NY Fed Exposé Matters, But Not as Much as You Think

By Joe Adler and Rob Blackwell
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WASHINGTON — A ProPublica investigation alleging weak supervision by the Federal Reserve Bank of New York has sent shockwaves through the regulatory community, but whether it will lead to any change of course in policy is still an open question.

At a time when some in Congress remain interested in imposing more curbs on the biggest banks, lawmakers including Democratic Sens. Elizabeth Warren and Sherrod Brown, have already pounced on the piece. The article — based on secret recordings in 2011 by a now-former examiner — suggests "regulatory capture" kept the New York Fed from adequately supervising Goldman Sachs.

Yet while observers say the report will provide more ammunition for supporters of tougher rules on banking giants, many predict the effect will be limited. They note the report's allegations are more nuanced than a smoking gun proving capture, and may therefore not change many minds in the policy debate.

"There's a little bit of eye of the beholder," said Brian Gardner, a policy analyst at Keefe, Bruyette & Woods. "People can read into it what they want to read into it."

The story, which also aired on the radio program "This American Life", details issues the examiner, Carmen Segarra, had with superiors over monitoring Goldman. In one example, a superior appears meek in a meeting with Goldman executives regarding the bank's failure to receive formal regulatory approval for a deal with Santander.

The story also illustrated pushback Segarra received over her claim that Goldman lacked a conflict of interest policy. The piece essentially concludes the New York Fed had not yet fixed flaws in its culture highlighted by an internal report the regulator had commissioned after the crisis.

Some lawmakers were quick to seize on the issue.

"Congress must hold oversight hearings on the disturbing issues raised by today's whistleblower report when it returns in November — because it's our job to make sure our financial regulators are doing their jobs," Warren, a Massachusetts Democrat, said in a statement after the report was published on Friday. On Tuesday, three House Democrats, including Financial Services ranking member Maxine Waters, similarly called for a hearing.

Although he stopped short of calling for a hearing, Brown, a top candidate to chair the Senate Banking Committee if Democrats keep the Senate in the midterm elections, said the claims should be examined.

"For too long, too many financial regulators have been too cozy towards the very industry that they are meant to police," he said in a statement. "We know that this was one of the problems that contributed to the financial crisis. These allegations deserve a full and thorough investigation, and American taxpayers deserve regulators who will fight each day on their behalf."

The Ohio lawmaker is one of the Senate's loudest champions for additional curbs to prevent "too big to fail," and his rise in the committee's ranks is seen as keeping attention on big-bank regulatory issues.

A former senior Senate staffer said the New York Fed allegations provide Brown with the basis for "one more talking point, one more hearing to build the case that something additional needs to be done."

Analysts said policymakers may see the report as reason to push for specific changes at regulatory agencies, such as rules requiring examiners to rotate between the largest institutions to prevent capture, or restrictions on former examiners to lobby regulators.

"Similar to the prohibitions on lobbying a member of Congress after you've worked [Congress], one could see a bill gathering steam about prohibitions on working for an institution which you regulated," said Edward Mills, an analyst at FBR Capital Markets. "I don't know if it really changes the push for legislation on 'too big to fail' per se. But does it give an opening for a bill that realigns the jobs of the regulators slightly or… how the regulators regulate the top institutions from a more structural than a substantive perspective? I think that certainly could happen."

The allegations could also reinvigorate a broader debate about the regulatory mission of the Federal Reserve. Critics of the central bank have included House Financial Services Chairman Jeb Hensarling and Sen. Richard Shelby, R-Ala., who stands to become Senate Banking Committee chairman if the GOP takes back the Senate.

"The Shelby-Hensarling perspective is more going to be: This is further evidence of why the Fed really shouldn't be doing bank regulation to begin with; they're simply too conflicted," said Mark Calabria, a former Banking Committee staffer who is now at the Cato Institute.

But others said attention to the allegations may ultimately fizzle, just as the narrative following other revelations about a large institution.

"The London Whale… would have presumably convinced most people that there were serious problems that were not being addressed at the managerial and regulatory levels and that fundamental changes needed to be made," Arthur Wilmarth, George Washington University law professor, said of the 2012 JPMorgan Chase trading fiasco. "After a flurry of concern and outrage, that kind of died down."

On the New York Fed allegations, Wilmarth said, "there will be some hearings, there will be some investigation, but not much will come from it."

Some said the report's allegations were too subtle to reshape the policy debate or trigger a new one.

"It exposed a disagreement" among examiners, but "I'm not sure it's fair to read that as regulatory capture. That's going a step too far," said Jaret Seiberg, an analyst at Guggenheim Securities. Still, Seiberg added, the article is "going to create tremendous political headaches for the Fed and one that's going to survive into the election and the new Congress."

Calabria said the report will likely only harden positions, not change them. He also noted that waiting until after the elections for lawmakers to debate the ramifications of the report may be too long for it to still be current.

"It's enough for you to feel comfortable in what you already believe," he said. "It's not so damning that if you were a skeptic" about additional regulatory reforms "that you would somehow change your mind."