Asking tough questions on timely issues

When it comes to the healthy discourse needed to inform effective public policy, the Atlanta Fed has a tradition of leadership. Over the years, the bank has provided unique gatherings for getting to the heart of timely and difficult issues in the financial sector, and the bank's economists have a track record of conducting policy research whose results may go against the prevailing views in order to confront potential threats to a safe and vibrant marketplace.

In 2006 the theme of the bank's annual financial markets conference was "Hedge Funds: Creators of Risk?" During this two-and-a-half-day event, Fed Chairman Ben Bernanke was on hand to talk about hedge funds and the rapidly growing marketplace for buying and selling risks. Also on the agenda were policymakers from the Securities and Exchange Commission, other Federal Reserve Banks, the Commodity Futures Trading Commission, and other agencies.

Building a successful conference requires more than just inviting the best and brightest minds. The bank's approach involves bringing together divergent viewpoints: academic experts, policymakers, and market practitioners. Some participants advocated the merits of unfettered financial innovation. In turn, their views were challenged by others who argued that hedge funds pose a systemic risk to the financial sector and that more regulation, or at least greater transparency, is needed.

We believe this honest and open exchange of ideas leads to the kind of lively discussion that advances public knowledge in a meaningful way. In turn, this knowledge is invaluable as the Fed pursues its mission to ensure a safe yet dynamic financial sector.

Another issue that has attracted the attention of Atlanta Fed economists and others is the central role of government-sponsored enterprises (GSEs), especially Fannie Mae and Freddie Mae, in the $10.7 trillion market for U.S. residential mortgages.

Housing GSEs play an important role in the financial sector that the Fed believes warrants greater scrutiny. Over the years, these institutions have aided in the development of the U.S. secondary mortgage market and reduced the cost of mortgage credit.

The Fed's primary concern about Fannie Mae and Freddie Mac revolves around the potential for their mortgage-oriented investment portfolios to propagate financial disruptions. GSE obligations are perceived by financial markets to be implicitly guaranteed by the U.S. government. As a result, Fannie Mae and Freddie Mac have funding costs lower than AAA-rated fully private firms, an advantage that has helped the GSEs become two of the largest U.S. financial institutions.

In an April 2006 working paper, the Atlanta Fed concluded that limiting the size of the GSEs' mortgage-oriented portfolios would be the most desirable method of mitigating their systemic risk. While major GSE reform legislation did not move out of Congress in 2006, policymakers on Capitol Hill and elsewhere continue to evaluate the pros and cons of GSE portfolio limits as a method to reduce systemic risk.

Effective policy requires time and understanding that comes with the input of a broad range of perspectives. The Atlanta Fed is committed to providing ongoing analysis of complex issues and, in doing so, to facing the sometimes hard realities in our changing financial sector.

(Top) Shalini Patel, senior economic analyst, with Paula Tkac, financial economist and associate policy adviser, of the Atlanta Fed Research Department

(Bottom) Atlanta Fed Financial Economist and Policy Adviser Larry Wall with Financial Economist and Associate Policy Adviser Scott Frame