The Sanders Report on the GAO Audit on Major Conflicts of Interest at the Federal Reserve

U.S. Senator Bernie Sanders (I-Vt.)
Washington, DC
October 19, 2011

As a result of an amendment by Sen. Bernie Sanders to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Government Accountability Office completed its second audit of the Federal Reserve. This report focuses on the enormous conflicts of interest that existed at the Federal Reserve during the financial crisis.

Here is what the GAO found:

- The affiliations of the Federal Reserve's board of directors with financial firms continue to pose "reputational risks" to the Federal Reserve System. (See page 32 of GAO report)

- The policy of the Federal Reserve to give members of the banking industry the power to both elect and serve on the Federal Reserve's board of directors creates "an appearance of a conflict of interest." (See page 32 of GAO report)

- The GAO identified 18 former and current members of the Federal Reserve's board affiliated with banks and companies that received emergency loans from the Federal Reserve during the financial crisis including General Electric, JP Morgan Chase, and Lehman Brothers. (See page 39 of GAO report)

- There are no restrictions on directors of the Federal Reserve Board from communicating concerns about their respective banks to the staff of the Federal Reserve. (See page 36 of GAO report)

- Many of the Federal Reserve's board of directors own stock or work directly for banks that are supervised and regulated by the Federal Reserve. These board members oversee the Federal Reserve's operations including salary and personnel decisions. (See page 41 of GAO report)

- Under current regulations, Fed directors who are employed by the banking industry or own stock in financial institutions can participate in decisions involving how much interest to charge to financial institutions receiving Fed loans; and the approval or disapproval of Federal Reserve credit to healthy banks and banks in "hazardous" condition. (See pages 41-42 of GAO report)

- The Federal Reserve does not publicly disclose its conflict of interest regulations or when it grants waivers to its conflict of interest regulations. (See page 47 and 49 of GAO report)

- 21 members of the Federal Reserve's board of directors were involved in making personnel decisions in the division of supervision and regulation at the Fed. (See page 105 of GAO report)

The GAO included several instances of specific individuals whose membership on the Fed's board of directors created the appearance of a conflict of interest including:

<u>Stephen Friedman, the former chairman of the New York Fed's board of directors.</u>

During the end of 2008, the New York Fed approved an application from Goldman Sachs to become a bank holding company giving it access to cheap loans from the Federal Reserve. During this time period, Stephen Friedman, the Chairman of the New York Fed, sat on the Board of Directors of Goldman Sachs, and owned shares in Goldman's stock, something that was prohibited by the Federal Reserve's conflict of interest regulations. Mr. Friedman received a waiver from the Fed's conflict of interest rules in late 2008. This waiver was not publically disclosed. After Mr. Friedman received this waiver, he continued to purchase stock in Goldman from October 2008 through January of 2009. According to the GAO, the Federal Reserve did not know that Mr. Friedman continued to purchases Goldman's stock after his waiver was granted. (See pages 34-35 of GAO report)

Jeffrey Immelt, the CEO of General Electric, and board director at the New York Fed

The GAO found that the Federal Reserve Bank of New York consulted with General Electric on the creation of the Commercial Paper Funding Facility established during the financial crisis. The Fed later provided $16 billion in financing to General Electric under this emergency lending program. This occurred while Jeffrey Immelt, the CEO of General Electric, served as a director on the board of the Federal Reserve Bank of New York. (See page 39 of GAO report)

Jamie Dimon, the CEO of JP Morgan Chase and board director at the New York Federal Reserve

Jamie Dimon, the CEO of JP Morgan Chase, served on the board of the Federal Reserve Bank of New York at the same time that his bank received emergency loans from the Fed and while his bank was used by the Fed as a clearinghouse for the Fed's emergency lending programs. (See page 40 of GAO report)

In March of 2008, the Fed provided JP Morgan Chase with $30 billion in financing to acquire Bear Stearns. During this time period, Jamie Dimon was successful in getting the Fed to provide JP Morgan Chase with an 18-month exemption from risk-based leverage and capital requirements. Dimon also convinced the Fed to take risky mortgage-related assets off of Bear Stearns balance sheet before JP Morgan Chase acquired this troubled investment bank. (See page 86 of GAO report)

Other central banks do a much better job than the Fed in mitigating conflicts of interest.

The GAO found that compared with central banks in other countries, the Federal Reserve does not do a good job in disclosing potential conflicts of interest and other important transparency issues. The GAO found that such transparency is "essential to the effective and credible functioning of a healthy democracy" and fulfilling the government's responsibility to citizens and taxpayers. (See page 65 of GAO report)

For example, the central bank in Australia prohibits its directors from working for or having a material financial interest in private financial companies located in its country. If such regulations were in place at the Fed, the CEO of JP Morgan Chase and many other bank executives would be prohibited from serving on the Fed's board of directors. (See page 65 of GAO report)

The central bank in Canada requires its directors to disclose any potential conflicts of interest as soon as they are discovered; avoid or withdraw from participation in any real, potential, or apparent conflicts of interest; and cannot vote on any matters in which there is a conflict of interest. If these regulations existed at the Fed, Stephen Friedman would have been required to immediately resign from Goldman's board, sell his Goldman stock, or resign from the Fed's board of directors. Instead, Mr. Friedman was allowed to financially benefit from the increase in Goldman's stock while it received approval from the Fed to become a bank holding company and received billions in emergency Fed loans. (See page 46 of GAO report)

The central bank in Canada also prohibits its directors from having affiliations with entities that perform clearing and settlement responsibilities in the financial services industry or serve as dealers in government securities. The Fed does not. These regulations would have prevented both Friedman and Dimon from serving on the Fed's board of directors. (See page 46 of GAO report)

The directors of central banks in Australia, Canada, England and the European Union all have to disclose potential conflicts of interest and must disclose its conflict of interest policies on the internet. The Federal Reserve does not. (See page 47 and 49 of GAO report)

The European Central Bank and the central bank in Australia both require its directors to annually disclose their financial interests. The Fed does not because it does not want to make it "burdensome" for people to serve on its board. (See page 50 of GAO report)

Federal Reserve Banks do not publish public information about vacant director positions. Instead of allowing the public to actively seek to apply to its board, the banking industry recruits most of the candidates to serve on the Federal Reserve's board of directors in private. (See pages 66-67 of GAO report)

In contrast, the central bank in England publicly advertises when it is seeking applications for board directors. The central bank in Canada allows the public to apply for vacant board member positions on the internet. (See page 66-67 of GAO report)

The GAO also found the following:

- In 2010, the 108 members of the Federal Reserve's board of directors are predominately white men who are senior executives of financial institutions. (See the front page of GAO report)

- While Congress has mandated that the Federal Reserve's board of directors consist of experts in labor, consumer protection, agriculture, commerce, and industry, only 11 of the 202 members of the Federal Reserve's board of directors represented labor and consumer interests from 2006-2010. (See page 19 of GAO report)

- When choosing who will serve on its board of directors, the Federal Reserve generally focuses its search on senior executives, usually CEOs or presidents in the financial industry. Of the 108 Federal Reserve board directors, 82 were the President or CEO of their company. (See page 28 of GAO report)

- The Federal Reserve claims that it is hard to recruit labor and consumer representatives to its board because many are "politically active," and the Federal Reserve has restrictions on a director's "political activity." (See page 30 of GAO report.) Sanders called this "laughable," compared to the political action of CEOs of large financial institutions serving on the Fed's board. For example, Jamie Dimon, the CEO of JP Morgan Chase currently serves on the board of directors at the Federal Reserve Bank of New York. According to the Center for Responsive Politics, Dimon has made over $620,000 in campaign contributions since 1990. http://www.opensecrets.org/news/2009/07/jpmorgan-ceo-jamie-dimon-donat.html