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Fed Tightens Rules for Regional Bank Directors (Update2)

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By Michael McKee and Scott Lanman

Nov. 25 (Bloomberg) -- The Federal Reserve tightened eligibility rules for the directors who choose regional Fed presidents after the central bank came under fire for letting a former Goldman Sachs Group Inc. chairman serve.

Board members of Fed banks who represent the public must end any association with a firm that becomes the owner or part of a bank, thrift or credit union, or they must resign from the regional Fed bank's board. The rules, announced today by the Fed in Washington, apply to the two-thirds of regional directors who don't represent banks.

The new Fed rules follow a proposal by Senate Banking Committee Chairman **Christopher Dodd** that aims to put more distance between the financial industry and the Fed by removing commercial banks' role in appointing directors and subjecting each board chairman to Senate confirmation.

"It's a very good idea to tighten it up to reduce any ambiguity," said former St. Louis Fed President William Poole, now a senior fellow at the Cato Institute in Washington. "It's obviously an effort to respond to the political pressure for changing the Federal Reserve structure."

Chairman **Ben S. Bernanke** goes before the Senate panel Dec. 3 in a confirmation hearing for his second term as central bank chief. He is likely to face questions about the central bank's record of supervision during the financial crisis and its role in taxpayer-funded rescues of firms including insurer American International Group Inc.

Senate Confirmation

The Fed came under fire after it granted a waiver allowing a Goldman Sachs board member to stay on as a member of the New York Fed board representing the public after Goldman Sachs became a bank holding company in September 2008. The change to a bank holding company put Goldman Sachs under the New York Fed's supervision.

The director, **Stephen Friedman**, bought additional stock in Goldman Sachs after receiving the waiver and while serving as chairman of the New York Fed's board.

Senator **Richard Shelby** of Alabama, the ranking Republican on the Senate Banking Committee, said Friedman's stock purchases were "deeply disturbing," according to an article in May in the Wall Street Journal.

Friedman, in his resignation letter in May, said he had been in compliance with Fed rules and that his service on the board was "mischaracterized as improper."

Exigent Circumstances

The new policy says Fed governors may approve a waiver in "rare and exigent circumstances" upon written request from the regional bank.

The Fed's 12 regional Fed banks, along with the Washington- based Board of Governors, make up the Federal Reserve system. The regional banks are private entities with nine-member boards of directors.

Regional directors together nominate a president who is approved by the governors in Washington. The New York Fed's president has a permanent seat on the policy-setting Federal Open Market Committee, while the others serve on the FOMC on a rotating basis. All are responsible for supervising banks in their regions.

"The whole idea of being chosen by the very institutions you're going to be having responsibility over seems somehow inherently contradictory," Dodd, a Connecticut Democrat, told reporters on Nov. 10.

Board Chairmen

Dodd wants directors who are currently chosen by banks to be picked instead by the Board of Governors in Washington. His proposal would also make the chairmen of the Fed banks appointees of the U.S. president subject to Senate confirmation.

The main role of the regional Fed bank chairmen is to lead the search for bank president.

St. Louis Fed President **James Bullard** said last week that the Dodd proposal is a "blatant politicization" of the central bank.

A report Nov. 17 by the U.S. financial rescue's special inspector general faulted the New York Fed for making "limited efforts" to protect taxpayer funds during last year's bailout of AIG. The New York Fed president at the time was **Timothy Geithner**, now the Treasury secretary.

Banks including Goldman Sachs received the full value on credit-default swaps purchased from AIG to protect against declines in mortgage-linked investments.

After the AIG report, Representative **Elijah Cummings**, a Maryland Democrat, and other lawmakers called for a "comprehensive congressional review" of the Fed system and consideration of "possible changes in its governance model."

Types of Directors

Regional Fed banks have three types of directors. Three Class A directors are elected by and represent member banks. Three Class B directors are elected by member banks to represent the public.

The chairman, vice chairman and one other seat on the board are Class C directors, chosen by the Fed's board of governors to represent the public.

Under the new Fed policy, if Class B or Class C directors have a role in any company that becomes a bank, a bank holding company, or in some other way is affiliated with a financial institution, they have 60 days to resign from the board or end the connection. During that period, the director would not be allowed to participate in board activities.

In addition, Class C directors who hold stock in a company that becomes a "financial stock issuer" during their term must sell their stock or resign from the Fed's board, also within 60 days. Until the stock is sold, the director cannot participate in board activities.

"It removes all ambiguity," said **George Scalise**, who served as chairman of the San Francisco Fed, one of 12 regional Fed banks, from 2003 to 2006. "What it translates into is a tightening up and broadening of the rules that were in place."

Scalise said he was speaking for himself and not as president of the Semiconductor Industry Association in San Jose, California.

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Last Updated: November 25, 2009 14:31 EST