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Fed's Dudley Got Waiver to Hold AIG Shares After 2008 Bailout

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July 21 (Bloomberg) -- The Federal Reserve Bank of New York's William C. Dudley received a waiver in 2008 to keep his personal holdings of American International Group Inc. shares after the insurer got a bailout from the central bank.

Dudley, who was the New York Fed's markets-group chief at the time and is now the bank's president, is the senior New York Fed official identified in a Government Accountability Office report today as receiving the waiver, Senator Bernard Sanders, a Vermont Independent, said in a statement. Jack Gutt, a New York Fed spokesman, said Dudley sold his shares after becoming president in January 2009, about four months after AIG's rescue.

The GAO criticized the Fed's standards for managing conflicts of interest, saying the Dudley example "highlights the potential for appearance concerns" even if the stake is a small percentage of the person's total holdings. New York Fed employees who requested permission to retain holdings in companies receiving assistance were "generally allowed" to keep the investments, the GAO said in its report after a yearlong review of the central bank's emergency-lending programs. The GAO didn't identify Dudley by name.

"The Fed has no comprehensive system in place to mitigate the tremendous conflicts of interest that exist," Warren Gunnels, a senior policy adviser for Senator Sanders, said in a telephone interview from Washington. "It looks like in almost every instance when an employee or an employee of a vendor had some investments in some of the same firms that received financial assistance at the Fed, they could simply go to the office of ethics and get a waiver."

GAO Audit

Gunnels said he reviewed the GAO audit before its publication and asked the GAO to name the senior New York Fed official who received the waivers for his AIG and General Electric Co. holdings.

"We just wanted to make sure the American people had the most transparent information possible about this report," Gunnels said. "And that they knew exactly who was potentially gaming the system."

Dudley "held shares in these companies as part of his personal portfolio that predated his service at the New York Fed," Gutt said in an e-mailed statement. The waiver was granted partly because "had he sold these shares immediately after the interventions it would have the appearance of a conflict."

After becoming New York Fed President, "Mr. Dudley volunteered to dispose of the shares at pre-determined dates, agreed to by the New York Fed's ethics office," Gutt said. "All shares have been disposed of."

AIG, GE

The waiver allowed the New York Fed official to keep holdings in AIG and GE, whose combined value comprised "less than 5 percent of the official's total financial holdings," the GAO said.

"It's shocking to me that Dudley would have any individual holdings of AIG, and it really questions the guy's judgment," said Mark Calabria, director of financial regulation studies at the Cato Institute in Washington.

The Fed on Sept. 16, 2008, authorized an $85 billion loan to AIG to avert the company's collapse, one day after Lehman Brothers Holdings Inc. filed the largest bankruptcy in U.S. history. The bailout later expanded to include $182 billion in aid from the U.S. Treasury and the Fed.

The waiver granted to the senior official said that the official's participation in decisions related to AIG and GE was "critical to the official's senior-level responsibilities," the GAO said.

'Appearance' of Conflict

The New York Fed's chief ethics officer judged that "divestiture of the holdings could violate securities law because of the official's access to material, nonpublic information" and that selling the shares could have "created the appearance of a conflict," according to the GAO.

The GAO said that it "did not assess the appropriateness" of the New York Fed's decisions to grant waivers and that "these decisions are case-specific and necessarily require subjective judgments."

The GAO's audit of the Fed's emergency-lending programs from 2007 to 2010 provides more details on the $3.3 trillion in aid provided to companies and markets to quell the financial crisis that brought down Bear Stearns Cos., Lehman and AIG. The Fed was forced to disclose the recipients of many programs in December 2010 by the Dodd-Frank Act, which also authorized the GAO audit.

Vendor Selections

"Without additional provisions in conflicts policies and procedures, the Reserve Banks risk being exposed to the appearance of conflicts and to questions about the integrity of their decisions and actions," the GAO said.

The GAO made seven recommendations to the Fed in the 266- page report, including strengthening polices for non-competitive vendor selections, conflicts of interests, risks related to emergency lending and documentation of lending decisions.

"To the extent not already addressed, the Board and the Reserve Banks will give each recommendation serious attention, and will strongly consider how best to respond to each," Scott Alvarez, the Fed's general counsel, said in a response included in the report.

--With assistance from Craig Torres in Washington. Editors: Kevin Costelloe, Carlos Torres http://sfgate.com/cgi-bin/article.cgi?f=/g/a/2011/07/21/bloomberg1376-LOP6W21A1I4H01-3VPM7A64N52L630G7JRJFEJOQV.DTL