CHAPTER 1

The Golden Age of Banking

I woke at 5 A.M. to the sound of a beeping garbage truck working its way down the street, noisily emptying rows of metal trash cans. I had fallen asleep four insufficient hours earlier. My eyes opened at the sound of the commotion; my mind was slow to follow. The room was pitch black, save for tiny rectangles of light that framed the bedroom windows where the thick shades didn't quite line up with the window frames.

I was disoriented. This was not my home. My own image came into focus, staring back at me from a full-length mirror that stood just a few feet from my bed. My mind cleared. I was in my good friend Denise's basement apartment on Capitol Hill, the one she used four times a year to show a line of women's designer clothing that she sold to her friends and colleagues. The rest of the time the apartment stood empty, and she had offered me its use.

Full-length mirrors were everywhere, used by her customers to view themselves when they tried on the colorful array of suits, dresses, and casual wear. For the month I would stay in this apartment, I found it somewhat disquieting to constantly be confronting my own image. At least the mirrors were slenderizing, the silver backings molded no doubt for that purpose to help sell the clothes.

I carefully navigated out of bed and gingerly shuffled across the parquet wood floor of this foreign room until I found the light switch on the wall. As I flipped it on, the room jarringly transformed from near blackness to glaring fluorescent light. I found a coffeemaker on the counter of the apartment's tiny efficiency kitchen, as well as a pound of Starbucks, helpfully left by Denise. I made a full pot of coffee and contemplated a long walk on the Mall to fill the time. I still had two hours to kill before driving to my first day of work as chairman of the Federal Deposit Insurance Corporation.

What a strange turn of events had brought me here. Four years ago, after nearly two decades in mostly high-pressure government jobs, I had left Washington with my family in search of a career that would provide a better work-life balance. I had worked as legal counsel to Senator Robert Dole (R–Kans.). I had served as a commissioner and acting chairman of the Commodity Futures Trading Commission (CFTC) and then headed government relations for the New York Stock Exchange (NYSE).

In 2000, I decided, "enough." I resigned my well-paying position with the NYSE and opted for a part-time consulting arrangement that gave me plenty of time to spend with my eight-year-old son, Preston, and one-year-old daughter, Colleen, whom my husband, Scott, and I had just adopted from China. But in early 2001, I was contacted by the new Bush administration, which convinced me to go back into the government as the assistant secretary of financial institutions of the U.S. Treasury Department. At the time, the financial system was in a relative state of calm, and the Bush folks assured me that I would have a nine-to-five existence at Treasury with no travel and plenty of time in the evenings and weekends for the family. The job had an interesting portfolio of issues but nothing of crisis proportions—issues such as improving consumer privacy rights in financial services and deciding whether banks should be able to have real estate brokerage arms.

Then came the 9/11 terrorist assault, followed by the collapse of Enron. What had started out being a nine-to-five job became a pressure cooker as I was tasked with heading a coordinated effort to improve the security of our financial infrastructure, strengthen protections against the illicit use of banks for terrorist financing, and help reform corporate governance and pension abuses to address the outrageous conduct of the Enron management. Nine to five became 24/7.

I completed my major projects and in the summer of 2002 said farewell to Washington. My husband and I moved to Amherst, Massachusetts, a serene and idyllic New England college town. He commuted back and forth from D.C.; I took a teaching post at the University of Massachusetts. The arrangement worked perfectly for four years, with adequate income, great public schools, and most important, a flexible work schedule with plenty of time for the family.

Then, in the early part of 2006, came a second call from the Bush administration: would I be interested in the chairmanship of the FDIC?

The FDIC was created in 1933 to stabilize the banking system after runs by depositors during the Great Depression forced thousands of banks to close. By providing a rock-solid guarantee against bank deposit losses up to the insurance limits ($100,000 when I assumed office in 2006; now $250,000), the agency had successfully prevented runs on the banking system for more than seven decades. I had worked with the agency during my

Treasury days and had also served on an advisory committee it had set up on banking policy.

In addition to its insurance function, the FDIC has significant regulatory authorities. For historical reasons, we have multiple federal banking regulators in the United States, depending on whether the banks are chartered at the federal or state level. In 2006, we had four bank regulators: two for federally chartered banks and two for state-chartered institutions. The Office of the Comptroller of the Currency (OCC) chartered and supervised national banks, which includes all of the biggest banks. The Office of Thrift Supervision (OTS), which was abolished in 2011, chartered and regulated thrifts, which specialize in mortgage lending. The FDIC and Fed worked jointly with the state banking regulators in overseeing the banks that the states chartered. If the state-chartered bank was also a member of the Federal Reserve System, it was regulated by the Fed. Those that were not members of the Federal Reserve System—about five thousand of them, the majority—were regulated by the FDIC.

The FDIC was also a backup regulator to the Federal Reserve Board, the OCC, and OTS, which meant that it had authority to examine and take action against any bank it insured if it felt it posed a threat to the FDIC. Importantly, in times of stress, the agency had sole power to seize failing insured banks to protect depositors and sell those banks and their assets to recoup costs associated with protecting insured deposits.

The Bush administration had vetted Diana Taylor, the well-regarded banking superintendent of the state of New York, to replace Donald Powell, a community banker from Texas who had been chairman since 2001. Don had left the FDIC some months earlier, leaving Vice Chairman Martin Gruenberg to be the acting chairman. It was an awkward situation. By statute, the FDIC's board had to be bipartisan, and by tradition the opposing party's Senate leadership had a strong hand in picking the vice chairman and one other board member. Marty was popular and well regarded but was essentially a Democratic appointee, having worked for Senate Banking Committee Chairman Paul Sarbanes (D–Md.) for most of his career. Understandably, the Bush administration was anxious to install one of its own as the chairman.

For whatever reason Diana's nomination did not proceed, and the Bush people were looking for a known quantity who could be confirmed easily and quickly. They viewed me as both. I had worked for Bush 43 at the Treasury Department and Bush 41 as one of his appointees on the Commodity Futures Trading Commission. In fact, I had been promptly and unanimously confirmed three times by the Senate (President Bill Clinton had reappointed me to the CFTC). That was due, in no small measure, to my early career with Senator Bob Dole, who was much loved in the Senate. Certainly, I had built my own relationships and record with senators, but Dole's afterglow had always helped ensure that I was well treated during the Senate confirmation process.

It was a difficult decision to make. We were happy in Amherst, and the family was reluctant to move. It was an ideal existence in many ways. We lived in a 150-year-old house across the street from the house where Emily Dickinson had lived and scribbled her poems on scraps of paper at a desk that overlooked our home. As I was a bit of an amateur poet myself, her house served as my inspiration when I wrote a rhyming children's book about the virtues of saving money. Our home stood two blocks from the village green. The kids and I walked everywhere—to school, to work, to shop. We hardly even needed a car. The people were friendly. The schools were good. Why should we move?

On the other hand, I was a government policy person at heart, and I thought—as I had when I took the Treasury Department job—that the FDIC position had an interesting portfolio of issues. For instance, Walmart had filed a controversial application for a specialized bank charter, exploiting a loophole in long-standing federal restrictions on commercial entities owning banks. In addition, Congress had recently authorized the FDIC to come up with a new system for assessing deposit insurance premiums on all banks based on their risk profile. Those were not exactly issues that would make the evening news, but as a financial policy wonk, I found them enticing.

So I agreed to accept, and, as expected, the confirmation process went quickly. The Bush people were eager for me to assume office, which didn't leave my husband and me enough time to find a new house and move the family. So here I was, living in a friend's borrowed apartment, while Scott, Preston, and Colleen stayed behind in Amherst until I could find us a place to live.

After downing my first cup of coffee, I thought better of the Mall walk—it was starting to rain. Instead, I made a mad dash to the drugstore to buy papers. I was drenched by the time I got back to the apartment. I plopped down on the living room couch, my wet skin sticking unpleasantly to the black leather upholstery. I dug into the papers in accordance with my usual ritual: *The Wall Street Journal* first, followed by *The New York Times,* then *The Washington Post,* finished off with the *Post*'s crossword puzzle. With my sleep-deprived brain, I didn't make it far on the puzzle. I regretted that I would be exhausted for my first day at the office.

It was really pouring rain by the time I left the apartment. I ran a half block to where I had parked our beat-up white Volvo sedan the night before, ruining my leather pumps in the process. I turned on the ignition and pressed "play" on the CD player, which held a Celtic Woman disc given to me by my kids for the trip. The soothing sounds of "Orinoco Flow" filled the car—a fitting song as I navigated flooded streets to reach the FDIC's offices at 550 17th Street N.W., a stone's throw from the White House. (Perhaps as an omen of things to come, the rains that day reached torrential levels, forcing the unprecedented closing of the Smithsonian museums and other government buildings.) The guard at the entry to the FDIC's parking garage raised a halting hand to signal that I should stop for the customary trunk search but then waved me on when he recognized my face from the photo that he—and all of the other security guards—had been given of the new FDIC chief.

I parked the car and headed for the small executive elevator that the FDIC reserved for its board members and their guests. I was already familiar with the FDIC building from my service on its advisory committee, so I was able to find my sixth-floor office with no difficulty. As I walked in the door, I was greeted by Alice Goodman, the longtime head of the FDIC's legislative affairs office. I had not yet had a chance to fill key staff positions, such as chief of staff, so I had asked Alice to serve temporarily as my acting deputy, to help me start learning and mastering the FDIC's organization, sift through the meeting requests, and organize the office. Alice had quite ably worked on my Senate confirmation and was willing to take a temporary detail to the Office of the Chairman. Soon I would hire Jesse Villarreal, who had worked for me at the Treasury Department, to serve as my permanent chief of staff.

Also helping out was Theresa West, a cheery, conscientious woman who was on detail from another division to serve as an administrative assistant. I was amazed that there was no secretary permanently assigned to the chairman's office. At the Treasury Department, the secretaries were the backbone of the organization, providing continuity and institutional memory to the political appointees, who came and went. Later, Brenda Hardnett and Benita Swann would join my office to provide crucial administrative support through most of my FDIC tenure.

The morning was spent on administrative necessities, such as filling out tax and benefit forms and other paperwork. Midway through the morning, Theresa suggested that we go to the security office so I could be photographed for my ID badge. We took the elevator to the basement and entered a small office staffed by a single young woman who was intently talking on the phone. As Theresa announced that the chairman was there for her ID photo, I was astonished to see the young woman hold up an index finger and continue talking on the phone. I was even more amazed to have to stand there for some time longer as the young woman finished what was clearly a personal call. Embarrassed and stammering, Theresa tried vainly to take charge of the situation through throat clearing and stern looks, but the woman just kept talking. I weighed my options. I could escalate by ordering the woman to terminate her phone call—reports of which would no doubt spread like wildfire throughout the agency—or I could let it go. I chose the latter.

What I didn't realize at the time—but was soon to discover—was that this employee's disaffection was only the tip of the iceberg for much wider issues of employee cynicism and anger caused by years of brutal downsizing. In the summer of 2006, FDIC employee morale problems ran deep through the agency. They would become a major preoccupation and challenge for me during my first several months at the FDIC.

In June 2006, the agency employed about 4,500 people with a billion-dollar operating budget. Since the 1990s, the agency's staff had been shrinking as the workload from the savings and loan crisis subsided. In 1995, the number of FDIC staff stood at 12,000. By 2001, that number had shrunk to 6,300. By the time I arrived, it had shrunk by another 1,800. There was no doubt that some of the downsizing had been necessary. However, in hindsight, the staff and budget reductions had gone too far. And it soon became clear to me that the layoffs—or "reductions in force," as the government calls them—had been carried out in a way that, rightly or wrongly, had given rise to a widespread impression among employees that decisions were based on favoritism and connections with senior officials, not on merit or relevance to core functions.

But the extreme downsizing was really just one symptom of a much more serious disease. That disease was the deregulatory dogma that had infected Washington for a decade, championed by Democrat and Republican alike, advocated by such luminaries as Clinton Treasury Secretary Robert Rubin and Federal Reserve Board Chairman Alan Greenspan. Regulation had fallen out of fashion, and both government and the private sector had become deluded by the notion that markets and institutions could regulate themselves. Government and its regulatory function were held in disdain.

That pervasive attitude had taken its toll at the FDIC, which had built a reputation as one of the toughest and most independent of regulators during the savings and loan crisis of the 1980s.

With more than $4 trillion in insured deposits, a robust regulatory presence was essential to protect the FDIC against imprudent risk taking by the institutions it insured. But the staff had been beaten down by the political consensus that now things were different. Quarter after quarter, banks were experiencing record profitability, and bank failures were at historic lows. The groupthink was that technological innovation, coupled with the Fed's seeming mastery of maintaining an easy monetary policy without inflation, meant an end to the economic cycles of good times and bad that had characterized our financial system in the past. The golden age of banking was here and would last forever. We didn't need regulation anymore. That kind of thinking had not only led to significant downsizing but had also severely damaged FDIC employees' morale, and—as I would later discover—led to the adoption of hands-off regulatory philosophies at all of the financial regulatory agencies that would prove to be difficult to change once the subprime crisis started to unfold.

The FDIC's flirtation with lighter touch regulation had also exacerbated tensions with our Office of the Inspector General (OIG). Virtually all major federal agencies have an OIG. These are independent units generally headed by presidential appointees whose job is to detect and prevent fraud, waste, abuse, and violations of law. War was raging between our senior management team and the FDIC's OIG when I arrived at the FDIC. I must have spent at least twenty hours during my first week in office refereeing disputes between the OIG's office and our senior career staff. I was amazed to learn that the FDIC OIG totaled some 140 people, which was many times the size of OIGs at other federal agencies.

Fortunately, in sorting out and resolving the raging disputes between FDIC management and OIG staff, I had an ally in Jon Rymer, a bank auditor by background, who had been confirmed as the new FDIC IG at the same time I was confirmed as chairman. So we were both entering our respective jobs with fresh perspectives and no axes to grind. Jon was intelligent, soft-spoken, and highly professional. His bespectacled, mild-mannered appearance and demeanor belied a steely toughness, cultivated no doubt by his twenty-five years in active and reserve duty with the army.

Jon and I were able to develop a good working relationship, and over time, we achieved better mutual respect and understanding between FDIC executive managers and the OIG. There was still tension, as was appropriate. But I actually came to enjoy the fact that we had this huge OIG that was constantly looking over our shoulders. It helped keep us on our toes and was one reason why when the financial crisis hit and we were forced to quickly put stabilization measures into place, we received clean audits and widespread recognition for our effective quality controls. In giving speeches, I would brag about the size and robust efforts of our OIG. And its investigation division would later play a lead role in ferreting out and punishing the rampant mortgage broker fraud that had contributed to scores of bank failures.

The agency's focus on downsizing and deregulation had also created major problems with its union, the National Treasury Employees Union (NTEU). Predictably, the NTEU had fought the downsizing tooth and nail, but it had other major grievances as well. One was a recently instituted pay-for-performance system, which forced managers to make wide differentiations among employees in making pay increase and bonus decisions. This was arguably an improvement over the old system, which had been akin to Lake Wobegon, where "everybody is above average," and basic competence would routinely result in a salary increase and year-end bonus. But the new system required managers to force employees into three buckets. The top rated 25 percent received sizable salary and bonus packages. The middle 50 percent received a more modest amount, and the bottom 25 percent received nothing. In essence, the system assumed that each division and office had 25 percent stars and 25 percent flunkies, with everyone else in the middle. Managers hated it. Employees hated it. The only people who liked it were the management consultants the agency had paid a pretty penny to create it.

The union was also outraged at a deregulatory initiative called Maximum Efficiency, Risk-Focused, Institution Targeted (MERIT) examinations, which severely limited our supervisory staff's ability to conduct thorough examinations at thousands of banks. By law, most banks must undergo a safety and soundness exam every year. These exams traditionally entail bank examiners visiting the banks on site and doing detailed reviews of loan files to determine whether the loans were properly underwritten and performing. In addition to reviewing loans, the examiners also look at a bank's investments and interview staff and senior executives to make sure policies and procedures are being followed. As any good examiner will tell you, it is not enough to simply examine a bank's policies to know whether it is being operated prudently; individual loan files must also be examined to make sure that the bank is following its procedures.

With MERIT, however, the FDIC had instituted a new program that essentially said that if a bank's previous examination showed that it was healthy, at the next exam, the examiners would not pull and review loan files, but instead would simply review policies and procedures. Prior to MERIT, examiners had been encouraged and rewarded for conducting thorough, detailed reviews, but under the MERIT procedures, they were rewarded for completing them quickly, with minimal staff hours involved. Career FDIC examiners derisively called MERIT exams "drive-by" exams. Their protests escalated as they became more and more concerned about the increasing number of real estate loans on banks' balance sheets. They knew, even in the summer of 2006, that real estate prices wouldn't rise forever and that once the market turned, a good number of those loans could go bad.

As it turned out, though I took the FDIC job because of my love for financial policy issues, I found that a substantial part of my time was spent dealing with management problems. In grappling with those issues, I worked closely with our chief operating officer, John Bovenzi, a ruddy faced, unflappable FDIC career staffer who had worked his way up to the top FDIC staff job. I also relied on Arleas Upton Kea, the head of our Division of Administration. A lawyer by training, Arleas was a savvy, impeccably dressed professional, toughened by the fact that she was the first black woman to have clawed her way up the FDIC's management ladder. Finally, I relied heavily on Steven App. Steve had recently joined the FDIC from the Treasury Department, where he had worked in a senior financial management position. I had known Steve when I was at Treasury and had tremendous respect for him. He would later play a key role in ramping up our hiring and contractor resources quickly, as well as working with me to manage the considerable financial demands that were placed on the agency as a result of the financial crisis.

At Arleas's suggestion, we hired a consultant and conducted detailed employee surveys to try to get at the root causes of the low staff morale. The surveys showed that employees felt that they were disempowered, that their work wasn't valued, and that they were cut off from any meaningful input in decision making. To counter their feeling of disempowerment, I created a Culture Change Council whose primary duty was to improve communication up and down the chain of command. I instituted quarterly call-ins for employees. We opened the phone lines and invited all employees to ask me any question they wanted. The first few calls were somewhat awkward. Most FDIC employees had never had a chance to interact directly with the chairman, and they weren't quite sure what to ask. So I found myself fielding questions on how to get a handicap parking space at one of our regional offices or how to sign up for our dental plan. Eventually the employees started focusing on broader, agencywide matters, and I found the calls tremendously helpful in learning what was on the minds of the rank and file. When I took office, the FDIC was ranked near the bottom of best places to work in the government, a ranking based on employee satisfaction surveys conducted by the Office of Personnel Management each year. Based on a survey completed before I left office, it was ranked number one. It took a lot of time to restore employee morale and trust at that disheartened agency. But we did it, and that best-place-to-work ranking is one of my proudest achievements.

Ultimately, we would revamp the pay-for-performance system, scrap MERIT exams, and begin hiring more examiners to enforce both safety and soundness requirements and consumer protection laws. We also started increasing the staff of our Division of Resolutions and Receiverships—the division that handles bank failures—which had been cut to the bone. These rebuilding efforts took time, and within a year I would find myself still struggling to revitalize an agency at the cusp of a housing downturn that would escalate into a financial cataclysm. It takes time to hire and train examiners and bank-closing specialists. We had to replenish our ranks just as the financial system started to deteriorate. In retrospect, those "golden age of banking" years, 2001–2006, should have been spent planning and preparing for the next crisis. That was one of the many hard lessons learned.