particular disruption that was going on in a particular market. Commercial paper, some of the money market mutual funds had also experienced problems.

Mr. HUIZENGA. Thank you. And could you characterize the ratio of domestic versus the foreign?

Ms. BROWN. It really varies by program, and I would be more than happy to provide a breakdown for each facility for the record.

Mr. HUIZENGA. That would be great. How many facilities, as you are using the term "facility," how many facilities are there? How many breakdowns do you think that would be?

Ms. BROWN. There were—I think it was somewhere in the 10 to 12 range.

Mr. HUIZENGA. Okay. I would appreciate the follow-up on that. So thank you. Thank you, Mr. Chairman. I appreciate that and I yield back.

Chairman PAUL. Thank you. And I now yield additional time to the gentleman from Missouri, Mr. Luetkemeyer, for a follow-up question.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. I would like to follow up just a little bit more on the swap line discussion we had a little bit ago. Can you tell me how many times the line has been used, or is it just beyond this—number of times per day—or has it just been only 3 or 4 times in the last 6 or 8 months?

Ms. BROWN. I am not sure that we tracked it by the number of times used, but we focused on the number of foreign central banks that were permitted to participate in the swap line. And there, would have been through the July timeframe.

Mr. LUETKEMEYER. Do you have an idea of how many times that was? We had the Chairman in here not too long ago, and he indicated that there was almost zero activity.

Ms. BROWN. I will say that when we issued our report, as of the end of June, the balance on the swap lines was zero at that time. So it may have been used and repaid.

Mr. LUETKEMEYER. Okay. Looking at those transactions, did you see anything in there that would pose a risk to the Fed or, therefore, our taxpayers?

Ms. BROWN. I think the potential for—because the Fed would be swapping dollars for foreign currency, with an agreement that the foreign central bank would reverse the swap at the same rate that the other—to the extent that rates move, there is a potential risk built into.

Mr. LUETKEMEYER. Did you see where it is a pass-through from other existing banks over in Europe through the central bank there, or was it just a direct swap through the European Central Bank?

Ms. BROWN. It was—once the swap happened with the particular central bank that the Fed engaged in swap activity with, the Federal Reserve didn't track what happened to those dollars once they were in the hands of the foreign central bank.

Mr. LUETKEMEYER. Okay. So basically there is a firewall, then, between the transaction and wherever else those moneys would go to, those other dollars would go to?

Ms. BROWN. Correct.

Mr. LUETKEMEYER. Is that a fair statement?

Ms. BROWN. I guess I am pausing on the firewall, but there is definitely a separation, yes.

Mr. LUETKEMEYER. Okay. There is no tangible liability exposure to us from one of the other banks in Europe that is going to be passed through the European Central Bank? I guess that is a better way to put it.

Ms. BROWN. The Central Bank would assume that risk.

Mr. LUETKEMEYER. Okay. So basically, then, there is no other risk that the Fed has assumed from those activities.

Ms. BROWN. Right, beyond the swap.

Mr. LUETKEMEYER. Okay. And the only risk that you see there is just the normal currency activity or the daily ups-and-downs of the value of the currency itself? All those other things in the transaction—

Ms. BROWN. There could potentially be others, but that was the one that immediately comes to mind.

Mr. LUETKEMEYER. Has the biggest risk?

Ms. BROWN. I would say that is the one that immediately comes to mind to me, and I do have a total on the number of transactions; 569, that is how many transactions there were.

Mr. LUETKEMEYER. During what time period?

Ms. BROWN. This would have been from the beginning of the program through June 29, 2011.

Mr. LUETKEMEYER. Really? Okay. One more quick question. In your report, you indicate that there is—the GAO found that conflict-of-interest policies could be strengthened. Can you give me an example of where there is a conflict of interest that you found, that there is a problem or exposure or concern?

Ms. BROWN. We found a number that raised issues. They raised an appearance of a conflict, and one had to do with senior Federal Reserve Bank of New York officials. They held stock in some of the institutions that had received assistance. AIG was one example.

Mr. LUETKEMEYER. Did you see a pattern with individuals or with particular companies, particular entities, like through AIG or other companies or other entities that were out there, that they were trying to work with?

Ms. BROWN. I wouldn't say we observed any type of pattern. We observed with the vendors that there were situations that the Federal Reserve Bank of New York, for example, could have taken additional steps to strengthen their management of conflicts of interest that may have existed within vendors, and done additional oversight of what the vendors were actually doing to make sure that they weren't exposed to conflicts.

Mr. LUETKEMEYER. Okay. Very good. Thank you, Mr. Chairman. I appreciate the second round.

Chairman PAUL. Thank you. And I now yield for follow-up question to Mr. Schweikert from Arizona.

Mr. SCHWEIKERT. And forgive me, I just want to make sure I was listening carefully to Congressman Luetkemeyer. On facilities that were with foreign central banks, was there a currency risk when the assets were moved back?

Ms. BROWN. That issue really comes up on the dollar swap lines, because that is actually a swap of U.S. dollars for foreign currency, with the agreement to reverse the swap.

Mr. SCHWEIKERT. It would be an unusual instrument to unwind it back to the value of the previous swap if there had been movement in the currency? That sort of defeats the purpose a bit.

Ms. BROWN. It is the nature of the swap, that you agree to exchange the currency and reverse it at a particular price, at a particular date in the future.

Mr. SCHWEIKERT. Okay. So there was—from what you were seeing, there was always a pledge on the value at the end—

Ms. BROWN. For the dollar swap line only.

Mr. SCHWEIKERT. Yes, that is the only one I was interested in.

Second of all, and I know this is a little on the annoying side, but if you would have one of your staff reach out to our office sometime in a couple of weeks, we would love to be able to chase down in writing—as you were saying, it was 2 percent that you saw that—of pledged assets that you thought may have been outliers. And this is one of those occasions I have to go through my file cabinet and find an article from a couple of months ago that I think was talking about specifically private label MBS that may have been pledged, that may have been much further in the dispute of what its true value was. And I am just trying to get my head around having read one thing and now in testimony making sure I am using the same definitions today.

Ms. BROWN. It is not only an issue of the same definitions, but this is something that could vary from facility to facility. And my comment was specific to two credit facilities; but this could actually be the case in one of the others.

Mr. SCHWEIKERT. It absolutely would be that way. It would absolutely be that way. There were five hundred and some different ones, as I think I just heard you say—

Ms. BROWN. For the transactions for the dollar swap lines, yes.

Mr. SCHWEIKERT. Okay. Last one is: Also, as long as we are asking to throw something into note, so that Inspector General comment before—I know this really isn't your area—but I would love someone, if there is a policy statement somewhere in the agency in regard to whether this really works to have one Inspector General doing both the Consumer Financial Protection Bureau and the Fed, even though they now wear very separate hats. And with that, Mr. Chairman, I yield back, and I thank you.

Chairman PAUL. I thank you. Does anybody else have any follow-up questions? If not, I want to thank the witness for appearing. And also, without objection, your written statement will be made a part of the record, and you are now dismissed and the second panel may come to the table.

Ms. BROWN. Thank you.

Chairman PAUL. We will now receive testimony from our second panel.

Our first panelist, Dr. Robert Auerbach, is Professor of Public Affairs at the LBJ School of Public Affairs at the University of Texas in Austin. He was an economist with the House of Representatives'

Committee on Financial Services, formerly the Committee on Banking, Finance, and Urban Affairs, for 11 years. He assisted Chairman Henry Reuss in the 1970s and the 1980s and Chairman Henry Gonzalez in the 1990s with oversight of the Fed, spanning four Fed Chairmen: Burns; Miller; Volcker; and Greenspan. He is the author of the book, "Deception and Abuse at the Fed: Henry B. Gonzalez Battles Alan Greenspan's Bank." He received two master's degrees in economics, one from the University of Chicago and one from Roosevelt University under Abba Lerner. He received his Ph.D. in economics from the University of Chicago where he studied under Milton Friedman.

Our second panelist is Dr. Mark Calabria who is the Director of Financial Regulation Studies at the CATO Institute. Prior to joining CATO in 2009, he spent 7 years as a member of the senior professional staff of the Senate Committee on Banking, Housing, & Urban Affairs, where he handled issues related to housing, mortgage finance, economics, banking, and insurance. Dr. Calabria has served as Deputy Assistant Secretary for Regulatory Affairs at the Department of Housing and Urban Development and has been a research associate with the U.S. Census Bureau's Center for Economic Studies. He is a frequent contributor to the New York Post, National Review, and Investors Business Daily, and frequently appears on CNBC, Bloomberg, Fox Business, BBC, and BNN. He received his Ph.D. in economics from George Mason University.

I would like to now recognize the second panel and also, under unanimous consent, your written testimony will be made a part of the record.

So I recognize Dr. Auerbach.

STATEMENT OF ROBERT D. AUERBACH, PROFESSOR OF PUBLIC AFFAIRS, LYNDON B. JOHNSON SCHOOL OF PUBLIC AFFAIRS, UNIVERSITY OF TEXAS AT AUSTIN

Mr. AUERBACH. Thank you very much, Chairman Paul and members of the subcommittee. I am honored to come back here where I worked for 11 years. One thing you left out: I also worked in the Reagan Administration, saying the same things, in between the periods I worked at the Treasury Department.

I want to talk about transparency at the Fed. The Fed is the powerful central bank of the United States that controls the money supply, regulates the banking system, and since 1962 makes loans to foreign banks without congressional authorization. The historical record of Federal Reserve officials blocking transparency and individual accountability, including destroying source records of its policymaking committee since 1995, is clear.

I want to especially thank Chairman Ron Paul and Senator Bernie Sanders for finally getting some kind of an audit at the Federal Reserve in the Dodd-Frank Act.

In 1976, when I was here, I assisted Henry Reuss in putting up an audit bill of the Fed. The Fed immediately mounted a huge lobbying campaign using the bankers that it regulates to come to Washington and go into all the offices here and stop the audit. Chairman Reuss went to the Floor of the House later when we got direct evidence of how the Fed used their offices and their facilities to organize the bankers they regulate to come to the Congress and lobby.

Finally, the bill was passed in 1978 down the hall at the Government Operations Committee with two glaring no-audit parts of the bill. One is anything to do with monetary policy or international transactions at the Fed.

Let me just talk one moment about those two areas. In the monetary policy area, there are tremendous opportunities to make billions of dollars on inside information from the many leaks of Fed monetary policy which I helped the committee investigate for many years. Let me just give you one little taste of it.

First of all, then-Chairman Greenspan said after a number of leaks, when the newspapers were publishing what they had said the previous day in their secret meetings, that we are beginning to look like a bunch of buffoons. They had at those secret meetings at the Kansas City Fed, where I used to work, central bankers from Bulgaria, China, the Czech Republic, Hungary, Poland, Romania, and Russia attending and listening to interest rate information that they would not give the Congress at that time.

Finally, the Federal Reserve decided that they would not like to have any more public minutes of their central policymaking committee. That was Arthur Burns in 1976 from a law then that was being passed, Government in the Sunshine Act, and a suit from a student at a university in Washington, D.C. So the Fed voted then in 1976, a 10–1 vote, that they would no longer have any transcripts of their central policymaking committee, and it was a 10–1 vote and the 17-year lie began.

Finally, in 1992 I came back for the second time, and I spoke with the great Henry B., as we called him in his district in San Antonio: How could it be that the most powerful central bank in the world had no transcripts of its meetings that they used to send out? What happened to them? So, Mr. Gonzalez had all the Fed Presidents come. All but two showed up. Chairman Greenspan sat in the middle, right where I am sitting, Members of the Board of Governors on each side, and they misled the Congress.

We put a lot of heat on them because they were Federal witnesses, and a few days later the Cleveland Fed broke and said, well, they had had a meeting 4 days earlier where they just decided how they would mislead the Congress. One person at that meeting, a staff person, a very good staff person who used to work with me at the Kansas City Fed, but he was assisting Greenspan, said, "the Chairman is not highlighting these transcripts. We are not waving red flags." And when Congressman Maurice Hinchey had asked him at the hearing right here, "Do you have any records?" Greenspan replied, "just some notes we keep."

After that, Greenspan sent a letter over here and said, this is 17 years later, we have those transcripts. I took a group of Republican and Democratic staffers over to the Board of Governors and found them right around the corner from Greenspan's office neatly typed. So they decided then that they would start issuing the transcripts again after a 5-year lag, much too long for timely accountability.

After I left the committee, and went down to Texas, I read that they had decided in 1995 to shred the records of the Federal Open Market Committee. Those transcripts had been kept and sent to the National Archives, but they decided to destroy them. So I wrote a letter to Alan Greenspan asking why they were doing that, and his Vice Chairman, a very good person inside the Fed—these are good people; they just have bad policies—Donald Kohn, who worked there for many years and became Vice Chairman, started at the Kansas City Fed, he wrote to me saying yes, we decided to destroy the transcripts of the meetings, but we think it is legal.

I just want to go through a few other things on the audits so you can get an idea of how bad the audits have been of the Fed, just two little points. One is the Los Angeles branch of the Kansas City Fed. You can ask me questions about it, when we found out that the auditing system there was corrupt. I took an excellent GAO team. Zoliason went in there and found that the system was completely corrupt. Greenspan admitted in a letter to the committee that they knew that the employees of the Fed had stolen at least $500,000 in the previous 10 years from the vault system of the 12 banks.

One other thing, and then I will quit. The airplane fleet of the Fed, 50-plus airplanes, the audit there was a joke. There was no audit. The people running the fleet in Boston used to laugh about it. And they appeared here. Mr. Castle allowed them to come, and they were very courageous, and they talked about it right in the committee room here. Carolyn Maloney, Congresswoman Maloney, helped in investigating them. That was a completely corrupted thing. It was typified by their backup plane that the Fed paid for in Teterboro airport that didn't exist most of the time. That is all I am going to say about that.

I have two other points. One is about paying off all the economists throughout academia on investigation of Henry B. Gonzalez; and what I consider malpractice, the present monetary policy of the Fed that was begun in October 2008 that has caused a lot of unemployment in the United States.

[The prepared statement of Dr. Auerbach can be found on page 33 of the appendix.]

Chairman PAUL. Thank you.

We will go to Dr. Calabria now.

STATEMENT OF MARK A. CALABRIA, PH.D., DIRECTOR OF FINANCIAL REGULATION STUDIES, CATO INSTITUTE

Mr. CALABRIA. Chairman Paul, distinguished members of the subcommittee, I thank you for the invitation to appear at today's important hearing.

As the subcommittee is well aware, the events of 2008 witnessed not only unprecedented disruptions to our financial markets, but also extraordinary responses on the part of our financial regulators and central bank. No entity was more deeply involved than the Federal Reserve System, particularly the New York Federal Reserve. Yet the Fed has consistently and repeatedly resisted efforts to bring accountability and transparency to its actions.

Congress and the public repeatedly warned that if details of the Fed's actions became public, further panic would ensue in our financial markets. Yet when that information, such as AIG's derivatives counterparties, finally did become public, disruptions were minimal or nonexistent.

Despite some notable attempts by the Fed to increase its communications with the public, I believe, given its track record, the public cannot rely on the Fed to voluntarily provide us with sufficient information to monitor its activities and judge the effectiveness of its actions. While the requirements of the Dodd-Frank Act in relation to auditing the Fed's activities are an important advance, they fall far too short of providing sufficient oversight of the Federal Reserve.

What auditing has been conducted so far has been focused on the Fed's response to the crisis. Accordingly, much of the audit requirements in Dodd-Frank have something of an historical feel about them. However, it is not enough just to get history right, although we are lucky if we do that, but also to ensure that future mistakes are avoided. I can think of few areas requiring as much mistake avoidance as monetary policy.

The Fed's role in helping to create the crisis via its easy money policies in the aftermath of the dot.com bubble and the events of 9/11 remain largely uninvestigated by Congress. If we truly wish to end financial crises, then I believe it is absolutely essential that Congress receive a full and objective evaluation of the Fed's role in fostering the housing bubble, particularly as it relates to monetary policy decisions between 2002 and 2005.

Disagreement as to the appropriate stance of current monetary policy I think also demonstrates Congress' need for objective, independent analysis of monetary policy.

Some might object that a GAO audit of the Fed subjects the Fed to political pressure. I think that such an objection ignores the simple fact that the GAO is not a political organization.

As mentioned, I served as staff on the Banking Committee for a number of years. I can say through all of my interactions with GAO, they are independent, they are unbiased, they are nonpolitical. I have not always agreed with the conclusions of GAO, but I have never felt that any of those disagreements were the result of politics or bias.

I think the subcommittee should also keep in mind that GAO exists for a very simple reason: that no Member of Congress or their staff are fully knowledgeable about the functioning of all the various government agencies. GAO simply exists to inform.

I would argue that there are few areas less understood than monetary policy and macroeconomics. Hence, I would argue there are few areas more in need of an audit than monetary policy and macroeconomics. Again, the purpose of GAO here is to try to provide some information so that Members can more actively engage, I think, and more effectively engage in oversight of the Federal Reserve.

Another objection to a GAO audit of the Fed is that such an audit would compromise the Fed's independence and subject it to political influence. I think such an objection confuses the very nature of Fed independence. The Fed's authority to regulate the value of money is one that is delegated from Congress. As Congress can and has legislated changes to the Fed, it should be beyond a doubt that the Fed is not independent of Congress; it is quite the opposite. It is a creature of Congress, and Congress has every right in that avenue to interject and regulate the activities of the Fed itself.

Setting aside the debate of the desirability and legitimacy of so-called independent agencies, it should be clear that their independence in any operational sense is supposed to be from the Executive Branch, not from Congress. It should also be clear, however, that in recent years, the Federal Reserve has coordinated its actions quite closely with the Treasury Department, in my opinion eroding any independence from the Treasury. The revolving door, both at the political and career levels, between the Federal Reserve and the Treasury Department further undermines the Fed's operational independence. I believe a GAO audit would help shine light on this relationship, actually helping to insulate the Federal Reserve from continued interference by the Treasury Department.

Again, the Dodd-Frank Act has made important advances in bringing transparency and accountability to the Federal Reserve. Unfortunately, it falls short in allowing Congress and the public to truly gauge the effectiveness of the Federal Reserve.

In order to improve Federal Reserve transparency, I would suggest that Congress mandate a regular audit of all Federal Reserve activities, including monetary policy. Such audits could be performed in a manner so as to minimize the disruptions to any ongoing deliberations of the Federal Open Market Committee. For instance, these audits could be kept confidential for a short amount of time, 6 months, a year. That is certainly something that could be done not to try to unduly influence ongoing activities, but again, this audit should be made public at some point.

I think it is also important to emphasize that evaluating the effectiveness of any government agency is made all the more difficult when that agency faces a variety of competing and sometimes conflicting objectives. If the Federal Reserve feels it is free to abandon price stability in order to achieve other objectives, such as rescue the financial industry or misguided attempts to influence the labor market, then I believe the value of an audit may potentially be very limited.

At a minimum, Congress should consider restricting the Federal Reserve to a single goal, that of price stability. Congress should also restrict the ability of the Fed to have discretion implementing that goal. On a very basic level, a central bank that is free to define price stability or define its own objective is a central bank without any meaningful constraints.

With that, again, I thank the chairman, I thank the subcommittee, and I look forward to your questions.

Chairman PAUL. Thank you very much.

[The prepared statement of Dr. Calabria can be found on page 70 of the appendix.]

Chairman PAUL. I yield myself 5 minutes for questioning.

My first question is for Dr. Calabria. I want you to follow up—I know you have talked about it in your statement—on this relationship of the Fed and the Treasury. You indicate that if there is to be any oversight or connection, it is more with the Congress than with the Executive Branch and the Treasury. Could you talk a little bit more about that, and exactly what you mean? And what has happened in the past that might suggest that we should be looking into the relationship of Treasury and the Fed and how that could be a negative, or why some people think it is a positive?

Mr. CALABRIA. There are a variety of different things. I will most directly touch on first the negotiation, implementation of Dodd-Frank. Treasury was the point person in negotiating Dodd-Frank for the Administration, yet several of the senior advisors at Treasury representing the Administration were staff on loan from the Federal Reserve. So again, I think many of us remember there was about a whole 5 minutes during the Dodd-Frank negotiations where maybe there really were going to be serious constraints on the Federal Reserve, where there would be a serious examination of the bank supervision and regulatory powers. Again, I think the Congress and GAO should take a look at whether the Fed should be supervising banks in general, and whether that conflicts and provides any conflict of interest with the monetary policy decisions.

But, having essentially Federal Reserve staff at Treasury negotiating on behalf of the Administration certainly, in my opinion, meant that there was going to be no chance that Congress was actually going to be able to peel back any of the powers of the Federal Reserve. So, again, the Treasury relies very heavily on Federal Reserve expertise and legislative decisionmaking.

Most importantly, however, and it is important to keep in mind that Fed independence really came out of this Treasury-Fed accord where, prior to the 1960s, the Federal Reserve supported Treasury prices essentially and tried to maintain the price of long-term Treasurys in order so that the Treasury Department could more easily and more cheaply fund its activities. And again, if you have this relationship—and you see this particularly with the second round of quantitative easing where the amount that the Fed was purchasing on a monthly basis was coincidentally very close to the amount that was being issued by the Treasury. And so the extent that we go down that road of potentially "monetarizing" the debt, which I think is the ultimate concern, that you have the Treasury market supported by the Federal Reserve, which, of course, reduces discipline on not only the Treasury, but reduces discipline on Congress to get its fiscal house in order.

So again, we rely on the markets to send us signals, and the Treasury market should be sending us a signal that we are headed towards a financial train wreck, but it is, of course, not, because the Federal Reserve is intervening in that market to reduce the price cycle that we would be receiving.

So that is an important part of the debt market. I think it is ultimately one of the more important aspects of this, but, again, you also see it in financial regulation.

I want to emphasize again the nature of independence is supposed to be not from Congress, but from the Executive Branch. There is a variety of literature, for instance, in economics that talks about a political business cycle where you would see the Federal Reserve try to loosen monetary policy in expectation of Presidential elections.

Again, I would say that the empirical results in this literature are mixed, but, again, the emphasis is on the Administration. We know that in terms of any President's reelection, it is going to be far more important what the Fed does compared to what any Member of Congress wants. So again, there are far different interests and far different incentives in Congress, where you have a unified incentive in the Executive Branch.

So, I would emphasize again the importance is to draw some independence from the Executive Branch and the Federal Reserve rather than from Congress.

Chairman PAUL. So just in summary, the way I understand that is when they talk about independence, they are really not talking about independence, they want to eliminate the role of the Congress, which you are arguing has a responsibility. So they want to be excluded from that supervision, but they don't want to be independent from the Treasury.

What about political or private interest influence? When the bailouts came, there had to have been some special interests and political interests. Would that—could that be said to be not independent either, but influenced by not only the Treasury, but outside interests? Do you think there is much—should there be concern about that?

Mr. CALABRIA. I think there should absolutely be strong concern about that on several levels. One could just look at monetary policy where monetary policy is conducted in partnership with the Federal Reserve's primary dealers in which it buys and sells Treasury securities with to conduct its monetary policy. Of course, if you are doing bank supervision, you have a financial crisis, and these primary dealers find themselves in trouble, the Federal Reserve has an incentive to try to essentially make sure that those primary dealers survive. And, of course, it doesn't want to make any of that public. I am sure you could ask any of the largest firms that were assisted. Whether it was Goldman or whether it was Societe Generale, they have not welcomed the attention that they have gotten when all of this information has come out.

We heard a little bit earlier about the GAO report. One of the things that struck me is that if you look through the tables and you look through the information in the GAO report, regardless of the program, it is the same companies that keep repeatedly coming up. Repeatedly we see Citi, repeatedly we see Bank of America, repeatedly we see Morgan Stanley. Regardless of the program, it seems to be that the concentration of the benefits of these programs are with a handful of corporations. And, of course, those corporations, I think, do not want the public attention that they have repeatedly received incredible assistance from the Federal Reserve or credible assistance that has been off budget.

So again, that relationship and that revolving door, we have seen it. And again, this is something that was talked about in Dodd-Frank, some of the governance issues. We all remember very much the role of Goldman essentially being the Chair of the Board at the New York Fed and some of the conflict of interest there. And certainly those were saying that the current president of New York Fed is a former Goldman employee. So not only am I concerned about the revolving door between Treasury and the Fed, I am also very concerned about the revolving door between Wall Street and the Fed.

Chairman PAUL. Thank you.

I yield 5 minutes to Mr. Luetkemeyer from Missouri.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Dr. Auerbach, in your testimony you mentioned two or three things; the L.A. Fed whenever there was some corruption exposed, and some folks stole some money, the Federal airplane—the Federal Reserve airplane fleet. The audits that are being performed or should be performed, would they have caught these abuses?

Mr. AUERBACH. Did the audits have abuses?

Mr. LUETKEMEYER. Would the audits that are being proposed—in other words, right now we have the Inspector General folks, or GAO, they are now doing the audit on the emergency loan program that was administered.

Mr. AUERBACH. Right. They don't touch any of these.

Mr. LUETKEMEYER. You are saying we should expand—

Mr. AUERBACH. Definitely.

Mr. LUETKEMEYER. —audit procedures because existing auditing procedures are not catching these things?

Mr. AUERBACH. Definitely. There are tremendous problems inside the Fed, and the in-house audits were no good at the Boston Fed. The courageous people there who testified right here about it said that someone came from upstairs at the Boston Fed near the harbor. Officials of the Fed are at the top; the people who run the airplane fleet were down below. Someone came down asking, is everything all right here? That was about the extent of the in-house audit.

There were all kinds of corruptions, and so many corruptions that Henry Gonzalez, the Chairman, asked me to call the Janet Reno Justice Department, which I did, and they didn't want to get into it. Nobody likes to attack the Fed in Washington. So they said, call the Inspector General at the Fed, which I did, a very nice man, Brent Bowen, and he said, "I don't know if I have jurisdiction up in Boston."

And that is one of the major problems of the Fed and this new consumer protection agency that is located inside the Fed. The IG of the Federal Reserve is appointed by the head of the Federal Reserve, so how can they investigate these things? Chairman Bernanke cannot be investigated, and his officials are the people they appoint. This should be a Presidential appointment and an independent IG at the Fed, if you want to start cleaning up this mess.

Mr. LUETKEMEYER. Do you think there is anything that should be off limits whenever it comes to disclosure of the Fed activities?

Mr. AUERBACH. That is a very interesting question, because the Fed is now shredding their documents. But Arthur Burns, who was the head of the Fed back in the 1970s, he died in 1987, and he sent his transcripts of the meetings up to the University of Michigan, the Ford Library. They had people from the National Archives, professional archivists who took out anything that had to do anything with national security, personnel. They were lightly edited.

So I was able to go up there and get copies of them all. They are very different from the kind of thing that the Fed issues. Ask any reporter who has received something from the Fed; it is mostly blanked out. This was a much better record.

What should be done now is that the Fed should be told that they cannot destroy those records. The records go to the National Archives after 30 years. There will be somebody looking at that.

And also on the FOIA requests, you should get professional archivists who know the rules in cooperation with the Fed instead of sending reporters blank pages.

Mr. LUETKEMEYER. Dr. Calabria, what do you think about that? Are there some things that you believe should not be disclosed or are off limits, or do you think everything is open to everybody?

Mr. CALABRIA. I think the way I would look at it is the question of when should it be disclosed. Ultimately, any sort of deliberations, any sort of economic forecasts should be disclosed at some point. I would be comfortable having some sort of time lag.

For instance, one of the things that Dodd-Frank does, and I think does correctly, despite much of what the bill doesn't do correctly, is require a disclosure of future discount window lending. And so the concern for the Federal Reserve would be if you disclose at the time that banks are coming to the discount window, that is a signal that such banks are weak, and I think that is a legitimate concern to raise.

But I think if you—and again, in Dodd-Frank it allows up to a 2-year delay for that disclosure. I would prefer something closer to a year, but I do—I would say a 6-month, a year delay on something like discount window is legitimate in that it will not scare away people from using a discount window. Of course, we could have a totally separate discussion of whether this should be a lender of last resort in a discount window. But again, if you are going to have one, and you want it to be effective, a delay in disclosure in that, I think, is reasonable.

A delay on disclosure on deliberations at the Federal Open Market Committee meetings, I think, is again reasonable. Ultimately, in a timely basis, all of this information should be made public, and I want to emphasize 5, 10 years is not timely. So again, we need to get it out in a reasonable amount of time.

Mr. LUETKEMEYER. Thank you. I yield back, Mr. Chairman.

Chairman PAUL. I thank the gentleman, and we will go into a second series of questions.

This question is for Dr. Auerbach, and it has to do with what you talked about when you were trying get an audit in the 1970s, and you didn't get too far in the Banking Committee even though it was the chairman of the Banking Committee who wanted to do it. Then they took it and they sent it over to the Government Operations Committee. And then when they gave the authority for the audit, it was actually exactly the opposite and closed that.

I want you to expand on that. And also, why don't you tell me why it is that the individuals either in the Fed or see to it that their people get in the Fed, how come they have this much power that they are able to control even the Banking Committee chairman and then pass legislation exactly opposite of it? I think it was at that time that they really put into it to—seems like where the greatest protection is on these foreign operations, I think that is where there is a lot of mischief, and even now with our partial audit, we hear about it, but we don't know exactly what transpired. Could you expand on that a little bit?

Mr. AUERBACH. Sure. Let me take the second part first on international operations. You were right about the bill that was finally passed where the GAO is not allowed to go into anything that has to do with the operations, international operations, or monetary policy, trophies that remained on the shelf of the Fed for a long time.

In international operations, when the Fed goes, for instance, and notifies brokers all over the world, brokers who are not investigated by anybody in the United States, and tells them, we want to buy, say, 5 billion in euros, that information is given to the brokers ahead of time. I am not saying the brokers are dishonest, but when there are billions at stake in these markets, they can place orders, or people in their office can place orders, long before the order is consummated.

The chairman wrote to Alan Greenspan and asked, "Why are you doing this? Why not just make an announcement that you are going in with 5 billion and let everybody in the market get in on it at the same time?" And he wrote back, "I think there is only about a 10-minute delay between the time we tell them to do it and they make these huge purchases. That is ample time to make a lot of money in the market. And so, the international operations should be audited by the GAO. It is really important, and I think when the Fed is going to do something, they should announce it.

I disagree a little bit with Dr. Calabria. I would not leave these decisions for discount rate changes and for anything the Federal Open Market Committee does for more than 6 months—even that is very long—because there have been so many leaks at the Fed. The FBI has been called in, all the rest. It is going to leak out anyway. There are several ways it leaks out. One is when we asked how many people at the Fed know about these secret interest rate decisions, we got a whole bunch of pages, single-spaced, of hundreds of people all over the country on these conference calls. And as Greenspan reported, he was saying he opens the Singapore edition of the Wall Street Journal and found out what the Fed did at their meetings before. So you can't tie up information that is so valuable for months that just benefits inside traders. And those trophies, when they did go over and put them in there, it kept the GAO out of a lot of the problems.

Can I say one other thing that I think is important? We have sitting in the audience Walter Charlton, who has had suits against the GAO since 1983 because the GAO has had a policy, alleged policy against older workers. I had excellent GAO people who were at the Los Angeles Fed who did the audits. They were excellent. They were old-timers at the GAO who knew how a central bank works, and knew what to get into and what to look at.

The suits now in the courts all these years, some of them have been adjudicated. The suits allege that they try to get rid of the older people. In a recent suit, I gather that after a joint session of Congress, 200 were rehired by the GAO. But they try to get rid of the older people, people who are 55 or older, around there, and hire young people. And I know they hire young people, because I used to have lunch with David Walker when he came to the LBJ school to get some of our excellent young students, but that lowers the amount they have to pay the people by a huge amount.

But what we need in the GAO are experienced auditors who know how central banks work and can get in there and really find out what is going on. That takes a lot of training to find out how to audit a vault facility.

The vault facility, since we found that team that was in there that I worked with, was excellent. They found out what was missing. It was just awful. The main ledger, the vault on the computer, everybody could get in there without a password. What happened to those officials when that went public? Nothing has happened since then at the Fed.

I think it is very important to get better GAO auditors—now, maybe they have them—who are experienced on how to audit a huge, enormous central bank with 20,000 employees. And they have vaults all over the country that hold all the money for the commercial banks, and the Bureau of Engraving ships it there. All the new money is in there also. It is a national security problem, and if Greenspan thought that the employees were stealing $500,000 in 10 years—we thought that was a tremendous understatement and so did the GAO crew—but I believe shortly thereafter, most of them were no longer at the GAO.

Chairman PAUL. Thank you.

I yield 5 minutes to Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I have a feeling that both of you gentlemen have a lot more to say and a lot more suggestions for us, so I think I will just use my time a little differently this time.

Dr. Calabria, you were the Director of Financial Regulatory Studies. What one regulation would you suggest would be impactful. Audit the full Fed? Is there something else that you see that would really protect our monetary system and really make an impact? What would be your suggestion?

Mr. CALABRIA. I think the focus really needs to be on defining and limiting the discretion for the Fed on price stability. So, again, you can do things like reduce—eliminate the dual mandate, having some sort of inflation targeting.

I would emphasize that ultimately what is going to be a constraint on the Fed is some sort of competition, so obviously encouraging alternative monetary mechanisms is something we should be looking at the in the long run, but certainly trying to find a way to constrain the Fed. So I would have a full audit. I would get rid of the dual mandates. I would put some statutory flesh around what exactly price stability means, because again, you can get rid of the dual mandate, but if the Fed decides that price stability is 3 or 4 percent, it doesn't really matter. You have to take some of these definitions back into Congress.

And again, I want to emphasize one of the reasons I think the Federal Reserve has been so effective over the years at thwarting Congress is that they come up here and they give you all this gobbledygook about M1, M2, and all this, and they try to confuse you. Again, the most important thing is to get information out there so that Members of Congress can even start with the very right questions and can push them and basically not let them get around that. So the most important thing we can do is educate Congress and the public on how exactly monetary policy works.

Mr. LUETKEMEYER. Very good. I asked for one, and got three. Must be D.C. Thank you.

Dr. Auerbach, with regard to the same question, you have had a lot of advice for us in some of your previous comments here. What piece of advice or regulation would you suggest?

Mr. AUERBACH. Price stability is certainly important, but the Fed should understand it is the 1949 Employment Act that said they have to do full employment also; that price stability helps produce full employment. And right now we have quite a bit of inflation. Year over year, 1 month it was 4 percent, then 5 percent. Then Chairman Bernanke testified that he doesn't see any inflation. How high does it have to go before he sees it? That is year-over-year inflation.

The other thing that I think that Congress should have something to say about is what I call malpractice at the Fed. In September 2008, when Lehman Brothers collapsed and the markets went crazy all over the world, one month later, the Fed decided that they would start paying the banks interest in order for them to hold their reserves.

I have that diagram—I wonder if you would put it up—of the amount of—there it is. The amount of excess reserve. You will notice that since—this is the Federal Reserve of St. Louis. It is zero. All of a sudden in 2010, the banks are intelligent. They say, look, we can get a quarter percent interest risk-free from the Fed; why should we loan it to businesses?

So the Fed begins pumping in their monetary base, they pumped in $1.9 trillion. How much of that got out for loans to banks and to businesses? $1.7 trillion was parked as excess reserves. It is there today. The total today is $1.6 trillion in excess reserves. It went through the roof.

We are in a position today where people inside the Fed, economists inside the Fed, like William Gavin, a great economist at the St. Louis Fed, published in their literature for the banks it is a much better investment to hold the money as excess reserves, tie it up, than to lend it out to people, because they get a quarter percent for sure, and we are in a terrible environment.

What should be done immediately? I call this malpractice. It has certainly increased unemployment in the United States. The Fed must stop paying the banks to hold reserves instead of lending it to businesses. And if they do that, they have to be very careful that the money supply doesn't balloon out or we will have a huge inflation. They will have to slightly raise their target interest rate to about a half percent. They should be doing that. They have been at zero long enough, and you can see what good that has done for the country.

Mr. LUETKEMEYER. Thank you very much. I yield back.

Chairman PAUL. Thank you.

I have one more question for the two of you. We talk about the transparency, and how to get information out, and how dangerous it is if someone gets the information, they can make some money on it because they anticipate what the market will do. And also, there is so often the unintended consequences of manipulating what they do, the economic consequences. And we talk and discuss, and there was a slight disagreement on exactly when we release information, when did the Fed do this, and when do we get a record of the history.

My question is a little bit different. It has actually to do with monetary policy per se, not how we tell—how the Fed manages monetary policy. My viewpoint, they have had two mandates, full employment, and I don't think either one of you enjoy that. If you really look at the old-fashioned way of measuring it, it is probably over 20 percent. Dr. Auerbach admitted that price stability, they are not doing very well there. But I got the indication from both of you that it wasn't the principle of setting the interest rates, it is how they do it, and when it is released, and the details of it.

But what about the question of whether or not they should be messing around with interest rates? Most economists these days, ever since the 1970s, they have played down wage and price controls. Wage and price controls aren't very good as a solution to solve the problem of price inflation created by too much money.

But setting interest rates is a pretty big deal. If interest rates—if prices are the signal that tells the businessman what to do and the consumer what to do, the supply and demand—and, of course, free-market economists predicted that socialism would absolutely fail without a pricing structure—why is it that we have accepted this idea that the Fed is all-knowing with their record?

So could you each tell me, do you think it would be bad to have a system where the Fed wasn't involved with setting interest rates, and maybe market rates would help? Maybe market rates would help savings. Maybe interest rates would go up, and the people who tend not to want to gamble in the stock market and the bond market, wouldn't this be a help to the economy? Could both of you make a comment about whether or not the Fed should be setting interest rates?

Mr. AUERBACH. I think that is a really good question. In 1979, we had a little party right here in this room, and the new Chairman was coming on board. He was a very good Chairman, Chairman Volcker. And at that time, by 1980, the inflation of the United States was going over 13 percent. Interest rates went up over 20 percent. There were mass bankruptcies in the country. And Volcker was laughing with us and said to two of us from the University of Chicago, you give me a pain in my you know what, and we laughed together. But then Volcker decided he wouldn't control interest rates, he would control the money supply and stop printing so much money, which he did. He paid a big price, but he stopped the country from going into a terrible inflation. I was in the Reagan Administration, and we had a double-dip recession, 10 percent unemployed, but then we had a long period of no inflation. So he did a great job, but we paid a terrible price.

But when Alan Greenspan came in, the idea of controlling the money supply was considered, oh, that is University of Chicago "monetarists," and they don't know what they are doing. So by the end of the 1980s, he decided the Fed would no longer target money. He would do what other central banks do: just target the interest rates.

And I think they should do both. They should watch the money supply, but they should do what Congressman Paul said: try to let the interest rates go to market rates instead of sitting on them.

Mr. CALABRIA. I would start by saying that I believe there is probably no more important price in the economy than the interest rate. You really do balance savings investment and you balance time preferences. Accordingly, when we get that wrong, we get a whole lot wrong, and you can have all sorts of disruptions to the economy. So ultimately, the answer should be a very strong "no," we should not have the Fed manipulating what is the most important price in the economy.

Chairman PAUL. I thank the panel for appearing. The Chair notes that some of the members may have additional questions for the first and second panel of witnesses which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This committee is now adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

A P P E N D I X

October 4, 2011

United States House of Representatives
Committee on Financial Services
Subcommittee on Domestic Monetary Policy and Technology
Hearing on: "Audit the Fed: Dodd-Frank, QE3, and Federal Reserve Transparency"
October 4th, 2011

Congressman Ron Paul
Statement for the Record

In his 1974 Nobel Prize address, the late Austrian economist Friedrich von Hayek attacked the pretense of knowledge, the idea that policymakers have sufficient knowledge and power to shape society as they wish. Our political leaders failed to take Hayek's message to heart, as succeeding generations have continued to allow this intellectual arrogance to continue unabated. Just as the New Mandarins squandered America's wealth, resources, and young men during the 1960s, today's economic Mandarins seem hell-bent on destroying every last vestige of the free market and driving the economy into ruin. Congress has abdicated its oversight over these "expert" economists at the Federal Reserve, to the detriment of the economic well-being of the American people. Despite overwhelming grassroots support behind auditing the Fed, only incremental progress has been made toward unmasking the Federal Reserve's activities. Full transparency of the Fed's operations remains an elusive goal, but one towards which I intend to devote my remaining time in Congress.

The Fed has been given a monopoly by Congress to conduct monetary policy, and in so doing it tinkers with the most important price of all, the rate of interest. Interest rates reflect the price of time, and changes in the interest rate affect the structure of production. Forcing changes to the interest rate, as the Fed does, has a more pronounced effect on the economy than any law Congress has ever passed. Interest rates are used by individuals to make decisions about what type of investments they undertake, how much money they invest, and for how long. The higher the interest rate, the more likely an individual is to save money; the lower the interest rate, the less likely he is to save. Borrowers take the interest rate into account when borrowing money to buy a house, pay college tuition, or start or expand a business. The lower the interest rate, the cheaper it becomes to borrow money and the more likely individuals are to borrow; the higher the interest rate, the less likely they are to borrow. In a free market, some people will want to save while others will want to borrow, and the interest rate is the price that coordinates the actions of borrowers and savers.

Manipulating the interest rate as the Federal Reserve does causes an enormous ripple effect throughout the economy. Most people do not think about how interest rates came to be, they merely make their economic calculations and decisions based on what the prevailing rate of interest is. Every day people go to work, buy and sell goods, and move their money in and out of the banking system. The isolated actions undertaken by individuals combine to create the market. The market is a truly awesome thing which most of us take for granted. No one marvels that bananas and oranges are available in supermarkets year-round, that cars from Germany and Japan travel our roads, or that our houses have electric lighting and indoor plumbing. Yet it was the actions of millions of people, each acting in his own self-interest and without any knowledge of how his actions might affect other people down the road, that resulted in each of those things happening. When government begins to interfere in that process, it leads to all sorts of problems.

As we meet here in this hearing room, the Federal Reserve is engaging in the second coming of Operation Twist, attempting to force already-low interest rates even lower. This crisis was begun because of the Federal Reserve's low interest rate policy which distorted the economy by shuttling resources and investment that would have been better allocated elsewhere into the housing sector. Instead of recognizing the futility of trying to inflate our way to prosperity with artificially low interest rates, and allowing the interest rates to reset to a true, market-determined rate, and allowing prices to fall so as to allow malinvested resources to be put to better use, the Fed repeated the mistakes of the past by pumping more money into the economy. With an official inflation rate of nearly four percent, interest rates on savings accounts of well less than one percent, and a stock market that has stagnated over the past three years, there is no incentive whatsoever for consumers to save or invest. Money sitting in the bank a year ago would have lost nearly four percent of its value by now, money invested in the stock market just as much, and money invested in Treasury bonds over one and a quarter percent. Is it any wonder that people have decided to consume rather than to save?

Savings and investment are required for economic growth, deferring present consumption in the hopes of gaining some greater future consumption. Imagine savings and investment in terms of wheat. Most of the wheat that is grown will be consumed after harvest, but a small amount will have to be saved for seed, in order to grow next year's crop. The more that is able to be saved for seed, the larger the crop will be in future years, enabling increased wheat consumption. What the Federal Reserve's actions are telling people is: don't save, there is no need. Consume that seed and don't worry about the future. And that is what this country has been doing for years. Capital is being consumed through the government's spurring of consumption, encouraging people to take on debt to fund frivolous spending and failing not only to increase present capital but also failing to replenish capital that is used up in the production process.

This all leads us to the need for Federal Reserve transparency. Congressional oversight of the Fed amounts to about twelve hours of hearings per year, and that's as far as it goes. Of those twelve hours, no more than five or ten minutes goes to any one Congressman, who has the opportunity to ask at most one question of Chairman Bernanke every six months. To claim that this is effective oversight is laughable. Even the increased amount of data disclosure mandated by the Dodd-Frank Act, a relative sea change, is only due to be released two years after the fact. The legislative cycle in Congress is so fast that many of us up here do not even remember what took place two weeks ago, let alone two years ago. Trying to set up a hearing such as this one requires weeks, if not months, of advance planning. To imagine that two years after the fact Congress will really seek to dig into the details of the Federal Reserve's lending activities defies common sense. Two years ago the Fed was already well into its first round of quantitative easing, it has since completed a second round, and it is now embarking on a third intervention into bond markets.

Attempting to audit the Fed through passage of new legislation is time-consuming as well. It took nearly a year and a half of effort to enact the few measures that made it into the Dodd-Frank Act. And this year my Audit the Fed bill has been referred, not to the Financial Services Committee as Fed audit bills have been for 40+ years, but to the Oversight and Government Reform Committee. While I am hopeful that Chairman Issa will act on that bill, which has over 180 cosponsors, time is quickly slipping away for this Congress to act.

While the Federal Reserve is not fully transparent, what is transparent are the effects the Fed's policy actions have on everyday people. A young couple is thrilled that interest rates are at historic lows so they take out a mortgage in order to buy the house they had always wanted. But as the Fed continues to print money in order to suppress interest rates, the price of food and heating begins to rise. Expenses rise faster than their paycheck, and they find themselves falling behind on their mortgage and eventually face foreclosure. Or imagine the elderly retiree dependent on Social Security and a small amount of savings. She has not received a cost of living increase to her Social Security in years, despite the ever-increasing cost of food and health care. Extended low interest rates mean that her savings account earns almost no interest each year, so her savings are rapidly depleting. She fears that within a couple of years she may be left with no money and no way to support herself. And then there is the single mother who has been laid off from work for the past 18 months because the rising prices of production inputs caused by the Fed's inflationary monetary policy forced her employer to downsize the company in order to reduce costs. And with prices for the company's finished goods continuing to rise as the Fed continues pumping new money into the economy, consumer demand has dropped, making it all the more likely that her company will never be able to rehire her.

But rest assured, the Fed tells us, as long as the bankers are doing alright, everything will be fine. Indeed, the banks do appear to be doing fine. Flush with cash and receiving interest payments from the Fed on their excess reserves, the financial sector has continued to record amazing profits. Every time a new piece of disappointing economic data comes out, we hear renewed cries from Wall Street for more action on the part of the Federal Reserve. Amazingly, some people are complaining that the latest round of $400 billion in bond purchases is too small. The fact that a $400 billion operation, equivalent to half the size of the Fed's pre-crisis balance sheet, is considered paltry is a sad indicator of how easily so many Americans are willing to accept big government. Bailouts of the financial sector are the new normal, only now they are conducted covertly through the Fed rather than through Congressional action so as not to arouse public ire as in 2008.

The Federal Reserve is a creature of Congress and should be treated as such, not as an organization exempt from Congressional oversight. Claims from the Fed and its defenders that a full audit of the Fed would endanger the Fed's independence are an attempt at provoking fears that Congress would directly intervene in the conduct of monetary policy. A bill that sets interest rates would endanger the Fed's independence; a bill that audits the Fed does not. Nowhere in any audit proposals has anyone ever expressed the desire that Congress dictate monetary policy or attempt to set interest rates. Congress does not have this power, nor should it, but it is accountable to the people through the ballot box; not so with the Federal Reserve, which tries to remain unaccountable both to Congress and to the American people. Pumping trillions of dollars into the economy with no oversight and accountability cannot be allowed to continue. Audit the Fed now.

Testimony of Robert D. Auerbach

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before the

Subcommittee on Domestic Monetary Policy and Technology

Committee on Financial Services

U.S. House of Representatives

October 4, 2011

"Audit the Fed: Dodd-Frank, QE 3, and Federal Reserve Transparency"

INTRODUCTION

Thank you Chairman Ron Paul, Ranking Member William Lacy Clay and members of the subcommittee for this opportunity to testify on transparency at the Federal Reserve. My name is Robert Auerbach. I am a Professor of Public Policy at the Lyndon B. Johnson School of Public Affairs at the University of Texas in Austin. On two separate occasions I had the honor to serve as an economist on the staff of this Committee (1977-81 and 1992-1997) and my 2008 book, Deception and Abuse at the Fed: Henry B. Gonzalez Battles Alan Greenspan's Bank details the oversight investigations that I staffed while serving Committee Chairman Henry S. Reuss in the late 1970's and Committee Chairman/Ranking Member Henry B. Gonzalez in the 1990's. I have also served as an economist in the U.S. Treasury's Office of Domestic Monetary Affairs during the Reagan Administration and at the Federal Reserve System.

The Fed is the powerful central bank of the United States that controls the money supply, regulates the banking system and, since 1962, makes loans to foreign countries without Congressional authorization. [1] The historical record summarized below, describing Federal Reserve officials blocking transparency and individual accountability, including destroying source records of its policymaking committee since 1995, leads to the following suggested remedies:

- **Independent Inspector General**: The Inspector General of the Federal Reserve should not be appointed by the chairman of the Federal Reserve Board as is currently the case. The IG should be a Presidential nominee whose credentials, abilities and independence are examined during a Senate confirmation process.
- **Preserve Transcripts**: The Federal Reserve should stop destroying the source transcripts and should stop turning off the recording system at its policy making committee, the Federal Open Market Committee (FOMC). This practice was approved in 1995 by an unrecorded vote of the FOMC directed by then-Chairman Alan Greenspan. [2]
- **Provide Minutes to Congress**: The minutes of the boards of directors meetings at the Federal Reserve's 12 district banks and the transcripts of the meetings of the Federal Reserve Board of Governors and of the FOMC, should be sent to the House and Senate banking committees within six months of the meetings. Trained archivists at the National

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[1] Auerbach, Deception and Abuse at the Fed, pp. 69 - 73.
[2] Auerbach, Deception and Abuse at the Fed, pp. 103 - 104.

Archives and Records Administration should edit those records to remove prescribed items in cooperation with the Federal Reserve.

- **Senate Confirmation of Bank Presidents**: The 12 Federal Reserve regional bank presidents who are eligible to vote on the money supply as members of the FOMC should be confirmed by the Senate. The presidents wield enormous power as members of the FOMC and they should be fully vetted in the confirmation process. I want to commend full committee Ranking Member Barnie Frank for addressing the regional bank presidents' role on the FOMC with H.R. 1512, although rather than removing them from the FOMC as proposed in the bill I would recommend Senate confirmation.

FED AUDITS

Chairman Ron Paul and Senator Bernie Sanders deserve great praise for their leadership in enacting the current Government Accountability Office (GAO) audit of the Federal Reserve as part of the Dodd-Frank Act. The Senate unanimously approved, by a 90 to 0 vote, the Sanders amendment to require disclosure of the recipients of the Fed's emergency loans. Hopefully this Congressional action set a precedent for fuller continuing audits of Federal Reserve operations.

In 1976, House Committee on Banking, Finance and Urban Affairs Chairman Henry Reuss proposed a GAO audit of the Fed. The Fed orchestrated a massive lobbying campaign using the officials of private banks to lobby to stop the audit bill.

Evidence of the lobbying campaign came from minutes of the board of directors of each of the 12 district Federal Reserve Banks. Chairman Reuss requested minutes from district bank meetings from 1972, 1974, and 1975. After a six-month delay with letters back and forth and meetings between Chairman Reuss and Federal Reserve Chairman Arthur Burns, the minutes arrived at the Congress. One response to the Reuss request for records was given by a St. Louis Fed President, as reported on the transcript:

> "I would also think that if this involves a lot of work, which it will, needless work, that someone on Mr. Reuss' Committee, a friendly individual should know what we're being called upon to do. Because I think this can be used against Reuss if we react intelligently and as I see it in the St. Louis case, it's appalling how skimpy or meaningless our minutes are, I'm sure we did this with great wisdom knowing that a man named Reuss would ask for them. The minutes are really terribly shallow. Tell nothing."[3] (Emphasis added)

[3] November 16, 1976 FOMC transcript, p.17.

Chairman Reuss' delivered a floor speech in 1976 detailing the evidence of the Fed's orchestrated lobby against the audit bill entitled: "What the Secret Minutes of the Federal Reserve Banks Meetings Disclose". The speech led to the passage of the Federal Reserve Reform Act of 1977 which brought Fed Bank directors under the federal government conflict of interest laws.

Despite this victory, the Fed won the first round on the audit effort. Chairman Reuss's audit bill could not garner enough support to pass out of the Committee. It was shunted to the Government Operations Committee where it passed in 1978, but only after glaring no-audit barriers on any Fed operations connected to monetary policy or international transactions were added.

In the Fed's monetary policy operations billions of dollars can be made from inside information from leaks of Fed policy. It is very difficult to police these leaks of inside information. One necessary step to stop leaks is to severely limit the interest rate policy information in the Federal Reserve to a few people. This has not happened. Many hundreds of Federal Reserve employees -- over 500 employees -- are directly involved in the secret meetings or in preparing information that has been discussed at these meetings.

The House Banking Committee received information in 1997 about non-Federal Reserve employees at Federal Reserve meetings where inside information was discussed. Congressmen Gonzalez and Maurice Hinchey asked Greenspan about the apparent leak of discount rate information and the presence of these people at Federal Reserve meetings. Greenspan was forced to admit that some non-Federal Reserve people had attended Federal Reserve meetings where the Federal Reserve=s future interest rate policy was discussed.[4] Greenspan included a 23-page enclosure listing hundreds of people at the Board of Governors in Washington, D.C. and in the 12 Federal Reserve Banks around the country who have access to at least some secret Federal Reserve information about non-public Federal Reserve interest rate policy.
Names of Avisiting scholars@ were listed who had attended pre-FOMC meetings at three Federal Reserve Banks. Greenspan also wrote:

> At the Federal Reserve Bank of Kansas City, over the 3-year period, a total of 28 foreign central bankers have attended 16 different Board of Directors meetings, including the

[4] Greenspan letter of April 25, 1997.

discussion and vote on discount rates. Those attending included Acentral bankers from Bulgaria, China, the Czech Republic, Hungry, Poland, Romania and Russia. [5]

At the December 19, 1989 FOMC meeting Greenspan warned about the ill effects of continuing leaks from the FOMC's supposedly secret meetings and said that "we're beginning to look like buffoons":

> [. . .] I would like to raise again a problem that continues to confront this organization with continuous damaging and corrosive effects, and that is the issue of leaks out of this Committee. We have two extraordinary leaks, and perhaps more, in recent days: in which John Berry at The Washington Post in late November had the time and content of a telephone conference; previous to that we had The Wall Street Journal knowing about telephone conferences and knowing a number of things that could only have come out of this Committee.
>
> As best I can judge from feedback I'm getting from friends of ours the credibility of this organization is beginning to recede and we're beginning to look like buffoons to some of them. [. . .] [6]

FOMC RECORDS

In 1976 two threats to Fed secrecy created high anxiety at the Federal Reserve Board of Governors. First, David Merrill, a law student at Georgetown University, brought a legal action challenging the 45-day delay in releasing the "Directive" on monetary policy.[7] It is a short report on policy actions that were authorized at the FOMC meeting. The Federal District Court agreed with Merrill. The Fed appealed up to the Supreme Court which remanded it back to the district court. Lacking funds for further extensive adjudication Merrill could not pursue the case. The Fed has all the money it needs or can order from the Bureau of Engraving and Printing to hire private law firms and fight any legal action.

The second attack on the Fed's secrecy was Congressional consideration of the "Government in the Sunshine Act" that was signed into law September 13, 1976. That law

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[5] Greenspan letter to Chairman Gonzalez, April 25, 1997, p. 2.

[6] Chapter 9, "Valuable Secrets and the Return of Greenspan's "Prophetic Touch" in Deception and Abuse at the Fed .

[7] The secret meetings at the Board of Governors in Washington D.C. revealed great alarm about transparency at the Arthur Burns Fed. This response was revealed in the FOMC transcripts Burns left upon his death in 1987 to the President R. Gerald Ford Library on the University of Michigan campus. The archivists of the National Archives and Records Administration lightly edited the transcripts.

required that: "The agency shall make promptly available to the public, in a place easily accessible to the public, the transcript, electronic recording or minutes of the meeting." The Fed frantically tried to protect itself from such transparency and individual accountability. Fearing the new legislation and the pending legal action for the disclosure of their records, Federal Reserve Chairman Arthur Burns led the Federal Reserve Open Market Committee in a 10 to 1 vote to discontinue transcripts of its meetings in 1976. That vote began the official 17-year Fed lie asserting that no transcripts were being maintained of FOMC meetings.

In 1992 I returned to the Banking Committee staff of then-Chairman Henry B. Gonzalez. Chairman Gonzalez and I could not believe that the most powerful central bank in the world, operating in our great democracy, had no complete records of its policy making committee, the FOMC. On October 19, 1993, Chairman Gonzalez convened a Fed oversight hearing focusing on transcripts. Seventeen officials of the Fed, seven members of the Board of Governors and ten of the twelve presidents of the Federal Reserve District Banks, testified in the Banking Committee chamber. Chairman Greenspan sat in the center of the long row of Fed officials. Prior to the hearing, Chairman Gonzalez sent the witnesses specific instructions that they reveal details of what records are kept by the Fed of their meetings.

A top Fed staff person, who would become vice chairman of the Board of Governors, explained on a confidential FOMC conference call four days before their Congressional testimony that Greenspan clearly intended to mislead Congress about written records of the FOMC: "The Chairman is not highlighting these transcripts ...We're not waving red flags." [8]

Jim McTague, now the Washington editor of Barron's, wrote about Greenspan's testimony: "In a performance that would have made professor Irwin Corey weep with admiration Mr. Greenspan avoided drawing attention to the existence of transcripts ..." Corey famously performed as a double-talking comedian.[9]

Several days after the hearing, the Cleveland Fed broke the silence and misdirection and informed the Congress of the deception. Chairman Greenspan then sent a letter admitting that transcripts existed. He claimed to have had memory problems. I led a group of Republican and Democratic staff to the Board of Governors where Fed staff showed us 17 years of neatly typed transcripts around the corner from Chairman Greenspan's office. Under pressure from this

[8] FOMC conference call transcript, October 15, 1993, p. 20.

[9] "Greenspan Has Himself to Blame for Fervid Interest in Transcripts," American Banker, December 1, 1993, p. 24.

Gonzalez investigation the Fed ended its 17-year lie by again issuing the transcripts but only with a 5-year lag, too long to establish timely individual accountability.

In 1995 Greenspan held a non-recorded vote of the FOMC – no finger prints – to destroy the source FOMC transcripts. I was informed by the Fed Vice Chairman Donald Kohn that this destruction would continue and that it was legal.[10] Previously these source records had been sent to the National Archives.

That same year the shredding machines at the Fed destroyed the source FOMC records when Fed officials bypassed the Congress and voted $5 billion to support the Mexican peso. That loan was collateralized by revenue from Mexico's oil industry. When the loan authorization was sent to the New York Federal Reserve Bank and was public information the peso stopped falling. The loan to Mexico that had been authorized was then not needed and was not made.

INVESTIGATIONS OF FED OPERATIONS

Congresswoman Carolyn Maloney joined Chairman Gonzalez in an investigation from 1995 to 1997 of the Fed's more than 50 contracted airplanes that were delivering paper checks across the country. The investigation found evidence of corruption in this system typified by the "backup plane" at Teterboro Airport. The Fed paid for this contracted plane that people at that Fed facility called the phantom plane because it was not present at Teterboro much of the time. We also uncovered evidence of nearly nonexistent in-house audits. Officials covered losses in the airplane fleet operations by transferring money from the Fed's employee pension fund.

The Reno Justice Department refused the Gonzalez request to investigate the extensive corruption found in the management of the airplane fleet and referred the Gonzalez inquiry to the Fed's Inspector General. The IG told me he did not know if he had jurisdiction because the fleet was managed by the Boston regional Fed Bank.

That weak dodge is consistent with my prior experience and underlies the importance of changing the structure of the Fed's IG. The Fed's Report to Congress and the Dodd-Frank law grant the Chairman of the Federal Reserve the authority to appoint his own Inspector General who is charged with investigating the Fed bureaucracy and who also serves as the IG for the new Consumer Financial Protection Bureau. This is a clear conflict as Chairman Bernanke can

[10] A letter from then Vice Chairman Donald Kohn to Robert Auerbach September 1, 2001. Included in Auerbach, "Stop the Fed From Shredding Its Record," Huffington Post, December 9, 2001.

"prohibit the Fed's Inspector General from carrying out or completing an audit or investigation or from issuing a subpoena ...": [11]

Another Gonzalez investigation began in 1997 when the Congress received information about alleged corrupt accounting at the cash section of the Los Angeles branch of the San Francisco Federal Reserve Bank that includes vaults containing cash and coins. The GAO assisted the Gonzalez's investigation. During the investigation Chairman Greenspan informed Ranking Member Gonzalez that the Federal Reserve knew that nearly $500 thousand that had been stolen from Fed vaults by Fed employees from 1987 to 1996.[12] The Gonzalez/GAO investigation indicated this was an understatement.

The following selections are from the September 30, 1996 published report of an excellent GAO team that investigated the cash section at the Los Angeles Branch of the Federal Reserve in coordination with a Gonzalez investigation. The report indicates how desperately the Fed operations need a complete competent audit. It is a matter of national security:

A bank had brought a deposit of $432,000 to the Fed and Fed employees mistakenly entered the transaction as $8,640,000. When Fed employees in the cash department counted the deposit they discovered an $8,208,000 mistake "they overrode the system control in the cash inventory system and forwarded the money for further processing. Although this error was corrected when the problem was detected at the end of the day, this resulted in an erroneous entry being made in the L.A. Bank's ledger for $8,640,000 that increased the cash in the vault amount and the depository institution's account. L.A. Bank officials had no explanation for why this occurred."

The GAO also reported: "We found that the October, November, and December 1995 monthly currency activity reports of the L.A. Bank were prepared and reported incorrectly. We confirmed that the reported receipts from currency deposited in the L.A. Bank by depository institutions (receipts from circulation) were not taken from the L.A. Bank's cash inventory

[11] Section 1081 of the Dodd-Frank Wall Street Reform and Consumer Protection Act states that, "...the Chairman of the Board of Governors of the Federal Reserve System shall appoint the Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection. The Inspector General of the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection shall have all of the authorities and responsibilities provided by this Act with respect to the Bureau of Consumer Financial Protection, as if the Bureau were part of the Board of Governors of the Federal Reserve System."

[12] Federal Reserve Board of Governors Chairman Alan Greenspan letter to Ranking Member Gonzalez, December 5, 1996.

records (in other words, independently determined) but rather 'forced' to ensure that the currency activity reports agreed with the daily balance sheet for the last day of the month." "The reports were prepared incorrectly at the direction of the L.A. Bank's management. L.A. Bank officials stated that the practice of forcing the reports to agree had been in place for some time." "We found that problems in currency reporting are linked to the limitations in the design of the underlying cash inventory system." "The L.A. Bank's inability to precisely summarize currency activity from its cash inventory records raises serious questions about the integrity of its accounting and internal controls." "We attempted to perform a comprehensive review of the L.A. Bank's internal controls and accounting practices over the money flowing through the Bank. Our efforts to perform a comprehensive review were substantially limited by the L.A. banks inability to provide the information needed for such a review.[...] we requested that the Bank provide us with [. . .] a general ledger history of all of the activity in its general ledger cash accounts for October through December 1995" [The bank did not provide the] general ledger of cash transactions because Bank officials stated that it would take them 3 weeks." [13]

This excellent GAO report demonstrates that the agency is capable of conducting exemplary audits of Fed operations if it is not constrained by statutory limitations and as long as experienced staff lead the investigations. The Fed vault facilities are a crucial part of the nation's payment system and should be a national security priority with full accountability to the Congress. The Fed banks contain uncirculated currency and coin transferred from the Bureau of Engraving and Printing. They also receive cash from banks throughout the country. The cash sections and vaults of the Federal Reserve District Banks and branches need to be investigated and audited with personnel who are experienced in central bank operations, independent of Fed officials and instructed to make thorough audits.

ACADEMIC INDEPENDENCE

Future GAO audits should target the massive number of Fed payments to academics who are not employed at the Federal Reserve. A Gonzalez investigation found that the Federal Reserve sent money and provided other benefits to economists throughout academia who specialize in monetary and financial subjects, and who were not employees of the Federal

[13] "Federal Reserve Banks, Inaccurate Reporting of Currency at the Los Angeles Branch, "Report to the Ranking Minority Member [The Honorable Henry B. Gonzalez], Committee on Banking and Financial Services," House of Representatives. GAO/AIMD-96-146, September 30, 1996. See also "EMBEZZLING FED MONEY AND FALSIFYING ACCOUNTING RECORDS," Deception and Abuse At the Fed," pp. 55-60.

Reserve. The Fed itself employed over 500 economists so the need to make all these outside payments is highly questionable.[14] Some academics received checks from a number of (up to five) district Fed Banks. Reuters reported Milton Friedman's views on this problem in 1993: "the Fed's relatively enhanced standing among the public has been aided 'by the fact the Fed has always paid a great deal of attention to soothing the people in the media and buying up its most likely critics' Recognizing that the Fed employs 'probably half of the monetary economists in the U.S. and has visiting appointments for two-thirds of the rest' he [Friedman] saw few among the academic community who were prepared to criticize the Fed policy." [15]

CONCLUSION

The current GAO audit of the Federal Reserve is a historic step towards greater transparency at the central bank. The Fed has a long history of fighting outside audits as various Fed officials have complained that they would constitute an infringement on central bank independence. In fact, the Fed's mythical flag of independence from politics, a favorite Fed mantra to avoid individual responsibility, is merely a shield intended to protect the institution from being forced to act in a more transparent fashion. Ongoing audits do not infringe on the Fed's independence which is protected in a myriad of ways, including self-funding and terms for members of the Board of Governors of 14 years. Board of Governor members can only be removed by impeachment and that has never happened.

Their long terms and very little chance of being impeached should allow independent votes. It has not prevented the fact that monetary policy has been very poor in periods such as the 1970's and since October 2008. I have been writing and speaking about the Federal Reserve's present misguided policy since 2009. [16]

Complete GAO audits and the other improvements I have described are essential for establishing a timely authentic record of policy actions and individual responsibility for the powerful unelected officials at the nation's central bank.

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[14] After the chapter in my book, "When 500 economists are not enough," was published on Huffington Post, , September 7, 2009, Ryan Grim followed up with an up to date article: "Priceless: How the Fed Bought the Economics Profession," September 7, 2009.

[15] Reuters interview reported July 7, 1993.

[16] "The Bernanke Fed Is in a Deep Hole With a $1.6 Trillion Time Bomb," Huffington Post/AOL, August 29, 2011.

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Testimony
Before the Subcommittee on Domestic Monetary Policy and Technology, Committee on Financial Services, House of Representatives

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FEDERAL RESERVE SYSTEM

Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance

Statement of Orice Williams Brown, Managing Director
Financial Markets and Community Investment

U.S. Government Accountability Office
GAO 90 YEARS 1921-2011
ACCOUNTABILITY ★ INTEGRITY ★ RELIABILITY

GAO-12-122T

October 2011

FEDERAL RESERVE SYSTEM

Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance

GAO
Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-122T, a testimony before the Subcommittee on Domestic Monetary Policy and Technology, Committee on Financial Services, House of Representatives

Why GAO Did This Study

The Dodd-Frank Wall Street Reform and Consumer Protection Act directed GAO to conduct a one-time audit of the emergency loan programs and other assistance authorized by the Board of Governors of the Federal Reserve System (Federal Reserve Board) during the recent financial crisis. This testimony summarizes the results of GAO's July 2011 report (GAO-11-696) examining the emergency actions taken by the Federal Reserve Board from December 1, 2007, through July 21, 2010. For these actions, where relevant, this statement addresses (1) accounting and financial reporting internal controls; (2) the use, selection, and payment of vendors; (3) management of conflicts of interest; (4) policies in place to secure loan repayment; and (5) the treatment of program participants. To meet these objectives, GAO reviewed program documentation, analyzed program data, and interviewed officials from the Federal Reserve Board and Reserve Banks (Federal Reserve System).

What GAO Recommends

GAO made seven recommendations to the Federal Reserve Board to strengthen policies for managing noncompetitive vendor selections, conflicts of interest, risks related to emergency lending, and documentation of emergency program decisions. The Federal Reserve Board agreed that GAO's recommendations would benefit its response to future crises and agreed to strongly consider how best to respond to them.

View GAO-12-122T or key components. For more information, contact Orice Williams Brown, 202-512-8678 or williamso@gao.gov

What GAO Found

On numerous occasions in 2008 and 2009, the Federal Reserve Board invoked emergency authority under the Federal Reserve Act of 1913 to authorize new broad-based programs and financial assistance to individual institutions to stabilize financial markets. Loans outstanding for the emergency programs peaked at more than $1 trillion in late 2008. The Federal Reserve Board directed the Federal Reserve Bank of New York (FRBNY) to implement most of these emergency actions. In a few cases, the Federal Reserve Board authorized a Reserve Bank to lend to a limited liability corporation (LLC) to finance the purchase of assets from a single institution. In 2009 and 2010, FRBNY also executed large-scale purchases of agency mortgage-backed securities to support the housing market. The Reserve Banks' and LLCs' financial statements, which include the emergency programs' accounts and activities, and their related financial reporting internal controls, are audited annually by an independent auditing firm. These independent financial statement audits, as well as other audits and reviews conducted by the Federal Reserve Board, its Inspector General, and the Reserve Banks' internal audit function, did not report any significant accounting or financial reporting internal control issues concerning the emergency programs.

The Reserve Banks, primarily FRBNY, awarded 103 contracts worth $659.4 million from 2008 through 2010 to help carry out their emergency activities. A few contracts accounted for most of the spending on vendor services. For a significant portion of the fees, program recipients reimbursed the Reserve Banks or the fees were paid from program income. The Reserve Banks relied more extensively on vendors for programs that assisted a single institution than for broad-based programs. Most of the contracts, including 8 of the 10 highest-value contracts, were awarded noncompetitively, primarily due to exigent circumstances. These contract awards were consistent with FRBNY's acquisition policies, but the policies could be improved by providing additional guidance on the use of competition exceptions, such as seeking as much competition as practicable and limiting the duration of noncompetitive contracts to the exigency period. To better ensure that Reserve Banks do not miss opportunities to obtain competition and receive the most favorable terms for services acquired, GAO recommended that they revise their acquisition policies to provide such guidance.

FRBNY took steps to manage conflicts of interest for its employees, directors, and program vendors, but opportunities exist to strengthen its conflict policies. In particular, FRBNY expanded its guidance and monitoring for employee conflicts, but new roles assumed by FRBNY and its employees during the crisis gave rise to potential conflicts that were not specifically addressed in the Code of Conduct or other FRBNY policies. For example, FRBNY's existing restrictions on its employees' financial interests did not specifically prohibit investments in certain nonbank institutions that received emergency assistance. To manage potential conflicts related to employees' holdings of such investments, FRBNY relied on provisions in its code that incorporate requirements of a federal criminal conflict of interest statute and its regulations. Given the magnitude of the assistance and the public's heightened attention to the appearance of conflicts related to Reserve Banks' emergency actions, existing policies and procedures for managing employee conflicts may not be sufficient to avoid the appearance of a conflict in all situations. As the Federal Reserve System considers revising its conflict policies given its new authority to regulate certain nonbank institutions, GAO recommended it consider how potential conflicts from emergency lending could inform any changes. FRBNY managed vendor conflict issues through contract protections and actions to help ensure compliance with relevant contract provisions, but these efforts had limitations. For example, while FRBNY negotiated important contract protections, it lacked written guidance on protections that should be included to help ensure vendors fully identify and remediate conflicts. Further, FRBNY's on-site reviews of vendor compliance in some instances occurred as far as 12 months into a contract. FRBNY implemented a new vendor management policy but has not yet finalized another new policy with comprehensive guidance on vendor conflict issues. GAO recommended FRBNY finalize this new policy to reduce the risk that vendors may not be required to take steps to fully identify and mitigate all conflicts.

While the Federal Reserve System took steps to mitigate risk of losses on its emergency loans, opportunities exist to strengthen risk management practices for future crisis lending. The Federal Reserve Board approved program terms and conditions designed to mitigate risk of losses and one or more Reserve Banks were responsible for managing such risk for each program. Reserve Banks required borrowers under several programs to post collateral in excess of the loan amount. For programs that did not have this requirement, Reserve Banks required borrowers to pledge assets with high credit ratings as collateral. For loans to specific institutions, Reserve Banks negotiated loss protections with the private sector and hired vendors to help oversee the portfolios that collateralized loans. The emergency programs that have closed have not incurred losses and FRBNY does not project any losses on its outstanding loans. To manage risks posed by these new lending activities, Reserve Banks implemented new controls and FRBNY strengthened its risk management function. In mid-2009, FRBNY created a new risk management division and enhanced its risk analytics capabilities. But neither FRBNY nor the Federal Reserve Board tracked total exposure and stressed losses that could occur in adverse economic scenarios across all emergency programs. Further, the Federal Reserve System's procedures for managing borrower risks did not provide comprehensive guidance for how Reserve Banks should exercise discretion to restrict program access for higher-risk borrowers that were otherwise eligible for the Term Auction Facility (TAF) and emergency programs for primary dealers. To strengthen practices for managing risk of losses in the event of a future crisis, GAO recommended that the Federal Reserve System document a plan for more comprehensive risk tracking and strengthen procedures to manage program access for higher-risk borrowers.

While the Federal Reserve System took steps to promote consistent treatment of eligible program participants, it did not always document processes and decisions related to restricting access for some institutions. Reserve Banks generally offered assistance on the same terms to institutions that met announced eligibility requirements. For example, all eligible borrowers generally could borrow at the same interest rate and against the same types of eligible collateral. Because Reserve Banks lacked specific procedures that staff should follow to exercise discretion and document actions to restrict higher-risk eligible borrowers for a few programs, the Federal Reserve System lacked assurance that Reserve Banks applied such restrictions consistently. Also, the Federal Reserve Board did not fully document its justification for extending credit on terms similar to the Primary Dealer Credit Facility (PDCF) to affiliates of a few PDCF-eligible institutions and did not provide written guidance to Reserve Banks on types of program decisions that would benefit from consultation with the Federal Reserve Board. In 2009, FRBNY allowed one entity to continue to issue to the Commercial Paper Funding Facility, even though a change in program terms by the Federal Reserve Board likely would have made it ineligible. FRBNY staff said they consulted the Federal Reserve Board regarding this situation, but did not document this consultation and did not have any formal guidance as to whether such continued use required approval by the Federal Reserve Board. To better ensure an appropriate level of transparency and accountability for decisions to extend or restrict access to emergency assistance, GAO recommended that the Federal Reserve Board set forth its process for documenting its rationale for emergency authorizations and document its guidance to Reserve Banks on program decisions that require consultation with the Federal Reserve Board.

Chairman Paul, Ranking Member Clay, and Members of the Subcommittee:

Thank you for the opportunity to discuss our work on the emergency assistance the Federal Reserve System provided to certain financial markets and financial institutions during the financial crisis that began in summer 2007.[1] From late 2007 through mid-2010, Reserve Banks provided more than a trillion dollars in emergency loans to the financial sector to address strains in credit markets and to avert failures of individual institutions believed to be a threat to the stability of the financial system. The scale and nature of this assistance amounted to an unprecedented expansion of the Federal Reserve System's traditional role as lender-of-last-resort to depository institutions. In March 2008, the Federal Reserve Board cited "unusual and exigent circumstances" in invoking its emergency authority under section 13(3) of the Federal Reserve Act of 1913 to authorize a Reserve Bank to extend credit to nondepository institutions. For the first time since the Great Depression, a Reserve Bank extended credit under this authority. The Federal Reserve Board would invoke this authority on three other occasions within that month and on several occasions in late 2008 when the failure of Lehman Brothers Holdings Inc. (Lehman Brothers) triggered a severe intensification of the financial crisis.[2] The Federal Reserve Bank of New York (FRBNY), which operated most of these programs under authorization from the Federal Reserve Board, faced a number of unique operational challenges related to implementation and oversight for numerous emergency programs, many of which required large vendor procurements to fill gaps in Federal Reserve System expertise. To date, most of the Reserve Banks' emergency loans have been repaid, and FRBNY projects repayment on all outstanding loans.

[1]The Federal Reserve System consists of the Board of Governors of the Federal Reserve System—a federal agency—and 12 regional Reserve Banks. For this testimony, I use Federal Reserve Board to refer to the federal agency and Federal Reserve System to refer collectively to the federal agency and one or more of the Reserve Banks.

[2]Lehman Brothers was an investment banking institution that offered equity, fixed-income, trading, investment banking, asset management, and other financial services. According to the bankruptcy examiner appointed by the bankruptcy court, Lehman Brothers originated mortgages, securitized them, and then sold the securitized assets. Although headquartered in New York, Lehman Brothers operated globally. Lehman Brothers had $639 billion in total assets and $613 billion in total debts as of May 31, 2008, the date of its last audited financial statements.

My statement today is based on our July 2011 report.[3] We completed this work in response to a mandate contained in Title XI of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Table 1 lists all programs covered by our review, including the broad-based programs and assistance extended to individual institutions. For these emergency programs or actions, where relevant, I will discuss (1) the Reserve Banks' controls over financial reporting and accounting; (2) the Reserve Banks' policies and practices for the use, selection, and payment of vendors; (3) the effectiveness of policies and practices for identifying and managing conflicts of interest for Reserve Bank employees, Reserve Bank vendors, and members of Reserve Banks' boards of directors; (4) the effectiveness of security and collateral policies in place to mitigate risk of losses; and (5) the extent to which program implementation resulted in consistent and equitable treatment of eligible participants.

Table 1: List of Federal Reserve Emergency Programs and Assistance Covered by Our Review

Programs and Assistance	Description	Reserve Bank
Broad-based programs		
Term Auction Facility *(Dec. 12, 2007)*	Auctioned one-month and three-month discount window loans to eligible depository institutions	All 12 Reserve Banks
Dollar Swap Lines *(Dec. 12, 2007)*	Exchanged dollars with foreign central banks for foreign currency to help address disruptions in dollar funding markets abroad	FRBNY
Term Securities Lending Facility *(Mar. 11, 2008)*	Auctioned loans of U.S. Treasury securities to primary dealers against eligible collateral	FRBNY
Primary Dealer Credit Facility *(Mar. 16, 2008)*	Provided overnight cash loans to primary dealers against eligible collateral	FRBNY[a]
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility *(Sept. 19, 2008)*	Provided loans to depository institutions and their affiliates to finance purchases of eligible asset-backed commercial paper from money market mutual funds	Federal Reserve Bank of Boston
Commercial Paper Funding Facility *(Oct. 7, 2008)*	Provided loans to a special-purpose vehicle to finance purchases of new issues of asset-backed commercial paper and unsecured commercial paper from eligible issuers	FRBNY
Money Market Investor Funding Facility *(Oct. 21, 2008, but never used)*	Created to finance the purchase of eligible short-term debt obligations held by money market mutual funds	FRBNY

[3]GAO, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, GAO-11-696 (Washington, D.C.: July 21, 2011).

Programs and Assistance	Description	Reserve Bank
Term Asset-Backed Securities Loan Facility *(Nov. 25, 2008)*	Provided loans to eligible investors to finance purchases of eligible asset-backed securities	FRBNY
Assistance to individual institutions		
Bear Stearns Companies, Inc. acquisition by JP Morgan Chase & Co.		
Bridge Loan *(Mar. 14, 2008)*	Overnight loan provided to JP Morgan Chase & Co. bank subsidiary, with which this subsidiary made a direct loan to Bear Stearns Companies, Inc.	FRBNY
Maiden Lane *(Mar. 16, 2008)*	Special purpose vehicle created to purchase approximately $30 billion of Bear Stearns's mortgage-related assets	FRBNY
American International Group, Inc. (AIG)		
Revolving Credit Facility *(Sept. 16, 2008)*	Revolving loan for the general corporate purposes of AIG and its subsidiaries, and to pay obligations as they came due	FRBNY
Securities Borrowing Facility *(Oct. 8, 2008)*	Provided collateralized cash loans to reduce pressure on AIG to liquidate residential mortgage-backed securities (RMBS) in its securities lending portfolio	FRBNY
Maiden Lane II *(Nov.10, 2008)*	Special purpose vehicle created to purchase residential mortgage-backed securities from the securities lending portfolios of AIG subsidiaries	FRBNY
Maiden Lane III (Nov.10, 2008)	Special purpose vehicle created to purchase collateralized debt obligations on which AIG Financial Products had written credit default swaps	FRBNY
Life Insurance Securitization *(March 2, 2009, but never used)*	Authorized to provide credit to AIG that would be repaid with cash flows from its life insurance businesses	FRBNY
Credit extensions to affiliates of some primary dealers *(Sept. 21, 2008)*	Loans provided to broker-dealer affiliates of four primary dealers on terms similar to those for Primary Dealer Credit Facility	FRBNY
Citigroup lending commitment *(Nov. 23, 2008)*	Commitment to provide nonrecourse loan to Citigroup against ring-fence assets if losses on asset pool reached $56.2 billion	FRBNY
Bank of America lending commitment *(Jan. 16, 2009)*	Commitment to provide nonrecourse loan facility to Bank of America if losses on ring- fence assets exceeded $18 billion (agreement never finalized)	Federal Reserve Bank of Richmond
Open market operations		
Agency Mortgage-Backed Securities Purchase Program *(Nov. 25, 2008)*	Purchased agency mortgage-backed securities to provide support to mortgage and housing markets and to foster improved conditions in the financial markets more generally	FRBNY

Source: GAO summary of Federal Reserve Board documents.

Note: Dates in parentheses are the program announcement dates. On October 3, 2008, the Federal Reserve Board authorized the Direct Money Market Mutual Fund Lending Facility (DMLF) and rescinded this authorization one week later. DMLF was not implemented.

[a]PDCF was administered by FRBNY with operational assistance provided by the Federal Reserve Banks of Atlanta and Chicago.

To conduct the work for our report, we reviewed documentation supporting the Federal Reserve Board's authorizations for the emergency programs, Federal Reserve System documents and press releases describing the purpose of the programs, and other relevant program documentation, including announced terms and conditions. To assess Reserve Banks' controls over financial reporting and accounting, we developed an audit strategy designed to leverage, to the extent possible, the audit work specific to the emergency programs performed by the Federal Reserve System's external and internal auditors. For example, we reviewed the external auditor's key audit documentation including audit strategy, planning, and accounting memoranda; internal control and account balance testing audit procedures and results; and summary memoranda. We evaluated the quality of this documentation against relevant auditing standards. To evaluate the Reserve Banks' policies and practices for the use, selection, and payment of vendors, we analyzed Reserve Banks' acquisition policies and guidance, vendor contracts, and vendor payment information. To evaluate the effectiveness of Reserve Bank polices and practices for managing conflicts of interest, we reviewed relevant Reserve Bank policies, including FRBNY's Code of Conduct, and relevant statutory prohibitions on conflicts of interest that apply to federal government and Federal Reserve System employees and federal government guidance for agencies' management of employee conflicts of interest. To assess the effectiveness of security and collateral policies in place to mitigate risk of losses, we reviewed relevant documentation to identify key features of security and collateral policies and determine how these policies were designed to mitigate risk of losses for each emergency program. We obtained and analyzed documentation of steps taken by the Reserve Banks to develop risk governance structures and practices needed to manage the risks associated with the emergency programs. To examine the extent to which program implementation resulted in consistent and equitable treatment of eligible participants, we reviewed and analyzed documentation of the basis for the Federal Reserve Board's decisions about which types of institutions would be eligible to participate in the emergency programs. To determine the extent to which the Reserve Banks offered the same terms and conditions to all participants, which for some programs included financial institutions affiliated with Reserve Bank directors, we reviewed documentation of program terms and conditions and obtained and analyzed program transaction data. For parts of our methodology that involved the analysis of computer-processed data, we assessed the reliability of these data and determined that they were sufficiently reliable for our purposes. For all objectives, we interviewed staff at the Federal Reserve Board, FRBNY, the Federal Reserve Bank of Boston, and the Federal Reserve Bank of Richmond.

The work on which this statement is based was conducted from August 2010 through July 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Federal Reserve Act of 1913 established the Federal Reserve System as the country's central bank. The Federal Reserve System consists of the Federal Reserve Board located in Washington, D.C.; 12 Reserve Banks, which have 24 branches located throughout the nation; and the Federal Open Market Committee (FOMC), which is responsible for directing open market operations to influence the total amount of money and credit available in the economy. Each Reserve Bank is a federally chartered corporation with a board of directors. The Federal Reserve Act authorizes the Reserve Banks to make discount window loans, execute monetary policy operations at the direction of the FOMC, and examine bank holding companies and member banks under rules and regulations prescribed by the Federal Reserve Board, among other things.

The Federal Reserve Board and the Reserve Banks are self-funded entities that deduct their expenses from their revenue and transfer the remaining amount to Treasury.[4] Federal Reserve System revenues transferred to Treasury have increased substantially in recent years, chiefly as a result of interest income earned from the Federal Reserve System's large-scale emergency programs. To the extent that Reserve Banks suffer losses on emergency loans, these losses would be deducted from the excess earnings transferred to Treasury.

Between late 2007 and early 2009, the Federal Reserve Board created more than a dozen new emergency programs to stabilize financial markets and provided financial assistance to avert the failures of a few individual institutions. The Federal Reserve Board authorized most of this emergency assistance under emergency authority contained in section

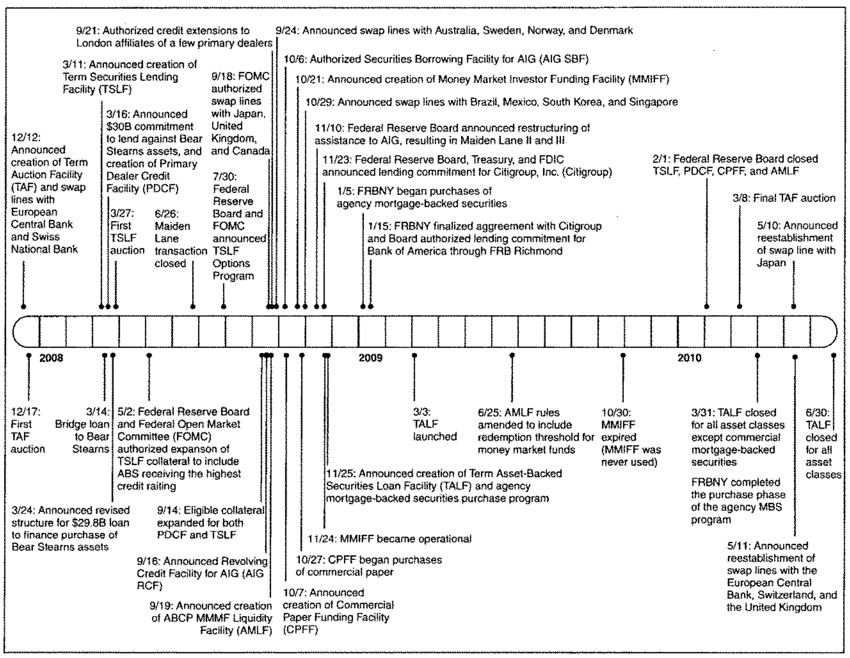
[4]These excess earnings remitted to Treasury consist of Reserve Bank earnings after providing for operating expenditures, capital paid out in dividends to banks that are members of the Federal Reserve System, and an amount reserved by Reserve Banks to equate surplus with capital paid in.

13(3) of the Federal Reserve Act.[5] Three of the programs covered by this review—the Term Auction Facility, the dollar swap lines with foreign central banks, and the Agency Mortgage-Backed Securities Purchase Program—were authorized under other provisions of the Federal Reserve Act that do not require a determination that emergency conditions exist, although the swap lines and the Agency MBS program did require authorization by the FOMC. In many cases, the decisions by the Federal Reserve Board, the FOMC, and the Reserve Banks about the authorization, initial terms of, or implementation of the Federal Reserve System's emergency assistance were made over the course of only days or weeks as the Federal Reserve Board sought to act quickly to address rapidly deteriorating market conditions. FRBNY implemented most of these emergency activities under authorization from the Federal Reserve Board. In a few cases, the Federal Reserve Board authorized FRBNY to lend to a limited liability corporation (LLC) to finance the purchase of assets from a single institution. The LLCs created to assist individual institutions were Maiden Lane, Maiden Lane II, and Maiden Lane III. In 2009, FRBNY, at the direction of the FOMC, began large-scale purchases of mortgage-backed securities (MBS) issued by the housing government-sponsored enterprises, Fannie Mae and Freddie Mac, or guaranteed by Ginnie Mae.[6] Purchases of these agency MBS were intended to provide support to the mortgage and housing markets and to foster improved conditions in financial markets more generally. Most of the Federal Reserve Board's broad-based emergency programs closed on February 1, 2010. Figure 1 provides a timeline for the establishment, modification, and termination of Federal Reserve System emergency programs subject to this review.

[5]At the time of these authorizations, section 13(3) allowed the Federal Reserve Board, in "unusual and exigent circumstances," to authorize any Reserve Bank to extend credit in the form of a discount to individuals, partnerships, or corporations when the credit was indorsed or otherwise secured to the satisfaction of the Reserve Bank, after obtaining evidence that the individual, partnership, or corporation was unable to secure adequate credit accommodations from other banking institutions. As a result of amendments to section 13(3) made by the Dodd-Frank Act, the Federal Reserve Board can now authorize 13(3) lending only through programs or facilities with broad-based eligibility.

[6]Mortgage-backed securities are securities that represent claims to the cash flows from pools of mortgage loans, such as mortgages on residential property.

Figure 1: Timeline of Federal Reserve Emergency Actions, December 2007–June 2010



Source: Federal Reserve System documents and press releases.

The Federal Reserve System and Its Emergency Activities Were Subject to Multiple Audits and Reviews

The Reserve Banks' and LLCs' financial statements, which include the emergency programs' accounts and activities, and their related financial reporting internal controls, are audited annually by an independent auditing firm. In addition, the Federal Reserve System has a number of internal entities that conduct audits and reviews of the Reserve Banks, including the emergency programs. As shown in figure 2, these other audits and reviews were conducted by the Federal Reserve Board's Division of Reserve Bank Operations and Payment Systems (RBOPS), the Federal Reserve Board's Office of Inspector General, and individual Reserve Bank's internal audit function. The independent financial statement audits and other reviews did not identify significant accounting or financial reporting internal control issues concerning the emergency programs.

Figure 2: Audit and Review Coverage of the Emergency Programs

Program	External auditor[a]	Internal audit function	Reserve Bank Operations and Payment Systems	Office of Inspector General
Agency MBS	√	√	√	
AIG[b]	√		√	
AMLF	√	√		√
Bank of America Corporation	√			
Citigroup, Inc.	√			
CPFF	√	√	√	√
Swap Lines	√	√	√	
Maiden Lane LLC	√	√	√	
Maiden Lane II LLC	√	√	√	
Maiden Lane III LLC	√	√	√	
MMIFF	√			√
PDCF[c]	√	√	√	√
TAF	√	√		
TALF	√	√	√	√
TSLF	√	√	√	√

Source: GAO analysis of audit reports and reviews.

Note: See figure 1 for abbreviations of program names. This figure does not include the Bear Stearns bridge loan, which was a one-time loan and was not a program.

[a]Audit coverage was provided as part of the overall audit of the Reserve Bank or LLC financial statements.

[b]Includes the AIG RCF, AIG SBF, and Life Insurance Securitization.

[c]Includes the credit extensions to affiliates of some primary dealers.

Reserve Banks Would Benefit From Strengthening Guidance for Noncompetitive Contracts Awarded in Exigent Circumstances

Reserve Banks Relied Extensively on Vendors to Establish and Operate the Emergency Programs, Particularly Those Designed to Assist Single Institutions

From 2008 through 2010, vendors were paid $659.4 million across 103 contracts to help establish and operate the Reserve Banks' emergency programs. The 10 largest contracts accounted for 74 percent of the total amount paid to all vendors. FRBNY was responsible for creating and operating all but two emergency programs and assistance and therefore awarded nearly all of the contracts.[7] See table 2 for the total number and value of contracts for the emergency programs and assistance.

[7]The Federal Reserve Bank of Boston entered into a single $25,000 contract for AMLF and the Federal Reserve Bank of Richmond entered into three contracts totaling $22.8 million for the Bank of America ring-fencing agreement.

Table 2: Number of Contracts and Fees Paid, By Emergency Program, Calendar Years 2008–2010

Dollars in millions

	Program	Number of contracts[a]	Total fees paid
Broad-based programs	Agency MBS program	6	$81.4
	AMLF	1	0.025
	CPFF	5	43.4
	MMIFF	1	0.4
	TALF	18	29.2
Programs that assisted a single institution	AIG Revolving Credit Facility	19	$212.9
	Bank of America lending commitment	3	22.8
	Citigroup lending commitment	3	21.4
	Maiden Lane (Bear Stearns)	42	158.4
	Maiden Lane II (AIG)	9	27.9
	Maiden Lane III (AIG)	12	57.0
	General[b]	4	4.5
Total		**103**	**$659.4**

Source: GAO analysis of Reserve Bank data.

Note: Reserve Bank programs and assistance listed include only those for which the Reserve Banks used vendors. See figure 1 for abbreviations of program names.

[a]Because some contracts included work on multiple programs, the sum of the contracts for each program is greater than the 103 total contracts identified in the table. Also, 36 subvendors were paid $3.3 million for the three Maiden Lane programs, CPFF, and TALF. The table does not include fees for subcontracts.

[b]Of the four general contracts, two were for advisory services related to how FRBNY managed the emergency programs overall. The other two included work on multiple programs, but FRBNY could not separate out what proportion of the total fees was assigned to each program.

As shown in table 2, the Reserve Banks relied on vendors more extensively for programs that assisted single institutions than for broad-based emergency programs. The assistance provided to individual institutions was generally secured by existing assets that either belonged to or were purchased from the institution, its subsidiaries, or counterparties.[8] The Reserve Banks did not have sufficient expertise available to evaluate these assets and therefore used vendors to do so. For example, FRBNY used a vendor to evaluate divestiture scenarios

[8]Any loans made under the Bank of America or Citigroup ring-fencing agreements were to be secured by specified pools of assets belonging to each institution. However, no loans were extended under the programs.

associated with the assistance to AIG. It also hired vendors to manage assets held by the Maiden Lanes. For the broad-based emergency programs, FRBNY hired vendors primarily for transaction-based services and collateral monitoring. Under these programs, the Reserve Banks purchased assets or extended loans in accordance with each program's terms and conditions. Because of this, the services that vendors provided for these programs were focused more on assisting with transaction execution than analyzing and managing securities, as was the case for the single institution assistance.

Reserve Banks Awarded Largest Contracts Noncompetitvely and Would Benefit From Additional Guidance on Seeking Competition

Most of the contracts, including 8 of the 10 highest-value contracts, were awarded noncompetitively, primarily due to exigent circumstances. These contract awards were consistent with FRBNY's existing acquisition policy, which applied to all services associated with the emergency programs and single-institution assistance.[9] Under FRBNY policy, noncompetitive processes can be used in special circumstances, such as when a service is available from only one vendor or in exigent circumstances. FRBNY cited exigent circumstances for the majority of the noncompetitive contract awards.[10] FRBNY officials said that the success of a program was often dependent on having vendors in place quickly to begin setting up the operating framework for the program. FRBNY's policy did not provide additional guidance on the use of competition exceptions, such as seeking as much competition as practicable and limiting the duration of noncompetitive contracts to the exigency period. To better ensure that Reserve Banks do not miss opportunities to obtain competition and receive the most favorable terms for services acquired, we recommended that they revise their acquisition policies to provide such guidance.

Vendor Fees Generally Came from Program Income or Participants

From 2008 through 2010, vendors were paid $659.4 million through a variety of fee structures. For a significant portion of the fees, program recipients reimbursed the Reserve Banks or the fees were paid from program income. The Reserve Banks generally used traditional market conventions when determining fee structures. For example, investment managers were generally paid a percentage of the portfolio value and law

[9]FRBNY is a private corporation and not subject to the Federal Acquisition Regulation.

[10]Of the noncompetitive contracts we reviewed, FRBNY awarded three under the sole-source exception, when a service was available from only one vendor.

firms were generally paid an hourly rate. Fees for these contracts were subject to negotiation between the Reserve Banks and vendors. For some of the large contracts that were awarded noncompetitively, FRBNY offered vendors a series of counterproposals and was able to negotiate lower fees than initially proposed.

Opportunities Exist to Strengthen Conflict Policies for Employees, Directors, and Program Vendors

During the crisis, FRBNY took steps to manage conflicts of interest related to emergency programs for its employees, program vendors, and members of its Board of Directors, but opportunities exist to strengthen its conflicts policies.

During the Crisis, FRBNY Expanded Its Efforts to Manage Employee Conflicts

Historically, FRBNY has managed potential and actual conflicts of interest for its employees primarily through enforcement of its Code of Conduct, which outlines broad principles for ethical behavior and specific restrictions on financial interests and other activities, such as restrictions on employees' investments in depository institutions and bank holding companies, and incorporates the requirements of a federal criminal statute and its regulations. During the crisis, FRBNY expanded its guidance and monitoring for employee conflicts. However, while the crisis highlighted the potential for Reserve Banks to provide emergency assistance to a broad range of institutions, FRBNY has not yet revised its conflict policies and procedures to more fully reflect potential conflicts that could arise with this expanded role. For example, specific investment restrictions in FRBNY's Code of Conduct continue to focus on traditional Reserve Bank counterparties—depository institutions or their affiliates and the primary dealers—and have not been expanded to further restrict employees' financial interests in certain nonbank institutions that have participated in FRBNY emergency programs and could become eligible for future ones, if warranted. Given the magnitude of the assistance and the public's heightened attention to the appearance of conflicts related to Reserve Banks' emergency actions, existing policies and procedures for managing employee conflicts may not be sufficient to avoid the appearance of a conflict in all situations. During our review, Federal Reserve Board and FRBNY staff told us that the Federal Reserve System plans to review and update the Reserve Banks' Codes of Conduct as needed given the Federal Reserve System's recently expanded role in regulating systemically significant financial institutions. In light of this ongoing effort, we recommended that the Federal Reserve System consider how potential conflicts from emergency lending could inform any changes.

FRBNY Primarily Used Contract Protections to Manage Risks Related to Vendor Conflicts, and the Lack of a Comprehensive Policy Created Certain Limitations

FRBNY managed risks related to vendor conflicts of interest primarily through contract protections and oversight of vendor compliance with these contracts, but these efforts have certain limitations. For example, while FRBNY's Legal Division negotiated contract provisions intended to help ensure that vendors took appropriate steps to mitigate conflicts of interest related to the services they provided for FRBNY, FRBNY lacked written guidance on protections that should be included to help ensure vendors fully identify and remediate conflicts. Rather than requiring written conflict remediation plans that were specific to the services provided for FRBNY, FRBNY generally reviewed and allowed vendors to rely on their existing enterprisewide policies for identifying conflicts. However, in some situations, FRBNY requested additional program-specific controls be developed. Further, FRBNY's on-site reviews of vendor compliance in some instances occurred as far as 12 months into a contract. In May 2010, FRBNY implemented a new vendor management policy but had not yet finalized more comprehensive guidance on vendor conflict issues. As a result, we recommended that FRBNY finalize this new policy to reduce the risk that vendors may not be required to take steps to fully identify and mitigate all conflicts.

Reserve Bank Directors Are Generally Subject to the Same Conflict Rules as Federal Employees and a Few Directors Played a Limited Role in Risk Oversight of the Programs

Individuals serving on the boards of directors of the Reserve Banks are generally subject to the same conflict-of-interest statute and regulations as federal employees. A number of Reserve Bank directors were affiliated with institutions that borrowed from the emergency programs, but Reserve Bank directors did not participate directly in making decisions about authorizing, setting the terms, or approving a borrower's participation in the emergency programs. Rather FRBNY's Board of Directors assisted the Reserve Bank in helping ensure risks were managed through FRBNY's Audit and Operational Risk Committee.[11] According to the Federal Reserve Board

[11] FRBNY's Audit and Operational Risk Committee, which includes directors, is appointed by its Board of Directors to assist the board in monitoring, (1) the integrity of the financial statements of the Reserve Bank, (2) the Reserve Bank's external auditor's qualifications and independence, (3) the performance of the Reserve Bank's internal audit function and external auditors, (4) internal controls and the measurement of operational risk, and (5) the compliance by the Reserve Bank with legal and regulatory requirements. The Audit and Operational Risk Committee also assesses the effectiveness of (2), (3), (4), and (5).

officials, Reserve Banks granted access to borrowing institutions affiliated with Reserve Bank directors only if these institutions satisfied the proper criteria, regardless of potential director-affiliated outreach or whether the institution was affiliated with a director. Our review of the implementation of several program requirements did not find evidence that would indicate a systemic bias towards favoring one or more eligible institutions.

Opportunities Exist to Strengthen Risk Management Policies and Practices for Future Emergency Programs

The Federal Reserve Board approved key program terms and conditions that served to mitigate risk of losses and delegated responsibility to one or more Reserve Banks for executing each emergency lending program and managing its risk of losses. The Federal Reserve Board's early broad-based lending programs—Term Auction Facility, Term Securities Lending Facility, and Primary Dealer Credit Facility—required borrowers to pledge collateral in excess of the loan amount as well as other features intended to mitigate risk of losses.[12] The Federal Reserve Board's broad-based programs launched in late 2008 and early 2009 employed more novel lending structures to provide liquidity support to a broader range of key credit markets. These later broad-based liquidity programs included Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Commercial Paper Funding Facility, Money Market Investor Funding Facility, and Term Asset-Backed Securities Loan Facility. These liquidity programs, with the exception of the Term Asset-Backed Securities Loan Facility, did not require overcollateralization. To help mitigate the risk of losses, the Term Asset-Backed Securities Loan Facility, as well as the programs that did not require overcollateralization, accepted only highly-rated assets as collateral. In addition, Commercial Paper Funding Facility, Money Market Investor Funding Facility, and Term Asset-Backed Securities Loan Facility incorporated various security features, such as the accumulation of excess interest and fee income to absorb losses, to provide additional loss protection. Also, for the assistance to specific institutions, the Reserve Banks negotiated loss protections with the institutions and hired vendors to help oversee the portfolios collateralizing loans. For each of the Maiden Lane transactions, FRBNY extended a senior loan to the LLC and this loan was collateralized by the portfolio of assets held by the LLC. JP Morgan Chase & Co. agreed to take a first loss

[12] We use the term "overcollateralized" to refer to Reserve Bank lending for which borrowers were required to pledge collateral in excess of the loan amount. By using this term, we do not intend to suggest that the amount of excess collateral required was inappropriately excessive given the Federal Reserve Board's policy objectives.

position of $1.15 billion for Maiden Lane and AIG agreed to assume a similar first loss position for Maiden Lanes II and III. As of July 2011, most of the Federal Reserve Board's emergency loan programs had closed and all of those that had closed had closed without losses. Moreover, currently, the Federal Reserve Board does not project any losses on FRBNY's outstanding loans to Term Asset-Backed Securities Loan Facility borrowers and the Maiden Lane LLCs.

Opportunities Exist for the Reserve Banks to Continue to Strengthen Policies for Future Emergency Programs

To manage risks posed by the emergency programs, Reserve Banks developed new controls and FRBNY strengthened its risk management practices over time. In particular, FRBNY expanded its risk management function and enhanced its risk reporting and risk analytics capabilities. For example, in summer 2009, FRBNY expanded its risk management capabilities by adding expertise that would come to be organized as two new functions, Structured Products and Risk Analytics. Although FRBNY has improved its ability to monitor and manage risks from emergency lending, opportunities exist for FRBNY and the Federal Reserve System as a whole to strengthen risk management procedures and practices for any future emergency lending. Specifically, neither FRBNY nor the Federal Reserve Board tracked total potential exposures in adverse economic scenarios across all emergency programs. Moreover, the Federal Reserve System's existing procedures lack specific guidance on how Reserve Banks should exercise discretion to restrict or deny program access for higher-risk borrowers that were otherwise eligible for the Term Auction Facility and emergency programs for primary dealers. To strengthen practices for managing risk of losses in the event of a future crisis, we recommended that the Federal Reserve System document a plan for more comprehensive risk tracking and strengthen procedures to manage program access for higher-risk borrowers.

While the Federal Reserve Board Took Steps to Promote Consistent Treatment of Participants, It Lacked Guidance and Documentation for Some Access Decisions

The Federal Reserve Board and the Reserve Banks took steps to promote consistent treatment of eligible program participants and generally offered assistance on the same terms and conditions to eligible institutions in the broad-based emergency programs. However, in a few programs, the Reserve Banks placed restrictions on some participants that presented higher risk but lacked specific guidance to do so. Further, certain Federal Reserve Board decisions to extend credit to certain borrowers were not fully documented.

The Federal Reserve Board Designed Program Eligibility Requirements to Target Assistance to Groups of Institutions Facing Liquidity Strains

The Federal Reserve Board created each broad-based emergency program to address liquidity strains in a particular credit market and designed program eligibility requirements primarily to target significant participants in these markets. The emergency programs extended loans both directly to institutions facing liquidity strains and through intermediary borrowers. For programs that extended credit directly, the Federal Reserve Board took steps to limit program eligibility to institutions it considered to be generally sound. For example, Term Auction Facility loans were auctioned to depository institutions eligible to borrow from the discount window and expected by their local Reserve Bank to remain primary-credit-eligible during the term the Term Auction Facility loan would be outstanding.[13] For programs that provided loans to intermediary borrowers, the Federal Reserve Board based eligibility requirements in part on the ability of borrowing institutions, as a group, to channel sufficient liquidity support to eligible sellers. For example, eligible Term Asset-Backed Securities Loan Facility borrowers included a broad range of institutions ranging from depository institutions to U.S. organized investment funds. Federal Reserve Board officials told us that broad

[13]The Reserve Banks extend discount window credit to U.S. depository institutions (including U.S. branches and agencies of foreign banks) under three programs, one of which is the primary credit program. Primary credit is available to generally sound depository institutions, typically on an overnight basis. To assess whether a depository institution is in sound financial condition, its Reserve Bank can regularly review the institution's condition, using supervisory ratings and data on adequacy of the institution's capital.

participation in Term Asset-Backed Securities Loan Facility was intended to facilitate the program goal of encouraging the flow of credit to consumers and small businesses.

While Reserve Banks Generally Offered the Same Terms to Eligible Participants, Some Programs Lacked Documented Procedures to Systematically Apply Special Restrictions

The Federal Reserve Board promoted consistent treatment of eligible participants in its emergency programs by generally offering assistance on the same terms and conditions to all eligible participants. For example, institutions that met the announced eligibility requirements for a particular emergency program generally could borrow at the same interest rate, against the same types of collateral, and where relevant, with the same schedule of haircuts applied to their collateral. As previously discussed, for a few programs, FRBNY's procedures did not have specific guidance to help ensure that restrictions were applied consistently to higher-risk borrowers. Moreover, the Federal Reserve Board could not readily provide documentation of all Term Auction Facility restrictions placed on individual institutions. By having written procedures to guide decision-making for restrictions and suggestions for documentation of the rationale for such decisions, the Federal Reserve Board may be able to better review such decisions and help ensure that future implementation of emergency lending programs will result in consistent treatment of higher-risk borrowers. Our review of Federal Reserve System data for selected programs found that incorrect application of certain program requirements was generally infrequent and that cases of incorrect application of criteria did not appear to indicate intentional preferential treatment of one or more program participants.

The Federal Reserve Board Did Not Fully Document the Basis for Extending Credit to a Few Affiliates of Primary Dealers

The Federal Reserve Board did not fully document the basis for its decisions to extend credit on terms similar to those available at PDCF to certain broker-dealer affiliates of four of the primary dealers. In September and November of 2008, the Federal Reserve Board invoked section 13(3) of the Federal Reserve Act to authorize FRBNY to extend credit to the London-based broker-dealer subsidiaries of Merrill Lynch, Goldman Sachs, Morgan Stanley, and Citigroup, as well as the U.S. broker-dealer subsidiaries of Merrill Lynch, Goldman Sachs, and Morgan Stanley. Federal Reserve Board officials told us that the Federal Reserve Board did not consider the extension of credit to these subsidiaries to be a legal extension of PDCF but separate actions to specifically assist these four primary dealers by using PDCF as an operational tool. Federal Reserve Board officials told us that the Federal Reserve Board did not draft detailed memoranda to document the rationale for all uses of section 13(3) authority but that unusual and exigent circumstances existed in each of these cases as critical funding markets were in crisis. However, without more complete documentation, how assistance to these broker-dealer subsidiaries satisfied the statutory requirements for using this authority remains unclear. Moreover, without more complete public disclosure of the basis for these actions, these decisions may not be subject to an appropriate level of transparency and accountability. The Dodd-Frank Act includes new requirements for the Federal Reserve Board to report to Congress on any loan or financial assistance authorized under section 13(3), including the justification for the exercise of authority; the identity of the recipient; the date, amount, and form of the assistance; and the material terms of the assistance. To address these new reporting requirements, we recommended that the Federal Reserve Board set forth its process for documenting its rationale for emergency authorizations.

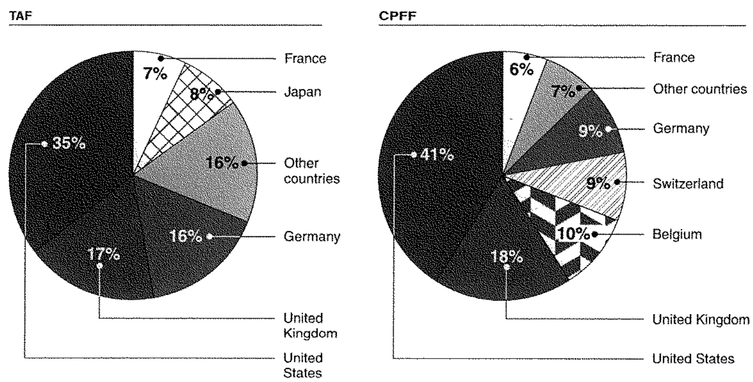
The Federal Reserve Board Generally Has Not Provided Documented Guidance to Reserve Banks on Types of Program Decisions That Require Consultation with the Federal Reserve Board

In authorizing the Reserve Banks to operate its emergency programs, the Federal Reserve Board has not provided documented guidance on the types of program policy decisions—including allowing atypical uses of broad-based assistance—that should be reviewed by the Federal Reserve Board. Standards for internal control for federal government agencies provide that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. Outside of the established protocols for the discount window, FRBNY staff said that the Federal Reserve Board generally did not provide written guidance on expectations for types of decisions or events requiring formal Federal Reserve Board review, although program decisions that deviated from policy set by the Federal Reserve Board were generally understood to require Board staff consultation. In 2009, FRBNY allowed an AIG-sponsored entity to continue to issue to the Commercial Paper Funding Facility, even though a change in program terms by the Federal Reserve Board likely would have made it ineligible. FRBNY staff said they consulted the Federal Reserve Board regarding this situation, but did not document this consultation and did not have any formal guidance as to whether such continued use required approval by the Federal Reserve Board. To better ensure an appropriate level of transparency and accountability for decisions to extend or restrict access to emergency assistance, we recommended that the Federal Reserve Board document its guidance to Reserve Banks on program decisions that require consultation with the Federal Reserve Board.

The Federal Reserve Board Took Steps to Prevent Use that Would Be Inconsistent with Its Policy Objectives

To assess whether program use was consistent with the Federal Reserve Board's announced policy objectives, we analyzed program transaction data to identify significant trends in borrowers' use of the programs. Our analysis showed that large global institutions were among the largest users of several programs. U.S. branches and agencies of foreign banks and U.S. subsidiaries of foreign institutions received over half of the total dollar amount of Commercial Paper Funding Facility and Term Auction Facility loans (see fig. 3).

Figure 3: Total Transaction Amount by Parent Company Country of Domicile for the Term Auction Facility and Commercial Paper Funding Facility

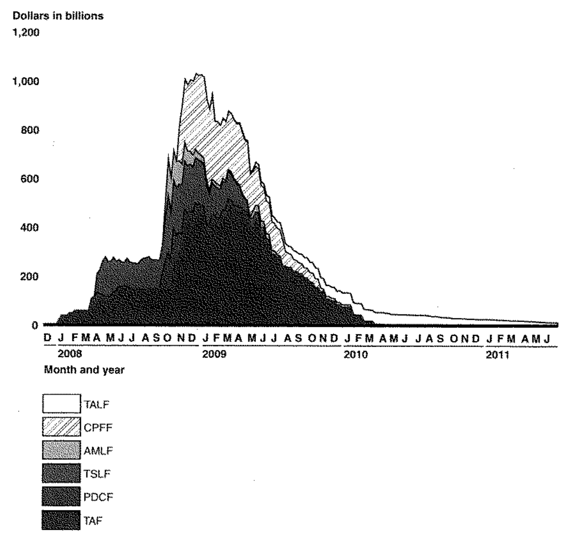


Source: GAO analysis of Federal Reserve System data.

Note: For Term Auction Facility, the total dollar amount of loans are aggregated at the level of the parent company for participating depository institutions. For Commercial Paper Funding Facility, the total dollar amount of issuance is aggregated at the parent company level and includes asset-backed commercial paper issuance by entities sponsored by the parent company or one of its subsidiaries. The country of domicile for parent companies is based on SNL Financial data.

According to Federal Reserve Board staff, they designed program terms and conditions to discourage use that would have been inconsistent with program policy objectives. Program terms—such as the interest charged and haircuts applied—generally were designed to be favorable only for institutions facing liquidity strains. Use of the programs generally peaked during the height of the financial crisis and fell as market conditions recovered (see fig. 4). Within and across the programs, certain participants used the programs more frequently and were slower to exit than others. Reserve Bank officials noted that market conditions and the speed with which the participant recovered affected use of the program by individual institutions. As a result of its monitoring of program usage, the Federal Reserve Board modified terms and conditions of several programs to reinforce policy objectives and program goals.

Figure 4: Total Loans Outstanding for Broad-Based Programs, December 1, 2007–June 29, 2011



Source: GAO analysis of Federal Reserve System data.

Note: See figure 1 for abbreviations of program names.

Concluding Observations

During the financial crisis that began in the summer of 2007, the Federal Reserve System took unprecedented steps to stabilize financial markets and support the liquidity needs of failing institutions that it considered to be systemically significant. To varying degrees, these emergency actions involved the Reserve Banks in activities that went beyond their traditional responsibilities. Over time, FRBNY and the other Reserve Banks took steps to improve program management and oversight for these emergency actions, in many cases in response to recommendations made by their external auditor, Reserve Bank internal audit functions, or the Federal Reserve Board's RBOPS. However, the Reserve Banks have not yet fully incorporated some lessons learned from the crisis into their policies for managing use of vendors, risk of losses from emergency lending, and conflicts of interest. Such enhanced policies could offer additional insights to guide future Federal Reserve System action, should it ever be warranted. We made seven recommendations to the Chairman of the Federal Reserve Board to further strengthen Federal Reserve System policies for selecting vendors, ensuring the transparency and consistency of decision making involving implementation of any future emergency programs, and managing risks related to these programs. In its comments on our report, the Federal Reserve Board agreed to give our recommendations serious attention and to strongly consider how to respond to them.

Mr. Chairman, Ranking Member Clay, and Members of the Subcommittee, this completes my prepared statement. I am prepared to respond to any questions you or other Members of the Subcommittee may have at this time.

GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact me at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made major contributions to this statement include Karen Tremba (Assistant Director), Tania Calhoun, and John Fisher.

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Testimony of Mark A. Calabria, Ph.D.
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Before the
U.S. House of Representatives
Committee on Financial Services
Subcommittee on Domestic Monetary Policy and Technology
On "Audit the Fed: Dodd-Frank, QE3, and Federal Reserve Transparency"
October 4, 2011

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Testimony of Mark A. Calabria, Ph.D.
Director, Financial Regulation Studies, Cato Institute
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Chairman Paul, Ranking Member Clay, and distinguished members of the Subcommittee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

The Federal Reserve and the Financial Crisis

As the Subcommittee is well aware, the events of 2008 witnessed not only unprecedented disruptions to our financial markets, but also extraordinary responses on the part of our financial regulators and central bank. No entity was more deeply involved than the Federal Reserve System ("Fed"), particularly the Federal Reserve Bank of New York.

Yet the Fed has consistently and repeated resisted efforts to bring any accountability and transparency to its actions. Congress and the public were regularly warned that if the details of the Fed's actions became public, further panic would ensue in our financial markets. For instance I distinctly remember, as a staffer for the Senate Banking Committee, listening to then Fed Vice Chair Donald Kohn tell that Committee that making the names of AIG's derivatives counterparties public would severely harm our financial markets. When those names were eventually released our world did not come to an end. In short, the Fed has a long tradition and strong preference for secrecy. Despite some notable attempts by the Fed to increase its communications with the public, I believe, given its track record, the public cannot rely on the Fed to voluntarily provide us with sufficient information to monitor its activities and judge the effectiveness of its actions. And while the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), in relation to auditing the Fed's activities are an important advance, they fall far too short of providing sufficient oversight of the Fed.

What auditing has been conducted has so far been focused on the Fed's response to the crisis. Among economists, on both the right and the left, there remains considerable concern and debate over the Fed's role in helping to create the crisis via its easy money policies in the aftermath of the dot-com bubble and the events of 9/11. If we truly wish to end financial crises, then I believe it is absolutely essential that Congress receive a full and objective evaluation of the Fed's role in fostering the housing bubble, particularly as it relates to monetary policy decisions made between 2002 and 2005.

Federal Reserve Audit Requirements under Dodd-Frank

The primary audit requirements of Dodd-Frank, as they relate to the Fed's actions during the financial crisis, are contained in Section 1109, which directs GAO to:

> "conduct a onetime audit of all loans and other financial assistance provided during the period beginning on December 1, 2007 and ending on the date of enactment of this Act by the Board of Governors or a Federal reserve bank under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Term Asset-Backed Securities Loan Facility, the Primary Dealer Credit Facility, the Commercial Paper Funding Facility, the Term Securities Lending Facility, the Term Auction Facility, Maiden Lane, Maiden Lane II, Maiden Lane III, the agency Mortgage-Backed Securities program, foreign currency liquidity swap lines, and any other program created as a result of section 13(3) of the Federal Reserve Act."

That audit was delivered to Congress in July. Importantly, the audit required by Dodd-Frank goes beyond a simple accounting of what was lent to whom, but also requires GAO to evaluate the effectiveness and policies of the various lending facilities. As GAO's audit makes clear, the Fed, and in particular the New York Fed, exercised considerable discretion in designing these lending programs and often did so in an extremely ad hoc manner. While it does appear that the Fed made attempts to treat all program participants fairly and equally, a lack of appropriate internal controls within these programs left open considerable potential for abuse.

In addition to the audit requirements of Section 1109, Dodd-Frank also requires under Section 1103(b) that the Fed provide:

> "disclosure in a timely manner consistent with the purposes of this Act of information concerning the borrowers and counterparties participating in emergency credit facilities, discount window lending programs, and open market operations authorized or conducted by the Board or a Federal reserve bank..."

The importance of Section 1103(b) is that participants in future discount window lending will eventually be identified to the public, along with the terms of such lending. Given that Dodd-Frank gives the Fed approximately two years to disclose such information in relation to discount window lending, I believe the risk that such disclosure will dissuade financial institutions from the use of the discount window has been minimized. Of course, if such disclosure encourages financial institutions to manage their operations in such a way to avoid the need for access to the discount window, then the strength of our financial system would likely be improved.

While Sections 1102, 1103 and 1109 of Dodd-Frank are without doubt improvements in Federal Reserve transparency, and some of the few positive provisions in the Act, they fall short of truly bringing the operations of the Fed into the light of day.

Although I believe it to be a grave mistake to continue to entrust the Federal Reserve with bank supervision and regulation, Congress has chosen to maintain, and extend, that situation. The requirements of Section 1108(b) of Dodd-Frank requiring the Fed's Vice Chair for Supervision to regularly appear before Congress should increase transparency and improve Congressional oversight as it relates to the Fed's bank supervision responsibilities.

The Federal Reserve Needs a Full and Continuous Audit

The non-monetary actions of the Federal Reserve in 2008 and 2009 will likely be debated for decades among economists and historians. Just as the causes of the Great Depression and the effectiveness of the New Deal remain in contention, so will recent actions. What we all can perhaps agree on, or at least hope, is that the extraordinary measures, by Congress, the Federal Reserve and the Treasury, will not be repeated soon or repeated often. Accordingly, much of the audit requirements in Dodd-Frank have something of an "historical" feel to them. However, it is not enough to just get history right, but also to insure that future mistakes are avoided. I can think of few areas requiring as much mistake-avoidance as monetary policy.

Others have already laid out the case that easy money contributed to the crisis,[1] so I will not repeat that argument here. I do believe, however, that the role of easy money in the fostering a housing bubble demonstrates the need for an on-going GAO audit of the Federal Reserve's monetary functions. Disagreement as to the appropriate stance of current monetary policy also demonstrates the need for objective, independent analysis.

What's GAO for?

GAO, the US Government Accountability Office, states its 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. We provide Congress with timely information that is objective, fact-based, nonpartisan, nonideological, fair, and balanced." (www.gao.gov).

Quite simply GAO is not a political organization. As someone who has interacted repeatedly and regularly with GAO over the last decade, including serving as a Congressional staff liaison for requested GAO reports, I can say they are independent, unbiased and non-political. I have not always agreed with the conclusions of GAO, but I have never felt as if such disagreements were the result of politics or bias.

Subjecting the Federal Reserve's monetary policy function to a GAO audit does not subject the Fed to "politics" – such a claim is not only insulting to

[1] See John Taylor, ***Getting Off Track***. Hoover Institute Press. 2009.

GAO, it is insulting to the very concept of Congressional oversight. GAO exists for the very simple reason that no one member of Congress, or their staff, fully understand and are knowledgeable about the functioning of the various government agencies. GAO exists to inform. And there are few areas less understood by Congress than monetary policy and macroeconomics. Hence there are few areas more in need of a GAO audit than the Fed. While the impact of getting wheat support prices or fair market rents wrong is not insignificant, getting monetary policy wrong can be disastrous for an economy.

On Fed Independence

A common objection to a GAO audit of the Fed is that such would "compromise' the Fed's independence and subject its actions to political influence. Such an objection confuses the very nature of Fed independence. The Fed's authority to regulate the value of money is one delegated from Congress. As Congress can, and has, legislated changes to the Fed, it should be clear beyond a doubt that the Fed is not "independent" of Congress. It is a creature of Congress.

Setting aside the debate over the desirability and legitimacy of so-called independent agencies, it should be clear that their independence, in an operational sense, is from the Executive Branch. It should also be clear, however, that in recent years the Fed has coordinated its actions quite closely with the Treasury Department, eroding any real independence. The revolving door, both at the political and career levels, between the Fed and the Treasury Department further undermines the Fed's operational independence. A GAO audit could shine a light on this relationship, helping to insulate the Fed from continued interference by the Treasury Department.

Improving Federal Reserve Transparency

The Dodd-Frank Act made important advances in bringing transparency and accountability to the Federal Reserve. Unfortunately it falls short in allowing Congress, and the public, to truly gauge the effectiveness of the Federal Reserve.

In order to improve Federal Reserve Transparency, Congress should mandate a regular GAO audit of all Fed activities, including monetary policy. Such audits can be performed in such a manner so as to minimize their disruptions to any on-going deliberations of the Federal Open Market Committee (FOMC). For instance audits can be kept confidential for a year after each FOMC meeting.

Evaluating the effectiveness of any government agency is made all the more difficult when that agency faces a variety of competing and sometimes conflicting objectives. If the Fed feels it is free to abandon price stability in order to achieve other objectives, such as supporting the financial industry or misguided attempts to influence the labor market, then an audit will have limited value. At a minimum Congress should restrict the Federal Reserve to a single goal, that of price stability. Congress should also restrict the Fed's discretion in implementing that goal. A central bank that is free to define price stability as whatever it wants is a central bank without any meaningful constraint.

Chairman Paul, Ranking Member Clay and members of the Subcommittee, I again thank you for the invitation to appear at today's important hearing. I firmly believe our monetary system was a central driver of the financial crisis and that its deep flaws remain in place. In order to both prevent future financial crises and protect our society from the significant harm that results from inflation, a vigorous debate as to the performance of the Federal Reserve is long overdue.

Addendum to three responses provided by Ms. Brown

The first is a clarification and amplification to my response to Rep. Luetkemeyer's question on the risk of the dollar swap line transactions to the Federal Reserve. As stated on p.19 of our report (GAO-11-696), in a typical swap line transaction, the Federal Reserve Bank of New York (FRBNY) exchanged dollars for the foreign central bank's currency at the prevailing exchange rate and the foreign central bank agreed to buy back its currency (to "unwind" the exchange) at this same exchange rate at an agreed upon future date. The foreign central bank would then lend the dollars to banks in its jurisdiction. Foreign central banks assumed the risk of losses on these dollar loans and paid FRBNY the interest collected on these loans. FRBNY did not pay interest on the foreign currency it received under the swap lines. To avoid difficulties that could arise for foreign central banks in managing the level of their currency reserves, FRBNY agreed not to lend or invest the foreign currency. However, as I noted at the hearing, in the unlikely event that a foreign central bank would fail to repay the dollars, FRBNY would be exposed to currency risk related to the foreign currency it held to collateralize the dollar swap transaction. For example, if a foreign central bank defaulted on a dollar swap line, the value of its currency held by FRBNY could decline significantly in value, exposing FRBNY to losses.

The second item is a follow up to my response to Rep. Schweikert's question on GAO's opinion with respect to the Federal Reserve Inspector General's additional duties to audit the Consumer Financial Protection Bureau (CFPB). While GAO has not specifically examined the Federal Reserve IG's new duties, we have commented on the consolidation of IG offices in our prior work (see GAO-02-575 and GAO-04-117T). As you know, the Dodd-Frank Act provides that the Federal Reserve IG shall have all the authorities and responsibilities provided by the Inspector General Act of 1978 (IG Act) with respect to CFPB, as if the Bureau were part of the Federal Reserve Board. This provision essentially consolidates the oversight of both the Board and the Bureau under one IG. In our prior report, *Inspectors General: Office Consolidation and Related Issues* (GAO-02-575), we addressed the issue of consolidating IG oversight so that certain IG offices would have oversight authorities and responsibilities for a number of other federal agencies, much like the Dodd-Frank Act tasks FRB IG with the oversight of CFPB. Our report stated that such consolidation would serve to enhance the overall independence, economy, efficiency, and effectiveness of the IG community. We also stated that consolidation of IG offices would serve to strengthen the ability of IGs to improve the allocation of human and financial resources. Our report added that any weaknesses associated with IG consolidation could be mitigated by providing an IG presence at each agency to plan oversight and provide adequate audit coverage. Therefore, the Federal Reserve IG would be expected to maintain a presence at CFPB to provide adequate oversight. Also, as our report explains, this type of consolidation is already being applied across the government with examples of the State Department IG providing oversight for the Broadcasting Board of Governors; the Agency for International Development IG providing oversight of the Overseas Private Investment Corporation and the Millennium Challenge Corporation; and the Transportation IG providing oversight of the National Transportation Safety Board. In addition, our report recommended that the Congress consider elevating the FRB IG to appointment by the President with Senate confirmation rather than appointment by the FRB Chairman.

Finally, table 1 responds to Rep. Huizenga's question on the usage of broad-based emergency lending facilities by entities with a foreign parent company. As I testified, the use by U.S. branches and agencies of foreign-owned banks varied by program. While there are eight broad-based programs, not all were used by entities owned by a foreign-parent company. The dollar swap lines were used by foreign central banks, for example.

Table 1: Lending to Entities with a Foreign Parent Company as a Percentage of the Total Dollar Transaction Amount for Each Broad-Based Emergency Facility

Facility Name	Percent of Total Lending
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)	0.1%
Commercial Paper Funding Facility (CPFF)	59.5
Money Market Investor Funding Facility (MMIFF)	N/A[a]
Primary Dealer Credit Facility (PDCF)	7.5
Term Asset-Backed Securities Loan Facility (TALF)	See note
Term Auction Facility (TAF)	64.6
Term Securities Lending Facility (TSLF)	51.0

Source: GAO analysis of Federal Reserve Bank of New York data

[a]MMIFF was never used.

Note: The Federal Reserve Board's analysis of TALF showed that while the majority of the U.S. companies that received TALF loans had U.S. domiciled material investors, 36 percent had one or more non-U.S. domiciled "material investors." A "material investor" was defined as an investor who owned, directly or indirectly, an interest in any class of securities of a borrower that was greater than or equal to a 10 percent interest in such outstanding class of securities.