Friedman Scandal Spurs Rules Change for Federal Reserve Banks

By Alain Sherter | Nov 25, 2009

The **Federal Reserve Board** is changing its rules for board members of member banks, presumably to avoid the sort of blatant conflict of interest that clouded **Stephen Friedman**'s tenure as chairman of the **Federal Reserve Bank of New York**.

Friedman served at the New York Fed while also sitting on the board of **Goldman Sachs**. He resigned from the bank in May after it was revealed that he had purchased shares in the investment bank just as the Fed was bailing out Wall Street.

Friedman denied he had broken any rules. Yet the scandal exposed (again) the incestuous relations between large financial companies and the dozen Federal Reserve banks ostensibly charged with watching them.

Among other changes, the new rules bar directors of Federal Reserve banks who are assigned to represent the public interest — known as “Class C” directors — from holding shares in a company that becomes a financial stock issuer during their term. Friedman was a Class C director at the New York Fed at the time he was boosting his holdings of Goldman stock.

In such cases, such directors must sell the stock or resign from the bank’s board. Until the offending stock is sold, directors are recused from their official duties and are prohibited from acquiring additional shares in the relevant company while they serve on the board.

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

The new regs should make a difference. But it’s likely to be marginal. Tightening the eligibility requirements for Federal Reserve bank directors may deter egregious abuses like Friedman’s. But they do little to stop the revolving door between Wall Street and government, nor weaken the financial industry’s hand in shaping U.S. economic policy.

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