

32 of 34 DOCUMENTS

American Banker

November 17, 2009 Tuesday

Regional Fed Role at Issue In Dodd Bill

BYLINE: Steven Sloan

SECTION: WASHINGTON; Pg. 1 Vol. 174 No. 207

LENGTH: 1025 words

WASHINGTON - While the Federal Reserve Board is busy fending off threats to its supervision powers, regulatory reform legislation offered by Senate Banking Committee Chairman Chris Dodd will force a fight over something far more fundamental: the independence of the central bank.

The proposal released last week by the Connecticut Democrat requires chairmen of the 12 regional Fed banks to be nominated by the president and confirmed by the Senate.

It would also require these chairmen to "make regular reports" to the Fed's board of governors in Washington. Dodd's bill does not specify what the reports should cover.

The goal is improving governance at the Fed banks, which are largely ruled by local bankers, but critics charge that it will unnecessarily politicize the system and slow reform efforts.

"In a bill that's already racked with politics, this is introducing more for little gain," said Douglas Landy, a former lawyer at the Federal Reserve Bank of New York who is now a partner at Allen & Overy LLP. "If you're a senator from Missouri, are you really going to want to lose control of your local reserve banks to Washington? It seems like this is an elephant sitting on a fly."

Gil Schwartz, a former Fed lawyer in Washington, agreed. "This makes the system much more political," he said. "It removes some of the separation that the reserve banks now enjoy from the rest of the government."

The regional banks, which until this year received little attention, are supposed to serve as the Fed's watchdog in local economies across the country.

The board of directors at each regional bank is separated into three classes: Class A directors are elected by member banks to represent their interests, Class B directors are elected by banks to represent the public and Class C directors are appointed by the Fed in Washington. Directors from each class form a search committee that is responsible for recommending to the Fed board in Washington who should be hired as the president of each regional Fed bank. The chairman must be a Class C director, and those directors may not be an executive at a financial institution.

Dodd made it clear last week that he does not like the current setup. That the presidents are "being chosen by the very institutions you're going to be having responsibility over seems somehow inherently contradictory," he told reporters last week.

In an interview on CNBC last week, Dodd said his plan to have the Senate confirm Fed bank chairmen is comparable to the way it currently confirms Fed governors.

"We confirm board members of the Federal Reserve today," he said. "That's nothing new."

The perception that Fed bank governance needed improving grew this year after former Goldman Sachs executive Stephen Friedman was forced to resign as the chairman of the Federal Reserve Bank of New York in May. After Goldman converted into a bank holding company under the New York Fed's purview in September 2008, Friedman sought a waiver

that would allow him to remain chairman. But as Fed lawyers in Washington considered the issue, he purchased more than 37,000 shares of Goldman stock, raising concerns that he was profiting from knowledge gained in his Fed role.

The public could have greater confidence in the central bank if it were clear that noninterested parties were running the system, said David Berenbaum, executive vice president of the National Community Reinvestment Coalition.

Dodd's bill "would reinforce a public perception of integrity to the process," he said. "We need the idea that there is a public role in the financial system."

But some question the need for greater oversight of the regional Fed banks if Dodd succeeds in his bid to strip supervision powers from the central bank entirely. That would leave the Fed with just monetary policy, an area where its independence is little challenged. Dodd has said he supports the central bank's independence in monetary policy.

"There is an argument that you don't want the regulated to pick their regulator," said Mark Calabria, the director of financial regulation studies at the Cato Institute and a former aide to Sen. Richard Shelby, the top GOP member on Senate Banking. "But Dodd's bill takes the regulation part out of the Fed, so it seems like the rationale for doing this is taken care of by other means."

But Berenbaum said that because Fed board members would still have a role in selecting their president, the need for greater oversight remains.

"Even with monetary policy, it should be influenced by objective board members who don't have a stake in the institutions that are impacted by that monetary policy," he said. "It should clearly be an arm's-length transaction."

In either case, the relationship of regional Fed banks to the board of governors in Washington would change if Dodd's bill passes as written. Subjecting the chairmen to Senate confirmation and requiring them to submit these "regular reports" to the Fed would be a departure from current practice. Today, the relationship between a regional bank and the Fed board is mostly dictated by its president and Dodd's changes would likely dilute the president's job.

"It makes more of a political connection between the chairman of a board of a reserve bank and the board in Washington," Schwartz said. "You're basically dividing the chairman's loyalty."

Regardless of how the Fed emerges from the regulatory reform debate, observers said Dodd's bill misses an important opportunity to question basic aspects of the regional Fed structure. Some have advocated revamping the locations of the Fed banks; there are three between Philadelphia and New York and only one on the entire West Coast. Others have questioned whether the Fed in Washington should reexamine its decision to delegate much of its supervisory function to the regional banks. None of these issues are addressed in Dodd's bill.

"This gets away from the questions of whether the Fed system is efficient, whether it's in the right cities and whether it is working the way we want it to," said Kevin Jacques, the chairman of finance at Baldwin-Wallace College. "We're kind of sidestepping that and running ourselves into a corner."

URL: <http://www.americanbanker.com/>

LOAD-DATE: November 16, 2009

LANGUAGE: ENGLISH

PUBLICATION-TYPE: Newspaper

JOURNAL-CODE: AB

Copyright 2009 SourceMedia, Inc.
All Rights Reserved