THE FEDERAL RESERVE

Real and Perceived Conflicts of Interest and a Path Forward

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THE CENTER FOR POPULAR DEMOCRACY

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FED UP

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Fed Up is a coalition of community organizations and labor unions across the country, calling on the Federal Reserve to reform its governance and adopt policies that build a strong economy for the American public. The Fed can keep interest rates low, give the economy a fair chance to recover, and prioritize genuine full employment and rising wages.
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Executive Summary

The Fed Up coalition's 2016 report "To Represent the Public" highlights the Federal Reserve's ongoing failure to comply with the Federal Reserve Act's requirement that regional Banks' boards of directors reflect the public they serve. Regional Banks' boards are disproportionately white, male, and from the corporate and financial sectors. In some cases, directors come from the very institutions that the Federal Reserve is supposed to oversee and regulate. Regional Banks have continually selected bank directors without transparency or public input, and most directors' backgrounds suggest that they are likelier to be familiar with the interests of the wealthy than with the interests of low-income individuals and communities of color.

The Federal Reserve must navigate between two important and competing priorities: ensuring price stability while pursuing maximum employment. Appointing directors to the Federal Reserve regional Banks' boards from a broad array of perspectives and experiences—including individuals who (like 80% of the American public) hold debt—will help ensure the interests of working families, and not just businesses, are fully served by our nation's monetary policy. Removing representatives of regulated entities from senior positions within the Federal Reserve will bolster both the integrity of the Federal Reserve System and the safety of our financial system. This report highlights the real and perceived conflicts of interest among regional Banks' boards that came to light during the financial crisis, and which persist today. The findings suggest the Federal Reserve must address the composition and diversity of its leadership while also improving transparency and accountability mechanisms. This report offers a series of concrete recommendations to mitigate conflicts of interest and ensure the Federal Reserve more fully represents the American public.

Key Findings

The structure and composition of the Federal Reserve's leadership leaves our monetary system open to widespread conflicts of interest and weakened regulatory capacity

- Following the 2008 financial crisis, the Government Accountability Office documented serious conflicts of interest among Federal Reserve leadership related to the Fed's emergency lending programs. Eighteen former and current members of regional Federal Reserve Banks' boards were affiliated with banks and companies that received a combined $4 trillion in emergency low-interest loans.
- The potential for real and perceived conflicts of interest among the Federal Reserve's directors persists today, negatively impacting the credibility and accountability of the Federal Reserve System. While the Federal Reserve's leadership is supposed to draw from a wide range of sectors, nearly three-quarters come from the banking and commercial sectors (and fully 25% of current Bank presidents have strong ties to Goldman Sachs).
- The potential for conflicts of interest will remain high as long as commercial banks and financial institutions continue to dominate Federal Reserve leadership, controlling the selection of two-thirds of directorships at regional Banks, and in turn influencing the selection and supervision of regional Bank presidents.
- In response to public concern over conflicts of interest identified during the financial crisis, the Federal Reserve's regional Banks have made some progress by publicly releasing conflict of interest policies, roles and responsibilities, and bylaws. The Federal Reserve should go further by publicly disclosing waivers requested or issued to directors on the conflict of interest policy, as well as information on each regional directors' financial holdings and interests.

Greater sectoral, gender, and racial diversity is required to ensure the Federal Reserve fully represents the public

- The current leadership of the Federal Reserve System does not adequately represent the demographics of our country: 92 percent of Federal Reserve Bank presidents are white and

83 percent are men. 68% of current regional board members come from banking or corporate backgrounds.

- The Federal Reserve's process for nominating, vetting, and electing Class A, B, and C directors is opaque and does not allow for adequate public input and representation.

It is common for Federal Reserve Bank directors to be politically active in a manner consistent with the Fed's guidelines around political activity

- The current rules governing political activity by Board directors are clear and allow wide latitude to conduct political activity, including donating to candidates and PACs, speaking out on behalf of political causes, joining political parties, and endorsing candidates.
- Many members of the current Federal Reserve leadership participate in political activity that is permitted by the Fed's guidelines. These rules around political activity would not preclude community and labor representation on the board.

Recommendations

- The Fed's Board of Governors and the regional Banks must take immediate steps to increase the independence and accountability of the Federal Reserve System while strengthening the diversity of perspectives influencing monetary policy. We recommend that Congress and the Federal Reserve work together to implement the following policies to address real and perceived conflicts of interest:
- Eliminate representatives and employees of regulated institutions from the boards of directors at the regional Federal Reserve Banks. In practice, this will mean eliminating Class A directors, who are elected by and represent the banking and financial industry.
- Ensure that all directors of the 12 regional Federal Reserve Banks are chosen through a process that is overseen by the Board of Governors, conducted in a transparent manner, and provides opportunities for public input. Commercial banks should no longer play any role in electing directors for regional Banks' boards.
- Conduct an annual review, in partnership with the Federal Reserve's Office of Inspector General and the Government Accountability Office, to ensure conflict of interest policies are rigorously enforced.
- Publicly disclose all waivers exempting Federal Reserve directors from conflict of interest rules. The Federal Reserve's regional directors must join regional Bank presidents in annually disclosing all financial interests.

The Federal Reserve Act mandates that Federal Reserve leadership must "represent the public" and come from a variety of economic backgrounds and perspectives. Building on our earlier study of the composition of regional boards, we here recommend the Federal Reserve take the following steps to ensure its leadership better reflects and represents the public:

- Improve the gender and racial diversity among regional directors
- Improve the sectoral diversity among regional directors.
    - Each regional board should include among its regional directors at least
        - One member from a labor organization;
        - One member from a university or policy think tank, and;
        - One member from a community organization with operations primarily within the region and in which community members participate in governance.
- Ensure there is a balance of debtors and creditors on the Federal Reserve Board. A debtor could include an individual paying off a small business loan, a student loan, a mortgage, or other consumer financial service that charges an interest rate.
- Ensure rules around political activity are clear and consistently applied. Federal Reserve leadership must affirm that representatives from community-based organizations and labor unions can serve in board leadership positions and are not precluded by these rules.

The Structure and Power of the Federal Reserve

The Federal Reserve is one of the most powerful institutions shaping the US economy. Charged with pursuing maximum employment, setting interest rates, and regulating banks, the Federal Reserve plays a critical role in ensuring our economy thrives. The presidents and boards of directors of the twelve regional Federal Reserve Banks are influential decision-makers that define our nation's monetary policy. Each of the twelve regional Banks has a nine-person board with three types of directors:

- Class A Directors are selected by and chosen from the member banks
- Class B Directors are elected by district member banks and are supposed to represent the public
- Class C Directors are appointed by the Fed's Board of Governors and are also supposed to represent the public

Regional Bank Class A, B, and C directors monitor the integrity of financial institutions and the stability of the financial system more broadly. Class B and C directors are responsible for selecting regional Federal Reserve Bank presidents, who serve five-year terms expiring in years ending in 1 and 6. Bank presidents consult the directors regarding economic conditions in their region, in order to inform the Federal Open Market Committee (FOMC). The FOMC is the nation's most powerful monetary policymaking body and can spur or stall economic growth by setting interest rates.[1] The seven-member Federal Reserve Board of Governors and the New York Federal Reserve Bank president join four regional Bank presidents (rotating on an annual basis) to form the FOMC.[2] The balance of power is tilted towards the regional Bank presidents whenever there are vacancies on the Federal Reserve Board of Governors, as has been the case during most of the Obama administration.[3]

In order to supervise and advise regional Bank presidents, directors are granted access to confidential information and significant regulatory power over banks and financial institutions. Given its enormous power to influence economic outcomes, the Federal Reserve's mandate "to represent the public" is designed to promote broad public accountability. The Federal Reserve's own Roles and Responsibilities manual for directors recognizes the need for diversity and independence in carrying out its work:

> **"Representation from a wide variety of occupational sectors, demographic groups, and geographic areas contributes to the formulation of sound monetary policy. The provisions also help protect against actual and perceived conflicts of interest, which is critical to maintaining the public's confidence in the integrity of the Federal Reserve."[4]**
>
> —The Federal Reserve

In practice, however, the Federal Reserve has failed to appoint diverse and independent leaders. There is inadequate racial and gender diversity on the boards. Although men are 49% of the US population, nearly three-fourths of all board members are men. Similarly, 83% of the Federal Reserve board members are white, although white people comprise only 63% of the US population.[5] The appointment process for regional directors remains opaque, and the boards' composition skews heavily towards the financial sector—68% of current regional board members come from banking or corporate backgrounds.[6]

The Financial Crisis: Widespread Conflicts of Interest at the Federal Reserve

Between 2007-2009, the Federal Reserve created dozens of new emergency lending programs designed to stabilize the financial markets and prevent America's largest banks from going bankrupt.[7] At the time, serious questions were raised about the integrity of these transactions, in light of the pervasive influence of the financial industry within the Fed.[8] Under the landmark Dodd-Frank financial reform bill, the Government Accountability Office (GAO) was required to conduct a thorough audit of the Fed's conflict of interest policies and practices. In 2011, the GAO released a report outlining associations between regional Banks and financial firms that posed "reputational risks" to the Federal Reserve System. The audit uncovered striking examples of conflicts of interest among the regional Federal Reserve Banks' boards and a lack of robust policies and safeguards in place. Eighteen former and current members of the Federal Reserve's board were affiliated with banks and companies that received a combined $4 trillion in emergency low-interest loans from the Federal Reserve during the financial crisis.[9] In some instances, the Fed's leadership approved and defined the terms of these emergency lending programs in a matter of days or weeks.10 The report also found that many of the Federal Reserve's directors owned stock or worked directly for banks that were supervised and regulated by the Federal Reserve.

Some notable examples of conflicts of interest include:

- **Stephen Friedman, former member of Goldman Sachs Board of Directors and the former chairman of the New York Fed:** In 2008, the New York Fed approved an application from Goldman Sachs to become a bank holding company. This enabled the investment bank to access cheap Federal Reserve loans. Goldman Sachs became a bank-holding company while Stephen Friedman was 1) the Chairman of the New York Fed, 2) on Goldman Sachs' Board of Directors, and 3) owned shares in Goldman's stock. As an investment bank, Goldman Sachs had been outside the supervisory authority of the Federal Reserve; however, in becoming a bank holding company, Goldman now fell under the Federal Reserve's regulatory oversight and Friedman's affiliation with Goldman Sachs was now prohibited by the Federal Reserve's conflict of interest regulations. As a result, Friedman requested a waiver from the Fed's conflict of interest rules in late 2008 that was approved in early 2009. [11] While the waiver was not publicly disclosed, the Federal Reserve cited the difficulty of finding a new Fed chairman during a financial crisis and the "unexpended and unforeseen" events as the rationale.[12] After receiving a waiver, Friedman continued to purchase Goldman stock (37,300 additional shares) from October 2008 through January of 2009. [13] The Federal Reserve was unaware that Friedman continued to purchase Goldman's stock after his waiver was granted.[14] He ultimately resigned in May 2009 amid concerns of wrongdoing, which Freidman described as "mischaracterizations" in his resignation letter. At the time of his resignation, the additional Goldman shares Friedman purchased had risen by $1.7 million in value.[15]
- **Jamie Dimon, the CEO of JP Morgan Chase and former board director at the New York Fed:** Dimon served on the board of the Federal Reserve Bank of New York at the same time that his bank received emergency loans from the Federal Reserve ($391 billion in total).[16] JP Morgan Chase was used by the Fed as a clearinghouse for the Fed's emergency lending programs at this time.[17] In 2008, the Federal Reserve provided JP Morgan Chase the $29 billion in necessary financing to acquire Bear Stearns.[18] Dimon convinced the Federal Reserve to take risky mortgage-related assets off of Bear Stearns' balance sheet before the JP Morgan Chase acquisition. During this time period, Jamie Dimon was also successful in pushing the Fed to provide JP Morgan Chase with an 18-month exemption from risk-based leverage and capital requirements.[19]
- **Jeffrey Immelt, the CEO of General Electric, and former board director at the New York Fed:** The Federal Reserve Bank of New York consulted with General Electric on the creation of the Commercial Paper Funding Facility (CPFF).[20] The CPFF was established during the financial crisis to stabilize the commercial paper market, which was under significant strain at the time.

New York Fed officials indicated they consulted with companies regardless of board affiliation. The Fed ultimately provided $16 billion in financing to General Electric under this emergency lending program. This occurred while Immelt was CEO of General Electric and served as a director on the board of the Federal Reserve Bank of New York.[21]

Conflicts of Interest: Policies, Reforms, and Gaps

Following public outcry and in response to recommendations from the Government Accountability Office, the Federal Reserve has taken some initial steps to improve the transparency around its conflict of interest policies and board structure. In addition to adherence to federal conflicts of interest laws, including the criminal statute that prohibits them from using their position to affect their financial interests,[22] Fed directors must comply with the conflict of interest policies, board bylaws, and committee structures of the 12 regional Banks (most of which now publish their policies online). Under regional Bank policies, Fed directors are not allowed to participate in any decisions, recommendations, or investigations related to organizations they are affiliated with and/or which may impact their own financial holdings.[23] Class A, B, and C directors are subject to different levels of restrictions on their engagement with institutions supervised by the Fed. Class A directors can be both affiliated with and own stock in an institution under the Fed's jurisdiction, while Class B can only own stock in regulated institutions. Class C directors are prohibited from doing either.[24]

Waivers and Financial Disclosures

Regional Bank directors must self-report any real or perceived conflicts of interest. After disclosure of the conflict, the individual must either recuse themselves from any conversations or decision making processes or receive waivers of federal conflict of interest rules if the financial interest is deemed "too remote or too inconsequential to affect the integrity" of their work or if the "need for [the director's] services outweighs the potential for conflicts."[25] To date, most regional Banks have not publicly disclosed details on the process and circumstances under which they issue waivers to Fed directors. The New York Federal Reserve Board established a formal waiver process following Stephen Friedman's Goldman Sachs conflict of interest controversy in 2008.[26] Based on this policy, New York Fed leadership and employees can request a waiver from the president or first vice president that enables them to continue working on a matter where they have a financial interest. These waivers are issued if "participation is critically important to the Bank and the financial interest is not so significant that it would compromise the employee's judgment."[27]

Federal Reserve Banks do not currently publicly disclose when a waiver has been requested or approved. According to the Government Accountability Office, "Reserve Banks are not required to disclose information to the public about waivers of the policy on director eligibility and qualifications for one of their directors that were granted by the Federal Reserve Board."[28] This stands in contrast to public companies on the New York Stock Exchange, which are required by the Securities and Exchange Commission to publicly disclose any waiver to the code of conduct to shareholders within four business days.[29] It's striking that policies governing publicly traded companies call for more transparency than rules governing our Federal Reserve System. In the past, public interest groups have been able to acquire select Fed waiver requests through Freedom of Information Act requests, but this information should be made publicly available from the outset.[30]

Given the Federal Reserve Bank presidents' enormous policymaking and regulatory power over financial institutions, Bank presidents are required to disclose all financial interests to a Bank's Ethics Officer on an annual basis.[31] In response to the GAO recommendations, regional Banks now either publish these Bank president filings on their website or make them available upon request. The disclosures list important information on the president's assets, holdings, gifts received, and affiliations outside the Fed that enable the public to hold them accountable. In order to promote greater transparency around conflicts of interest, all Federal Reserve regional directors, in addition to Bank presidents, should be required to annually disclose information on their financial interests and holdings.[32]

Restricting the Power of Class A Directors

Reforms in both federal law and the by-laws of regional banks have limited the power of Class A directors, who are elected by and represent member bank interests. Under the Dodd-Frank financial reform bill, Class A directors can no longer appoint Reserve Bank presidents. Based on our review of the 12 regional Banks' bylaws, Class A directors cannot appoint or weigh in on personnel who are responsible for supervising and regulating commercial banks.[33] They are also often prohibited from voting on institution-specific regulatory matters.[34] Some regional Banks, like the Atlanta Federal Reserve, delegate all bank supervision and regulation activities to an Executive Committee comprised of Class C directors.[35] The growing number of restrictions on the roles and responsibilities of Class A directors reflect a recognition that bankers and financial services actors have inherent conflicts of interest that prevent them from fulfilling a governance function. The best way to eliminate these conflicts is to remove representatives of regulated entities entirely from the Fed's governance structure.

The Federal Reserve in 2016: the Potential for Conflicts of Interest Persists

The financial crisis—and resulting Wall Street bailouts—highlighted the need for improved regulatory oversight of our financial system. Dodd-Frank expanded and deepened the Fed's regulatory powers but did not affect the overrepresentation of the banking and financial sectors – an essential first step in mitigating conflicts of interest before they can occur. Rather than addressing calls to improve its sectoral diversity, the Federal Reserve has actually increased the already disproportionate number of board seats held by banking and commercial sectors since 2011. The current boards skew heavily towards the banking and commercial sectors, with 68 percent of seats from those two sectors as of 2016.[36] In fact, a full 25 percent of current Bank presidents had strong ties to Goldman Sachs before their Fed tenure.[37]

The continued dominance of the financial sector within the Federal Reserve's leadership leaves our monetary and banking system vulnerable to continued risks. Financial companies and banks with over $50 billion in assets are now required to submit living wills to the Federal Reserve and the Federal Deposit Insurance Corp (FDIC) that outline how the company would declare bankruptcy in the event of a financial crisis or company failure.[38] In 2014, the Fed and the FDIC determined 11 living wills for major banks were inadequate. While the FDIC ultimately deemed these plans not credible, the Fed failed to make a final determination. As a regulator overseeing the living will process, the Fed is required to issue guidance and direction (as well as critical feedback on shortcomings of the plans) in order to strengthen the final product. Earlier this year, Senator Elizabeth Warren and other congressional leaders pushed Federal Reserve Chair Janet Yellen to account for the discrepancy in regulatory decisions between the FDIC and the Fed.[39] In April 2016, the Federal Reserve and the FDIC eventually found that five leading financial institutions have inadequate living wills. These included Morgan Stanley (whose CEO James Gorman is a Class A director on the New York Fed Board) and Goldman Sachs (which has many former executives in senior positions throughout the Federal Reserve System).[40] [41] [42] The Fed's regulatory power to address these types of shortcomings will be compromised as long as representatives from regulated entities continue to serve in leadership positions in the Fed.

The potential for conflicts of interest extends beyond Class A directors. Class B and C directors, who in theory are elected to represent the public (and are entrusted with regulatory powers), often draw from the same pool of influential individuals with close ties to the banking and financial sectors.

Case Study: David Cote, Class B Director, New York Federal Reserve

In March 2014, the New York Federal Reserve Bank announced that David Cote had been elected as a Class B director to fill a term expiring at the end of 2016.[43] Cote is the CEO of Honeywell International, a Fortune 100 company that manufactures consumer and aerospace products. In this capacity, Cote earned over $29 million in compensation and bonuses in 2014.[44] From 2007-13, Cote also served on the board of JP Morgan Chase, an affiliation that was not listed on the New York Fed's director election ballot, [45] the public announcement of his Fed appointment, [46] or his bio on the Fed's website.[47]

Cote reportedly faced pressure to leave JP Morgan Chase because of his poor performance on a 3-person "Risk Policy Committee." [48] [49] This committee was tasked with overseeing the CEO and senior management's risk management functions, oversaw the bank's Chief Risk Officer and approved the risk policies in use.[50] At its own admission, and following a thorough audit, JP Morgan Chase identified widespread "lapses in oversight [and] deficiencies in risk management" during Cote's tenure. [51] The risk committee failed to anticipate and prevent the company's role in scandals like the London Whale trading controversy, which caused the company to lose $6 billion in trading credit default swaps in 2012.[52] Both the Department of Justice and the Securities and Exchange Commission launched formal probes to investigate. JP Morgan Chase paid the federal government a $1.7 billion criminal settlement for failing to act on Bernie Madoff's Ponzi scheme (felony violations under the Baking Secrecy Act).[53] Cote's poor risk management track record is particularly troubling given the fact that Federal Reserve directors are tasked with monitoring and containing systemic risk in our financial system.[54]

In February 2016, Cote sold $36 million of shares in United Technologies Corp only three days before Honeywell approached United Technologies about a purchase offer. [55] When news of the purchase offer went public, United Technologies stock fell by 2.4% (which typically happens after these types of deals are announced). If Cote hadn't sold off the stock before the deal was publicly announced, his stake in the company would have been worth roughly half a million dollars less.[56] Some have speculated this may prompt an insider trading investigation by the Securities and Exchange Commission.[57] This track record raises serious questions about the appropriateness of Cote's role at one of our country's most powerful banking regulators.

Our economy will be open to systemic risk as long as people affiliated with institutions regulated by the Fed continue to occupy Fed leadership positions. These individuals should be prohibited from serving as directors. This would be one of the most immediate and direct steps to mitigate conflict of interest risks. More broadly, the vetting, nomination, and election process must hold prospective Fed directors to the highest ethical standards, and should take into account individuals' track records with monitoring financial institutions.

The People's Fed: A Path Forward

In order to make the Federal Reserve a fully public institution, the Center for Popular Democracy is calling on the Fed to eliminate representatives and employees of regulated institutions from the boards of directors at the regional Federal Reserve Banks. In practice, this will include eliminating Class A directors who are elected by and from the financial industry. In addition to improving gender and racial diversity on the boards, each regional board should include among its directors at least one member from a labor organization, one from a university or policy think tank, and one from a community organization with operations primarily within the region and in which community members participate in governance. We need people who represent the public and can bring the perspectives of low-wage workers, people who hold debt, and communities of color to the regional Banks. This may help ensure that the Fed takes working families' perspectives into account when setting monetary policy and pursuing its full employment mandate.

When the Federal Reserve Act passed in 1913, commercial banks had enormous power. Through the creation of a Federal Open Market Committee and laws like the Federal Reserve Reform Act of 1977, Congress has repeatedly acted to curb the power of commercial banks and ensure broader representation of the public within the Fed. Now over 100 years since its formation, the Fed still falls short on this aim and continually appoints a leadership with inadequate gender, racial, and sectoral diversity. Currently, 92 percent of Federal Reserve Bank presidents and 100 percent of the voting members of the Federal Open Market Committee are white. Meanwhile, 83 percent of regional bank presidents are men.[58] Fed leadership is supposed to draw from a broad array of economic backgrounds and perspectives. In reality, it skews heavily towards the financial sector, with 68 percent of Federal Reserve Bank directors coming from banking or commerce industries.[59] As our economy evolves, a growing number of the corporate executives who serve as regional directors also have ties to the financial sector.[60]

It is clear that many within the current Fed leadership do not integrate the perspective of low-wage or unemployed workers into their understanding of the economy. For instance, New York Fed director James Gorman, current CEO of Morgan Stanley, said America's economy "is not an economy under fundamental stress," and characterized the jobs situation as "phenomenal" [61] during an interview at Davos in January 2016. While this may characterize a select experience—in 2014, Gorman received one of the largest raises of any Wall Street CEO with a salary and pay package totaling $22.5 million—this rosy outlook does not accurately reflect the lived reality of 7.4 million unemployed Americans, 6.4 million Americans who work part-time involuntarily, and the many millions more who have dropped out of the labor force entirely.[62 63]

Moreover, many Fed leaders have proven unable to accurately project economic trends and identify risks in our financial system. William Dudley, current New York Federal Reserve President and Vice-Chairman of the FOMC, previously served as the chief economist at Goldman Sachs where he worked for over 20 years.[64] In 2004, Dudley co-authored a now notorious paper with Glenn Hubbard that characterized the US economy as thriving and reinforced the financial sector's growing reliance on derivatives such as mortgage-backed securities.[65] There is widespread agreement that the unfettered use of derivative securities (including mortgage-backed securities and credit default swaps) resulted in enormous market volatility and eventual market collapse, giving way to the largest global financial crisis in history.[66] The Federal Reserve must have a leadership in place that is well-equipped to identify systemic risks to our financial system and provide the requisite oversight to hold banks and financial institutions accountable.

Maximizing Employment and Guaranteeing Price Stability: Important and Competing Priorities

The Federal Reserve must navigate between two important and competing priorities: guaranteeing price stability and maximum employment. While the Fed's written mandate gives equal weight to these priorities, many feel the Fed has historically prioritized the interests of corporations and wealthy individuals.[67] This position is bolstered by a review of the actions of regional Bank presidents who are selected by regional directors and usually have strong ties to the financial sector. In 2009, Congressman Barney Frank requested analysis from the House Financial Services Committee on the voting record of the Federal Open Market Committee—the Federal Reserve's most powerful policy-making body. The Financial Services Committee's analysis identified a pattern of hawkish policy stances and consistent calls for interest rate increases among regional presidents. Ninety percent of the dissents (in favor of interest rate increases that generally benefit wealthy individuals) came from regional Bank presidents, rather than members of the Board of Governors.[68] This adds preliminary evidence to mounting claims that regional directors from the financial sector often skew the Federal Reserve's decision-making toward pro-corporate monetary policy.

Balancing Creditors and Debtors

Many directors' backgrounds suggest that they are likelier to be familiar with the interests of the wealthy than with the interests of low-income individuals and communities of color. In light of this disconnect between the Fed's leadership and the average American, the Federal Reserve must take steps to include debtors and not just creditors within the Federal Reserve structure. Directorships are currently held disproportionately by creditors. This can range from large global banks and financial institutions issuing millions or billions in loans annually, down to local credit unions and community banks. Creditors generally stand to gain from interest rate increases regardless of the institution's geography, size, and financial services provided. Creditors and debtors experience changes in interest rates in interrelated but fundamentally distinct ways. A debtor could include an individual paying off a small business loan, a student loan, a mortgage, or other consumer financial service that charges an interest rate. Eighty percent of Americans hold some form of debt. According to a recent Pew survey, a growing number, nearly 7 in 10 Americans, feel non-mortgage debt (including credit card and student loan debt) is a necessity even though they prefer not to have it.[69] Ensuring a balance of creditors and debtors may help ensure that the interests of working families, and not just businesses, are fully served by our nation's monetary policy. In turn, this could ensure Fed's mandate to promote full employment (along with the Fed's responsibility to promote "consumer protection, fair lending, and community development") is more fully realized.[70]

The Federal Reserve's Policies on Political Activity

As the public calls for broader representation on the Fed, many are reviewing the Fed's policies on political activity to ensure they would allow broader community and labor representation among directors. The Federal Reserve Bank's board of directors must follow specific guidelines on their personal political activity. The stated aim of this policy is to "preserve the political independence of the Federal Reserve, which is essential to the System's ability to conduct its activities, including the formulation of monetary policy, in a nonpartisan manner." [71] The Fed's policies on political activity are permissive, and provide individuals appointed to the Fed with significant latitude in their personal political activity. The existing guidelines do not preclude community and labor representation on Banks' boards of directors.

According to the rules, regional board directors are legally permitted to donate to candidates and PACs, speak out on behalf of political causes, express opinions on partisan political issues, join political parties, participate in nonpartisan voter registration activities, and endorse candidates.[72] Directors are prohibited from political activity that could associate the Federal Reserve with a particular political party or partisan activity. During their tenure with the Fed, directors cannot campaign for (or against) a candidate in a partisan election, be a member of a partisan fundraising or campaign committee, act as a delegate, run for elected office, or serve on a PAC's leadership committee.[73] Given the fact that these rules allow significant leeway, and that individuals working at tax exempt community organizations or unions already face restrictions around partisan political activity, these rules would not impede civically active members of labor and community-based organizations from serving on their regional Banks' boards.

In fact, many current directors are, through their advocacy and financial contributions, politically active individuals:

- **Suzanne Sitherwood, Class C Director, St. Louis Federal Reserve:** Sitherwood, the CEO of the Laclede Group, was appointed as a Class C Director in January 2016.[74] Sitherwood is active in Georgia politics and has donated to several candidates.[75] She served with Georgia Secretary of State Karen Handel on an Atlanta Regional Commission study of energy in the Atlanta area and served on the governor's Energy Policy Council.[76] [77] In 2010, she was listed on the Top 100 Most Influential Georgians list in recognition of her position as Chair of the Georgia Chamber of Commerce.[78]
- **Steve Maestas, Class C Director, Kansas City Federal Reserve:** Maestas, the CEO of the real estate firm Maestas Development Group in Albuquerque, New Mexico, is a major political donor. In 2014, Maestas gave $50,000 to West Main Street Values, a PAC that spent heavily in support of Senator Lindsey Graham's re-election bid.[79] Maestas has given tens of thousands of dollars to candidates for office in New Mexico, including $27,000 to Allen Weh, a 2010 gubernatorial candidate.[80] Maestas' wife Debbie is the state chair of the New Mexico Republican Party.[81]
- **Michael Angelakis, Class C Director, Philadelphia Federal Reserve:** Angelakis serves as Senior Advisor on the Executive Management Committee at the Comcast Corporation,

which has been a major player in the debates over how to regulate internet service providers, or "net neutrality." Amidst speculation that the Federal Communications Commission was developing new rules around net neutrality in 2014, Angelakis told the Washington Post that proposed regulations were "unfortunately a negative."[82] The National Cable and Telecommunications Association (NCTA) lobbied extensively against the new FCC regulations.[83] Angelakis gave $5,000 to NCTA's PAC in 2015.[84] In 2015, Angelakis also gave $20,000 to the National Republican Congressional Committee and to the presidential campaign of Jeb Bush.[85]

- **Greg Armstrong, Class C Director, Dallas Federal Reserve:** Armstrong, the CEO of Plains All American Pipeline LP—one of the largest pipeline operators in the United States—provided political contributions to Jeb Bush's presidential campaign and Jeff Cloud, an incumbent on the Oklahoma Corporation Commission, which is responsible for regulating oil and gas drilling in Oklahoma.[86] [87]Armstrong has also given $20,000 to the Association of Oil Pipelines PAC, which has spent over $110,000 supporting federal candidates and their PACs.[88]
- **Thomas Fanning, Chair, Atlanta Federal Reserve:** Fanning, the CEO of one of America's largest electric companies, Southern Company, is an active donor through both personal giving and the Southern Company PAC. He has donated to the PowerPac of the Edison Electric Institute, Senator Mitch McConnell's 2014 campaign, and former Speaker John Boehner's Super PAC.[89] [90]
- **David Cote, Class B Director, New York Federal Reserve:** Cote has been active and outspoken politically, especially on the subject of deficit reduction. After serving as one of President Obama's appointees to the National Commission on Fiscal Responsibility and Reform (also known as the Bowles-Simpson Committee), Cote co-founded an advocacy organization called Fix the Debt.[91] [92] Fix the Debt promotes austerity and reduced spending by the Social Security and Medicare systems.
- **Greg Brown, Chair, Chicago Federal Reserve:** Brown is a politically active CEO of Motorola who was appointed by President Obama to the President's Management Advisory Board[93] and Skills for America's Future Board in 2011.[94] Brown publically supported Gov. Chris Christie's 2016 presidential campaign. He hosted several high-dollar fundraisers for Christie [95] and in 2015 donated to the Christie's PAC, Leadership Matters for America. [96] In January 2016, Brown co-hosted a reception for Chris Christie in Chicago that drew a minimum of $1,000 per attendee, [97] which appears to contravene the Federal Reserve's restriction against "hosting a political fundraiser, or soliciting money for a political fundraiser."[98]

Consistent Application of the Rules

Through its policy on political activity by directors, the Federal Reserve recognizes that legally permissible political activity does not necessarily impact an individual's impartiality or ability to serve in a leadership position. While the rules around political activity for Federal Reserve directors are clear, these rules must be consistently applied in the case of community and labor groups. Organizations governed by community members and employees, such as unions, continue to represent less than five percent of all Fed board seats.[99] The Federal Reserve should clarify and publicly affirm that affiliation with politically active labor and community-based organizations does not, and should not, exclude candidates from consideration for Fed directorships, so long as candidates comply with the Fed's guidelines for political activity.

Conclusion

The American people deserve a Federal Reserve leadership that is representative (reflecting the full diversity of our country) and independent (free of conflicts of interest). We need clear rules in place and meaningful public representation through a diverse, independent, and accountable Fed leadership to achieve this ambition. The Federal Reserve must take immediate steps to improve the gender, racial, and sectoral diversity of its directors. In the long-term, representatives and employees of regulated institutions should be eliminated from the boards of directors at the regional Federal Reserve Banks. But more immediately, the Federal Reserve should promote greater transparency by publicly disclosing directors' financial interests and instances when waivers are granted to the conflict of interest rules. Changes to Federal Reserve leadership and improvements in the transparency and accountability of the Federal Reserve System will go a long way towards ensuring we have an economy that works for the American people.

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