Financial Industry Wants Fed As Its Watchdog

By Editor Test *Wed, Dec 9, 2009*

The Federal Reserve "is the financial fire department… to which financial institutions and markets naturally turn in time of crisis," say the leaders of MetLife, Goldman Sachs and other large financial services companies.

On its blog last week, the Financial Services Forum, a trade group, said its members want the Federal Reserve, not a new financial regulatory agency, to supervise large financial institutions.

FSF chairman is C. Robert Hendrikson, CEO of MetLife. Its members include the CEOs or other senior executives of AIG, Allstate, and Prudential Financial, as well as Goldman Sachs, Fidelity Investments, UBS AG, US Bancorp and other large financial institutions.

In endorsing the Fed, the FSF opposes Senate Banking Committee chairman Chris Dodd (D-CT), who has "proposed to create a single federal banking regulator out of the multiple agencies that now supervise them, including stripping the Federal Reserve and the Federal Deposit Insurance Corp. of their bank supervisory powers," according to *Politico.com*.

Last Saturday, during a Senate hearing to consider Fed chairman Ben Bernanke's re-appointment to another term, Sen. Dodd criticized the economist harshly for his assurances during 2008 that the sub-prime crisis was "contained" and by his failure to negotiate better terms for the government in bailing out AIG and its counterparties, notably Goldman Sachs.

The December 3 FSF blogpost said:

> Federal Reserve Chairman Ben Bernanke, who faces what will most likely be a contentious re-confirmation hearing this morning, will no doubt be confronted with questions regarding the recent financial crisis, and what role the Fed, in its capacity as supervisor of large financial institutions, played in that crisis.
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> While the House Financial Services Committee passed a bill [December 2], by a vote of 31-27, which would expand the Fed's role as a supervisor, Republican and Democratic members of the Senate Banking Committee reportedly agree on little else other than that the Fed should be stripped of all supervisory powers.
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> Senate Banking Committee Chairman Chris Dodd, last month, characterized the Fed as an "abysmal failure" in its duties as regulator of bank holding companies. The Committee's Ranking Member, Richard Shelby of Alabama, has been quoted as saying that "all roads lead to the Fed," regarding regulatory shortcomings. In addition, the Fed's supervisory duties are seen as a distraction from its principle role as the monetary authority and the lender-of-last-resort, as Senator Dodd recently argued in an interview on CNBC.
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> An appropriate policy response to the financial crisis requires an accurate diagnosis of the problems

and deficiencies that helped create the crisis. Clearly, a major theme of the financial crisis is catastrophic failures of regulatory oversight.

But the notion that "all roads lead to the Fed" is refuted by the basic facts. Most of the notorious names of this financial crisis—Bear Stearns, Lehman Brothers, Merrill Lynch, Countrywide, Washington Mutual, IndyMac, and AIG—*were not supervised by the Fed*, either at the subsidiary or holding company level.

The Fed had principal supervisory authority over five of the largest bank holding companies—Wells Fargo, JP Morgan Chase, Citigroup, Wachovia, and Bank of America. Three of these large banking companies, Wells Fargo, JP Morgan Chase, and Bank of America, experienced difficulties principally because they absorbed the other failing institutions.

Wells absorbed Wachovia; JP Morgan Chase absorbed Bear Stearns and Washington Mutual; Bank of America absorbed Countrywide and Merrill Lynch. In this way, these three Fed supervised bank holding companies not only survived the financial crisis, but served as instruments of stabilization and recovery. The Fed's supervisory record through the financial crisis, while not perfect, is a good one.

Furthermore, supervisory authority is altogether consistent with and supportive of the Fed's role as the monetary authority, for the very simple and straightforward reason that financial institutions are the transmission belt of monetary policy. First-hand familiarity with the activities, condition, and risk profiles of the financial institutions through which it conducts open market operations—or to which it might extend discount window lending—is critical to the Fed's effectiveness as the monetary authority.

The Administration is correct that our nation's financial sector needs a systemic supervisor—some agency tasked with looking at "the big picture"—and that the Federal Reserve is best suited to serve that role because of its unique tools, powers, and institutional experience. It is the financial fire department—the agency to which financial institutions and markets naturally turn in time of crisis—and is the only financial agency with decades of capital markets experience.

The Fed has been a supervisor of financial institutions since its creation by Congress in 1913. Its supervisory duties complement, not distract from, its role as the monetary authority and lender-of-last-resort. Its supervisory record through the financial crisis is not perfect, but is solid. It has unrivaled institutional experience in supervising large and complex financial institutions.

For these compelling reasons, the Fed should retain its existing supervisory powers and should be carefully considered by Congress for the role as the systemic supervisor.