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Preparing the Public for a New Monetary Policy Framework[1]

Policymakers are discussing a range of issues related to the Federal Reserve's longer-run framework for monetary policy implementation, and at some point in the future may consider options for a new implementation framework. Some of those options might preserve aspects of the Committee's current framework and involve relatively little change, while others might involve substantially more change. Communicating these changes to the public well in advance of implementation would promote understanding and Federal Reserve transparency, as well as provide sufficient lead time for the private sector and System to prepare for the changes. Because the Federal Reserve's decisions are important to different audiences with varying degrees of interest in and understanding of monetary policy—market participants, the media, the general public, and the Congress—effective communication of a new policy rate and/or operating framework is likely to require a suite of vehicles through which information is disseminated. With appropriate planning, such communications would be manageable and would contribute to institutional accountability.

It seems likely that the volume of Federal Reserve communications with the public would be larger the greater is the divergence between the implementation framework employed at present and the new framework. On the one hand, if the Committee wished to retain the current framework—continuing with the federal funds rate as policy interest rate and the administered rates as policy tools, as well as continuing to operate on the flat portion of the reserves demand curve—its communications could be relatively limited, although it would still need to clarify its intentions for the SOMA portfolio to the extent that those intentions differed from those announced in the September 2014 Policy Normalization Principles and Plans. On the other hand, if a future framework involved a change to the policy interest rate (IR)—for instance, replacing the federal funds rate with the overnight bank funding rate (OBFR), an administered rate (or

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rates), or a secured (repo) rate—or in the operating regime (OR), a larger volume of communications likely would be necessary to adequately inform the public.[2]

In this memo, we consider different aspects of communications in the event that the Federal Reserve decided to adopt a new IR or OR—including, for the OR, communications surrounding possible changes to reserves requirements and/or the discount window. The next section addresses the initial announcement and the communications that might follow during a transition period leading up to the date when the changes become effective for the IR/OR. After that, we discuss communications about and preparations for a change in reserve requirements or the discount window. Then we suggest ways that FOMC meeting communications might change if the Committee were to adopt a new policy interest rate.[3] The final section of the memo considers some changes that would be necessary to adapt internal procedures to a new policy interest rate, as well as other conforming changes for Federal Reserve rules and regulations.

1. Announcement and transition communications for the policy framework

If the Committee should decide to adopt a new operating regime and perhaps also a new policy rate, its announcement to the public could communicate clearly about the rationale for the change and about how the Federal Reserve plans to use its operational tools within the new framework. The announcement could also indicate that, while money market rates play a central role in the implementation of monetary policy, the relevant interest rates for economic activity are longer term and that the adoption of a new framework is unlikely to affect the transmission of monetary policy to those economically relevant yields. However, if the Committee judged that a new policy rate would enhance the efficacy of monetary policy, then the announcement could also communicate how the change would help the FOMC to better meet its statutory goals. The announcement could note that the Committee would continue to monitor all sorts of real-time

[2] For a discussion of alternative policy interest rates, see the LRF supplementary memo “Alternative Policy Rates,” October 7, 2016. For a review of IR/OR frameworks, see the forthcoming LRF main memo “Interest Rate Targets and Operating Regimes.”

[3] In this memo, we take the FOMC’s current communications approach as given and do not suggest using the announcement of a new IR/OR as an opportunity to undertake an overhaul of the Committee’s communications vehicles (for instance, by rewriting the FOMC statement or reformulating the SEP). While there may be advantages to considering major changes to some of the Committee’s communications vehicles at some point, tying those changes to the announcement of the new IR/OR could suggest that these changes have significant implications for the Committee’s response to macroeconomic developments and the outlook.

information about economic and financial conditions, and retains access to a broad set of tools to ensure the appropriate transmission of monetary policy.

In making the formal announcement of a new IR/OR, the Committee could release a document similar to the Policy Normalization Principles and Plans issued in September 2014 listing the high-level features of the new framework including the policy interest rate, the operating regime, the policy tools that support the framework, and the breadth of counterparties. If the decision about a new IR/OR was taken at an FOMC meeting with a press conference, the Chair could use the press conference to present some information about the new framework and answer general questions. Changes to the operating regime such as those involving reserve requirements or the discount window could be announced separately by the Board given the different governance of these tools; that announcement could be issued at a different time or together with the announcement of the new IR/OR.

In order to provide technical detail, the Committee could consider issuing a document similar to the Bank of England's "Red Book," which articulates the Bank's objectives of using the Sterling Monetary Framework. The Red Book is available in print and through a dedicated companion website (see the BoE Red Book website). Such a document and website, made available jointly on the websites of the Board and FRBNY, could be particularly effective if they presented an integrated discussion of the overall implementation framework together with a description of the available policy tools.

In addition to operational details directed primarily at market participants, System websites could provide basic descriptions of the new framework or FAQs aimed at the general public. Economics working papers, shorter notes, or staff instructional videos might also be helpful, particularly in communicating the money-and-banking-level basics of the new framework.[4] The Chair or other members of the Board of Governors could consider whether a scheduled testimony provided a good opportunity to present the new framework to the Congress. If the

[4] FEDS paper 2015-047, "Monetary Policy 101: A Primer on the Fed's Changing Approach to Policy Implementation" by Jane Ihrig, Ellen Meade, and Gretchen Weinbach provided an undergraduate-level presentation of the normalization framework; the paper was published subsequently in the *Journal of Economic Perspectives* and discussed on academic blogs such as http://www.moneyandbanking.com/.

Committee favored this sort of multi-pronged approach to communications, the rollout would need to be well-planned and coordinated across the entire System.

The Committee might want to consider how far in advance of the actual adoption of the new framework to make the formal announcement—some period between announcement and adoption would permit time for the public and Federal Reserve staff to prepare for the change.[5] This approach would be similar to the one taken for revising the calculation of the effective federal funds rate (EFFR), although in that case, the initial FRBNY announcement did not indicate a precise implementation date; it did, however, indicate that it would subsequently provide additional information as well as an implementation date.[6] During this interim period between announcement and adoption, the Committee could begin giving greater prominence to the new IR/OR in its communications. Finally, if the Committee were to decide to replace the federal funds rate with a new policy interest rate, it would likely be desirable to continue publishing the EFFR, so that the adoption of a new policy interest rate would not necessitate the updating of private contracts that rely on the EFFR. Market participants might prefer to update private contracts nonetheless, and the transition period should be adequate to accommodate such changes.

2. Communications about and preparations for changes in reserve requirements and the discount window

If the Federal Reserve should decide to make structural changes to reserve requirements—for example, by eliminating required reserves or adopting a voluntary reserves regime—it would want to communicate clearly about the rationale for the change and about how it sees the change as fitting into its operational framework for monetary policy.[7] As already noted, changes to reserve requirements might be announced at the same time as the changes to the IR/OR—for instance, in a joint statement issued by the FOMC and Board. If changes to reserve requirements

[5] While the minutes would summarize the discussion of longer-run framework issues for FOMC meetings when the topic was on the agenda, they might be difficult to interpret or draw a clear signal from depending on the range of views expressed.
[6] In its initial announcement on February 2, 2015, the FRBNY indicated that it expected to revise the calculation of the EFFR—and also introduce the OBFR—after it had completed data collection, which was expected to last "approximately one year" (https://www.newyorkfed.org/markets/opolicy/operating_policy_150202.html).
[7] See the LRF supplementary memo "Considerations for the Design of Reserves Operating Regimes," September 30, 2016, for a discussion of these issues.

were undertaken separately and unless the Board were to decide to issue a white paper examining the pros and cons of such a change in advance, the first communication about the change would appear on the Board's website as a proposal to amend Regulation D. Although the minimum public comment period for such a change is 30 days, the Board might want to consider whether it would be appropriate to allow a somewhat longer period for comments—perhaps 60 or even 90 days—in light of the importance of the change.[8] After the consideration of the public comments, the Board could finalize the amendment to Reg. D and provide an effective date.

The time between the announcement of the proposed amendment and its effective date would provide a window that could be used to educate depository institutions and System staff involved in reserves administration about the technical aspects of the new reserve requirements.[9] For example, the first communication regarding the second phase of the simplification of reserves administration project in 2013 was sent out eight months before the project was completed. A number of channels were used in that project to provide information to depository institutions, including conference calls under the "Ask the Fed" program coordinated by the Federal Reserve Bank of St. Louis; targeted emails from the Customer Relationship Support Office at the Federal Reserve Bank of Chicago; and moderated discussion sessions with groups such as the American Bankers Association and the Community Depository Institutions Advisory Council.

The Federal Reserve may also consider the restructuring of the discount window in order to separate out the interest rate control function from the liquidity backstop function—see the forthcoming LRF supplementary memo "Standing Lending Facilities" for a discussion of the issues and possible options, one of which is the creation of a new standing lending facility (the Depository Institution Repo Facility) that would draw upon the authority in Section 14 of the Federal Reserve Act.[10]

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[8] The comment period commences when the proposal is published in the *Federal Register*.

[9] As noted in the LRF supplementary memo on reserves operating regimes, it would be possible to couple a change to the reserves regime with a reduction in the mandatory weekly reporting of banks' daily reservable liabilities to a much lower frequency along with the development of alternative means to collect data to compile the monetary aggregates for the public data release. If the Board were to decide to change the weekly reporting requirement, it would need to factor in additional time for Board staff to develop and operationalize the alternative method for data collection.

[10] It is conceivable that the creation of such a facility would require the Board to issue a new rule.

If the current discount window were to be restructured, the process would be similar to the one outlined for a change in reserve requirements. A proposal to amend Regulation A would require a period for public comment; the restructuring of the discount window in 2002-2003 provides a helpful example of the preparations and communications involved in such a change. In that case, the proposal was announced on May 17, 2002, and the *Federal Register* notice, which launched a 90-day public comment period, appeared a few days later.[11] The Board approved the final rule on October 31, 2002, and the change took effect on January 9, 2003.

During the public comment period, an article in the *Federal Reserve Bulletin* outlined the rationale for discount window credit, discussed the shortcomings of the discount window at the time, and detailed the proposed restructuring including the types of credit, interest rates, eligibility, and required collateral.[12] After the Board approved the final rule, a number of efforts were undertaken across the System to educate depository institutions and their regulators about the objectives and specifics of the new discount window programs, and these efforts continued until after the effective date of the change. The outreach to regulators extended beyond the Federal Reserve and included other bank supervisors. This effort was importantly directed at communicating that the primary credit program was intended to be "no questions asked" in most circumstances and at securing a buy-in from the regulators on this important point.

For either a change to reserve requirements or the discount window, general background information could be provided on System websites in the form of staff papers or notes, web pages, or FAQs. The Chair or other members of the Board of Governors could consider whether a scheduled testimony provided a good opportunity to explain the change to the relevant regulation and how it would complement the operational framework.

3. Changes in FOMC postmeeting communications for a new policy interest rate

The Committee's postmeeting communications separate the stance of monetary policy necessary to achieve the statutory goals, including the target range for the federal funds rate announced in the FOMC statement, from the settings of the policy tools, which are detailed in the

[11] The press release (announcement) provided a brief description of the proposed restructuring of the discount window.
[12] See Brian F. Madigan and William R. Nelson (2002), "Proposed Revision to the Federal Reserve's Discount Window Lending Programs," *Federal Reserve Bulletin*, vol. 88: 313-319 (article).

implementation note. This separation also makes clear that the operational settings of the IOER rate, ON RRP rate, and discount rate help the Committee achieve its policy target despite the different governance of the tools. Should the Committee decide to adopt a different market rate as its policy target, it would be relatively easy to adapt the current communications set-up by substituting the OBFR or secured (repo) rate for the federal funds rate in the FOMC statement. The implementation note could continue to include the settings for the relevant set of policy tools used to implement the monetary policy stance.

Transitioning the postmeeting statement and implementation note in the event that the Committee decides to adopt an administered rate (or rates) as its policy rate could be done in several ways. Announcing the setting of an administered rate in the FOMC statement would be consistent with the Committee's current practice, and many foreign central banks that have an administered rate as a policy rate do this.[13] For example, the Bank of Japan, Reserve Bank of New Zealand, and Swedish Riksbank single out one administered rate to summarize the stance of policy and announce it in their statements. While the advantage of including a single administered rate in the postmeeting statement is that the stance of policy is clear, a disadvantage is that communications could be more complicated and potentially confusing if multiple administered rates were important to conveying the stance of policy. (Furthermore, the postmeeting statement might need to be issued jointly by the FOMC and Board if the Committee did not have governance authority over all of the administered rates in the statement.) The European Central Bank (ECB) cites three administered rates in its statement, but highlights one (currently, the deposit rate) as being "most relevant" for money market rates. As an alternative to listing administered rate(s) in the postmeeting statement, the Committee could instead indicate that it "decided to [maintain] [tighten] [ease] the stance of monetary policy" while keeping the settings for the administered rates in the implementation note.

However the Committee might choose to announce the settings for administered policy rates, it might decide to reference a market rate in other public communications, a practice followed by a number of foreign central banks.[14] This market rate would serve as an "implicit" official rate

[13] For more detail, see the LRF foundational memo "The Foreign Experience with Monetary Policy Implementation," July 8, 2016.
[14] For further information, see the memo cited in footnote 10.

and could be used in a variety of communications (such as speeches, press conferences, the *Monetary Policy Report*, and so on) in the context of describing the stance of monetary policy or its connection to money market rates—similar to the way the ECB references EONIA in its communications. Referencing a market rate could help clarify the Committee's intentions, particularly if the administered rate settings were not announced in the postmeeting statement; obviously, it would be important in this case to take care that the public did not confuse the referenced market rate with the FOMC's new policy rate.

Finally, the policy rate that FOMC participants forecast as representing appropriate monetary policy in the Summary of Economic Projections (SEP) would also transition if the Committee decided to replace the federal funds rate target. Whether a different market rate or an administered rate or rates is adopted, participants could forecast the rate or the midpoint of a range for the new policy rate. During the transition period between the announcement and adoption of the new framework, participants might want to consider other possible changes to the SEP—for instance, whether to provide information on the size of the balance sheet associated with appropriate monetary policy if the new operating regime envisioned active management of the balance sheet as a tool of monetary policy.

4. Internal procedures and conforming changes associated with a change in the policy interest rate

During the period between the Committee's announcement and adoption of the new framework, Board staff would adapt internal tables, graphs, and models—and, importantly, Tealbook materials—to account for the change in policy rate and assess possible changes to the H.15 and other public data releases. Among the more important updates would be to the FRB/US model, which is made available on the Board's website. The monetary policy reaction function and term structure equation in FRB/US would be re-estimated in light of the Committee's new policy rate; staff anticipates no material changes to model estimates, but the update could be the subject of a FEDS Note or related documentation as part of the suite of communications during the rollout of the new policy rate and could help convey the message that the new operating framework has no meaningful implications for the transmission process or the Committee's reaction function.[15]

The period between announcement and adoption of a new policy rate would also give staff time to review Federal Reserve rules and regulations, and determine necessary conforming changes. There are four references in Regulations A, D, and J to the federal funds rate or targeted federal funds rate. The reference in Reg. J, for example, on the applicable interest rate in assessing damages in the event of failure to execute a payment order, refers to the federal funds rate published by the FRBNY; it is possible that no change would be required in this case given that FRBNY intends to continue publishing a daily EFFR. However, other references in the regulations may need to be changed and could require a public comment period before amendment.[16]

[15] In the event that the Committee chose to replace the federal funds rate target with an administered rate, the FRB/US model would likely have an equation linking the administered rate in the monetary policy reaction function with a money market interest rate. Should the Committee decide to reference a market rate in its public communications (as the ECB does with EONIA), the equation could link the administered rate with that market rate. If the Committee were to decide that it did not want to reference any market rate, the market rate chosen for the linking equation in FRB/US might receive some attention and could be misconstrued as an implicit official rate.

[16] The Federal Reserve Act contains one reference to the "current rate applicable in the market for Federal funds" in Section 11A(c)(4). This would appear to refer to the EFFR published by FRBNY.