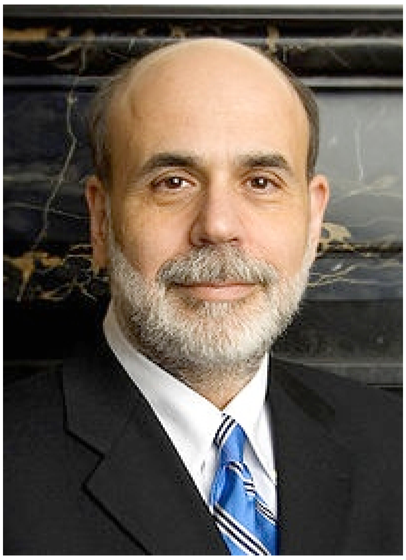
Fed Insiders Selling Inside Information



In an effort to plug leaks at the Federal Reserve, the U.S.'s central bank issued a statement yesterday that members of the Federal Open Market Committee "will refrain" from sharing insider information "with any individual, firm, or organization who could profit financially from…that information."

Since the establishment of the Federal Reserve in 1913, its operations and decision-making processes have been deliberately opaque. In the 1990s the minutes of its policy meetings weren't made public for five years. And with then-Chairman Alan Greenspan's deliberate obfuscation of Fed policy — called "FedSpeak" — an entire cottage industry sprang up trying to interpret the Fed's machinations and likely next moves on monetary policy.

But facing increasing pressure from Congress and the public to become more "transparent" and "legitimate", the Fed began implementing policies designed to discourage the selling of insider information by members of the staff.

According to its *Policy on External Communications*, the Fed now says that:

> Members of the official staff should refrain from publicly expressing their own personal views regarding prospective monetary policy decisions and should never speculate about future monetary policy decisions…
>
> Whenever staff makes public comments on monetary policy, they should clearly indicate that those comments are solely their own responsibility and should not be interpreted as representing the views of the FOMC, its principals, or any other person associated with the Federal Reserve System.

In other words, if you are on the staff at the Federal Reserve, you are to "refrain from" expressing your opinion publicly about the future of monetary policy based on your insider information, BUT IF YOU DO, you should make clear that your comments "are solely [your] own." Obviously, staff members have been doing precisely that for years: basing their comments on what inside information they have and then declaring it to be their own opinion!

The new rules further state that:

> To ensure that no member of the public is able to profit financially from acquiring nonpublic information about economic and financial conditions…staff will not provide such information to any individual, firm, or organization…
>
> Staff will strive to ensure that their contacts with members of the public do not provide any profit-

> seeking person or organization with a prestige advantage over its competitors.

So, to review: if you are a staff person at the Fed and have inside information that might be valuable to an outsider who might be able to use that information to gain an economic advantage, you are to "refrain" from sharing that information. But IF YOU DO, you must make clear that these are just your own opinions. And you certainly don't want to share this information FOR MONEY!

It doesn't take a high-priced lawyer to determine that these rules are so poorly written and enforced that they simply invite insiders with inside information to do precisely that, and many have.

Take Larry Meyer, for instance. He founded an investment consulting business, Laurence H. Meyer and Associates, Ltd., prior to joining the Fed as a governor in 1996. When he left the Fed in 2002, he returned to his firm, now called Macroeconomics Advisers, which "issues regular reports on the economic outlook and monetary policy prospects, sponsors quarterly outlook meetings, prepares periodic policy analyses, and offers other ancillary services…" One of those services to his high-end clients who pay him upwards of $75,000 for it is an email on breaking events inside the Fed. Despite having retired from the Fed, he (and others who have left the Fed) still have access, not only to the Federal Reserve building, but to meetings, group discussions and policy analyses taking place inside. One of those emails was definitely worth the price to his clients. On August 10, 2010, the FOMC announced the start of QEII (additional monetary stimulus to help the limping economy). Just nine days later, Meyer sent a note to his clients about the discussion during that meeting indicating that there was significant disagreement about the policy, with "deep divisions" among the members. This was valuable information to have, and it was received well before the Fed published its own minutes from that meeting after the usual three-week delay. Meyer noted that a number of the committee members were miffed at not knowing about the pace of mortgage prepayments which indicated that the Fed's support for the economy was weakening until just before the meeting. He wrote:

> For a few members, it was too late to affect their decisions; for others it was a very important factor, even the most influential factor.

Five days after Meyer's clients received the inside information about the divisions and disagreements, the *Wall Street Journal* published a more detailed account of that meeting, and the yield on the 10-year treasury note jumped 20 basis points — a huge rise — that cost investors on the wrong side of the trade millions of dollars. As *Reuters* pointed out, "Small wonder that large funds are willing to shell out tens of thousands of dollars a year to receive 'color' — as investors refer to the useful tidbits [like Meyer's] that … such consultants supply." Haag Sherman, chief investment officer of Salient Partners which manages $8 billion in assets, says that "even the slightest hint of the possible direction of policy can give investors a huge leg up." He added:

> The fact that government today is driving the markets more than any time in recent history and having insight into near-term … plans provides a money manager with a significant competitive advantage.

Meyer isn't the only one milking the advantage of having inside information. One of the most obvious is former Fed chairman Alan Greenspan's offering of similar consulting services to PIMCO, the largest bond fund in the world. Susan Bies retired from the Fed's board in 2007 and took a position with Bank of America.

Alice Rivlin served as a Fed governor and is now a fellow at the Brookings Institute. She likes to think she followed the rules by not trading on her insider connections at the Fed: "It's certainly not what Fed officials should be doing. The rules when I was there were you don't talk to anybody about anything that could be used for commercial purposes." And Ernest Patrikis, a former number two official at the Federal Reserve Bank of New York, became a partner at the White and Case law firm. He was emphatic:

> If Bernanke can't stop the leaks he ought to have a full press conference after [each] meeting. It's inappropriate for certain people to gain an advantage on information from the Fed.

It's ironic (but satisfying) to see that the harder the Fed tries to present an image of honesty, integrity, and transparency, the more citizens discover that for years the Fed and its committee members have been operating behind closed doors, allowing special privileges for its special customers, all the while claiming to be pure as the driven snow.

Photo: Chairman of the Federal Reserve System, Ben Bernanke