



*Integrity,
Fairness AND Resolve:*
LESSONS *from* BILL TAYLOR *and* THE LAST FINANCIAL CRISIS

By: *Tim Todd*

Integrity, Fairness and Resolve: LESSONS FROM BILL TAYLOR AND THE LAST FINANCIAL CRISIS

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BY THOMAS M. HOENIG, PRESIDENT AND CHIEF EXECUTIVE OFFICER,
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Banking AND Financial Crises 1980-1994

During this period, 2,912 federally insured depository institutions failed with a total of \$924 billion in assets. Among them were 1,617 federally insured banks that were either closed or received FDIC assistance and an additional 1,295 savings and loan (S&L) institutions were either closed or received assistance.¹

1980

Combined bank and S&L failures: 22²

MARCH 27, 1980

Silver futures tumble 50 percent amid the Hunt family's attempt to corner the silver market. Margin calls and market turmoil lead to a scramble for cash. The day is dubbed "silver Thursday."

1981

Combined bank and S&L failures: 44

1982

Combined bank and S&L failures: 115

JULY 5, 1982

Oklahoma City-based Penn Square Bank fails. Although a small institution, it had sold energy loan participations to numerous larger banks that suffered the consequences.

1983

Combined bank and S&L failures: 99

1. *Managing the Crisis: The FDIC and RT Experience, 1980-1994*, the Federal Deposit Insurance Corporation, August 1998.
2. Numbers also include open bank assistance. All data from *Managing the Crisis: The FDIC and RT Experience, 1980-1994*, the Federal Deposit Insurance Corporation, August 1998.

1984

Combined bank and S&L failures: 106

MAY 1984

Continental Illinois National Bank and Trust Company, the nation's seventh-largest bank by deposits, collapses and is put through a resolution process. The events are seen as originating the concept that a financial institution could be "too big to fail" without doing substantial harm to the nation's financial system. A major contributor to Continental's insolvency was its heavy involvement in purchasing loan participations from Oklahoma's Penn Square.

1985

Combined bank and S&L failures: 174

MARCH 5, 1985

Depositors start a run on Cincinnati-based Home State Savings amid concerns about the institution's ability to manage investment losses. The run leads to widespread concern about the safety of the state's privately held thrifts.

MAY 9, 1985

Allegations of fraud at Baltimore's Old Court Savings and Loan lead to a run at its locations. Similar events follow at other thrifts in the state as depositors, after witnessing what happened in Ohio, worry about the viability of a fund that covers the state's private savings and loans.

1986

Combined bank and S&L failures: 205

1987

Combined bank and S&L failures: 251

1988-1992

Height of the banking crisis: One bank or S&L fails, on average, every day. Average assets: \$385 million.³

1988

Combined bank and S&L failures: 464

1989

Combined bank and S&L failures: 533

APRIL 14, 1989

Regulators seize Charles H. Keating Jr.'s Lincoln Savings and Loan. It is soon revealed that a group of U.S. senators had intervened with regulators on Keating's behalf two years earlier. The senators, who had also received campaign donations from Keating, soon become known collectively as the "Keating Five" and face a lengthy Senate ethics investigation.

1990

Combined bank and S&L failures: 382

1991

Combined bank and S&L failures: 271

1992

Combined bank and S&L failures: 181

1993

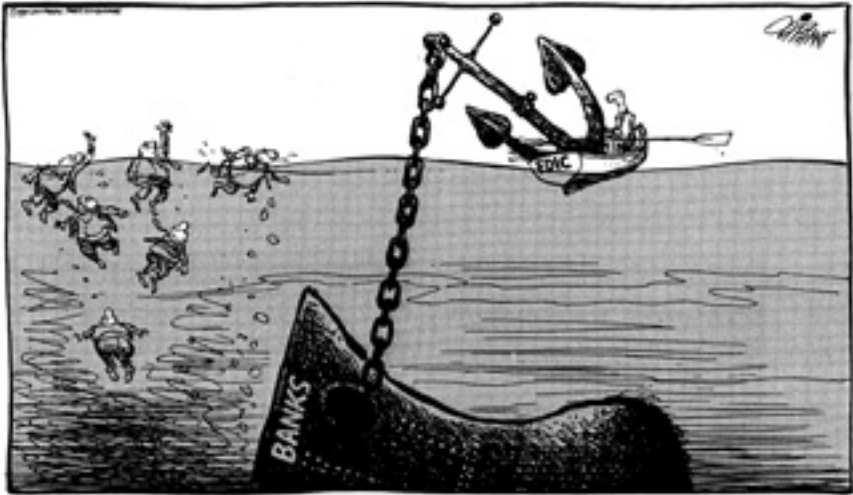
Combined bank and S&L failures: 50

1994

Combined bank and S&L failures: 15

3. *Managing the Crisis: The FDIC and RT Experience, 1980-1994*, the Federal Deposit Insurance Corporation, August 1998.

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Mounting bank failures presented a serious problem for the nation and for the insurance fund responsible for protecting depositors from losses. As head of the FDIC, Bill Taylor came up with a plan that he hoped would reduce the agency's cost of dealing with a failed institution.

Foreword

Bill Taylor led the Federal Reserve, other banking supervisors and the financial industry through the crisis of the 1980s.

I first met Bill when he was deputy director at the Board of Governors in the late 1970s. I worked in bank supervision at the Federal Reserve Bank of Kansas City. He was an experienced examiner and banker who had seen it all. He was quick but cool under fire. He made you feel responsible but did not leave you isolated. And he had a great sense of humor, which helped all of us get through some very rough times. Bill was the leader of Bank Supervision at the Federal Reserve System from the time he walked into the Board in 1976 to the day he left to be chairman of the Federal Deposit Insurance Corporation (FDIC) in 1991.

This short biography of Bill is provided to remind all of the Bank's examination staff that it is their tireless efforts that ensure that our financial system remains strong. Individuals do make a difference in outcomes. Bill made a difference. Bill understood that every bank failure hurt not only its owners but also the community in which it operated, whether international or local in scope. He knew we couldn't prevent every failure, but through tough examinations and careful action and patience, you could reduce the number and you could contain some – perhaps a lot – of the damage. He was forthright in his views and firm in his conclusions but also fair to an extreme both to his staff in the field and to the banker who might be in trouble.

In his role as chairman of the FDIC, Bill took some unpopular positions. He understood that it is not just about closing banks in a timely manner. Yes, he knew that if a situation was hopeless, you had to act. And he did so, many times. But he also knew that when you closed a bank, you also took a lot of the community, its small businesses and consumers down with it. When he could, he tried to work with the bank, even when it meant taking a chance that it could cost the fund more if he was wrong. Accordingly, he acted only after he did his homework and always with the best interest of the public in mind.

As you read through this story, the events of that early period will have a very familiar ring. If Bill were here today, he would probably share my disappointment that we learned so little from the crisis of the '80s. Once again we are experiencing a financial crisis. Once again we are learning the lessons of too much leverage, weak underwriting standards and too little bank director oversight. After the last crisis, no "rules of the road" were introduced regarding any of these categories that history and experience tells us are fundamental to

Cartoon illustration by Dick Wright of "The S&L Bailout". Originally appeared in the *Presidence Journal Bulletin*, 1990. Use courtesy of Dick Wright, Warrenton, Virginia.



THE S+L BAILOUT

For editorial cartoonists, the idea that turmoil in the financial system was pulling the nation under – under water, specifically – was a popular concept.

performance and are countercyclical. Rules that are clear and enforceable, work to contain excess risk during booms, and mitigate the misery during the correction. Yet again without firm guidance, the regulatory authorities were reluctant to insist that more conservative financial practices and standards be adopted and implemented. Almost certainly, Bill would have an appropriate, cutting remark for the fact that too big to fail is still the standard for our ever-larger institutions, and that we appear to have learned nothing from the failure of Continental Illinois. Nearly 20 years later, we still bail out the very largest institutions and close others.

I am pleased to offer this short biography of Bill Taylor. The Federal Reserve Bank of Kansas City has many banking supervision staff members who have received the Bill Taylor Award in Washington. I also know that all of you work at a high level of excellence every day in a very difficult field. It is my hope that this biography will help all employees understand the meaning of the award and the legacy of the man who was the most effective head of banking supervision that any agency has ever had. Bill Taylor was an examiner, yes, but importantly, he was a leader.

A handwritten signature in black ink, reading "Thomas M. Hoenig". The signature is fluid and cursive, with a prominent flourish at the end of the last name.

Thomas M. Hoenig,
President and Chief Executive Officer,
Federal Reserve Bank of Kansas City

Best & Writest — John Branch. © 1991 NAS. Distributed by North America Syndicate.



A similarity between the financial crises of the 1980s and the turmoil of the late 2000s was the pressure on the government to bail out financial institutions with the goal of protecting the broader financial system and economy. Unfortunately, this is not the only parallel.

William Taylor Jr. 1939-1992

CHAIRMAN, FDIC: 1991-1992

DIRECTOR, DIVISION *of* BANKING SUPERVISION *and*
REGULATION, FEDERAL RESERVE: 1985-1991

When William Taylor died in the late summer of 1992, some 1,500 mourners packed Washington's National Cathedral to pay their respects to the Federal Deposit Insurance Corporation (FDIC) chairman who had spent almost all of his adult life in banking supervision with the Federal Reserve.

Befitting his stature, the service was attended by not only friends and family, but also the then-current and former heads of the FDIC, the Treasury and the Federal Reserve, as well as numerous staffers and others.

In coverage of his untimely death at age 53, *USA Today* wrote that Taylor was “a blunt troubleshooter who managed to win the admiration of bankers, regulators and members of Congress.”

The respect was evident at the service.

Former Federal Chairman Paul Volcker cut short a trip to Russia to deliver a eulogy, touching on everything from Taylor's passing too young and the need to celebrate his life, to his strengths as a leader and expert in his field.

Bill “had a sixth sense shared by the best financial analysts,” Volcker said. “He knew when something's not quite right.”¹

At the other end of the spectrum was Congressman Henry Gonzales, a long-time Federal Reserve critic, who told reporters that Taylor's death was a “calamity”² and a “loss to the nation.”³

“Of all the regulators I have known during nearly 31 years on the (House Banking) Committee, Bill Taylor stands out pre-eminently as the man who stood up to the most powerful political and financial forces in our country, never compromising his integrity,” Gonzales said.⁴

1. *American Banker*, Aug. 25, 1992.

2. *Associated Press* story published Aug. 21, 1992.

3. *New York Times*, Aug. 21, 1992.

4. *New York Times*, Aug. 21, 1992.

What kind of person earns the respect of both the Fed's most outspoken chairman and arguably the most vocal critic in the Fed's history?

A person who even today is lauded for his toughness, his willingness to speak his mind and his insistence on treating everyone fairly. With Bill Taylor, there was no nonsense.

Big shoulders

William Taylor Jr. was born June 24, 1939, the son of an immigrant Scottish coal miner,⁵ in south Chicago and raised in that city's western suburbs.⁶ Taylor's father, William, died when the boy was 10, leaving his mother, Emma, to raise her son and two daughters, Betty and Ruth. Bill Taylor excelled at Proviso Township High School, gaining notoriety as a member of the school's high-powered wrestling team while holding down a part-time job. He led the squad to an Illinois state championship – the school's eighth – with a dominating senior season culminating in Taylor winning the individual state championship in his weight class.⁷

That kind of success is only a starting point for many graduates of Proviso. The school's long list of prominent alumni include everyone from self-made millionaire Christopher Paul Grander, whose life was the basis for the film "The Pursuit of Happiness," to astronaut Eugene Cernan, the last man to walk on the surface of the moon.



Proviso Township High boasts an unusually long list of prominent alumni. Before Bill Taylor was a student there, the school's football team featured future NFL Hall of Famer and legendary linebacker Ray Nitschke. Contemporaries said Taylor sometimes referenced Nitschke in conversation.

You want tough?

The year before Taylor started at Proviso, the star of the high school football squad was the team's quarterback: Ray Nitschke, an NFL Hall of Famer as a linebacker for the Green Bay Packers, who is remembered even today as perhaps the toughest man to ever play professional football.

After Taylor's high school success, he continued wrestling in college. He attended Cornell College, a liberal arts school in Mount Vernon, Iowa, about four hours west of Chicago, where he took part in numerous campus activities and was president of his fraternity,⁸ while working

5. BusinessWeek, Aug. 17, 1992.

6. Chicago Tribune, Aug. 26, 1991.

7. Numerous Chicago Daily Tribune articles and www.pths57.com.

8. From bio on www.pths57.com.

three jobs to get himself through school.⁹ The school's wrestling program dominated its conference, and Taylor was a three-time conference champion who wrestled deep into the NCAA national tournament as both a junior and again as a senior.¹⁰ He was later inducted into the school's Athletics Hall of Fame.

"Almost a trademark of Bill's was eyesight so poor that he only removed his glasses when he reached the edge of the mat," college friend Bob Bowman later recalled.¹¹ "He would hand them to his coach ... who would point Bill to the center of the mat where he would do the rest."

Contemporaries later talked about how his background shaped the person he became.

"(He) was very Midwestern in his approach to life: Identify the problem, identify the solution and go to it," Diane Casey, the Executive Director of the Independent Bankers Association of America, told a reporter in 1992.¹²

After graduation in 1961, he returned to Chicago, where he started working as a bank examiner with that city's Federal Reserve Bank.

In a convocation address years later, Taylor joked that he went back to Chicago because Cornell left him with "a pretty substantial level of debt, and the need for a job."¹³

He was back in the city for only three days before he found the Federal Reserve position.

In the same convocation speech, using what one contemporary referred to as Taylor's "rapid-fire Chicago wit,"¹⁴ along with his proclivity for self-deprecation, he offered a definition of the type of person who spends a career making sure banks are well-run.

"A bank examiner is a man who always looks past middle age, is wrinkled, cold, passive, noncommittal, with eyes like a codfish. Polite in contact, but at the same time unrespon-

9. *Remarks by Barron Bremner, Taylor's Cornell wrestling coach, at a 1992 event for C Club members, courtesy of Cornell College archives, Mount Vernon, Iowa.*

10. *Numerous Iowa newspaper accounts.*

11. *Transcript of eulogy given at Chicago memorial service.*

12. *San Jose (Calif.) Mercury News, Aug. 21, 1992.*

13. *Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.*

14. "Appreciation of Bill Taylor" written by Brian Quinn, executive director of the Bank of England. Published Aug. 28, 1992.

15. *Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.*

WILLIAM TAYLOR
Economics
Melrose Park, Illinois



Bill Taylor as a student at Cornell College in Mount Vernon, Iowa.

sive, cold, calm, damnably composed as a concrete post or a plaster Paris cast, a human petrification ... and without the charm of a friendly germ. No passion, no sense of humor. Happily – they never reproduce and all of them finally go to hell," he told the graduates.¹⁵

He then added that “if you find any such people, please send them to me.”

Like most bank examiners, much of Taylor’s time with the Chicago Fed was spent on the road in banks conducting exams. Later, when Taylor became FDIC chairman, he was the first person to hold that position who had real-world experience in bank examination. But it was not the only way he earned his living.

After eight years at the Chicago Fed, he changed careers, going to work for a Chicago bank in 1968 and then, in 1972, taking a job in real estate. He returned to the Fed in 1976, working at the Board of Governors in Washington, D.C., where he focused on the Real Estate Investment Trust crisis¹⁶ and was the chief of financial institutions supervision.

He was back following his true calling.

“I’m an examiner,” Taylor told a reporter in early 1992.¹⁷ “That’s what I am and that’s what I’ve always been.”

Crisis (silver) ...

With his return to the Fed, Taylor became an officer, quickly rising through the ranks. In 1977, he became assistant director of Banking Supervision and Regulation. He became associate director in 1979, director in 1985 and staff director in 1987.¹⁸

Combined, he spent 15 years as one of the Fed’s top regulators, including serving as the head of Supervision and Regulation from 1985 through his 1991 appointment to FDIC chairman by President George H.W. Bush. Among other contributions, Taylor led the Federal Reserve in adopting on-site annual examinations as the base of the Fed’s supervisory program long before such exams were the industry standard.¹⁹

Taylor’s career as one of the nation’s top banking regulators spanned one of the most tumultuous times in the nation’s financial history, starting with a crisis that emerged from an unlikely source as the Hunt brothers from Texas attempted to corral the world’s silver market.

“For all its oddities, that spectacular effort to corner the silver market was a serious matter,” Volcker said later.²⁰ “Its unraveling came close to unhinging some of our most prominent financial institutions at a time when the economy was already deeply troubled.”

The three Hunt brothers, Nelson Bunker, Herbert and Lamar, said it was the troubled economy that drove them to the silver market in the first place. Although the Hunts actively bought silver as early as

16. *American Banker*, Aug. 21, 1992.

17. *ABA Banking Journal*, Feb. 1, 1992.

18. *Washington Post obituary*, Aug. 21, 1992.

19. *Written text of Richard Spillenkothen comments. Reception for William Taylor*, Oct. 29, 1991.

20. “*Bill Taylor – Public Servant*,” eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

1970 at around \$1.50 an ounce,²¹ their buying increased dramatically in 1979 amid growing economic and global unrest, including such events as the taking of U.S. hostages in Iran and the Soviet push into Afghanistan.²²

Silver prices – stoked by inflationary fear, the Hunts’ large-scale buying or a combination of both – soared. After selling for around \$9 an ounce in the fall of 1979, silver approached \$50 an ounce only a few months later in early 1980. Although the Hunts were by far the biggest buyers, the rally brought others into the silver market, including individuals selling silverware, jewelry and even family heirlooms to cash in.

Then it all collapsed.

On March 27, 1980, silver futures went into a freefall after Bunker Hunt announced that he and four partners planned to sell bonds backed by their silver holdings. The market, fearing the Hunts needed cash, sent silver futures tumbling below \$11 an ounce. The Hunt brothers, who some reports suggested were holding nearly two-thirds of the world’s available silver supplies on “silver Thursday,”²³ lost more than \$2 billion.²⁴ As the Hunts scrambled to meet margin calls, there was growing fear that if the brothers could not meet their debts, some Wall Street firms and even some large banks might collapse.²⁵

The crisis was made worse when the brothers refused to pay Bache Group Inc. about \$200 million the brokerage lent them for silver purchases. After the refusal, Bache started selling the collateral, which included both silver and some stock.²⁶ Meanwhile, the Hunts started selling Bache Group stock, sending its shares plummeting and raising questions about the firm’s viability.

A reporter asked Bache Group Executive Vice President Elliot J. Smith if his firm had any regrets about being involved with the Hunts.

“THERE WAS A *desperate need* FOR SOMEONE WITH
THE PRACTICAL ABILITY TO SIZE UP THE SITUATION...”

“That’s like asking if I should have gotten divorced from my first wife earlier,” Smith said.²⁷ “Based on all the facts that were known to this firm at the time we extended margin credit to the Hunts, the firm acted in good faith, using good business judgment.”

The dramatic collapse even fueled concern about the very futures markets themselves.

21. Dallas Morning News, March 22, 2009.

22. Time, May 12, 1980.

23. Time, May 12, 1980.

24. Dallas Morning News, March 22, 2009.

25. Time, May 12, 1980.

26. Los Angeles Times, March 28, 1980.

27. Los Angeles Times, March 28, 1980.

“There was a desperate need for someone with the practical ability to size up the situation, to get the facts when those facts were elusive, to assess the



Herbert Hunt (left) told a House subcommittee at a 1980 hearing that his family did not “attempt to corner, squeeze or manipulate the silver market.” The collapse of the market was only the start of the problems for Herbert and brother Nelson Bunker (right), who faced legal issues including lawsuits and tax problems. Throughout, the Hunt brothers contended they did nothing wrong.

potential damage, and most of all to decide, to act, to follow through,” Volcker said.²⁸ “Fortunately, that person existed right there in the Fed, and his name was Taylor.”

Order was finally restored after a consortium of institutions agreed to provide a line of credit to the brothers. Later, a federal jury ruled the Hunts conspired with other investors in a racketeering scheme focused on controlling the world’s silver market. The family faced numerous lawsuits, tax problems and bankruptcy, but contended throughout they did nothing wrong.

In a 2009 interview, the aging Bunker Hunt told a reporter that he and his brothers were blamed for the silver hysteria, but thousands of people were buying at that time.

“I don’t think anybody can corner the market,” he said.²⁹ “But, I guess if you buy up a lot of items ... the price can go up.”

In an interview for the same newspaper article, Hunt family biographer Harry Hurt III said he believed Bunker when he said the family was not trying to corner the market, and that most Hunt family critics had it wrong when they made such accusations.

“They were doing something much crazier than” cornering the market, he said.³⁰ According to Hurt, Bunker thought the apocalypse was at hand and paper money would be worthless.

“The guy was a fanatic,” Hurt said.³¹ “He really believed that stuff.”

28. “Bill Taylor – Public Servant,” eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

29. Dallas Morning News, March 22, 2009.

30. Dallas Morning News, March 22, 2009.

31. Dallas Morning News, March 22, 2009.

... after crisis (*Penn Square*) ...

News accounts said the silver market collapse was one of the most trying events in the nation's financial history. Unknown at the time, of course, was that within a few years it would be a virtually forgotten crisis, lost behind a cloud of events with the failure of numerous banks and the later savings and loan crisis. At that time, it was the most substantial turmoil to rock the nation's financial system since the Great Depression.

In the late 1980s, Taylor summarized his work during the crisis by saying it was "rather an obscure job, but really during the last five to ten years it's been one of the most interesting and exciting obscure jobs (in) the world."³²

And the excitement was just getting started. Volcker later said it was "a comfort to me personally" when Taylor was promoted to lead the Fed's supervisory efforts in 1985.³³

"To me, there was no more important and sensitive staff position in the labyrinth of Washington banking bureaucracy," Volcker said.³⁴ "And there Bill faced challenges literally without precedent."

He was involved in almost every prominent bank failure of the period.

And there were many as agricultural, energy and real estate markets went through a boom-and-bust cycle that took many banks with them, primarily in the U.S. plains, West and Southwest.

"Bankers loaned on the assumption of escalating prices," Taylor said in a 1988 interview.³⁵ "No one ever considered that prices could fall. (For example) lending 75 percent on \$30 (a barrel) oil puts you in the low \$20s. All of a sudden oil drops to \$10 a barrel. Trouble.

"When you make gross assumptions about the future, you run into gross problems."

Perhaps nowhere is that statement more appropriate than in regard to one of the most

32. *Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.*

33. "Bill Taylor – Public Servant," eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

34. "Bill Taylor – Public Servant," eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

35. *ABA Banking Journal, October 1988.*



Hundreds of depositors lined up outside of Penn Square Bank after it failed over the July 4th holiday weekend in 1982. Because of the small bank's connections to larger institutions, its failure had far-reaching implications.

noteworthy – and far-reaching – banking failures of the period: the collapse of Oklahoma's Penn Square Bank.

Through aggressive lending to the then-booming oil and gas industries, the bank tucked inside an Oklahoma City shopping mall had grown from \$62 million in assets in 1977 to \$520 million by summer 1982 and was servicing \$2 billion in loans.³⁶ Because it was a relatively small bank, when Penn Square found an eager wildcatter or prospector needing money to sink a new well or buy a prospective oil field, it would make the loan, but then sell most of it, through a participation, to a much larger bank. When the energy boom ended and Penn Square failed over the July 4th weekend in 1982, it turned out to be one of the landmark events in the '80s banking crisis as it brought to light new risks for a financial system that was highly interconnected.

Penn Square's failure was a key contributor to the spring 1984 collapse of Continental Illinois National Bank and Trust, then the nation's seventh-largest bank; the largest bank in Chicago; and, briefly, the nation's largest corporate lender.³⁷ Continental was the largest participant in Penn Square's oil and gas loans and, in its first quarterly report after Penn Square's failure, noted \$1.3 billion in nonperforming loans and assets as it became apparent nearly all the Penn Square loans were bad.³⁸ Penn Square also contributed to the later insolvency of Seattle's Seattle-First National Bank and had a significant impact on numerous other major financial institutions.

Ironically, before it started working with Penn Square, Continental was known as a cautious lender and had been one for decades.³⁹

"I know most of what happened," the head of lending for one of Continental's rivals told a reporter in 1984.⁴⁰ "But I don't know why it happened. And I'm sometimes not even sure it happened."

So, why did the big banks get involved with a small Oklahoma lender making high-risk energy loans?

To borrow the age old answer: Because that's where the money was.

The 1979 ouster of the Shah of Iran thrust America into an oil crisis where prices soared and supplies dwindled. Today, many Americans likely recall long lines of automobiles at the gas pumps. In oil-rich states, however, they remember boom times. And, with much of the rest of American business and industry struggling, in part because of high oil prices, the energy boom was especially attractive. Some likely thought it was one of the biggest financial opportunities in American history.

36. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

37. *Washington Post, July 29, 1984.*

38. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

39. *Washington Post, July 29, 1984.*

40. *Washington Post, July 29, 1984.*



David G. Taylor, chairman of Continental Illinois National Bank and Trust Co., speaks with the media at a 1984 press conference. The bank, one of the nation's largest and the biggest in Chicago, eventually collapsed due in large part to business relationships with Oklahoma's Penn Square Bank.

Almost everybody wanted in on the action, so the deals were made easily.

“The alliances that bound Penn Square and its various correspondent banks would, if rendered in a diagram, defy easy comprehensibility,” writer Mark Singer later explained.⁴¹ “A school friend of (Penn Square’s chief of oil and gas lending Bill) Patterson’s mentions Penn Square to a banker from Continental Illinois. Before long, Continental believes in Penn Square and Penn Square believes in Continental. A college fraternity pal of Patterson’s works for Northern Trust and soon that bank is involved. Penn Square finds its way to Seattle-First by apparent happenstance. ... Michigan National calls upon Continental Illinois. Chase Manhattan bumps into Northern Trust. Michigan National consults Chase Manhattan. A foamy egalitarian spirit – the spirit of opportunity – suffuses these relationships.”

Eventually, 53 banks bought participations.⁴²

Although the long line of banking dominos had major implications for the financial system, Taylor told a story about being contacted by an Oklahoma oilman, showing the impact such failures can have on the local community and the public.

“He said, ‘I’m just a small driller. I’ve got eight wells here. I employed 13 people. And I had trouble making my loan payments. But I made them every week. The bank was closed and liquidated and they (the FDIC) took my checking account and payroll account and offset them against my loan. Then they called my loan because it was on a demand basis – because my banker told me to put it on a demand basis. My people were put out of work that day. The wells were shut down, the

41. *Funny Money* by Mark Singer, Alfred A. Knopf, New York, 1985.

42. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994*, the Federal Deposit Insurance Corporation, August 1998.

machinery's been sold, and I was making my payments. There's oil in there, there's revenue there. And now that's all capped and the people are gone," Taylor recounted.⁴³

He told the story to illustrate a point: "Liquidating the good with the bad is very expensive to everybody."

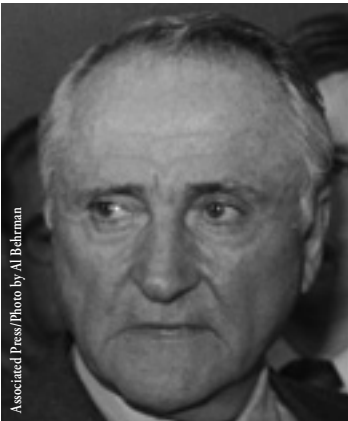
... after crisis (S&Ls part I)...

In Ohio, the Federal Reserve found itself playing a key role in resolving a crisis that, sadly, would be something of a precursor of events that would later rock the nation's financial system.

In the early spring of 1985, savings and loans throughout Ohio were subject to what was later called "the most widespread run on depository institutions since the Great Depression"⁴⁴ after losses suffered by the state's largest privately insured S&L became widely known.

Although a different set of circumstances than Penn Square, the failure of Home State Savings Bank showed again that in an interconnected financial system, the risks and the crisis can begin anywhere and have far-reaching implications.

Events in Ohio started unfolding quickly after Fort Lauderdale, Fla.-based ESM Government Securities failed on March 4. A largely unregulated government securities dealer, ESM collapsed after it was revealed the firm was missing about \$300 million that



Associated Press/Photo by Al Behrman

Marvin L. Warner was eventually sentenced to prison for his role in the collapse of Ohio's Home State Savings Bank. Warner, however, contended he was "the biggest victim of them all."

had been hidden amid massive fraud, leading the Securities and Exchange Commission to file suit.^{45, 46} Home State had heavy exposure to ESM through repurchase agreement transactions and had borrowed almost 50 percent of its funds from the firm. Home State's losses were pegged at \$150 million or more.⁴⁷ Comparatively, Home State had listed \$1.4 billion in assets and \$668 million

43. ABA Banking Journal, Feb. 1, 1992.

44. "Financial Crisis Management: Four Financial Crises in the 1980s," U.S. General Accounting Office staff study, May 1997.

45. "Financial Crisis Management: Four Financial Crises in the 1980s," U.S. General Accounting Office staff study, May 1997.

46. Wall Street Journal, March 11, 1985.

47. "Financial Crisis Management: Four Financial Crises in the 1980s," U.S. General Accounting Office staff study, May 1997.

in deposits as of the end of the quarter before the crisis.⁴⁸

The Home State run started the day after ESM was shut down. Within a few days, media accounts estimated as much as \$60 million had been withdrawn by Home State depositors.⁴⁹ Questions were also being raised about Home State's owner, Marvin L. Warner, and ESM's leadership. Warner, a former U.S. ambassador to Switzerland, had a personal account with ESM and was involved in channeling business from a Florida thrift for which he had served as chair.⁵⁰

Home State was a state-chartered and privately insured thrift. As such, its deposits were covered by the Ohio Deposit Guarantee Fund, which was created in 1955.⁵¹ Although later media accounts suggested the fund was comfortable with the widely held, but incorrect, impression that the insurance fund was closely connected to the state of Ohio, it was actually funded by the S&L industry and run by industry executives, including David Shiebel, Home State's chairman,⁵² who served as a fund trustee.

Those close ties, critics said later, left the fund unwilling to act against a struggling institution.

"Basically, they had the fox watching the henhouse," Stephen Farrar, the then-treasurer of North Carolina's private insurance fund told a reporter.⁵³ "Nobody is going to come down hard on someone else if the roles can be reversed."

Home State's size also gave it further leverage over the fund. It was seven times larger than any of the 70 other privately insured Ohio institutions and provided one-quarter of the fund's total assets.⁵⁴

"Home State was so big that the insurance fund couldn't cover a calamity at Home State and still survive," then-Xavier finance professor Philip Glasgo told a reporter.⁵⁵ "Home State kind of had the fund over a barrel."

At the time of Home State's collapse, the insurance fund had about \$130 million in total assets to guarantee \$4.3 billion in deposits throughout the state. As those numbers became widely known – and heavily questioned – depositors at the state's other S&Ls became jittery and started to demand their money. The crisis reached something of a boiling

point when a local talk radio show told depositors they should start pitching tents outside the institutions so they could be sure to get their money.⁵⁶

"Lines started forming in front of several Cincinnati thrifts yesterday morning and lasted

48. Wall Street Journal, *March 11, 1985*.

49. Washington Post, *March 12, 1985*.

50. Washington Post, *March 17, 1985*.

51. Chicago Tribune, *April 7, 1985*.

52. Chicago Tribune, *April 7, 1985*.

53. Chicago Tribune, *April 7, 1985*.

54. Chicago Tribune, *April 7, 1985*.

55. Chicago Tribune, *April 7, 1985*.

56. New York Times, *March 16, 1985*.



When the collapse of Ohio's Home State Savings Bank rippled through the rest of the state's savings and loans, it was seen as a major financial crisis. Unfortunately, it turned out to be only the start of the S&L turmoil.

Officials had finally worked out a plan that would gradually separate Home State from ESM. It was set to begin on May 1 – two months too late.⁵⁹

To stem the tide of withdrawals from his state's thrifts, Ohio Gov. Richard Celeste on March 15 ordered a three-day holiday and closed all of the state's S&Ls as newspaper photos showed angry depositors gathered outside institutions in a scene more reminiscent of the Panic of 1907 than the America of 1985.⁶⁰

"The whole system is based on trust and that's what's been shaken," depositor Susan Caspar told a reporter after her husband successfully withdrew a \$16,000 certificate of deposit.⁶¹

In calling the holiday, which was later extended to five days, Celeste said it would provide "a cooling-off period that conserves funds and is fair to depositors until concern subsides and until we can convincingly demonstrate the soundness of our system."⁶²

Meanwhile, state officials had been working with the Federal Reserve Bank of Cleveland to line up credit and with officials from Washington, D.C., including Volcker and Taylor, to assess the situation and explore solutions. Some Fed examiners

throughout the day," *The Wall Street Journal* reported a couple of days after the Home State failure.⁵⁷

It was later revealed that Ohio officials had been concerned about Home State's close ties to ESM for three years. Ironically, they had decided not to act on those concerns because they were fearful of the consequences – specifically a panic on the scale of what eventually happened.

"The issue was not Home State, but to spare the (Ohio Deposit Guarantee) Fund and avoiding spooking all the state's depositors," a former state banking official told *The New York Times*.⁵⁸

57. *Wall Street Journal*, March 15, 1985.

58. *New York Times*, March 21, 1985.

59. *New York Times*, March 21, 1985.

60. *New York Times*, March 16, 1985.

61. *Chicago Tribune*, March 19, 1985.

62. *UPI story published March 15, 1985*, Los Angeles Times.

were even dispatched to monitor withdrawal activity at some S&L locations.⁶³ A Fed study found that many of the institutions would not qualify for federal deposit insurance because they had too little capital.⁶⁴ The Fed also concluded that many of the thrifts chose the private insurance fund because it was less expensive and less burdensome than federal deposit insurance. The Ohio Deposit Guarantee Fund had no legal power to ensure compliance and no cease and desist powers.⁶⁵

Because the thrifts had no connection to the federal insurance pools, the federal agencies had little information about the thrifts or the fund, although officials at the Cleveland Fed had been concerned for some time about both the fund and the thrifts.⁶⁶ Despite these challenges and others, the Fed played a key role in solving the crisis.

“At this moment, the Fed seems best able to work with the state,” Ohio Congressman Willis D. Gradison Jr. told *The New York Times*.⁶⁷ “The Fed has the greater power to assist and great flexibility and can move with greater speed than the bank board can.”



Ohio Gov. Richard Celeste (right), here with Vice President Walter Mondale while running for office, ended up closing Ohio savings and loans for five days in an effort to restore order. Celeste also warned other governors about the potential for a similar crisis in their states.

63. “Financial Crisis Management: Four Financial Crises in the 1980s,” U.S. General Accounting Office staff study, May 1997.

64. *New York Times*, March 16, 1985.

65. “Financial Crisis Management: Four Financial Crises in the 1980s,” U.S. General Accounting Office staff study, May 1997.

66. “Financial Crisis Management: Four Financial Crises in the 1980s,” U.S. General Accounting Office staff study, May 1997.

67. *New York Times*, March 16, 1985.

Ohio officials responded with emergency legislation that eventually freed \$129 million in funding,⁶⁸ and Volcker said publicly that the Fed would lend to institutions strong enough to reopen.⁶⁹

Warner, who proclaimed he was “the biggest victim of them all,”⁷⁰ was eventually sent to prison in connection with the crisis.

Meanwhile, Celeste warned his Maryland counterpart, Gov. Harry Hughes, that his state’s privately insured thrifts were also at risk.

“You’re sitting on a time bomb,” Celeste said.⁷¹

A few weeks later, it went off.

Time magazine noted that, in Maryland, “depositors knew all too well what to do. They gathered up their lawn chairs, thermos bottles and portable radios and lined up outside the banks as if they were embarking on a familiar American outing. In a sense, they were. Only two months ago, depositors across the U.S. witnessed scenes right out of the Great Depres-



Associated Press/Photo by Beald Gray

Maryland Gov. Harry Hughes found himself in the midst of a savings and loan crisis in his state only weeks after similar events in Ohio.

sion during a panic that temporarily shut down Ohio’s ... privately insured thrifts.”⁷²

The Maryland panic started amid reports about management improprieties after Baltimore-based Old Court Savings and Loan’s president and part-owner Jeffrey Levitt stepped down under pressure from the state’s thrift insurance fund. The Maryland Savings-Share Insurance Corp. had become concerned about sloppy management – there were reports that the thrift’s leaders had given themselves exorbitant consulting fees and were writing millions of dollars in bad checks – as the thrift had grown from an institution with \$140 million assets to one with \$873 million in a three-year span.⁷³ Meanwhile, state officials were also telling another thrift that it needed to bolster its cash position.⁷⁴

As was the case in Ohio, depositors became fearful that the \$286 million state insurance fund would be quickly exhausted by the \$7.2 billion in guaranteed deposits.

The run was on.

68. Cincinnati Enquirer, April 13, 2002.

69. New York Times, March 21, 1985.

70. Numerous newspaper accounts including Cincinnati Enquirer, April 13, 2002.

71. Time, May 27, 1985.

72. Time, May 27, 1985.

73. Time, May 27, 1985.

74. Time, May 27, 1985.

Depositors lined up 10 deep at many of Old Court's seven Baltimore-area offices in the hours after Levitt's departure was reported in the news on May 9. Police were called to keep the order at one suburban location where more than 150 customers were hoping to close their accounts.⁷⁵ By the end of the day, depositors had pulled out more than \$12 million.⁷⁶

"The thing that's scaring me is that everyone else is scared," auto mechanic Jeff Shank told a reporter while withdrawing his savings from an Old Court branch.⁷⁷

Media accounts compared the run to something between a beach party atmosphere and a refugee camp as investors scrambled to get their cash. There were reports of individuals waiting in line for as long as nine hours. Many told reporters that they had put their savings with Old Court because it paid interest rates much higher than what they could find anywhere else.⁷⁸ In fact, Old Court's interest rates, among the highest in the nation,⁷⁹ attracted significant interest from out-of-state depositors.⁸⁰

The crisis spread as depositors, fearful about both the strength of the institutions and the failure of the private insurance fund, raced to pull their money from other Maryland thrifts including First Maryland Savings and Loan. Like Old Court, First Maryland also enticed depositors with exceptionally lucrative interest rates – as much as 20 percent compared to market rates of around 7 percent.⁸¹

"First Maryland was a disaster waiting to happen" an attorney involved in the investigation later said.⁸²

It was later revealed that First Maryland, among other lapses, had made numerous insider loans at below market rates. It had also lent millions to developers who had made no effort to repay as well as others who could not find funding elsewhere.⁸³

"(First Maryland) had a reputation in the industry as an easy place to get a loan,"



Depositors brought along lawn chairs and waited in line to withdraw savings from an Old Court Savings and Loan location in a Baltimore suburb in May 1985.

⁸³

Neil J. Dilloff, the chief investigator of First Maryland said.⁸⁴

Maryland officials eventually froze funds in a total of more than 100,000 accounts at First Maryland, Old Court and another thrift,

75. New York Times, *May 10, 1985.*

76. The (Annapolis, Md.) Capital, *May 14, 1985.*

77. Time, *May 27, 1985.*

78. Washington Post, *May 15, 1985.*

79. Washington Post, *March 21, 1985.*

80. Washington Post, *May 13, 1985.*

81. New York Times, *April 17, 1988.*

82. New York Times, *April 17, 1988.*

83. New York Times, *April 17, 1988.*

84. New York Times, *April 17, 1988.*



The number of individuals sentenced to prison for their role in failed savings and loans was fodder for editorial cartoonists nationwide, including this one from Florida.

\$22 million in Community Savings and Loan money he had stashed in Swiss accounts, Billman lived under various aliases while authorities from numerous agencies including the State Department, Interpol and others, worked to bring him to justice.⁸⁶ Although he was on the lam for four years, he was hardly in hiding. One newspaper account described Billman enjoying the Mediterranean sun from the bow of his yacht, sipping a mixed drink with his Danish mistress at his side. Back in the United States, Billman had left behind not only Community Savings and Loan depositors, but also a wife and three children.⁸⁷

As was the case in Ohio, the response to the Maryland crisis involved a combination of actions by state officials and federal regulators. In the midst of the crisis, Gov. Hughes urged depositors to stay calm as he pointed out that there was “an aggressive effort on the part of the Federal Reserve.”⁸⁸

Some insight into the Fed’s role in responding to the Maryland crisis was offered in a 1998 article written by David Fettig of the Federal Reserve Bank of Minneapolis.

“At the beginning of the run, there were 15 Fed examiners on site; that number quickly grew to over 200 and ‘mini-examinations’ were conducted at all of Maryland’s 102 privately insured S&Ls to qualify them to borrow from the Fed’s discount window,” Fettig wrote.⁸⁹

Arthur Zohab, then an examiner with the Richmond Fed, explained to Fettig some of what was uncovered about Old Court’s lending.

“We found hydroelectric plants being financed, race horses, hotels from

Community Savings and Loan. The move was blamed for at least one suicide when a 46-year-old jobless man under treatment for depression killed himself after being unable to withdraw his life savings of \$27,000.⁸⁵

The suicide victim is in sharp contrast to Tom Billman, the head of Community Savings and Loan, who, rather than face legal consequences, fled the country to Europe. Fueled by

85. *Associated Press, as appearing in the Los Angeles Times, Nov. 17, 1985.*

86. *Washington Post, March 2, 1993.*

87. *Washington Post, Feb. 3, 1991.*

88. *The (Annapolis, Md.) Capital, May 14, 1985.*

89. *The Region, June 1998.*

Ocean City to Miami, rehab housing in a number of cities, but rarely a residential mortgage,” Zohab said.⁹⁰ “And we said: ‘We don’t know what this is, but it is not an S&L as we’d define the term.’”

Taylor was pivotal in coordinating the Fed’s response.

“Often working as a troubleshooter for ... Volcker, Taylor won praise from state officials in Maryland and Ohio after he was dispatched to help them when their state-insured savings associations failed,” wrote Jerry Knight, a reporter with *The Washington Post*.⁹¹

Volcker later said that Taylor “well understood the human equation, how even experienced bankers could be tempted to push expansion beyond the capacity to control or take exotic new risks before they could be understood. The 1980s provided object lessons in all of that and much more. Eventually, some of those who had bent ethical standards and even the law itself found their fortunes lost and reputations shattered.”⁹²

Levitt was among them. He was eventually sentenced to jail after it was discovered he had stolen nearly \$15 million from the thrift. At his sentencing, he talked about a gambling addiction run amok, but evidence was presented of all kinds of excess including 17 cars and a Rolls-Royce golf cart with a television in the dashboard.⁹³ Christie’s auction house was commissioned to sell numerous items from the Levitt estate including work by seminal artists Matisse and Picasso.

Among the accounts held at the thrift was that of Levitt’s high school class, which was saving for its 25-year reunion. The class was able to recover the money, but Levitt was the talk of the event.

“It seemed everybody had the same opinion about Jeffrey,” a classmate said.⁹⁴ “The surprise wasn’t that he tumbled, but that he got so high to begin with.”

For the private thrifts, the second S&L crisis in only a few months spelled the end.

In a 1987 speech, Taylor listed all that had unfolded over only a few years from the Texas Hunts and their silver to Penn Square in Oklahoma to Continental in Illinois to the thrifts in Ohio and Maryland. He also noted that failures and problem banks were on the rise.



Jeffrey Levitt pleaded guilty to taking \$14.6 million from the depositors of Old Court Savings and Loan. Levitt blamed his actions on a gambling addiction.

90. *The Region*, June 1998.

91. *Washington Post*, May 4, 1990.

92. “Bill Taylor – Public Servant,” eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

93. *Washington Post*, Oct. 26, 1986.

94. *Washington Post*, Oct. 26, 1986.

“These are financial issues and problems that we had not really dealt with in a large quantity in the post-war period until this recent decade,” Taylor said. “Bank failure has become a growth industry.”

The industry would continue to boom.

... after crisis (*S&Ls part II*)

For those who witnessed the '80s and early '90s first hand, the most recent financial crisis has to seem like more than a bit of déjà vu.

The U.S. S&L industry was created in the 1800s to provide home mortgages and expand homeownership by lending within communities, but the industry changed dramatically when regulations were relaxed and investors sought more substantial returns.

“Many savings and loans used the new freedoms to offer high interest rates to attract deposits and then tried to earn hefty profits with risky loans and investments, especially in real estate,” award-winning *New York Times* journalist David Rosenbaum wrote in 1990 as the crisis continued to unfold.⁹⁵ “Some savings and loans were run by rogues, others by incompetents. Their deals – sometimes shady, sometimes merely chancy – often went sour.”

Rosenbaum wrote that the institutions themselves were not at risk because the government insured the investors. The institutions, in many ways, were placing their bets with taxpayer money.

“THE WHOLE THRIFT FINANCIAL STRUCTURE WAS
fundamentally flawed FROM THE BEGINNING.”

“It enabled savings institutions, no matter how sick, to pull in deposits and risk that money with long odds against them, knowing the government stood to be the big loser.”

S&L executives, he wrote, were living by the 3-6-3 rule: “Pay 3 percent on deposits, charge 6 percent on mortgages and tee off on the golf course at 3 o’clock.”

To some degree, it worked. But inflation began to spiral, and the Volcker-led Fed was forced to push interest rates to record highs in a fight to contain it. It was a bad combination for lenders, who were tied to long-term loans at interest rates far below market levels. It was especially damaging for the S&Ls, which were structured to take short-term deposits.

“The whole thrift financial structure was fundamentally flawed from the beginning,” industry analyst Bert Ely told *The New York Times* in 1988.⁹⁶ “It is borrowing short to lend

95. *New York Times*, June 6, 1990.

96. *New York Times*, June 12, 1988.

long. Sooner or later you are going to have a disaster.”

That disaster left virtually the entire industry insolvent. As a result, regulations were relaxed, allowing the institutions to make large unsecured loans and investments to stay afloat in the difficult environment. However, when the economy recovered and interest rates returned to more manageable levels, the S&Ls did not back down. In fact, rather than breathing a sigh of relief that the storm had passed, the industry was using its new freedoms to take on further risk to fuel further growth.

“Someone at the time should have said this is ludicrous,” Taylor, then head of the Fed’s supervisory operations, told Rosenbaum for the 1990 *New York Times* article.⁹⁷ “No one in finance has ever been able to grow like this and stay alive.”

With the S&Ls deeply into all types of speculative investments including land and buildings, the collapse could not be stopped once the bottom fell out. The crises hit its peak in 1989 when more than 500 thrifts or banks failed.⁹⁸

Arguably the most well-known of the failed institutions was Lincoln Savings and Loan Association, the Irvine, Calif.-based institution that was owned by millionaire banker Charles H. Keating Jr.

Former FDIC Chairman L. William Seidman later said Keating was behind “one of the more heartless and cruel frauds in modern history.



Joan Leff was one of many victims in the failure of Lincoln Savings and Loan, which was owned by Charles Keating.

“His tellers were told to persuade depositors, many of whom had lodged their life’s savings with Lincoln, to move their money from insured deposits to the bonds of Keating’s holding company, which even at that time the regulators adjudged insolvent.”⁹⁹

Among the victims was Joan Leff, a nursing home office manager, who took \$90,000 from a divorce settlement to Lincoln planning to buy a certificate of deposit that would generate interest to help with her monthly rent. Instead a salesman talked her into buying a bond that he said was safe and insured. It was actually a junk bond. Leff ended up losing her residence and was forced into a cheap one-bedroom apartment.

97. *New York Times*, June 6, 1990.

98. Number includes open bank assistance. *Managing the Crisis: The FDIC and RT Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

99. *Full Faith and Credit, 1993, Random House, New York, NY.*

“It’s not like I invested in penny stocks or pork bellies or even the stock market,” Leff told a reporter.¹⁰⁰ “I thought a bank would be safe.”

It was later discovered that members of Keating’s sales staff were given a memo listing a dozen selling points that concluded with a reminder that “the weak, meek and ignorant are always good targets.”¹⁰¹

Despite the outrageous behavior, Keating’s name is not remembered decades later for fraud but because of the so-called “Keating Five” – a group of five U.S. senators who intervened on Keating’s behalf with federal regulators in 1987. After Lincoln was seized by regulators in April 1989, details of a meeting between the five senators – to whom Keating had contributed a total of \$1.3 million in gifts and contributions – and Edwin J. Gray, then-head of the Federal Home Loan Bank Board, came to light.¹⁰²

In addition to a political scandal and a lengthy Senate ethics investigation that dominated the headlines, the Lincoln collapse eventually cost taxpayers more than \$3 billion. When he bought it in February 1984, Keating had paid only \$51 million for the thrift.¹⁰³



As FDIC chairman, William Seidman also led the Resolution Trust Corporation that Congress created to liquidate assets of the failed savings and loans.

As a result of 1989’s collapse of the S&Ls, Congress created the Resolution Trust Corporation to liquidate assets that included a wide range of numerous real estate assets from shopping malls to residential developments.

“The job combined all the best aspects of an undertaker, an IRS agent and a garbage collector,” Seidman, who also served as head of the RTC in addition to his FDIC post, wrote in his 1993 memoirs.¹⁰⁴ “Each savings and loan arrived with records in disarray, key personnel gone, lawsuits by the hundreds and a management that was still mismanaging or had departed and left the cupboard bare.”

In a January 2009 interview with CNBC-TV, Seidman briefly explained how the RTC operated.

100. Associated Press story published Aug. 9, 1990.

101. Associated Press story published Aug. 9, 1990.

102. New York Times, Nov. 22, 1989.

103. New York Times, Nov. 22, 1989.

104. Full Faith and Credit, 1993, Random House, New York, NY.

“What we did, we took over the bank, nationalized it, fired the management, took out the bad assets and put a good bank back in the system,” he said, suggesting such an entity should be a model for dealing with the failure of large financial firms.¹⁰⁵

To create the RTC, the White House turned first to Taylor, asking him to be the first acting president of the RTC Oversight Board, a Cabinet-level panel that set policy for the RTC.¹⁰⁶ Taylor was heavily involved in its creation, forming an entity that he said would handle “the world’s greatest liquidation.”¹⁰⁷

He became more deeply involved with the RTC when the head of the oversight board, Daniel Kearney, resigned in a dispute with the Treasury Department and left the RTC without a leader.

“WHO DID THEY BORROW FROM THE FED TO SAVE THE DAY? *It was Bill Taylor.*”

“Who did they borrow from the Fed to save the day? It was Bill Taylor,” Rep. Gonzales later recalled, adding that Taylor lived the rest of his life without ever receiving “proper credit for what he did, but he saved the RTC.”¹⁰⁸

Taylor filled the post on an interim basis for four months, taking leave from his position at the Fed.¹⁰⁹

In an early 1990 interview, Taylor was asked about the causes of the thrift crisis.¹¹⁰

“The whole thing offers many lessons, most of which have been taught before,” Taylor said. “Fast growth, unstable funding sources, human frailty and a lack of controls can severely damage an institution – but the big gamble that causes the most fatalities is in the area of asset quality. Making loans (or equity investments) that do not generate sufficient cash flow to service the debt and cover the risks involved is the greatest danger facing financial institutions, including banks.”

Taylor’s strong reputation only grew through the crisis. He played a key role in making sure that legislation to address the S&L crisis contained tough regulations to prevent future losses by making thrift owners risk more of their own funds.¹¹¹

Criticism of the RTC swelled as the cost of liquidating assets continued to spiral.

Media accounts in the spring of 1990 indicated that the agency was prepping to spend nearly \$1 billion a day over a two-month span as it worked to resolve 141 failed institutions.¹¹² The entire

105. *Bloomberg*, May 13, 2009.

106. *Washington Post*, May 4, 1990.

107. *The Region*, February 1990.

108. *San Jose (Calif.) Mercury News*, Aug. 21, 1992.

109. *Associated Press*, published Aug. 21, 1992.

110. *The Region*, February 1990.

111. *Washington Post*, May 4, 1990.

112. *New York Times*, May 2, 1990.

process was expected to handle as many as 800 institutions and cost from \$300 billion to \$500 billion by the time it was complete.¹¹³

The nominee

Seidman, an extremely outspoken man who was serving as both FDIC chairman as well as the operational head of the RTC took much of the heat for the manner in which events were unfolding. He also continued to battle with the administration. In the spring of 1990, with friction between Seidman and the administration continuing, media reports were touting Taylor as Bush's choice to be the new head of the FDIC. The implication was clear: Bush wanted the change, and he wanted it now.

In his memoirs, Seidman writes about learning that a Treasury official had leaked to a *New York Times* reporter that the White House wanted Taylor at the FDIC.

“It appeared that the administration was prepared and determined to proceed,” Seidman wrote.¹¹⁴ “Bill Taylor was a good friend, a first-rate regulator, and a very capable person. At my request, we met in my office in the middle of April (1990). Would he be willing to take my job? He said he had thought about the matter and he would, even though it would mean a substantial cut in pay.”



President George H.W. Bush made it clear he wanted Bill Taylor to lead the FDIC after growing increasingly frustrated with William Seidman.

That the White House would court Taylor for the job was not surprising. In addition to his work on the RTC, Bush had previously asked Taylor to take over as head of the Office of Thrift Supervision. Taylor passed on the offer as the OTS was moved under the Treasury. Taylor was seen as a troubleshooter for then-Fed Chairman Volcker and had earned praise from numerous sources, including officials in Ohio and Maryland after he worked to help both those states address problems with their savings institutions.

President Bush later said that Taylor had an independent mind, was unafraid to speak out, understood banking and finance, but above all he had “a firm sense of responsibility

¹¹³. *New York Times*, May 2, 1990.

¹¹⁴. *Full Faith and Credit*, 1993, *Random House*, New York, N.Y.

and duty.”¹¹⁵

The current and future FDIC leaders were virtually exact opposites in terms of interacting with the media.

Seidman loved the press and was almost never without a quick quip or quote – among the more notable, he once said that he named his dog after Rep. Frank Annunzio, a powerful member of the House Banking Committee, because the dog was so dumb it could not remember its name.

“(Seidman) was everywhere,” author Martin Mayer later wrote, “on all the television news shows and both radio and television talk shows, making four, five speeches a week around the country, reveling in his own prominence and that of his agency.”¹¹⁶

Taylor, meanwhile, was at the other extreme. He said little to the media, if anything. One press account noted he rarely returned reporters’ phone calls.¹¹⁷

“THE GREATEST SUCCESSES ARE *invisible*.”

Taylor’s interaction with the press was not at all unusual for someone in bank examination and especially in his position. Confidentiality is crucial. Taylor later noted that, in the supervision business, the “greatest successes are invisible” because the once-troubled firms were able to recover while failures are thrust into the public spotlight.¹¹⁸

Reflecting today, it seems apparent that commentators of the era misinterpreted both men to some degree.

Although Seidman may have adored the spotlight, he was also thrust into that position as bank failures soared. Prior to the crisis, the FDIC was a relatively minor agency, and its head could move around Washington in anonymity. Mayer notes that, at the start of the ’80s, the FDIC was “the smallest of the bank regulatory potatoes.”¹¹⁹ The crisis changed that, and a strong case can be made that Seidman’s visibility, ego aside, was crucial to both maintaining public trust and protecting the FDIC’s insurance fund, which some were eyeing to cover the losses connected to the S&L debacle. Seidman eventually lost that battle as Federal Savings and Loan Insurance Corporation, which covered the thrifts, became insolvent and, as a result, was abolished.

115. *Transcript of Bill Taylor’s swearing-in ceremony for the FDIC*. Oct. 31, 1991.

116. *The Greatest Ever Bank Robbery*, Martin Mayer, Charles Scribner’s Sons, New York, N.Y., 1990.

117. *Washington Post*, May 4, 1990.

118. *The Region*, February 1990.

119. *The Greatest Ever Bank Robbery*, Martin Mayer, Charles Scribner’s Sons, New York, N.Y., 1990.

Commentators, recognizing Bush’s anger with Seidman, thought the White House favored Taylor because he would be easier to control and less likely to speak out. They would learn

otherwise. Certainly, Taylor's sharp mind was apparent in one early article that offered an unusually high level of detail about a meeting the Fed's top regulator had with congressional staffers.

"In a recent session with congressional banking committee staffers, Taylor listened patiently to complaints that home builders are suffering because the new law reduced the amount a thrift can lend to a single borrower from 50 percent of its capital to only 15 percent," wrote Jerry Wright of *The Washington Post*.¹²⁰ "The way (Taylor) saw it, he said, if you lend 15 percent of your capital to one borrower, you can make six bad loans before you go broke. If you lend 50 percent you make two bad loans and you're broke. Taylor's analysis ended any talk of loosening the rule, a staff member who attended the session said."

Although it was widely known that Bush wanted Taylor – the president had gone so far as to say during a press conference that Seidman was planning early retirement and suggested Taylor for the post, although Seidman's memoir disputes that claim – Seidman would not leave. And, by law, the president could not force him out.

So, Taylor was left stuck in a very public state of limbo for more than a year as Seidman remained on the job. The stubborn FDIC chairman refused to be pushed out of office even when a horse-riding accident landed him in the hospital.

"Rather than using it as a graceful way to exit, Seidman had the hospital install extra phones and a fax machine so that he could run the FDIC from his bed," wrote Barbara Rehm of the *American Banker*.¹²¹

Seidman finally left when his term ended in October 1991.

There had been some concern that Taylor might face a difficult confirmation hearing because of the Bank of Credit and Commerce International (BCCI) debacle. The international private bank operated



The Bank of Credit and Commerce International had connections with numerous criminals and even some of the world's most notorious dictators.

in numerous countries and was the focus of an undercover investigation that discovered connections to drug barons, money launderers and even some of the world's most notorious dictators. Some jokingly suggested BCCI, which skirted numerous regulators but was actually based in Luxembourg, actually stood for "the Bank of Crooks and Criminals

¹²⁰. *Washington Post*, May 4, 1990.

¹²¹. *As republished in The Chicago Daily Herald*, June, 2, 1991.

International.” There was fraud at an unprecedented level.

“This bank would bribe God,” one BCCI employee famously said.¹²²

BCCI had secretly acquired control of Washington’s First American Bankshares, despite the Federal Reserve’s efforts to make sure there was no possible connection between the two. Critics often noted that First American was almost literally in the backyard of the Federal Reserve’s Washington offices and yet it took the Fed years to uncover what had occurred.

Although there were a few difficult questions during Taylor’s Senate hearing, he was unanimously confirmed.¹²³

“During his time at the Fed, (he) ... built strong personal and professional relationships with influential aides in both houses and in both parties,” *The Washington Post* wrote at the time of the confirmation hearings.¹²⁴ “Taylor, they say, was a person who would sit down in a cluttered congressional catacomb and quietly discuss the health of the banking system with the demeanor of the family physician.”

Taylor was sworn in on Oct. 31, 1991, as the FDIC’s 15th chief executive.

Media accounts reviewing Seidman’s six-year stint at the FDIC noted that his taking the role of leading the RTC in addition to being FDIC chief was “one of the most audacious turf acquisitions Washington has seen.”¹²⁵ After Seidman’s departure, the jobs were split into two positions. But Seidman and the financial turmoil had put the FDIC squarely on the front page.

“A decade ago, not too many people knew what the FDIC did,” said Seidman’s predecessor at the FDIC, William Isaac.¹²⁶ “Today, not too many people don’t.”

Speaking about Taylor’s then-upcoming move into the position, Isaac told a reporter that the crisis had made the FDIC chairmanship “one of the most visible and important jobs in government right now The president has a lot at stake here.”¹²⁷

So did the nation.

With an average of one bank failing every day,¹²⁸ and more than 1,000 during the crisis, the FDIC fund was dwindling. As if to turn up the pressure on his successor, Seidman spent his last day after six years on the job warning congressional leaders that a \$70 billion loan the administration was seeking to restore the fund – a controversial step that was only

122. Behind Closed Doors, BCCI: The Biggest Bank Fraud in History, *Financial Times*, 1991.

123. *Washington Post*, Sept. 24, 1992.

124. *Washington Post*, Sept. 24, 1992.

125. *Washington Post*, Oct. 19, 1991.

126. *Associated Press*, published Aug. 14, 1991.

127. *Associated Press*, published Aug. 14, 1991.

128. Managing the Crisis: The FDIC and RTC Experience, 1980-1994, *the Federal Deposit Insurance Corporation*, August 1998.

another reason to further anger an already outraged public – might not provide enough money to keep the fund solvent.

The next day, it was Bill Taylor’s problem.

The FDIC

In the beginning, the slide projector was going all the time.

The most extensive profile of Taylor written during his FDIC tenure starts by talking about the projector, with its clunky carousel set to automatically change the slides every few seconds. With a bulky “ker-chunk” and a “whirr,” the face, name and title of another FDIC field staffer rotated into illumination on the office wall of the FDIC’s new chairman.

“When he’s in Washington, he keeps the projector going so he can build up the recognition almost subliminally as he works at his desk,” wrote reporter Steve Cocheco.¹²⁹

Those people, Taylor knew, were the key.

While head of supervision for the Fed, he was asked about the central bank’s most notable accomplishments in supervision, and he talked all about the staff.

“They have a great capacity to respond to a variety of crises in a variety of locations and sectors,” Taylor said.¹³⁰ “This is especially true of the field force. We have been able to challenge the people and they have responded magnificently. They sense it as their duty. They are prepared to make sacrifices and most importantly have a tremendous desire and ability to perform. They are the force. I would take them anywhere.”



Bill Taylor was known as a “data junkie” who used push pins to mark banking failures on a map in his office.

Despite his immense faith in the examination staff, Taylor also recognized that they sometimes had to proceed carefully in their jobs, especially with the economy and financial system in turmoil.

During his Senate confirmation hearing, Taylor was asked specifically about overzealous regulators causing the credit crisis as they clamped down on lending. The increased vigilance by regulators, some senators suggested to Taylor, came in an effort to make up for their being too lax in the past.

“There’s bound to be among all of the examiners someone who overreacts,” Taylor told Utah Sen. Jake Garn during the hearing.¹³¹ “The worrisome part is that the banker is intimidated to lend, not just by the examiner, but by economic circumstances.”

¹²⁹. ABA Banking Journal, Feb. 1, 1992.

¹³⁰. The Region, February 1990.

¹³¹. New York Times, Sept. 25, 1991.

Only a few months after Taylor took the FDIC position, the administration convened a meeting of senior examiners in Baltimore to discuss the credit crunch and real estate issues. After the meeting, Taylor made it clear that bankers should not consider the meeting a push to get the examiners to go easier on the banks. In fact, he noted that, as a former examiner, if someone told him that he had caused the credit crisis by doing his job, “I would have felt pretty abused.”¹³²

However, the examiners were told that they hold a public trust and, with the nation struggling in a crisis, “you should be damn sure of what you’re doing.”¹³³

He kept a file in his desk of complaints from banks who believed examiners were too tough with them, and he was known to frequently tell the field offices that he would not tolerate regulators who were unfairly hard on banks.¹³⁴ After being confronted by an angry former director of a failed S&L – the man pointed at Taylor during a breakfast meeting with North Carolina financial institutions and said that the FDIC’s investigation process was “a shakedown” – Taylor met privately with the man in his Washington office. The man was pleased when Taylor told him that he had instructed the FDIC inspector general to look into how attorneys had handled the case.¹³⁵

He was known as a “data junkie”¹³⁶ who always carried a floppy disk that contained the financial information of the nation’s 50 largest banks in his jacket pocket and a humorous “supervision kit” prepared by his Fed colleagues at the time of his departure that included a map and stick pins in reference to his method of tracking the nation’s banking failures.¹³⁷

Despite the computer disk, Taylor was known to be impatient with technology. At the FDIC, he wanted to knock down an office wall so he could talk with his secretary rather than use the agency’s complex phone system. A staffer later recalled that Taylor said the only thing he hated more than the FDIC’s voicemail was using e-mail.¹³⁸

In his first days on the job, Taylor pushed the \$70 billion government loan request through Congress. He then started working on an unprecedented 22 percent increase in the premiums paid by banks to maintain the insurance fund.¹³⁹ The effort put him against both the Bush administration, which saw it as giving bankers less to lend and thereby worsening the credit crisis, as well as the banking industry.

“You can’t assert independence if you can’t pay your own bills,” he said publicly

132. ABA Banking Journal, *Feb. 1, 1992.*

133. ABA Banking Journal, *Feb. 1, 1992.*

134. New York Times, *Aug. 21, 1992.*

135. Washington Post, *July 27, 1992.*

136. USA Today, *Aug. 21, 1992.*

137. *The Bill Taylor Supervision Kit, prepared for the reception for William Taylor, Oct. 29, 1991.*

138. ABA Banking Journal, *Vol., 84, 1992.*

139. American Banker, *June 15, 1992.*

in explaining why the premiums had to increase.¹⁴⁰

Meanwhile, he was more blunt with the banking industry's influential lobbyists, telling them that "the best way to get the government out of the banking business it to keeping the banking business out of the public's pocket."¹⁴¹

He was outraged that the FDIC's expenses had exceeded their income for six consecutive years; however, he also confessed he felt "enormous pressure everywhere" in seeking the premium hike.¹⁴² He joked to his wife that, when it was all said and done, he would likely end up pumping gas for a living,¹⁴³ referencing a job he held while attending high school back in Chicago.¹⁴⁴

Treating sick banks

In addition to shoring up the FDIC fund, Taylor's other top priority was in creating a new process for dealing with failing institutions that he believed would save the fund money.

The idea was known as "the hospital."

The concept called for the takeover of a struggling institution with a temporary manager hired to run the firm as a going concern, with the FDIC providing funds and acting as owner. The institution would continue to serve its community, although some activities, such as expansion, would be limited.

"At some point, that thing will turn around and show a profit if that (manager) is any good," Taylor said.¹⁴⁵ "And after it runs profitably a couple of quarters, we'll say, 'You've been in the hospital six months, let's take you to an investment banker or to our resolutions division.'"

Under this plan, Taylor said the bank would still be sold, but not in the fire-sale environment that emerges when a bank fails and the agency is scrambling to find a buyer and no one wants the assets. Even desirable assets go for below value.

"I don't think there's any hope that you're going to avoid losses that are there," Taylor said.¹⁴⁶ "Losses are losses and there's nothing to do about it. But when you take performing assets and put them into liquidation, you're going to lose money."

Harrison Young, then the FDIC's director of resolutions, explained to a *Washington Post* reporter how the value of a struggling bank sinks to the point of no return.

140. *American Banker*, Aug. 21, 1992.

141. *The Independent*, Aug. 29, 1992.

142. *New York Times*, Aug. 21, 1992.

143. *New York Times*, Aug. 21, 1992.

144. *Chicago Tribune*, Aug. 26, 1991.

145. *ABA Banking Journal*, Feb. 1, 1992.

146. *ABA Banking Journal*, Feb. 1, 1992.

“Sick banks take a long time to die,” Young said.¹⁴⁷ “And while they are doing that, depositors leave . . . Borrowers leave, too. Second, everybody is demoralized. Problem assets do not really get attended to. Management is desperate for earnings and they make more bad loans. Everything deteriorates.”

With the hospital plan, Taylor said the FDIC would be in the position to continue rejecting offers until a suitable purchase price was reached.

Analysts said the hospital idea was loosely modeled on how the Continental Illinois failure was handled during the '80s banking crisis when Taylor was with the Federal Reserve.

“SICK BANKS TAKE A *long time to die.*”

In January 1992, the plan was implemented when the FDIC put \$1.2 billion into Brooklyn, N.Y.-based CrossLand Savings Bank, New York's largest savings bank at the time¹⁴⁸ and the second-largest savings bank on the East Coast,¹⁴⁹ with deposits of \$5.6 billion and assets of \$7.3 billion.¹⁵⁰ It was the first time the government had taken over an institution since it unwound Continental, which was deemed “too big to fail” without causing damage to the economy and the nation's financial system.

Per the hospital plan, the CrossLand takeover was done not because of the institution's size, but because the FDIC believed it was cheaper than paying out claims to depositors. Congress had recently passed legislation mandating that the FDIC pursue the least-cost option for resolving failed firms, which, it could have been argued, lent at least a degree of support to the hospital plan if it proved successful.

The plan was apparently something Taylor had been considering for some time. During his Senate confirmation hearing, he talked about the need for new ways to deal with failing institutions. As far as the issue of “too big to fail” was concerned, Taylor said nothing was too big to fail, but it was instead a question of an institution potentially being “too big to liquidate” without causing wider damage.

“For example, there may be banks whose role in our financial system may make outright liquidation an inappropriate response if these banks cease to be viable. However, this is not

to say that these banks cannot fail,” Taylor testified.¹⁵¹ “If they do fail, they can be merged, sold, or recapitalized, with shareholders, managers and directors suffering the same adverse consequences they would

147. Washington Post, Oct. 22, 1991.

148. New York Times, Aug. 21, 1992.

149. Managing the Crisis: The FDIC and RTC Experience, 1980-1994, *the Federal Deposit Insurance Corporation, August 1998.*

150. Managing the Crisis: The FDIC and RTC Experience, 1980-1994, *the Federal Deposit Insurance Corporation, August 1998.*

151. *Transcript of the hearing before the Committee on Banking, Housing and Urban Affairs of the United States Senate on the nomination of William Taylor, Sept. 24, 1991.*

if the institution had been closed and liquidated.”

To administer the hospital plan, the FDIC installed a veteran banker, Richard Kraemer, as president and directed him to collect as much as possible on bad real estate loans and restructure other loans.

“When you work with these borrowers you come out better than if you had a fire sale,” Kraemer told a reporter.¹⁵²

Kraemer was also charged with tightening CrossLand down to a core business of residential real estate lending.¹⁵³

All CrossLand branches were closed for one hour on the afternoon of Jan. 24, 1992, and then reopened under FDIC ownership. Numerous media accounts noted that Taylor would not say the move marked a change in policy, but it was clearly interpreted as such.

Certainly it was hugely controversial, with criticism coming from numerous sources.

CrossLand was a savings bank, which meant it was regulated by the Office of Thrift Supervision, but insured by the FDIC. At the time of its failure, analysts said that it should have been forced to shut down years earlier because it never reached minimum standards put in place in 1989 after the S&L crisis. It had been insolvent for more than a year,¹⁵⁴ and was obtaining cash by paying above-market interest rates for deposits.¹⁵⁵

A day before the FDIC takeover, New York Congressman Charles Schumer said CrossLand was “a case study of what is wrong with our banking system, with institutions soaking up insured deposits and using them to fund high-risk speculative loans.”¹⁵⁶

CrossLand had a complex history with junk bonds, where it lost millions, that resulted in some CrossLand officers facing accusations of fraud and a tax evasion probe launched by state officials.¹⁵⁷



Associated Press/Photo by Joe Marquette

U.S. Rep. Charles Schumer saw Brooklyn's CrossLand Savings as a microcosm of fundamental problems with the nation's banking system.

152. Washington Post, March 1, 1992.

153. Wall Street Journal, March 2, 1992.

154. Washington Post, March 1, 1992.

155. Managing the Crisis: The FDIC and RTC Experience, 1980-1994, *the Federal Deposit Insurance Corporation*, August 1998.

156. New York Times, Jan. 25, 1992.

157. Washington Post, March 1, 1992.

In addition to cries of “socialism,” some critics said that the FDIC was playing favorites with failing banks and decided to use the new plan with CrossLand because it was an election year and the administration did not want to suffer the political fallout of a New York failure.

Others said that even if it is cheaper to the FDIC, it was giving special treatment to CrossLand’s depositors, borrowers and employees that was not given to others when their institutions failed. For example, depositors at some other failed institutions lost money in accounts that were above the FDIC’s \$100,000 limit or lost high-paying interest rates on certificates of deposit. As long as the government owned CrossLand, their customers would not be victim to such occurrences.

New York bankers complained because they now felt like they were in competition with the government.

Jonathan Macey, a Cornell University professor, told a reporter that the FDIC was “using bank insurance funds ... in an attempt to jump-start” a struggling New York economy.¹⁵⁸

Certainly, CrossLand’s failure would have had some economic impact. In addition to lost jobs, depositors would have been at risk of losing part of \$112 million that was in accounts of more than the \$100,000 insurance cap. Also, an asset liquidation would have dumped more than \$1 billion in real estate onto a struggling New York market while it was believed that an aggressive collection effort from some delinquent borrowers risked forcing bankruptcy on some major developers who had constructed hotels, offices and apartments throughout New York City.¹⁵⁹

“We have to experiment,” the FDIC’s Young told a reporter.¹⁶⁰ “When somebody says, ‘Hey, this is inconsistent with what you did before,’ to a degree our answer is, ‘I hope so.’”

Further compounding the situation, and raising the need to try the “hospital” solution, Taylor noted that “there were essentially no bids. So, what do you do, dump the \$8.5 billion (in CrossLand assets) and send 400 people up to Brooklyn” to clean it up?¹⁶¹ The agency received only two bids: one for only the deposits from 20 of CrossLand’s 44 New York branches and one contingent on the FDIC providing a long-term note to fund the deposits at a yield much higher than the FDIC’s cost of funds.¹⁶²

One media account noted there was also another factor in the FDIC’s decision with CrossLand.

Although the institution had lent millions to wealthy Manhattan developers and had millions

158. Washington Post, *March 1, 1992.*

159. Washington Post, *March 1, 1992.*

160. Wall Street Journal, *March 2, 1992.*

161. Washington Post, *March 1, 1992.*

162. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

more at stake as a partner in numerous real estate ventures, most of CrossLand's depositors were working-class families in Brooklyn and Queens.

Stephan Labton, a reporter with *The New York Times*, later wrote that Taylor reached his decision to have the government operate CrossLand "after walking through Brooklyn and concluding that closing the institution ... could have a devastating impact on the local economy."¹⁶³

For the FDIC, of course, the risk was that, rather than improve, things would continue to worsen, and the institution would actually lose value.

"I question what they gain by delaying the sale," banking analyst Bert Ely told a reporter.¹⁶⁴ "They're kidding themselves if they think the bids will get any better."

Standing his ground

With the '92 presidential election on the horizon, the White House was pushing the message that both banks and the economy had turned the corner. Taylor, meanwhile, continued to project record bank failures and said he was concerned about the potential for lingering real estate problems.¹⁶⁵

In the summer of '92, with bank profits rising, Taylor refused to change his outlook that the industry was still at risk. He projected there would be 200 bank failures by year end with \$86 billion in assets and another \$82 billion in 1993. Critics said that Taylor's pessimism was creating another hurdle for banks and hurting investor confidence.

He responded to critics in an interview with *The American Banker*.

**“THINGS HERE HAVE BEEN VERY BAD AND THE SYSTEM
HAS BEEN IN *deep trouble.*”**

"I'm not too cautious," Taylor said.¹⁶⁶ "Things here have been very bad and the system has been in deep trouble. When you have \$600 billion of (assets) on the problem list, it is pretty hard not to take that seriously.

"If things get better, we're prepared to say so. But all of us have tried to project what is going to happen and it's always gotten worse."

BusinessWeek called him "the Administration's prophet of gloom."¹⁶⁷

The outspoken Seidman joked to a reporter that Bush might actually yearn for Seidman's return to the FDIC.¹⁶⁸

163. *New York Times*, Aug. 21, 1992.

164. *Wall Street Journal*, Jan. 27, 1992.

165. *BusinessWeek*, Aug. 17, 1992.

166. *American Banker*, June 15, 1992.

167. *BusinessWeek*, Aug. 17, 1992.

168. *BusinessWeek*, Aug. 17, 1992.

Although having a position at odds with the administration grabbed the headlines, Taylor, in fact, had critics on both sides of the aisle. While Bush supporters may have been angry about Taylor's unwillingness to proclaim that conditions were improving, others suggested that the FDIC was holding off on closures until after the election as a favor to the White House. In response to those critics, Taylor noted that in 1991, the FDIC fund went \$7 billion into the red to cover anticipated losses in 1992.

"That was the first time in history the fund went negative on presumed, not actual, losses," Taylor said.¹⁶⁹ "I can't close banks that are not yet insolvent."

He told another reporter that he did not face any pressure from the administration to ease up on the banks, although some may have thought otherwise.

"They have never given me any instructions other than, 'Go fix it. Don't make any mistakes,'" Taylor said.¹⁷⁰

Taylor's willingness to be direct to those on both sides of the political spectrum was well-known. Numerous newspaper articles note that close associates had no idea if Taylor was a Democrat or Republican.

"He didn't care about politics," said Independent Bankers Association of America Executive Director Diane Casey in a 1992 interview.¹⁷¹ "He cared about what was the best solution."

There are also stories of him being direct in situations far removed from the grind of politics and banking.

"You never had to wonder where Bill stood on things," later recalled Isaac, the former FDIC chairman.¹⁷² "He would tell you with unmistakable clarity if he disagreed with you, you knew it and you knew why. If he liked and respected you, you knew it and knew it was real.

"If you were fortunate enough to spend more than a little time with him, you experienced the full range of his emotions. You knew his love, anger, frustration and good humor."



Brian Quinn, executive director of the Bank of England, said that Bill Taylor was an inspiration to bank examiners.

169. Money, Aug. 1992.

170. BusinessWeek, Aug. 17, 1992.

171. San Jose (Calif.) Mercury News, Aug. 21, 1992.

172. American Banker, Aug. 27, 1992.

Then-Bank of England Executive Director Brian Quinn recalled that Taylor, who often used public transportation abroad because he felt it gave him a greater feel for the country and its people, got into an argument with a German youth on a Frankfurt bus about the Gulf War and America's role in the Middle East.

It was “this directness and honesty, together with his evident understanding of the technicalities of supervision, (that) inspired great commitment and loyalty from his staff,” Quinn said.¹⁷³

And he was not a quitter.

“BILL IS ONE OF THESE VERY *intense* PEOPLE HE IS JUST VERY *tenacious*. WHEN HE PICKS UP A PROBLEM, HE WON'T LET IT GO UNTIL HE *solves* IT.”

“Bill is one of these very intense people,” former Fed boss Jack Ryan told a reporter.¹⁷⁴ “He is just very tenacious. When he picks up a problem, he won't let go until he solves it.”

During his Senate confirmation hearing, Taylor talked about favoring an open environment where opinions were shared, even if there was disagreement.

“You do not win everything, but you never are forced to mute your opinions, and I have never done that in my life and I hope I would never start,” he told the Committee.¹⁷⁵ “Some people may wish I would, but I really do not think that is part of my basic nature.”

He was also well-known for the importance he played on being well capitalized. In humorous remarks made during a farewell ceremony at the time of Taylor's Fed departure, Fed successor Richard Spillenkothen said Taylor had raised more capital “than Wall Street has seen in the last 10 years.” It was done, Spillenkothen said, “not through early intervention, prompt intervention or timely intervention, but rather through a process called violent intervention.”¹⁷⁶

Seidman later recalled that Taylor's legacy at the Fed was “standing up to the biggest holding companies, requiring them to quit paying dividends and to shore up their capital. He was a tough but fair supervisor – a person who understood the private sector.”¹⁷⁷

His feelings about capital levels remained unchanged when he took the FDIC job, where some began to joke that,

173. “Appreciation of William Taylor,” by Brian Quinn, published Aug. 28, 1992.

174. American Banker, Aug. 15, 1991.

175. Transcript of the hearing before the Committee on Banking, Housing and Urban Affairs of the United States Senate on the nomination of William Taylor, Sept. 24, 1991.

176. Written text of Richard Spillenkothen comments. Reception for William Taylor, Oct. 29, 1991.

177. The Albany (N.Y.) Times Union, Aug. 21, 1992.

under Taylor, FDIC stood for “Forever Demanding more in Capital.”¹⁷⁸

Stability and tragedy

Although experts often speak broadly in terms of a 15-year banking and thrift crisis from 1980 through 1994, the worst of the crisis is usually marked as the period between 1988 and 1992.¹⁷⁹ To put some perspective on it: Over that five-year-span, a bank or S&L failed on the average of once a day. In fact, throughout the broader 15-year span, one failed, on average, every other day.¹⁸⁰

Although Bush and others turned out to be correct in saying that conditions were improving in 1992, Taylor was almost exactly on the mark with his forecast of 200 failures. By the end of the year, 181 financial institutions had failed or received open bank assistance.¹⁸¹

As expected, conditions continued to improve in 1993, and by the end of summer, the government was ready to cash out of the “hospital” bet Taylor had placed on Brooklyn’s CrossLand Savings. In August, the FDIC’s board agreed to sell the firm to a group of investors for \$332 million after Kraemer slashed assets by 25 percent. *The Wall Street Journal* wrote that it was a good price and provided “a sweet ending to a controversial takeover.”¹⁸²

When the deal was announced, the FDIC estimated that using “the hospital” for CrossLand ended up saving the FDIC’s insurance fund about \$400 million when compared against the cost of a failure. Although the figures had to surprise Taylor’s critics, the numbers were right in line with the FDIC’s original expectations. Years later, well after the FDIC’s commitments to the transaction were resolved, an analysis showed the agency ended up recovering nearly \$500 million, meaning the resolution, in the end, cost only a little more than half of what had been projected had it been handled through a more conventional method.¹⁸³

Tragically, the man who had been correct on both counts did not live to see it.

After suffering intestinal cramps, Taylor was admitted to Fairfax Hospital in subur-

ban Washington for surgery to remove an obstruction from his colon on Aug. 13, 1992. A week later, he died of a heart attack that came while recovering from a bout of pneumonia. At the time of his death, doctors thought the worst had passed.

“We left there yesterday and the doctor said he was progressing fine,” FDIC Vice

178. *American Banker*, Aug 21, 1992.

179. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

180. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

181. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

182. *Wall Street Journal*, Aug. 13, 1993.

183. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

Chairman Skip Hove told a reporter.¹⁸⁴ “Then: boom.”

He was survived by his wife, Sharon, and children Claire, Emily and William III.

The news shocked those who had worked closely with him.

The tributes to the man and his work came quickly from throughout the financial services sector and around the world.

“I have been in and around government a good number of years, and have seen the best and worst it has to offer,” former FDIC Chairman Isaac said. “I have known many highly principled and dedicated public servants. Two of the finest were Bill Taylor and his former mentor, Paul Volcker.”

“Chairman Taylor was the quintessential public servant,” said Paul Schosberg, then president of Savings & Community Bankers of America.¹⁸⁵ “He was a fair, dedicated professional who cared deeply about the nation’s financial system and the people in it.”

“He was an extraordinary person – a well-respected and extremely capable public servant of unquestioned integrity,” said then-Fed Chairman Alan Greenspan.

“An extended conversation with Taylor left one with the sense that this was a man who understood all the big financial issues, international and domestic, in depth,” wrote the *ABA Banking Journal* reporter Steve Cocheco. “Yet, he had a way of relating them to real-life issues that is unusual. His answers to questions often included examples drawn from his career, or detailed hypothetical examples devised off the top of his head.”¹⁸⁶



Tadao Chino, head of the Asian Development Bank, said that though he and Bill Taylor came from different cultural backgrounds, they shared a common philosophy about financial system stability.

Tadao Chino, who later became president of the Asian Development Bank, wrote an article for *The New York Times* about meeting with Taylor in 1987 to discuss U.S. and Japanese banking issues.

“Though we were from very different cultures, Bill and I shared the same philosophy – we both believed strongly in the value of the stability of the international financial system,”

184. *American Banker*, Aug. 21, 1992.

185. San Jose (Calif.) *Mercury News*, Aug. 21, 1992.

186. *ABA Banking Journal*, October 1992.

Chino wrote.¹⁸⁷ “How I wish I could consult with him now on how to deal with our current difficult financial situations. I know I would be able to count on him for valuable advice.”

The Bank of England’s Quinn, in a separate article, wrote that Taylor brought “a combination of vision and hard-headed technical expertise that served his country well, notwithstanding the complaints from some U.S. commercial bankers who found the medicine which he administered sometimes hard to take.”¹⁸⁸

In his eulogy, Volcker read the long list of crisis where Taylor had played a key role in maintaining the stability of the financial system, from the silver crisis, through banking and the S&Ls.

He “was a charter member of the small group of officials from various institutions that together devised the way and means to staunch the financial bleeding well enough to avert a broader economic debacle,” Volcker said.¹⁸⁹ “And he did so in a way that commanded the respect and the confidence of his peers throughout government, of Congressional committees and their staff, and of the economic policy makers in the Administration.”

“Something a lot people didn’t know about him: He was compassionate,” said FDIC board member C.C. Hope,¹⁹⁰ whom Taylor swore into office only hours before going into surgery with an IV in one arm.¹⁹¹ “He was very concerned that we would do the right thing always.”

Legacy

Although Taylor was head of the FDIC at the time of his death, his long-time role with the Federal Reserve meant his passing had a profound impact on that institution as well. A collection was organized to help fund the education of Taylor’s three children. Taylor was by no means wealthy. While at the Fed, he was well-known for driving an aging Chevette in from his home in the Virginia suburbs every morning and, at the time he became FDIC chairman, a financial disclosure showed his largest asset was a Federal Reserve retirement account totaling less than \$250,000.¹⁹²

Some within the Fed, however, refused to contribute to the fund – not because they were not saddened by his passing and not because they were not concerned about his children.

187. *New York Times*, Sept. 20, 1992.

188. “Appreciation of William Taylor” by Brian Quinn, Aug. 28, 1992.

189. “Bill Taylor – Public Servant,” eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

190. *American Banker*, Aug. 21, 1992.

191. “Bill Taylor – Public Servant,” eulogy delivered by Paul Volcker, Aug. 24, 1992, *Congressional Record*.

192. *Washington Post*, Sept. 24, 1991.

Their reason for not giving? They felt Taylor would not have been comfortable with such a fund and would have wanted his children to earn their own way.

As it turned out, all three Taylor children completed graduate degrees without tapping the fund and the money was donated to Cornell College, with most of the funds going to the William Taylor Memorial Scholarship fund and the rest going to a fund for his old fraternity. The contribution, made in 2003, totaled \$100,000.¹⁹³ Ten years earlier, shortly after his death, Taylor posthumously received the Alumni Association of Cornell College Distinguished Achievement Award.



Federal Reserve Bank of New York President William McDonough said Bill Taylor embodied the ideals of a central banker and a banking supervisor.

service and to the well-being of this nation's financial markets in his many years as the head of Bank Supervision at the Federal Reserve Board and as chairman of the FDIC," McDonough said.¹⁹⁴ "For many of us, he embodied the ideals of a central banker and a bank supervisor: measured, professional, impartial, and unstinting in his willingness to go the extra distance in his search for the right answers to the problems he needed to address. His years in the bank supervisory community were cut all too short. We have sadly missed the benefits of his wisdom."

Taylor's legacy also continues in other areas.

In 1993, the Federal Reserve established the William Taylor Award for Excellence in Bank Supervision to recognize individuals demonstrating extraordinary achievement in financial regulation.

The Group of 30, under Volcker's leadership, created the William Taylor Memorial Lecture, which has featured many prominent individuals speaking about important issues and new challenges in the area of financial regulation.

When then-Federal Reserve Bank of New York President William McDonough gave the lecture in 2002, he opened his comments by talking about Taylor.

"He was deeply committed to public

¹⁹³. Cornell College eReport, Winter 2003.

¹⁹⁴. William J. McDonough, "Issues in Corporate Governance," William Taylor Memorial Lecture, Sept. 29, 2002, Washington, D.C.

Chicago

There was, of course, a memorial service in Chicago where, instead of a former Fed chairman, Taylor's old college friend Bowman delivered the eulogy. There he told stories about being part of a group of friends starting out on Chicago's north side.

"That he made it to the top, as I look back at the wonder of it all, is perhaps not as remarkable as it is reassuring when you consider the man," Bowman said.¹⁹⁵

The man who had made his mark on the nation's financial system had changed little from the person he knew in college, Bowman told those at the service.

"It has been said that life shrinks and expands in proportion to one's courage and so I believe that it was the extraordinary stamina of body and mind and the indomitable spirit which was nurtured through Bill's love and pursuit of wrestling in the early years of his life that carried him to prominence in the affairs of our country...

"When you think about it, the regulation of banking, or any industry for that matter, is only required when those within the industry do not do their jobs – so who better to be in charge than Bill, a person who did his so well."¹⁹⁶

Only a few years earlier, with the nation in the midst of crisis, Taylor had described his role a little differently.

"I am simply one of a group of people that tries to keep the financial system intact with minimal government interference and to try to get it back on track when a part of it breaks or vary a part of it that can't be fixed," Taylor said.¹⁹⁷ "Sort of the pit crew of finance. You might say it's a bad business, but I can tell you business has been very good."



Bill Taylor.

195. Transcript of eulogy given at Chicago memorial service, courtesy of Cornell College.

196. Transcript of eulogy given at Chicago memorial service, courtesy of Cornell College.

197. Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.



Long lines of depositors, such as this one outside of an Old Court Savings and Loan location near Baltimore in 1985, seemed more like a page from the Great Depression or the early 1900s and not something America would face in the late 20th century.

Epilogue

In his own words

Many of the issues that were under consideration during the financial crisis of the 1980s and 1990s returned to the forefront as the nation worked to make its way out of another financial crisis in 2009-10. Taylor's "hospital" plan, although not used by the agency again, was noted in some media reports as regulators wrestled with unique options for dealing with the nation's financial crisis in 2008-09.¹⁹⁸

Certainly, it is impossible to know how events may have evolved differently had Taylor not died in the late summer of 1992. Similarly, there is obviously no way to know what he would think of the current environment, or how his opinions on banking supervision and regulation would have changed over the years.

However, it is understandable that some may be interested in, or at least curious about, his views on these issues and others. Former FDIC Chairman William Issac said that, if Taylor had not died after only 10 months in office, "he would have gone down in history as the best chairman the FDIC has ever had."¹⁹⁹ It was a comment echoed by many others, who note that he was also the greatest director of supervision in the Federal Reserve's century-long history. Comments like that makes his opinions on these important topics worth review.

In that regard, below are some public comments Taylor made while either head of supervision at the Fed or as FDIC chairman. Note that the comments in quotation marks are Taylor's words. Text outside of the quotation marks was added for clarification.

ON COMPLEX MORTGAGE PRODUCTS:

"Some (adjustable rate mortgages) are more complicated than a VCR; you have to understand the arithmetic to be sure you are making the right payment. We find cases all the time where banks charge the wrong amount inadvertently. If the errors are in the bank's favor, they have to make restitution. But even though we watch out for you, you must also watch out for yourself."²⁰⁰

198. American Banker, July 28, 2009.

199. American Banker, Aug. 21, 1992.

200. Money, Aug. 1992.

ON THE IMPACT VARIABLE-RATE LENDING CAN HAVE AMID ECONOMIC FLUCTUATIONS:

“If you look at all the recessions in this half of the century, the biggest expense of the typical household – the mortgage – didn’t increase. Every year the borrower paid off a little more of the mortgage and made a little ground.” In this example, the borrower benefitted from inflation because the rise in real estate values came with no increase in their costs. With ARMs, “that cushion can now be taken away by a rate rise. This will probably put the effects of a recession on the doorstep more quickly.”²⁰¹

ON THE FED’S ROLE *in* SUPERVISION:

“The key role for the central bank in all this is to see that in the process of change the stability of the banking system is maintained. As the lender of last resort, it is essential that the Federal Reserve be able to assess the risk of new powers and new geography. Maintaining a strong supervision function is essential in this regard.”²⁰²

ON THE NEED *for* THREE PRINCIPAL FEDERAL BANKING REGULATORS:

“I’ve always answered this question in a very straightforward fashion and the answer is ‘no.’ There should be one. It should be the Federal Reserve. Many people don’t agree with that, but that’s my opinion.”²⁰³

ON CLASSIFYING LOANS *and* EXAMINERS BEING “WRONG”:

“You can’t be single minded and say that all loans must have cash flow. But what we are teaching our examiners is this: If they are not going to criticize a loan for a project that does not have a prospect of fairly immediate revenue, they must have an exceptional story. “I can recall examiners classifying real estate credits that didn’t have sufficient cash flow based on existing market economics, and the bank arguing violently with them. Then the building would sell for twice the loan value.” Bankers would turn to the examiner and say, “See, you people were wrong about collateral values,” and at the time it looked that way, but “sometimes, worse than being wrong is being right too soon.”²⁰⁴

201. ABA Banking Journal, October 1988.

202. The Region, February 1990.

203. The Region, February 1990.

204. ABA Banking Journal, October 1988.

ON MARKET-VALUE ACCOUNTING *for* BANKS:

“I’d go so far as saying it’s silly.” One of the purposes of banking is making illiquid loans, for example to a small local business that no one would be interested in on a secondary market. “If you are going to make illiquid loans, by definition, there is no market. So how can you mark them to market?”²⁰⁵

ON BASIC BANKING:

“There are many bankers who do basic blocking and tackling. They are fundamental in the way they go about it. They don’t grow as fast as others, but they do grow pretty well over time.”²⁰⁶

ON DEREGULATION / THE THEN-PROPOSED REPEAL *of* GLASS-STEAGALL:

“Bankers, and rightly so, argue that the reason they need more powers is because everyone else is in their business and yet (they) are kept out of everyone else’s. To a degree, this is true. Big corporations no longer go to the banks for their loans. They generally access the public markets directly through the commercial paper mechanism. Every insurance man and broker, every department store, offers a kiosk that says, ‘We’ll invest your money, we offer a mutual fund, you can write checks, we take care of all of your financial services.’ And so we’ve come to have a psyche of financial services industry. And so it goes. And some people think that these additional powers can lead to greater problems and potential conflicts of interest in the provision of financial services. But you’d have to say the course of the debate, the tender of the debate, really seems headed for more powers for banks. Now one never knows. It’s not over til it’s over. But there seems to be an awful lot of conversation in this regard and ... (this) old examiner ... has these suspicions lurking in his heart. Suspicions that say the answer to world hunger is not eating someone else’s lunch.”²⁰⁷

ON THE EROSION *of* BANKING BARRIERS *and* THE INTEGRATION *of* FINANCIAL SERVICES:

“The erosion of banking barriers comes in two principal areas: that of bank powers and that of bank geography. In the area of powers, it is clear that many major countries around the world have allowed, or are in the process of allowing, banks into the securities business. Our banks have been prohibited from such activities since the early ’30s. It is

205. ABA Banking Journal, Feb. 1, 1992.

206. ABA Banking Journal, October 1988.

207. Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.

argued that to stay competitive with the rest of the world's banks, at a time when integrated global banking is becoming more of a reality, our banks should be allowed into the business. It seems like a good bet that this argument will prevail and I would hope that careful consideration is given to the safety and soundness implications of banks taking on these new types of risk. Probably the more dramatic erosion of barriers lies in the relaxation of interstate restrictions on bank holding companies. In 1980 there was only one state that allowed a bank holding company from another state to own a bank within its borders. Today, almost all states allow some form of interstate banking. In this case I am worried about banks expanding too fast or without full knowledge about what they are acquiring.”²⁰⁸

ON THE POTENTIAL *for* ANOTHER CRISIS *in* THE STYLE *of* THE SAVINGS *and* LOAN DEBACLE:

Bank supervision and regulation “ is a business of worrying and today we have to be in that mode when thinking about the real estate situation and the increasing corporate leverage that you see in these leveraged buyout deals. Combine these worries with a strong and growing economy with stable prices and low interest rates and one's sense of well-being appreciates. However, add a more negative scenario on these other factors and life gets tougher. Hopefully, another S&L-type crisis is not looming out there, but the fact that we have had such a crisis ought to make all of us in the business of banking supervision pay very close attention to our business.”²⁰⁹

ON THE LIKELY OUTCOME *of* THE THEN-ONGOING INDUSTRY EVOLUTION INCLUDING CONSOLIDATION, DEREGULATION *and* INTERNATIONALIZATION:

“You come down to the end of the road and you say there's stress and there are all these changes and what is the future of banking? ... It looks like pressure for more deregulation will continue. Banks getting into other businesses, more internationalization of banking markets, you'll be able to cash your check in Paris drawn on your Japanese bank in Chicago. The holding company structure will continue to grow, maybe at the margin, meaning less local control, maybe more services. Banking concentration measured on a national market basis will no doubt increase. Bigger banks will get bigger. There will be more big banks. Not to say that the small banks (will disappear) ... But the country is seemingly headed towards a higher level of concentration.

“The banking structure of the country will change, and has changed I think already. It’s just now a matter of playing it out from a state and county type of banking arrangement to a nationwide banking arrangement. It may take a while to sort through, but I think that’s where it’s going.

“Although I have some hope for moderation, the increased competition brought about by all these changes and in combination with the fascination of this country for debt and leverage will continue to create stress that will require very close attention.”²¹⁰

210. *Written prepared remarks for Cornell convocation ceremony, Oct. 1, 1987, courtesy of Cornell College.*

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This Time
It's Different
(OR IS IT?)

Thomas M. Hoenig

PRESIDENT *and* CHIEF EXECUTIVE OFFICER

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WESTERN STATES BANK DIRECTORS EDUCATION FOUNDATION

TUCSON, ARIZ. • OCT. 30, 2006



Associated Press/Unknown photographer

When U.S. investors have seen opportunities such as energy or farmland as the sure-fire route to a financial windfall, the result has instead often been a financial crisis. It happened in the early 1980s and again with the crisis that started in 2007.

This Time It's Different

(OR IS IT?)

Those of you with several years of business experience in this part of the country may recognize that many of the things we are hearing today about the economy have counterparts in the past: Asset values are appreciating, farmland values are strong and we are all well-aware of what has occurred this year with the energy markets. In short, for many in this area of the country, times are good.

At the start of the 1980s, we were told that oil prices could only go higher, farmland was a solid investment because, “they aren’t making any more of it,” and housing and stock markets would continue to climb.

Of course, if you were involved in business or banking 20 years ago, you will recall that several of the financial decisions made on those speculative forecasts created their own sets of problems, some reaching far beyond local banks.

Today, I am told that while there may be some similarities with current banking conditions and those of a quarter century ago, things are different this time. You may be hearing the same thing from investors and bankers, and, in fact, you may be saying to yourself: This time it’s different.

Or is it?

Through the late ’70s and ’80s, I had the opportunity of being an officer in banking supervision at the Federal Reserve Bank of Kansas City. I spent those years heavily involved in the banking crisis that enveloped the Tenth Federal Reserve District, a region that includes the central United States: Nebraska, Kansas, Oklahoma, Wyoming, Colorado, northern New Mexico and western Missouri.

Confidence abounded among borrowers, bankers and even supervisors during the early 1980s. And, as with any euphoric environment, potential pitfalls abound.

I realize this is not new information to many of you – maybe to none of you. But I believe that this is a particularly apt time to take a retrospective look at banking and finance. We now have a new generation of bankers who haven’t experienced much in the way of a substantial banking downturn. Furthermore, many who can recall the 1980s will soon be leaving the business, and we need to gain from their knowledge and experience before they

leave. Lastly, it never hurts to be reminded of important lessons.

Let me share with you some statements that we actually heard from bankers and bank directors during the '80s:

- “I am the CEO of this bank, and we’re doing it my way.”
- “Yes, we loaned a hundred percent on this project, but everyone knows that the collateral value can only go up during construction.”
- “If you understood this better, you wouldn’t have a problem with it.”
- “Although this is unconventional, our accountant says it is perfectly legal.”
- “The corporate plane will save money for the bank in the long run.”
- “We have put our problems behind us – our bank rating will be much improved at our next exam.”
- “If it weren’t for the examiners, this bank wouldn’t have failed.”

Lessons from the 1980s

Before I go further, let me provide a brief background on the 1980s to remind us of the context of these stories – all of which happened in our Federal Reserve District. In the 1980s, community banks made up much of the District banking population, with a number of regional organizations filling out the total – a trend that continues today with additional entry by a number of large interstate organizations.

District banks played various roles in speculative booms in agriculture, energy and commercial real estate – all of which were significant for the District economy – and which all came to a precipitous end. The price of crude oil, for example, rose from \$2.75 a barrel in 1973 to a peak of nearly \$37 in 1981 before dropping to \$10 in 1986. Similarly, farmland values in Nebraska rose by more than fourfold in the 10-year period before 1982, but then dropped by 45 percent during the next five years. Inflation was around 13 percent at the beginning of the 1980s, and the prime rate reached 20.5 percent in 1981.

The sharp economic fluctuations had a severe impact on District banks. During the 1980s, 309 banks failed in District states, which was 11 percent of the 1980 District banking population. Now, let me recognize one very important point before I go on. Most banks in the 1980s, like banks today, were well-run, prudent and successful. But some managers couldn’t resist the possibility of greater profit. These examples are designed to steer you away from similar mistakes.

For each of the statements I shared previously, there is a story around the events that

eventually unfolded. I have three more statements for which I want to provide the story of the consequences. I hope these will serve as examples of what you, as directors, need to be alert to when exercising oversight at your banks. Age-old behaviors, such as greed, shortsightedness, and arrogance, are at the center of these problems, and, I would caution, they are with us today just as they were in the 1980s.

The first comment stems from one of the most prominent examples of the '80s banking crisis:

“The examiners are dead wrong; they don’t understand what we’re doing – they don’t have a clue about our business.”

At the height of the agricultural, energy and commercial real estate booms of the late 1970s and early 1980s, competition among lenders was intense. When our examiners would ask about a loan with questionable characteristics during this period, they too often heard bankers say, “If I don’t make the loan, the banker down the street will.” In many cases, unfortunately, this turned out to be a race to the bottom.

Nowhere was this more evident than in the area of energy lending. Good loan underwriting standards were often swept away under an aura of optimism and the belief that oil prices could only go up. In this environment, repayment ability was not a concern, especially because rising oil prices would bail out any lender, and good loan documentation was something to be done later, provided the lending business slowed down at some point.

One notable or, in this case, notorious district energy lender was Penn Square Bank of Oklahoma City. If you’ve read books like *Funny Money* or *Belly Up*, you know a lot of major banks courted Penn Square and competed with one another to participate in the bank’s seemingly lucrative energy lending business. Energy lending was the hottest ticket in banking then, and in the race to stake out a position, none of these major banks paid any real attention to Penn Square’s loan underwriting and administration or did much in the way of their own due diligence. In many cases, the loan participations were bought on blind faith and unlimited optimism. For Penn Square, this provided an incentive to make loans to anyone who walked in the door, and Penn Square sold more than \$2.1 billion in loan participations to 88 banks, including eight of the top 50 banks in the country. Greed, thus, overwhelmed reason for all who were involved. This, in some ways, strikes me as similar to some “hedge funds” excesses of the recent past.

The outcome of these practices back then was the failure of Penn Square Bank during

the Fourth of July weekend in 1982. At the Federal Reserve, we were faced with a decision on whether to continue lending to Penn Square through the discount window or to stop and let it fail that weekend. With all the questionable energy loans on Penn Square's books, there was little to be salvaged, and a few colleagues and I found ourselves spending the holiday weekend working on what to do about it. After Penn Square's failure, FDIC Chairman William Isaac made clear where the blame lay when he stated, "The Penn Square debacle was caused by a gross dereliction of duty on the part of the bank's board of directors and management."

Penn Square's failure also led to a ripple effect within the banking industry. A staggering total of more than \$1.1 billion in Penn Square loans had been sold to the supposedly more sophisticated Continental Illinois National Bank. These loans received little, if any, review by Continental Illinois' management and served as the initial impetus toward that bank's eventual failure in 1984. Seattle-First National Bank was also a heavy buyer of Penn Square loans. After Penn Square's failure, Sea-First quickly slipped from being a darling of stock market analysts to a bank shut out of funding markets and pushed to the brink of failure. The only thing that prevented it from becoming the largest U.S. bank failure at that time was its hurried acquisition by Bank of America under a special Washington state failing-bank law. Several other major banks also took significant losses on Penn Square loans and fell into a weakened condition.

The simple fact is there are times when it is wise not to jump on the bandwagon. In some instances, it is better to let the parade pass you by. As directors, you should be extremely cautious if your management can't fully and clearly explain the business lines they are about to enter or if there is too much of a rush to jump in.

“If you understood this better, you wouldn't have a problem with it.”

There are a host of stories from the 1980s and early 1990s of individuals thinking they had a sure thing – something that would produce spectacular returns with little or no risk. Unfortunately, bank directors have sometimes been caught up in this enthusiasm as well. One banker, for instance, became a loan originator, relying entirely on another organization to be the secondary market conduit. It seemed like a foolproof strategy with far better returns than the bank's ag lending business in the 1980s – simply find willing loan

customers funneled through from distant sources, make sure the loan paperwork is filled out properly, and then watch the conduit purchase the loans and place them in the secondary market. For several years, this strategy worked – great origination and servicing fees, virtually no credit risk with the quick sale of loans, and a big boost to local employment. Eventually, however, the market conduit cancelled its contract with the bank, thus leaving the bank itself to fund and hold all the loans it was making. The bank's balance sheet ballooned with the influx of loans, and the bank soon found that many of these loans were of questionable quality – a fact that eventually led to the bank's failure.

Another bank from this period had a history of struggling along and was glad to finally pick up some new ownership, especially because this change brought in two fast-track partners from a securities firm. Soon the bank's investment portfolio was earning returns well above market rates – an outcome that pleased the directors and led to management bonuses.

No one seemed prepared to question how the bank could continue to earn above-market returns on U.S. government securities. The answer came out later. One of the partners in the securities firm was charged with fraud, through a Ponzi scheme, and with money laundering, and the bank became a defendant in a securities lawsuit. After losing the lawsuit, the bank was insolvent.

Similar stories can be found in other banks. A particularly common story concerns structured notes. How many banks bought such notes through bond salesmen with the idea that they carried high returns but were safe because they were backed by the Federal Home Loan Bank System and the federal government? One banker even told us he didn't have to worry about his securities because his broker “controlled” the risk for him. In many cases, bankers never gave a second thought to the significant risks structured notes presented to their banks.

“Didn't you learn from corporate finance that leverage can be powerful?”

Franklin Savings was a Kansas thrift institution that made a name for itself through its complex arbitrage operations, expert staff and ability to “outsmart” major securities firms on trades. Franklin Savings started out as a small traditional thrift institution in a small Kansas town. Like many thrifts in the early 1980s, Franklin Savings faced substantial losses from interest rate mismatches in its mortgage portfolio. In response, Franklin changed its business model to an arbitrage and hedging strategy, using brokered deposits to fund its

positions in mortgage-backed securities, junk bonds and the futures market. The thrift brought in an impressive staff of Wall Street and capital markets hotshots to carry out its strategies, and in just a few years, Franklin grew from virtually nothing to one of the largest and most profitable thrifts in the country with more than \$11 billion in assets.

While Franklin Savings had impressive returns for a number of years, its rapid growth — along with tighter thrift capital standards under FIRREA (Financial Institutions Reform, Recovery and Enforcement Act of 1989) — turned its leverage into a regulatory issue. Also, unexpected movements in interest rates led to sizable losses at Franklin in 1989 and to further declines in its capital ratio and net interest margins. In a dispute over accounting practices, the Office of Thrift Supervision seized Franklin in 1990. What followed was a series of articles and court cases in which a number of well-known arbitrage experts took turns defending and criticizing Franklin's reporting of hedging gains and losses and the length of time it could take in recognizing some notable losses. There was no consensus on whether Franklin was a viable institution or was truly insolvent. In the end, the courts largely deferred to the OTS.

Among the lessons we can learn from Franklin Savings is that an institution's management should be able to explain fully its strategy and risk exposure to directors, current and prospective investors, and bank supervisors. Franklin also could be regarded as forerunner to today's hedge funds, except that it was relying on insured depositors and its thrift charter for funding advantages and didn't have large, sophisticated investors as its target clientele. As a result, it had a great responsibility to be transparent in its strategies and to maintain its capital at prudent levels and in compliance with minimum supervisory standards.

Some might quibble about whether the thrift examiners were knowledgeable enough to judge Franklin's activities. But they had enough experience by then to be skeptical when managers at problem institutions would tell them: "We're too sophisticated to get into trouble," "You don't understand, we know what we are doing," and "We have a tax – or an accounting – angle that will make this pay off."

Conclusion

My purpose in reviewing these stories with you today is not that I think a return to a 1980s-style crisis is imminent. Certainly, banking conditions today are good: strong earnings, good asset quality, no bank failures in more than two years. However, those who, in the early 1980s, predicted an endless rise in energy markets and real estate values were as confident in

their outlook as we are today. And, certainly, the same rules and lessons continue to apply in banking and finance.

Although the world has changed during the last quarter of a century, at least one thing has not – human nature. As I mentioned earlier, greed, pride, arrogance and other human frailties are often at the root of bad banking decisions, and those qualities remain with us today. They still motivate behavior as they have in the past, and, in many cases, these frailties keep us from acting on the lessons we should have learned from previous generations. In addition, no matter how sophisticated we think current analytical tools, management information systems and financial instruments are, the most critical element in banking is still individual experience and judgment. In the end, bank employees, and, I would stress to this audience, bank directors, are still making the important decisions. The quality of those decisions will always depend on human characteristics and our ability to learn from the past.

One banking scholar said, “There is really nothing new in banking and finance; each generation just thinks there is.” So, are we in a different situation than 20 years ago? I would suggest that one way we can ensure a different outcome is if you, in your oversight capacity as bank directors, are willing to be skeptical, willing to ask the difficult questions and unwilling to accept the answer “This time it’s different.”

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