Letters from the Secretariat

Delegates,

It is my distinct pleasure to welcome you to EagleMUNC V! My name is Kerianne DiBattista, and I am the Secretary-General of EagleMUNC V. I am a senior at Boston College in the Morrissey College of Arts and Sciences majoring in International Studies with a concentration in Economics. I am originally from Long Island, NY, and I have been participating in Model UN conferences since I was in tenth grade, rising to become Head Delegate and Secretary-General of my high school conference. At BC, I travelled to several conferences with our MUN team and I have participated EagleMUNC since my freshman year. As you begin your EagleMUNC V experience, I implore you to explore the conference theme, "The Interplay of Power and Ethics," and make your EagleMUNC experience the best it can be! Thank you, and I'll see you at EagleMUNC!

Best Regards,
Kerianne DiBattista
Secretary-General, EagleMUNC V

Dear Delegates,

It is my great pleasure to welcome you to EagleMUNC V! My name is Jack Massih and I am the Under Secretary-General of Political Affairs. I am a senior at Boston College studying Political Science and Economics. I began participating in MUN my sophomore year of high school and have been hooked ever since. I joined the EagleMUNC team as a freshman for the first year we moved off BC’s campus and into Boston, and it has been a joy to witness the conference continuously grow and evolve since then. The Political Affairs team has been working incredibly hard to prepare for the most innovative and exciting conference in EagleMUNC history. I am looking forward to seeing all of your creative and thoughtful responses to the diplomatic predicaments and crises you confront over the weekend.

Best,
Jack Massih
Under Secretary-General Political Affairs, EagleMUNC V
Introduction

Message from the Chair

Dear Delegates,

My name is Jack Donovan, and I'll be chairing the FOMC committee this year at EagleMUNC V. I am a senior majoring in Political Science and minoring in English. I am originally from Windham, NH, and have participated in Model UN since freshman year of high school. I look forward to meeting you all, as well as chairing this thrilling committee where I will assume the role of Ben Bernanke, the FOMC chairman in 2008.

Attached here is a brief overview of what you will need to know before arriving. I have faith that all of you will put forth policy that these United States can be proud of—its economic stability and hopeful prosperity entirely depend on it.

Sincerely,

Jack Donovan
Federal Open Market Committee

Introduction

The Federal Open Market Committee (FOMC) is a committee within the Federal Reserve System tasked with overseeing the United States’ open market operations, primarily the buying and selling of treasury securities (generally bonds representing a holding of US debt). This responsibility makes the FOMC the primary organ of monetary policy within the US.

Monetary policy controls the amount of available dollars ($USD) in the national money supply as well as the cost of money and credit. Monetary policy is conducted through treasury security, bond, and note transactions. When the FOMC chooses to reduce the money supply to control economic activity, they will sell treasury securities with a guaranteed rate of interest, allowing banks to purchase them with their customers’ deposits (the bank’s liabilities) so as to decrease the amount of cash the bank has to lend (bank loans are a bank’s assets). And if the FOMC wishes to increase the money supply to stimulate economic growth under, they buy back these treasury securities from the banks, injecting more money into the economy to be lent by the banks and spent by consumers.

Structure of the FOMC

The FOMC is comprised of the Board of Governors of the Federal Reserve System, a seven-member body also tasked with adjusting the reserve requirement and the discount rate, both of which act as crucial parts of monetary policy within the banking system. The rest of the Committee is comprised of the President of the Federal Reserve Bank of New York and a rotating group of eleven Reserve Bank presidents who
Federal Open Market Committee

serve one-year terms. The rotating seats are filled from the following four groups with one Bank president from each group: Boston, Philadelphia, and Richmond; Cleveland and Chicago; Atlanta, St. Louis, and Dallas; and Minneapolis, Kansas City, and San Francisco.¹

Hawk or Dove?

Financial experts have a clear interest in the FOMC’s actions and policy decisions. To better predict the outcome of FOMC meetings, therefore, people assign members a number from 1-5 (1 is Dove, 5 is Hawk)², referring to each member's attitude towards inflation. Because the Federal Reserve has two mandates, full employment and keeping inflation down, a balancing act is required for the FOMC members.

This balance is necessary because actions favoring one side (employment or inflation) typically worsen the other. A Dove will be more concerned with jobs, while a Hawk will be more concerned with inflation.³ The balance of Hawks and Doves is closely watched by those interested in predicting the trends in monetary policy and is key part of the dynamic of the FOMC. However, FOMC voting members have been known to change their views as new information about the state of the economy is revealed, or if they are convinced that voting a certain way is the best decision for the American economy.

Federal Open Market Committee

Members (2007-2008)

Board of Governors:
Ben Bernanke - Chairman (3 Neutral)
Donald Kohn - Vice Chairman (1 Dove)
Randall Kroszner (4 Moderate Hawk)
Frederic Mishkin (1 Dove)
Kevin Warsh (4 Moderate Hawk)
Elizabeth Duke (2 Moderate Dove)
Susan Bies (4 Moderate Hawk)

Federal Reserve Bank Presidents
Timothy Geithner - President of the Federal Reserve Bank of New York (2 Moderate Dove)
Gary H. Stern - President of the Federal Reserve Bank of Minneapolis (2 Moderate Dove)
Charles Plosser - President of the Federal Reserve Bank of Philadelphia (5 Hawk)
Sandra Pianalto - CEO of the 4th District Federal Reserve Bank of Cleveland (2 Moderate Dove)

Alternate Members
Christine Cumming - First VP of the Federal Reserve Bank of New York (2 Moderate Dove)
Richard Fisher - President of the Federal Reserve Bank of Dallas (5 Hawk)
Jeffrey Lacker - President of the Federal Reserve Bank of Richmond (4 Moderate Hawk)
Dennis Lockhart - President of the Federal Reserve Bank of Atlanta (2 Moderate Dove)
Janet Yellen - President of the Federal Reserve Bank of San Francisco (1 Dove)
Brian Madigan, Director of Monetary Affairs (3 Neutral)
Scott G. Alvarez, General Counsel (3 Neutral)
The FOMC’s responsibilities are clearly very intertwined with the banking system. And because the Board of Governors of the Federal Reserve System conduct monetary policy in ways that couldn’t be explained without an understanding of the banking system, here’s a brief overview.

When you deposit your money in a bank, you are giving that bank the right to use your money for their business activities (lending) with the guarantee that your money will be available to you when you want it. Your checking account, then, is a liability to the bank. It’s a certain amount of money they owe you if you wanted to withdraw all of it tomorrow. On the other hand, if you have a loan (car, mortgage, college), that is your liability because you owe that money to the bank or institution that loaned it to you. Your loan is the bank’s asset because it represents an amount that you’ve guaranteed to repay by using collateral (a car, house, or some item of value). The interest rate on a loan will thus reflect the consumer’s credit history and the ability of the bank to seize assets to account for the loan amount.

Banks are required to keep a certain percentage of their deposits (corporate and individual savings and checking accounts) on hand in case of an economic downturn and subsequent runs on the bank. This is what is called a reserve requirement, and it is a tool the Board of Governors uses to shape monetary policy. The way this works is that a decrease in the reserve requirement will allow banks to lend more against their liabilities because they will have a smaller amount of money they’re required to keep on hand. And by raising it, the bank must keep more of its liabilities, restricting loans and
money supply growth. Each scenario is helpful in the event of economic stability and downturn, respectively.

The discount rate is the other monetary tool the Board of Governors has at its disposal. This relates to the minimum rate of interest at which banks can borrow from one another to meet their respective reserve requirements. Effectively, this controls the cost of lending money. By having a lower discount rate, banks are able to lend out more and borrow from a Federal Reserve Bank lending facility to meet their requirement. With a higher discount rate, banks are further pressured to keep their requirement on hand as the interest they’d have to incur if they lent a portion of their requirement would offset any potential gain.

To summarize, there are three methods of monetary policy: open market operations (the purchase and sale of treasury securities, bonds, and notes to control the national money supply), the reserve requirement (controlling the money available to loan through bank reserves), and the discount rate (altering the cost of lending to incentivize banks to lend and spend a certain way). All of these policies work to create a balanced and unified approach to sustainable economic growth. What could go wrong?

The Crisis

While this background guide details events that took place during this critical time in American history, this does not ensure that these events will transpire the same way in our committee. Everything before August 2008 is set, but the rest will be up to you to decide.

---

4 The Federal Reserve. "Discount Rate." Board of Governors of the Federal Reserve System.
Federal Open Market Committee

The economic disaster of 2008 begins in 1999 with the passage of the Gramm-Leach-Bliley Act, which rendered two important provisions within the Glass-Steagall Act of 1933 null. These provisions placed a restriction on commercial banks from engaging in investment activity, considered one of the primary factors in creating the unstable economic climate of 2008.

The Emergency Economic Stabilization Act of 2008 was passed in response to the subprime mortgage crisis, and the link between financial institutions and the mortgage market is crucial to understanding this recession.

When someone wishes to purchase a home, they must take out a mortgage (home loan) to account for the amount of money they don’t have on-hand. The interest rate on a mortgage is determined by a variety of factors, including the borrower’s credit history, annual income, and the value of the house being purchased. Lower rates are for those with excellent credit (720+) and income sufficient to cover the monthly payments. Monthly payments, by extension, are calculated based on the home’s value and the amount paid down at the time of purchase. Higher rates are reserved for

---

subprime borrowers, who typically have credit ratings below 720 and have had difficulty repaying debt in the past. This higher interest rate will result in increased monthly payments to account for the greater risk of foreclosure to the lender. A mortgage issued to a subprime borrower is a subprime mortgage.

Mortgages, however, can also have variable rates (Adjustable-Rate Mortgages) that are adjustable based on an index that reflects the lender’s cost of borrowing on the credit market. This rate, plus a constant margin (fixed percentage the lender adds to the index rate) comprise the monthly payments for ARMs.

The story of the 2008 Financial Crisis starts here. From 2004-2006, the percentage of subprime mortgages originated (issued in a given year) increased from an 8% historical average to 20%. And in 2006, the amount of subprime mortgages with adjustable rates was 80%. This means that not only were a far greater number of mortgages issued to unqualified borrowers, but these (typically inexperienced) borrowers were also making payments with adjustable rates that would rise significantly if housing prices dropped. This is the “housing bubble.”

As housing prices fell, refinancing mortgages to get a better

---

6 Mann, Jake “The Subprime Lending Boom”
9 Simkovic, Michael. "Competition and Crisis in Mortgage Securitization."
10 Ibid.
Federal Open Market Committee

interest rate became more difficult. This resulted in greater rates of foreclosure, and people’s homes were seized and sold at auction to account for the loss to the lender.

This phenomenon affected Wall Street because the use of mortgage-backed securities (MBS) and collateralized debt obligations (CDO) to finance household debt greatly expanded between 2004-2006 as well. Essentially, MBS and CDOs are collections of mortgages that people invest their money in for the high rates of return (as a result of the higher interest rates on mortgages). Mortgages were also viewed as low-risk as well because people generally make their mortgage payments.

So banks, to reduce their risk from lending to subprime borrowers, sought to maximize their returns by packaging these mortgages into investment vehicles with high credit ratings (A, AA, or AAA). So while a large portion of the mortgages in a security could be B, BB, or BBB rated, the overall security would have a higher rating. This led investors to believe that their investment was solid: a security that had high rates of return and little risk of losing value. As more money was invested in these junk mortgage securities, banks were able to continue their lending practices, at least until the bubble popped.

---

11 Lemke, Lins and Picard, Mortgage-Backed Securities, Chapter 3.
Federal Open Market Committee

When foreclosures began to spike in 2006, these securities didn’t immediately respond. Credit rating agencies continued to give these securities A ratings, and investment continued. It was only when investment slowed amid the housing crisis that mortgage lenders began declaring bankruptcy. Bear Sterns was bought by J.P. Morgan Chase, and the value of the investment securities plummeted, taking with it pension funds, retirement accounts, and life savings. This is where the FOMC will step in.

The Emergency Economic Stabilization Act of 2008

The solution supported by the FOMC in 2008 included the following.\(^\text{12}\)

It sought to stabilize the economy by providing up to $700 billion to the Treasury Secretary to buy mortgages and other assets were weighing down financial institutions and making it difficult for individuals and small businesses to access credit. It also allowed companies to insure assets at increased risk.\(^\text{13}\)

The government tried to preserve homeownership by allowing for victims of predatory lending practices to modify their loan terms. It additionally called on federal agencies owning or holding loans to modify them.

The bill attempted to protect taxpayers by requiring companies selling their bad assets to the government to provide equity to the government, allowing taxpayers to benefit from future growth that the company experiences as a result of participating in the program.

\(^{12}\)“Emergency Economic Stabilization Act of 2008”
\(^{13}\)
Federal Open Market Committee

It sought to prevent executives from dumping their bad assets on the government, and walking away with millions in bonuses. It prevented companies participating in the program from certain tax benefits, and required executives to return unearned bonuses, and in some instances, pay to participate in the program.

Lastly, it outlined strong oversight by only providing the Treasury with $250 billion to start, then requiring the president to approve the next $100 billion, and subjecting the last $350 billion to potential Congressional disapproval.

However, as many will have noticed, this bill did not nearly accomplish what it set out to do. For this reason, it is not seen as a perfect solution in the eyes of many - can you think of something better? Some alternative solutions included mortgage assistance, bank recapitalization, asset liquidity, financial market reform, and monetary consensus reform.

For more information:
https://www.thebalance.com/what-was-the-bank-bailout-bill-3305675
http://www.globalresearch.ca/obama-bank-bailout-there-is-an-alternative/12181

Present Day

As you know, the FOMC isn't just for economic emergencies like those in 2008. As time moves forward, members will have to evaluate the health of the economy and any risks they believe it will face in the near future. FOMC members are tasked with several important questions each year, decisions investors everywhere pay attention to,
Federal Open Market Committee

and decisions that absolutely affect the economy and the daily lives of Americans. The question you must answer during such times: When should we raise the funds rates?

Raising the rate entails making the cost of borrowing money (the cost to banks borrowing from the Fed) greater, and is meant to control inflation. Hawks will be concerned about too much inflationary growth, and doves will be concerned about the constraints placed on an economy if the cost of borrowing were to grow. This task, as always, requires balance and detailed thought.

Questions to consider:

Has the economy recovered?
Is the current economic climate able to sustain increased rates?

For more information:
http://www.investopedia.com/articles/06/interestaffectsmarket.asp

FOMC Parliamentary Procedure

Seeing at the FOMC has nonvoting members and only the Board of Governors influences the discount rate and reserve requirement, this committee will take place in EagleMUNC world. This means that every member of the body has an equal vote and is able to influence all areas of monetary policy under the Federal Reserve System (the three outlined in this guide). All other procedures will follow the Crisis Committee rules outlined in the EagleMUNC handbook.
Works Cited


"Federal Open Market Committee (FOMC) Definition | Investopedia." Investopedia.

Hamrick, Mark. "7 Benefits of a Federal Reserve Interest Rate Hike." Bank Rate, n.d.


Federal Open Market Committee


