FIGHTING TO SAVE MAIN STREET FROM WALL STREET AND WALL STREET FROM ITSELF

BULL BY THE HORNS

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FORMER FDIC CHAIRMAN

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SHEILA BAIR

SIMON & SCHUSTER

New York London Toronto Sydney New Delhi

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To my beloved children,
Preston and Colleen,
and my husband, Scott,
a true saint.

Prologue

Monday, October 12, 2008

I took a deep breath and walked into the large conference room at the Treasury Department. I was apprehensive and exhausted, having spent the entire weekend in marathon meetings with Treasury and the Fed. I felt myself start to tremble, and I hugged my thick briefing binder tightly to my chest in an effort to camouflage my nervousness. Nine men stood milling around in the room, peremptorily summoned there by Treasury Secretary Henry Paulson. Collectively, they headed financial institutions representing about $9 trillion in assets, or 70 percent of the U.S. financial system. I would be damned if I would let them see me shaking.

I nodded briefly in their direction and started to make my way to the opposite side of the large polished mahogany table, where I and the rest of the government's representatives would take our seats, facing off against the nine financial executives once the meeting began. My effort to slide around the group and escape the need for hand shaking and chitchat was foiled as Wells Fargo Chairman Richard Kovacevich quickly moved toward me. He was eager to give me an update on his bank's acquisition of Wachovia, which, as chairman of the Federal Deposit Insurance Corporation (FDIC), I had helped facilitate. He said it was going well. The bank was ready to go to market with a big capital raise. I told him I was glad. Kovacevich could be rude and abrupt, but he and his bank were very good at managing their business and executing on deals. I had no doubt that their acquisition of Wachovia would be completed smoothly and without disruption in banking services to Wachovia's customers, including the millions of depositors whom the FDIC insured.

As we talked, out of the corner of my eye I caught Vikram Pandit looking our way. Pandit was the CEO of Citigroup, which had earlier bollixed its own attempt to buy Wachovia. There was bitterness in his eyes. He and his primary regulator, Timothy Geithner, the head of the New York Federal Reserve Bank, were angry with me for refusing to object to the Wells acquisition of Wachovia, which had derailed Pandit's and Geithner's plans to let Citi buy it with financial assistance from the FDIC. I had little choice. Wells was a much stronger, better-managed bank and could buy Wachovia without help from us. Wachovia was failing and certainly needed a merger partner to stabilize it, but Citi had its own problems—as I was becoming increasingly aware. The last thing the FDIC needed was two mismanaged banks merging. Paulson and Bernanke did not fault my decision to acquiesce in the Wells acquisition. They understood that I was doing my job—protecting the FDIC and the millions of depositors we insured. But Geithner just couldn't see things from my point of view. He never could.

Pandit looked nervous, and no wonder. More than any other institution represented in that room, his bank was in trouble. Frankly, I doubted that he was up to the job. He had been brought in to clean up the mess at Citi. He had gotten the job with the support of Robert Rubin, the former secretary of the Treasury who now served as Citi's titular head. I thought Pandit had been a poor choice. He was a hedge fund manager by occupation and one with a mixed record at that. He had no experience as a commercial banker; yet now he was heading one of the biggest commercial banks in the country.

Still half listening to Kovacevich, I let my gaze drift toward Kenneth Lewis, who stood awkwardly at the end of the big conference table, away from the rest of the group. Lewis, the head of the North Carolina–based Bank of America (BofA)—had never really fit in with this crowd. He was viewed somewhat as a country bumpkin by the CEOs of the big New York banks, and not completely without justification. He was a decent traditional banker, but as a deal maker, his skills were clearly wanting, as demonstrated by his recent, overpriced bids to buy Countrywide Financial, a leading originator of toxic mortgages, and Merrill Lynch, a leading packager of securities based on toxic mortgages originated by Countrywide and its ilk. His bank had been healthy going into the crisis but would now be burdened by those ill-timed, overly generous acquisitions of two of the sickest financial institutions in the country.

Other CEOs were smarter. The smartest was Jamie Dimon, the CEO of JPMorgan Chase, who stood at the center of the table, talking with Lloyd Blankfein, the head of Goldman Sachs, and John Mack, the CEO of Morgan Stanley. Dimon was a towering figure in height as well as leadership ability, a point underscored by his proximity to the diminutive Blankfein. Dimon had forewarned of deteriorating conditions in the subprime market in 2006 and had taken preemptive measures to protect his bank before the crisis hit. As a consequence, while other institutions were reeling, mighty JPMorgan Chase had scooped up weaker institutions at bargain prices. Several months earlier, at the request of the New York Fed, and with its financial assistance, he had purchased Bear Stearns, a failing investment bank. Just a few weeks ago, he had purchased Washington Mutual (WaMu), a failed West Coast mortgage lender, from us in a competitive process that had required no financial assistance from the government. (Three years later, Dimon would stumble badly on derivatives bets gone wrong, generating billions in losses for his bank. But on that day, he was undeniably the king of the roost.)

Blankfein and Mack listened attentively to whatever it was Dimon was saying. They headed the country's two leading investment firms, both of which were teetering on the edge. Blankfein's Goldman Sachs was in better shape than Mack's Morgan Stanley. Both suffered from high levels of leverage, giving them little room to maneuver as losses on their mortgage-related securities mounted. Blankfein, whose puckish charm and quick wit belied a reputation for tough, if not ruthless, business acumen, had recently secured additional capital from the legendary investor Warren Buffett. Buffett's investment had not only brought Goldman $5 billion of much-needed capital, it had also created market confidence in the firm: if Buffett thought Goldman was a good buy, the place must be okay. Similarly, Mack, the patrician head of Morgan, had secured commitments of new capital from Mitsubishi Bank. The ability to tap into the deep pockets of this Japanese giant would probably by itself be enough to get Morgan through.

Not so Merrill Lynch, which was most certainly insolvent. Even as clear warning signs had emerged, Merrill had kept taking on more leverage while loading up on toxic mortgage investments. Merrill's new CEO, John Thain, stood outside the perimeter of the Dimon-Blankfein-Mack group, trying to listen in on their conversation. Frankly, I was surprised that he had even been invited. He was younger and less seasoned than the rest of the group. He had been Merrill's CEO for less than a year. His main accomplishment had been to engineer its overpriced sale to BofA. Once the BofA acquisition was complete, he would no longer be CEO, if he survived at all. (He didn't. He was subsequently ousted over his payment of excessive bonuses and lavish office renovations.)

At the other end of the table stood Robert Kelly, the CEO of Bank of New York (BoNY) and Ronald Logue, the CEO of State Street Corporation. I had never met Logue. Kelly I knew primarily by reputation. He was known as a conservative banker (the best kind in my book) with Canadian roots—highly competent but perhaps a bit full of himself. The institutions he and Logue headed were not nearly as large as the others—having only a few hundred billion dollars in assets—though as trust banks, they handled trillions of dollars of customers' money.

Which is why I assumed they were there, not that anyone had bothered to consult me about who should be invited. All of the invitees had been handpicked by Tim Geithner. And, as I had just learned at a prep meeting with Paulson, Ben Bernanke, the chairman of the Federal Reserve, and Geithner, the game plan for the meeting was for Hank to tell all those CEOs that they would have to accept government capital investments in their institutions, at least temporarily. Yes, it had come to that: the government of the United States, the bastion of free enterprise and private markets, was going to forcibly inject $125 billion of taxpayer money into those behemoths to make sure they all stayed afloat. Not only that, but my agency, the FDIC, had been asked to start temporarily guaranteeing their debt to make sure they had enough cash to operate, and the Fed was going to be opening up trillions of dollars' worth of special lending programs. All that, yet we still didn't have an effective plan to fix the unaffordable mortgages that were at the root of the crisis.

The room became quiet as Hank entered, with Bernanke and Geithner in tow. We all took our seats, the bank CEOs ordered alphabetically by institution. That put Pandit and Kovacevich at the opposite ends of the table. It also put the investment bank CEOs into the "power" positions, directly across from Hank, who himself had once run Goldman Sachs. Hank began speaking. He was articulate and forceful, in stark contrast to the way he could stammer and speak in half sentences when holding a press conference or talking to Congress. I was pleasantly surprised and seeing him in his true element, I thought.

He got right to the point. We were in a crisis and decisive action was needed, he said. Treasury was going to use the Troubled Asset Relief Program (TARP) to make capital investments in banks, and he wanted all of them to participate. He also alluded to the FDIC debt guarantee program, saying I would describe it later, but his main focus was the Treasury capital program. My stomach tightened. He needed to make clear that they all had to participate in both the Treasury and FDIC programs. My worst fear was that the weak banks such as Citi would use our program and the strong ones wouldn't. In insurance parlance, this is called "adverse selection": only the high risks pay for coverage; the strong ones that don't need it stay out. My mind was racing: could we back out if we didn't get 100 percent participation?

Ben spoke after Hank, reinforcing his points. Then Hank turned to me to describe the FDIC program. I could hear myself speaking, walking through the mechanics of the program. We would guarantee all of their newly issued debt up to a certain limit, I said, for which we would charge a fee. The purpose of the program was to make sure that they could renew their maturing debt without paying exorbitant interest rates that would constrain their ability to lend. The whole purpose of the program was to maintain their capacity to lend to the economy. We were also going to temporarily guarantee business checking accounts without limit. Businesses had been withdrawing their large, uninsured checking accounts from small banks and putting the money into so-called too-big-to-fail institutions. That was causing problems in otherwise healthy banks that were small enough to fail. It was essential that all the big banks participate in both programs, otherwise the economics wouldn't work. I said it again: we were expecting all the banks to participate in the FDIC programs. I looked around the table. Were they listening?

Hank asked Tim to tell each bank how much capital it would accept from Treasury. He eagerly ticked down the list: $25 billion for Citigroup, Wells Fargo, and JPMorgan Chase; $15 billion for Bank of America; $10 billion for Merrill Lynch, Goldman Sachs, and Morgan Stanley; $3 billion for Bank of New York; $2 billion for State Street.

Then the questions began.

Thain, whose bank was desperate for capital, was worried about restrictions on executive compensation. I couldn't believe it. Where were the guy's priorities? Lewis said BofA would participate and that he didn't think the group should be discussing compensation. But then he complained that the business checking account guarantee would hurt his bank, since it had been picking up most of those accounts as they had left the smaller banks. I was surprised to hear someone ask if they could use the FDIC program without the Treasury capital program. I thought Tim was going to levitate out of his chair. "No!" he said emphatically. I watched Vikram Pandit scribbling numbers on the back of an envelope. "This is cheap capital," he announced. I wondered what kind of calculations he needed to make to figure that out. Treasury was asking for only a 5% dividend. For Citi, of course, that was cheap; no private investor was likely to invest in Pandit's bank.

Kovacevich complained, rightfully, that his bank didn't need $25 billion in capital. I was astonished when Hank shot back that his regulator might have something to say about whether Wells' capital was adequate if he didn't take the money. Dimon, always the grown-up in the room, said that he didn't need the money but understood it was important for system stability. Blankfein and Mack echoed his sentiments.

A Treasury aide distributed a terms sheet, and Paulson asked each of the CEOs to sign it, committing their institutions to accept the TARP capital. My stomach tightened again when I saw that the terms sheet referenced only the Treasury program, not the FDIC's. (We would have to separately follow up with all of the banks to make sure they subscribed to the FDIC's programs, which they did.) John Mack signed on the spot; the others wanted to check with their boards, but by the end of the day, they had all agreed to accept the government's money.

We publicly announced the stabilization measures on Tuesday morning. The stock market initially reacted badly, but later rebounded. "Credit spreads"—a measure of how expensive it is for financial institutions to borrow money—narrowed significantly. All the banks survived; indeed, the following year, their executives were paying themselves fat bonuses again. In retrospect, the mammoth assistance to those big institutions seemed like overkill. I never saw a good analysis to back it up. But that was a big part of the problem: lack of information. When you are in a crisis, you err on the side of doing more, because if you come up short, the consequences can be disastrous.

The fact remained that with the exception of Citi, the commercial banks' capital levels seemed to be adequate. The investment banks were in trouble, but Merrill had arranged to sell itself to BofA, and Goldman and Morgan had been able to raise new capital from private sources, with the capacity, I believed, to raise more if necessary. Without government aid, some of them might have had to forego bonuses and take losses for several quarters, but still, it seemed to me that they were strong enough to bumble through. Citi probably did need that kind of massive government assistance (indeed, it would need two more bailouts later on), but there was the rub. How much of the decision making was being driven through the prism of the special needs of that one, politically connected institution? Were we throwing trillions of dollars at all of the banks to camouflage its problems? Were the others really in danger of failing? Or were we just softening the damage to their bottom lines through cheap capital and debt guarantees? Granted, in late 2008, we were dealing with a crisis and lacked complete information. But throughout 2009, even after the financial system stabilized, we continued generous bailout policies instead of imposing discipline on profligate financial institutions by firing their managers and boards and forcing them to sell their bad assets.

The system did not fall apart, so at least we were successful in that, but at what cost? We used up resources and political capital that could have been spent on other programs to help more Main Street Americans. And then there was the horrible reputational damage to the financial industry itself. It worked, but could it have been handled differently? That is the question that plagues me to this day.

IN THE FOLLOWING pages, I have tried to describe for you the financial crisis and its aftermath as I saw it during my time as chairman of the Federal Deposit Insurance Corporation from June 2006 to July 2011. I have tried to explain in very basic terms the key drivers of the crisis, the flaws in our response, and the half measures we have undertaken since then to correct the problems that took our economy to the brink. I describe in detail the battles we encountered—both with our fellow regulators and with industry lobbyists—to undertake such obviously needed measures as tighter mortgage-lending standards, stronger capital requirements for financial institutions, and systematic restructuring of unaffordable mortgages before the foreclosure tsunami washed upon our shores. Many of those battles were personally painful to me, but I take some comfort that I won as many as I lost. I was the subject of accolades from many in the media and among public interest groups. I was also subject to malicious press leaks and personal attacks, and my family finances were investigated. I even received threats to my personal safety from people who took losses when we closed banks, warranting a security detail through much of my tenure at the FDIC. But I am taking the reader through it all because I want the general public to understand how difficult it is when a financial regulator tries to challenge the conventional wisdom and make decisions in defiance of industry pressure.

I grew up on "Main Street" in rural Kansas. I understand—and share—the almost universal outrage over the financial mess we're in and how we got into it. People intuitively *know* that bailouts are wrong and that our banking system was mismanaged and badly regulated. However, that outrage is indiscriminate and undirected. People feel disempowered—overcome with a defeatist attitude that the game is rigged in favor of the big financial institutions and that government lacks the will or the ability to do anything about it.

The truth is that many people saw the crisis coming and tried to stop or curtail the excessive risk taking that was fueling the housing bubble and transforming our financial markets into gambling parlors for making outsized speculative bets through credit derivatives and so-called structured finance. But the political process, which was and continues to be heavily influenced by monied financial interests, stopped meaningful reform efforts in their tracks. Our financial system is still fragile and vulnerable to the same type of destructive behavior that led to the Great Recession. People need to understand that we are at risk of another financial crisis unless the general public more actively engages in countering the undue influence of the financial services lobby.

Responsible members of the financial services industry also need to speak up in support of financial regulatory reform. All too often, the bad actors drive the regulatory process to the lowest common denominator while the good actors sit on the sidelines. That was certainly true as we struggled to tighten lending standards and raise capital requirements prior to the crisis. There were many financial institutions that did not engage in the excessive risk taking that took our financial system to the brink. Yet all members of the financial services industry were tainted by the crisis and the bailouts that followed.

As I explain at the end of this book, there are concrete, commonsense steps that could be undertaken now to rein in the financial sector and impose greater accountability on those who would gamble away our economic future for the sake of a quick buck. We need to reclaim our government and demand that public officials—be they in Congress, the administration, or the regulatory community—act in the public interest, even if reforms mean lost profits for financial players who write big campaign checks. Our government is already deeply in debt because of the lost revenues and stimulus measures resulting from the Great Recession. Financially, morally, and politically, we cannot afford to let the financial sector drive us into the ditch again.

I am a lifelong Republican who has spent the bulk of her career in public service. I believe I have built a reputation for common sense, independence, doing the right thing for the general public, and ignoring the special interests. Many of my positions have received editorial endorsements ranging from *The Wall Street Journal* to *The New York Times,* from the *Financial Times* to *The Guardian* to *Mother Jones.* My most cherished accolade during the crisis came from *Time,* which, in naming me to its 2008 "100 Most Influential People" list, called me "the little guy's protector in chief." I've always tried to play it down the middle and do what I think is right.

I want to explain why we are where we are in this country and how we can find ways to make it better. Our current problems are as bad as anything we have faced since the Great Depression. The public is cynical and confused about what it has been told concerning the financial crisis. In this book, I have tried to help clear away the myths and half-truths about how we ran our economic engine into the ditch and how we can get our financial and regulatory system back on track. We need to reclaim control of our economic future. That is why I wrote this book.

Sheila Bair, April 2012

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[1] 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[2], 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[3] 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[4], 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.