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THE BEST POLICY

Fed Dread

The New York Fed is the most powerful financial institution you've never heard of. Look who's running it.

By Eliot Spitzer

Posted Wednesday, May 6, 2009, at 12:29 PM ET

The kerfuffle about current New York Federal Reserve Bank Chairman Stephen Friedman's purchase of some Goldman stock while the Fed was involved in reviewing major decisions about Goldman's future—well-covered by the *Wall Street Journal* here and here—raises a fundamental question about Wall Street's corruption. Just as the millions in AIG bonuses obscured the much more significant issue of the $70 billion-plus in conduit payments authorized by the N.Y. Fed to AIG's counterparties, the small issue of Friedman's stock purchase raises very serious issues about the competence and composition of the Federal Reserve of New York, which is the most powerful financial institution most Americans know nothing about.

A quasi-independent, public-private body, the New York Fed is the first among equals of the 12 regional Fed branches. Unlike the Washington Federal Reserve Board of Governors, or the other regional fed branches, the N.Y. Fed is active in the markets virtually every day, changing the critical interest rates that determine the liquidity of the markets and the profitability of banks. And, like the other regional branches, it has boundless power to examine, at will, the books of virtually any banking institution and require that wide-ranging actions be taken—from raising capital to stopping lending—to ensure the stability and soundness of the bank. Over the past year, the New York Fed has been responsible for committing trillions of dollars of taxpayer money to resuscitate the coffers of the banks it oversees.

Given the power of the N.Y. Fed, it is time to ask some very hard questions about its recent performance. The first question to ask is: Who is the New York Fed? Who exactly has been running the show? Yes, we all know that Tim Geithner was the president and CEO of the N.Y. Fed from 2003 until his ascension as treasury secretary. But who chose him for that position, and to whom did he report? The N.Y. Fed president reports to, and is chosen by, the Fed board of directors.

So who selected Geithner back in 2003? Well, the Fed board created a select committee to pick the CEO. This committee included none other than Hank Greenberg, then the chairman of AIG; John Whitehead, a former chairman of Goldman Sachs; Walter Shipley, a former chairman of Chase Manhattan Bank, now JPMorgan Chase; and Pete Peterson, a former chairman of Lehman Bros. It was not a group of typical depositors worried about the security of their savings accounts but rather one whose interest was in preserving a capital structure and way of doing business that cried out for—but did not receive—harsh examination from the N.Y. Fed.

The composition of the New York Fed's board, which supervises the organization and current Chairman Friedman, is equally troubling. The board consists of nine individuals, three chosen by the N.Y. Fed member banks as their own representatives, three chosen by the member banks to represent the public, and three chosen by the national Fed Board of Governors to represent the public. In theory this sounds great: Six board members are "public" representatives.

So whom have the banks chosen to be the *public* representatives on the board during the past decade, as the crisis developed and unfolded? Dick Fuld, the former chairman of Lehman; Jeff Immelt, the chairman of GE; Gene McGrath, the chairman of Con Edison; Ronay Menschel, the chairwoman of Phipps Houses and also, not insignificantly, the wife of Richard Menschel, a former senior partner at Goldman. Whom did the Board of Governors choose as its *public* representatives? Steve Friedman, the former chairman of Goldman; Pete Peterson; Jerry Speyer, CEO of real estate giant Tishman Speyer; and Jerry Levin, the former chairman of Time Warner. These were the people who were supposedly representing our interests!

Of course, there have been the occasional nonfinance representatives from academia and labor. But they have been so outnumbered that their presence has done little to alter the direction of the board.

So is it any wonder that the N.Y. Fed has been complicit in the single greatest bailout of poorly managed banks in history? Any wonder that it has given—with virtually no strings attached—practically the entire contents of the Treasury to the very banks whose inability to manage risk has brought our economy to its knees? Any wonder that not a single CEO or senior executive of a major bank has been removed as a condition of hundreds of billions of direct cash and guarantees? Any wonder that, despite its fundamental responsibility to preserve the integrity of the banking system, it sat quietly on the sidelines as the leverage beneath the banks exploded and the capital underlying their investments shrank?

I do not mean to suggest that any of these board members intentionally discharged their duties with the specific goal of benefitting themselves. Rather, what we have seen is disastrous groupthink, a way of looking at the world from the perspective of Wall Street and Wall Street alone. That failure has brought the world economy to the edge of unraveling. And some of Geithner's early missteps betrayed an inability to get beyond this tunnel vision, such as the idea that the banks need to be first in line to be paid and to be paid in full. We can only hope that Geithner, who, to his credit, did try to raise some of the regulatory issues that mattered while he was at the Fed, is no longer in the mental prison of Lower Manhattan and will have more success now that he has a board of one—President Obama.

Perhaps it is time to calculate what these board members have been paid by their banks in salary and bonuses over the years and seek to have them return it to the public as small compensation for their failed oversight of the N.Y. Fed. And more fundamentally, perhaps it is time to take a hard look at the governing structure and supposed independence of this institution that actually controls the use of our tax dollars and, heaven help us, the fate of our economy.

***Slate V: Timothy Geithner on* Charlie Rose**

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Article URL: http://www.slate.com/id/2217811/