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Arne Hansen and Dirk Meyer*

The European Central Bank's Ethical Rules

Incidents at the US Federal Reserve Raise Questions About the Rules of Conduct for the European Central Bank's Governing Council

The study analyses the private securities transactions at the US Federal Reserve that have been made public since late 2021 and are worthy of criticism. It is shown by way of example that under the current applicable rules of conduct for the European Central Bank's Governing Council members, such questionable transactions would neither be reported nor prohibited. The important goal of avoiding even the appearance of personal insider benefits and interest-driven monetary policy decisions is thus not achieved. In this respect, the rules of conduct for the members of the European Central Bank's Governing Council require urgent revision even after they were recently adapted.

Rules of conduct are a necessary, confidence-building substitute conscience

Trust is a necessary precondition for state money to be able to fulfil its three functions without restriction: unit of account, means of payment and store of value. Central banks are special institutions that produce this commodity. For some central banks, the postulate of independence applies. Especially in this constellation, democratic control and supervision of a central bank's functionaries is lacking. The integrity of this group is therefore an important prerequisite for money holders to have and retain confidence in the currency. That is why a codified set of rules, which provides guidelines on transparency and the behaviour of decision-makers, is indispensable as a kind of substitute conscience. Even the appearance of a breach of trust should be avoided.

In concrete terms, there are two potential interdependencies that are not mutually exclusive:

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- Individual securities investments or transactions influence the decisions of the governors and endanger the independence of their actions – possibly with high economic damage.
- The use of insider knowledge enables individual profits from investments or transactions. Initially, no economic damage is caused, but there is an ethically and politically unacceptable problem of justice and distribution.

Questionable securities transactions by some Fed members

Four members of the US Federal Reserve (Fed) have come under fire for questionable financial transactions surrounding key monetary policy decisions during the 2020 pandemic. A brief overview shows examples of the investments and securities transactions that came under criticism.¹

Fed Chair Jerome Powell

Jerome Powell was confirmed for a second term as Fed chair in March 2022.² His private securities portfolio shows that he had long been exposed to municipal bonds in amounts ranging from \$1.165 to \$5.4 million.³ He benefited from price increases related to the Fed's decision in April 2020 to purchase short-dated municipal bonds

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- 1 For more details on these transactions, see Hansen and Meyer (2022).
- 2 The financial disclosures of Jerome Powell are available at the U.S. Office of Government Ethics (2021a). Further details on these offer Kuttner (2021), Wiebe (2021) and Dörner (2021).
- 3 The U.S. Office of Government Ethics' data collection only captures value ranges.

up to half a trillion US dollars. On 1 October 2020, Powell sold between \$1 and \$5 million worth of shares in his Vanguard Total Stock Market Index Fund – in time for the Dow Jones to fall by about 6% in October. On that day, according to meeting minutes, he was in contact with Treasury Secretary Steven Mnuchin four times. This may also be connected to the Trump administration's rejection of a new stimulus package. The only stipulation of the behavioural guidelines was that a sale should not have been made between 5 and 16 September (financial trading blackout period).⁴ The transaction took place after the Federal Open Market Committee (FOMC) meeting on 15-16 September, but before the minutes of that meeting were published on 7 October.⁵ It is noteworthy that the trading blackout period does not include this stretch of time, as information advantages between the meeting and the release of the minutes are likely to be inherent.⁶ The minutes identified several downside risks as possible threats to economic recovery.

What is more, a financial advisor working on behalf of Jerome Powell's family trust conducted five transactions in December 2019 during the Fed's trading blackout period (Federal Reserve Bank, 2022e). The advisor later acknowledged that the timing of these trades was an "oversight" (Siegel, 2022; Smialek, 2022c).

Former Vice Chair Richard Clarida

A second case concerns alleged portfolio restructurings by then Fed Vice President Richard Clarida, who on 27 February 2020 made a shift from bond funds to equity funds/ETFs in the range of \$1 to \$5 million, as shown in what he declared to the US Office of Government Ethics in May 2021 as complete disclosures for the 2020 calen-

dar year.⁷ The date of this reallocation is one day before Powell signalled possible Fed intervention should the pandemic situation worsen. According to the Fed, the transactions had been planned for the long term and had also been approved by the Ethics Committee.

However, this account of a portfolio reallocation appears questionable after Clarida subsequently supplemented his declaration on 16 December 2021 in order "to correct inadvertent errors in the financial disclosure report I signed on May 14, 2021" (U.S. Office of Government Ethics, 2021c). Among other things, that supplement shows that on 24 February 2020, Clarida first sold shares in the same equity exchange-traded fund (ETF) in which he invested three days later – each in the range of \$1 to \$5 million.⁸ Were these components of a long-term investment strategy?⁹ The process of a relatively late submission of a late disclosure seems remarkable in itself, because apparently no one but Clarida himself had performed a reconciliation between the approved, executed and then disclosed transactions. Clarida finally retired from his position at the Fed in mid-January 2021, two weeks before the official end of his term of service.

In the three days between the sale and repurchase by Clarida, US securities prices fell. After Clarida's buyback on 27 February and Powell's announcement of possible Fed rescue measures on 28 February, the S&P 500 Index initially continued to fall, but the buy level was reached again by mid-May, and then prices continued to rise – especially since the Fed followed up Powell's signals with extensive monetary policy action. However, the decisive factor for an evaluation of such transactions should not be their possible profits. Rather, the transactions themselves already give reason to cast doubt on the independence and integrity of the Fed.

Robert Kaplan, former President of the Dallas Fed

In 2020, Robert Kaplan, former manager of Goldman Sachs, held a securities portfolio of 17 stocks, two equity ETFs on the S&P 500 and three bond funds/ETFs. In addition, there were seven alternative investments, including an investment in the Kansas City Royals baseball team. His Financial Disclosure Form 2020 shows 26 transactions, including 21 combined purchases/sales of

4 The Open Market Committee's blackout period begins on the second Saturday before an FOMC meeting and ends at the close of the last day of the meeting. According to a voluntary code in force until April 2022, no securities transactions were allowed during this period (Federal Reserve Bank, 2017, Rule No. 3). As of May 2022, the blackout period was extended by one day. It now ends at the end of the day following the last day of the meeting (Federal Reserve Bank, 2022b, Attachment 4).

5 The associated meeting minutes are published three weeks after each FOMC meeting. The information contained in the minutes can go beyond the Fed statement published on the last day of the meeting and the subsequent press conference.

6 This is evidenced, for example, by the significant price losses on the stock markets on 5 January 2022, which were triggered by the publication of the December FOMC meeting minutes. The minutes indicated that the Fed could tighten its monetary policy much faster than previously assumed (Frühau and Petersdorff, 2022). Rosa (2013) presents a detailed analysis of the effect of the FOMC minutes on the financial markets.

7 The financial disclosures of Richard Clarida are available at the U.S. Office of Government Ethics (2021b, 2021c). Further details on these present Petersdorff (2021a), Smialek (2022a-b) and Torres (2022, 2021).

8 This involved the iShares Edge MSCI Min Vol USA ETF (USMV).

9 A representative of Clarida stated in July 2022, that Clarida "sold out of the stock fund to create liquidity" and later "decided that it would be better to return to the stock fund" (Smialek, 2022c).

one security each during the year.¹⁰ The latter basically characterises a speculative engagement. Kaplan was involved in monetary policy decisions in the FOMC at the time. He commented on his resignation announcement of 27 September 2020: “Unfortunately, the recent focus on my financial disclosure risks becoming a distraction to the Federal Reserve’s execution of that vital work” (Marte et al., 2021).

Eric Rosengren, former President of the Boston Fed

As a member of the FOMC, Eric Rosengren could attend its meetings, which made him privy to inside information. His annual financial disclosure for 2020 shows holdings in four real estate investment trusts (REITs), an ETF S&P 500 Technology Stocks and six stocks.¹¹ What is striking is a strong, in part exceedingly short-term shifting with a total of 68 transactions. At least seven securities were bought and sold within a year, six within three months and three after exactly one month. Thus, the 30-day minimum holding period was just met (Federal Reserve Bank, 2017, rule No. 3). This shows a quite speculative character. The sales of 17 and 20 September 2020 shortly after the trading blackout period of the FOMC meeting and before publication of the related meeting minutes appear particularly problematic. At the same time, he traded all four REITs in 2020. The Fed purchased \$40 billion per month in this class of securities. In addition, 13 transactions took place between March and July, i.e. shortly after an ethics department’s email request to please refrain from securities trading in the near future.

Comparative overview of central compliance rules on securities transactions

The following is a comparative review of the rules of conduct on securities transactions by decision-makers at the European Central Bank (ECB), the German Bundesbank and the Federal Reserve System.

The ECB and the Deutsche Bundesbank

The ECB’s compliance rules are laid down centrally in two guidelines as well as in the Ethics Framework and the Code of Conduct for Senior Officials (European Central Bank, 2015a-d, 2019, 2020). In November 2021, the ECB revised these guidelines (European Central Bank, 2021b-

10 The financial disclosures of Robert Kaplan were published by the financial news website WallStreetOnParade.com (Kaplan, 2021). Petersdorff (2021b-c) offers further details.

11 See the Confidential Financial Disclosure Report 2020 by Eric S. Rosengren (2021), which was made available to the authors on request by the Boston Fed. For further details, see Torres et al. (2021) and Edelman (2021).

c). Furthermore, there are additional requirements by the national central banks.¹² As a result of the requirement to implement the revised guidelines, harmonised minimum standards with partly stricter national regulations will apply in the future. The principle applies that high-ranking functionaries may not use insider information for private financial transactions. Furthermore, these transactions should be “non-speculative, restrained and in reasonable proportion” (European Central Bank, 2020, 31). The formulation of a medium- to long-term investment horizon (Article 10 Guideline (EU) 2021/2253 of the ECB) corresponds to this. The investments in shares and bonds as well as the investments derived from them of financial corporations with a place of business in the EU are prohibited. Short-term transactions of the same security that was bought or sold in the previous month must be approved. Transactions in government bonds of euro area member states are also subject to approval. There are special requirements for other investments such as gold and foreign exchange.¹³ The bonds recently issued by the EU within the framework of the Next Generation EU recovery fund and the solidarity package are not explicitly covered. All other funds and real estate purchases are exempt from approval. In addition, all restrictions are lifted if an asset management company is granted full power of disposal. In general, private financial transactions of more than €10,000 in a calendar month must be reported to the Compliance and Governance Office within 30 calendar days.

The German Bundesbank sets more restrictive investment limits. Whereas at the ECB there is no trading blackout period at all according to publicly available rules, securities transactions with shares, bonds, money market instruments and derivatives are “to be refrained from” for the members of the Executive Board of the Bundesbank “in the period of seven days before and on the day of the meeting of the ECB Governing Council”.¹⁴ In addition, there is a holding period for securities of at least six months.¹⁵

Institutionally, the ECB has set up an ethics committee consisting of three external members. Its members are appointed by the Governing Council.¹⁶ In addition, there

12 For example, Deutsche Bundesbank (2016).

13 For individual forms of investment, see also European Central Bank (2021c), Article 11.

14 Own translation of the authors, the German original version can be found at Deutsche Bundesbank (2016), No. 8 (4).

15 In contrast, European Central Bank (2021c) in Article 11 paragraph 2c) only generally provides for rules that shall “restrict short-term trading” and are to be implemented in the internal rules of the Eurosistem central banks.

16 Similarly, the Fed’s inspector general is appointed and removed by the Fed itself, which has recently led to calls for more independent investigations, see Torres (2022) and Siegel (2022).

is an internal Compliance and Governance Office. With the amendment of the Ethics Framework 2020, an internal reporting platform (“whistleblowing tool”) was also established. The counterpart to the Fed’s Financial Disclosure Reports are the ECB’s Declarations of Interests pursuant to Article 10 of the Code of Conduct for Senior Officials. According to this, an annual declaration must be made “about the member’s previous occupational activity, private activities, official mandates and financial interests” (European Central Bank, 2019, Article 10.1).¹⁷

As an innovation, the ECB guideline on the ethics framework, which was reformed at the end of 2021, specifies for Eurosystem central banks that “their members of staff ... who meet with external parties ... (a) maintain neutrality ...; (b) observe a seven-day quiet period prior to any monetary policy meeting ...; (c) keep basic records of the meetings; and (d) avoid any conduct that could be perceived as granting external parties any advantages” (European Central Bank, 2021c, Article 5). As early as 2020, criticism was levelled at the communication practices of ECB chief economist Philip Lane, as he had made bilateral phone calls to a few financial market participants in the hours immediately after ECB Governing Council meetings on the latest ECB decisions (Fairless, 2020). As a result of the criticism, the ECB announced its intention to reconsider this specific method of communication (Arnold, 2021a). In September 2021, the *Financial Times* reported that Philip Lane had revealed a hitherto unpublished ECB inflation forecast at a meeting with a few economists from German banks, from which conclusions could be drawn about the future development of interest rates (Arnold, 2021b). The *Financial Times* report was described by the ECB as inaccurate, but it led to further criticism of the lack of transparency of such meetings between ECB officials and third parties (Canepa, 2021).

The Federal Reserve System

Members of the Board of Governors of the Federal Reserve System and the presidents of the Federal Reserve Banks are subject to the rules of the Voluntary Guide to Conduct and, in addition, to other requirements of the regional Feds.¹⁸ As a result of the publicly discussed securities transactions by Fed members, it was announced in October 2021 that the investment guidelines would be revised and made considerably more restrictive.¹⁹ The rule

17 These statements are published by the ECB. See https://www.ecb.europa.eu/ecb/access_to_documents/document/declarations/html/index.de.html.

18 The rules are laid down in Federal Reserve Bank (2017, 2022a). For further details on these, see Hansen and Meyer (2022).

19 For more information on the announcement of the Federal Reserve Bank (2021), see *Börsen-Zeitung* (2021), *Handelsblatt* (2021) and *Petersdorff* (2021d).

changes were adopted in February 2022 and are intended to strengthen confidence in the impartiality and integrity of the FOMC by preventing even the appearance of conflicts of interest (Federal Reserve Bank, 2022c-d; Smialek and Ngo, 2022).²⁰ Among other things, the purchase of individual stocks or sector funds as well as individual bonds, cryptocurrencies, commodities, foreign currencies and derivatives was prohibited (Federal Reserve Bank, 2022d, Section 3 and 4). For the purpose of approval, transactions must be announced 45 days in advance and the minimum holding period increases from one month to one year (Federal Reserve Bank, 2022d, Section 4 b-c). Short-term speculative trading is thus prohibited. The blackout period for securities transactions has been extended by one day following each FOMC meeting.²¹ Likewise, trading is generally not to be permitted during financial market stress periods (Federal Reserve Bank, 2022d, Section 4 d).

As a first consequence of the new investment guidelines, Jerome Powell had declared in December 2021 that, in the event of his reappointment as Fed Chair, he would sell his holdings of municipal bonds as soon as possible, but within 90 days at the latest, and ensure that all proceeds are invested in conflict-free assets (Powell, 2021; U.S. Office of Government Ethics, 2022a-b).

In July 2022, a report by the Fed’s inspector general found that Powell’s and Clarida’s “trading activities did not violate the laws, rules, regulations, or policies as investigated”, although it noted evidence of financial activity which was not allowed or disclosed (Federal Reserve Bank, 2022e). The report drew some criticism from Fed experts and lawmakers stating that it restored little confidence that officials might be penalised in case of financial wrongdoings (Siegel, 2022).

Gaps in the ECB’s compliance requirements

Based on the ECB’s Declarations of Interests, the deficiencies that continue to exist are highlighted by means of a concrete example. This will be followed by a generalised list of structural deficits in the ECB’s investment guidelines.

Declarations of Interests – A stocktaking of the ECB’s Governing Council members

A comparison of the self-declarations of financial circumstances for 2020 and 2021 (European Central Bank, 2021a, 2022) reveals that ECB President Christine Lagarde’s securities portfolio consisted unchanged of the

20 The new rules apply from May and July 2022 respectively.

21 As is specified in Federal Reserve Bank (2022d), Section 4 e in conjunction with Federal Reserve Bank (2022b), Attachment 4.

same two funds. In contrast, ECB Executive Board member Isabel Schnabel reduced the number of positions in her portfolio from 44 to 11. In the process, she sold all 33 individual shares she had previously held. As of 31 December 2021, she still held ten ETFs and one actively managed fund.

The current ECB disclosures also reveal a relatively strong regional portfolio orientation among other Council members.²² For example, the Estonian central bank president, Madis Müllner, holds shares in three companies based in his home country. The head of the Maltese central bank, Edward Scicluna, holds shares in some non-listed Maltese companies. Pierre Wunsch, president of the Belgian central bank, holds shares in two Belgian start-up companies. On the other hand, there are some Council members who neither have large cash holdings in banks supervised by the Single Supervisory Mechanism (SSM) nor any shares, bonds or funds, such as Frank Elderson (ECB Executive Board), Gabriel Makhoulf (Central Bank of Ireland) or Bundesbank President Joachim Nagel, whose predecessor Jens Weidmann held two ETFs. The self-declarations of another group of members only show cash holdings above €100,000 at at least one bank under SSM supervision, including ECB chief economist Philip Lane, Fabio Panetta (ECB Executive Board) and Robert Holzmann (Austrian National Bank). A special case is François Villeroy de Galhau (Banque de France), whose securities account contains only shares of the ceramics supplier Villeroy & Boch. He comes from a family of industrialists who are co-owners of the traditional company.

A hypothetical case comparison of the Fed's and ECB's disclosure rules

In the public perception, former Fed Vice President Richard Clarida's investment decisions are a case of misconduct. His – subsequently corrected – transactions show a total of eight securities transactions for the year 2020 (see Table 1).

As a member of the ECB's Governing Council, Clarida's problematic transactions would not have been disclosed to the public. In particular, the portfolio restructurings (items 4-6) of 27 February 2020, in which a shift from bond funds to equity funds/ETFs in the amount of \$1 to \$5 million took place – one day before the Fed informed about possible interventions – would not have been noticed. The same applies to the sale of the iShares Edge MSCI Min Vol USA ETF (item 2) on 24 February, which was repurchased three days later in the same order of magnitude (item 6) and almost two weeks later in a smaller amount (item 8) – supposedly for his wife. In the ECB's Declarations of Inter-

²² Further details offer Ettel and Zschäpitz (2022).

Table 1
Former Fed Vice Chair Richard Clarida's disclosed securities transactions, 2020

	Date	Security	Transactions	Amount (USD)
(1)	24 February	Schwab Strategic 1000 ETF	Sale	250,000-500,000 (correction)
(2)	24 February	iShares Edge MSCI Min Vol USA ETF	Sale	1,000,000-5,000,000 (correction)
(3)	24 February	iShares Core High Dividend ETF	Sale	100,000-250,000 (correction)
(4)	27 February	Pimco Income Fund Inst. Class Shares	Sale	1,000,001-5,000,000
(5)	27 February	Pimco StocksPLUS Fund Inst. Class Shares	Purchase	1,000,001-5,000,000
(6)	27 February	iShares Edge MSCI Min Vol USA ETF	Purchase	1,000,001-5,000,000
(7)	8 March	Schwab 1000 ETF	Sale	500,001-1,000,000
(8)	8 March	iShares Edge MSCI Min Vol USA ETF	Purchase	250,001-500,000

Source: U.S. Office of Government Ethics (2021b, 2021c).

ests, Clarida would only have had to provide information on the ownership of a corresponding security, in which the iShares Edge MSCI Min Vol USA ETF would have been listed unchanged year-on-year. Neither the amount of the holding nor the transaction dates and volumes would have been disclosed.

Structural deficits of the ECB investment guidelines

Even apart from the lack of a concrete minimum holding period and a trading blackout period, the compliance rules for investments by ECB Council members are considerably softer than those of the Fed. For example, the self-declarations of assets in the so-called Declarations of Interests only include the type of investments (with a security identification number, if applicable) held on a specific date at the end of each year (European Central Bank, 2021a, 2022). In contrast, the annual report of the US Office of Government Ethics records all investments with their investment value and the income accrued from them on an annual reporting date.

In addition, all transactions carried out during the year are listed there. Purchases and sales are listed by value and by date. The latter information is important in order to be able to trace any temporal connections of the transactions with market-relevant decisions of the central bankers. Yet at the ECB, transactions carried out during the course of the year are only visible with regard to the portfolio composition on the reporting date at the end of the year. In

other words, purchases and sales during the year cannot be traced. Further information such as transaction dates and volumes remain hidden, especially since the form for the information explicitly states: “Amount of money not needed” (European Central Bank, 2021a, 2022).

Proposed changes to the ECB’s rules of conduct

In order to avoid even the appearance of personal insider benefits and interest-driven monetary policy decisions, the ECB should revise its compliance rules.²³ In addition to information on the value of financial assets, the so-called Declarations of Interests should be supplemented by information on the annual transactions by type, value and date. All transactions should be submitted to the Compliance and Governance Office for approval. Financial trading blackout periods, as indicated by the Bundesbank for a period of seven days before and on the day of the Governing Council meeting, would make sense – possibly even to be extended until the publication of a meeting protocol. Another confidence-building measure would be a minimum holding period for securities, e.g. similar to the six months at the Bundesbank or now 12 months at the Fed. The ethics committee should also be able to stipulate the exclusion of trading in times of capital market tensions and in anticipation of special decisions.

Conclusions

Research by journalists in autumn 2021 revealed securities dealings by some high-ranking members of the Federal Reserve Bank, which led to criticism, discussions and ultimately to a tightening of the Fed’s compliance rules. Even after the adoption of two new ECB guidelines at the end of 2021, ECB Governing Council members are subject to much softer investment rules. Nonetheless, the ECB leadership assesses its ethical standards as “the basis for public trust and ultimately for the ECB’s credibility” (European Central Bank, 2021d).²⁴ The authors therefore suggest a number of additional rule commitments that the ECB could implement. These include a minimum holding period for securities, a trading blackout period before and on the day of the Governing Council meeting, value-based information on financial assets, information on annual transactions by type, value and date, and a general authorisation requirement for all securities transactions.

²³ The Governing Council has to review these at least every three years, see European Central Bank (2021c), Article 15 paragraph 2. See also Meyer and Hansen (2021).

²⁴ This is a quote from Christine Lagarde.

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