Federal Reserve Board Oral History Project

Interview with

Don E. Kline

Former Associate Director, Division of Banking Supervision and Regulation

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Interviewers: Michael Martinson and Cynthia Rotruck Carter

Federal Reserve Board Oral History Project

In connection with the centennial anniversary of the Federal Reserve in 2013, the Board undertook an oral history project to collect personal recollections of a range of former Governors and senior staff members, including their background and education before working at the Board; important economic, monetary policy, and regulatory developments during their careers; and impressions of the institution's culture.

Following the interview, each participant was given the opportunity to edit and revise the transcript. In some cases, the Board staff also removed confidential FOMC and Board material in accordance with records retention and disposition schedules covering FOMC and Board records that were approved by the National Archives and Records Administration.

Note that the views of the participants and interviewers are their own and are not in any way approved or endorsed by the Board of Governors of the Federal Reserve System. Because the conversations are based on personal recollections, they may include misstatements and errors.

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MR. MARTINSON. Today is December 1, 2009. I am Michael "Mike" Martinson, a retired associate director in the Board's Division of Banking Supervision and Regulation (BS&R). I am joined by Cynthia Rotruck Carter, currently on staff in that division. As part of the Board's Oral History Project, we are interviewing Don E. Kline, also a retired associate director in BS&R. For many years, Mr. Kline was the head of the applications area. Don worked at the Board from 1963 to 1996.

Professional Background and Early Years at the Federal Reserve Board

MR. MARTINSON. Let's start by talking about what you did before coming to the Board and how you came to the Board.

MR. KLINE. I graduated from Juniata College in Huntington, Pennsylvania. I also had a stint in the U.S. Navy. Then, in 1962, I was with U.S. Steel in its management training program. During 1962, the steel industry tried to raise the prices of steel, but President John F. Kennedy forced the industry to pull back from the price increase. This led U.S. Steel to tighten up on its management structure. I was in an acting payroll supervisor position. The company decided to combine the payroll function with another department that already had a permanent manager. I was given the option of becoming a cost analyst again or leaving. I chose to leave.

I sent resumes to various government agencies and corporations, one of which was the Board of Governors of the Federal Reserve System. It turned out that the Fed did not have anything available.

I accepted a job in the accounting department of Welch Grape Juice Company in Westfield, New York. I was going to be the liaison accountant from the headquarters to the six plants they had around the country. About six weeks or so into the orientation program, about the time I was expected to start working full time, I received a letter from the Board indicating that a position had opened up on its field examination force. That was a group that examined/audited the Federal Reserve Banks. Although the salary wasn't too good, living expenses and all travel expenses were covered, and it was a chance to travel all over the country. So, as gracefully as I could, I bowed out of Welch Grape Juice, joined the Federal Reserve, and started a career as a field examiner of the Federal Reserve Banks. That was in June 1963.

In November 1964, while examining the Richmond Reserve Bank, a small group of us made arrangements to go to a Navy football game in Annapolis and have dinner in Washington. One of the two secretaries who traveled with the field force had a friend who was also working at the Board, and she was invited to join us. That was November 14, 1964. So I met this very attractive woman whose name was Helen, and we seemed to like each other. [Laughter] I visited her a couple of times. Then the field force went on to finish up the year in Boston, and Helen and I spent a lot of time on the telephone. I ended up coming back to Washington for Christmas with Helen, and we decided to get married. We got married on December 30, 1964, and we've been married since. I continued traveling with the Board's group. Helen had two children that were both in school. We decided that it was better for them to have a home base than travel around the country. I wrote to Fred Solomon, the director of banking supervision [the Division of Examinations] at the time, and I asked about the possibility of transferring in to the Board. He offered me a position in the merger section of the Division of Examinations.

MS. CARTER. When you were a field person, you were not physically in Washington?

MR. KLINE. No, we traveled all the time.

MS. CARTER. So you did not have an office in Washington.

MR. KLINE. No.

MS. CARTER. There was no staff here?

MR. KLINE. No. The assistant director at that time, James C. "Jim" Smith was here, and he may have had a secretary. But we took everything with us and moved it from place to place.

MR. MARTINSON. You examined all of the operations of the Reserve Bank, not just supervision, correct?

MR. KLINE. It was as much an audit as an examination. We were auditing the balance sheet, but there was an examination aspect to it that covered all the functions of the Bank. I did accounting departments and a couple of other things.

After Helen and I got married, I wrote and asked Fred about transferring. I transferred in some time during 1965. One of the conditions of the transfer was that I go to one of the Federal Reserve Banks and travel with their commercial bank examiners for six months. I went down to Richmond every week and traveled with their examiners while examining the banks. I returned to the Board in December.

MR. MARTINSON. That's when an exam was more like an audit, right?

MR. KLINE. Well, to some extent that was it, yes. But commercial bank examinations focused much more on asset quality, capital adequacy, and management. I learned a lot, and it was very useful in my work on applications.

By the time I returned, the bank holding company section had started to develop so fast that I never got into the merger section. Instead, I was assigned to the bank holding company section, and that's where I stayed. For several years I worked my way up, reviewing bank holding company applications. But this is before the one-bank holding companies were included; that came up a couple of years later.[1] The Board had jurisdiction over multibank holding companies, but there weren't many of them. If the bank was a state member bank or a national bank, the owners had to get permission to vote the stock of the bank. That's how the Board had some control over the ownership of the individual banks but not the activities of corporate owners. As far back as 1933 there were concerns about bank ownership. But the Bank Holding Company Act (BHCA) of 1956 did not include one-bank holding companies. Some of the big banks realized that they could form a one-bank holding company over them, engage in all kinds of nonbanking activities, and the Board couldn't touch them—prior to the 1970 BHCA amendments. CitiBank—then called First National City Bank—was one of the first. Then all the big banks started forming holding companies to own themselves so they could engage in these other activities and be affiliated with the bank. That led to the 1970 amendment to the Bank Holding Company Act that brought jurisdiction to the Board over one-bank holding companies.

Chairmanship of William McChesney Martin

MR. MARTINSON. William McChesney Martin was the Fed Chairman then. Do you remember much about how the Board functioned then?

MR. KLINE. Martin was a real gentleman. At that time, the Board had about 600 people, and there was a tremendous familylike atmosphere. The few guards all knew your name after a while. Every year at Christmastime, Chairman Martin handed out something to all

[1] The Bank Holding Company Act of 1956 required that bank holding companies register with the Board of Governors of the Federal Reserve System, which was given regulatory authority over these corporations. The 1970 amendments to the BHCA changed the definition of bank holding companies to include companies that controlled only one bank but restricted the definition of a bank to those institutions that accepted demand deposits and made commercial loans. The amendments also modified the standards under which bank holding companies could engage in nonbanking activities.

the support staff involved with the Board. I don't know what he gave everyone or how many people that was at the time, but that was the kind of atmosphere.

One of the things that I liked—and that I think was a real selling point for the people in supervision and regulation who worked on applications—was that everyone in the bank holding company section went to the Board when an application was on the agenda. Every application required Board action, and when the Board discussed an application, we all went to the Board Room. We got to participate. We all presented applications. At first it was the manager, but, gradually, the people who worked on the application would make the presentation, and that continued. I don't know if that happens anymore, but, in my opinion, this was one of the real pluses of working at the Board.

MR. MARTINSON. When I came in 1971, it was still the same. You would go to the Board Room to present your application, and you would stay for the whole meeting and hear about other things that went on. That was a good education process.

MR. KLINE. The Board members would question you—sometimes rather harshly. Some Board members were nicer than others. But it was real interesting, and I think that it served the staff well. Martin left in 1970 and was replaced by Arthur F. Burns. Burns was here for eight years. Then G. William Miller was Chairman after Burns.

MS. CARTER. Miller came in March 1978.

MR. KLINE. The atmosphere changed at the Board when Burns became Chairman. He was completely different than Martin.

The Bank Holding Company Applications Process during the Burns Chairmanship

MR. MARTINSON. Burns came in 1970. The Bank Holding Company Act was amended in that year, and the holding company applications took off.

MR. KLINE. Well, all the larger banks had made themselves subsidiaries of one-bank holding companies. Now they all had to register with us, because they became subject to the Bank Holding Company Act. They all had these nonbanking activities, and registration was a very significant process. The Board went through several years of adding to the list of what bank holding companies might be permitted to do. And those that could then qualify did so, while others had to divest. The divestiture period ran up through about 1980, I believe.

MR. MARTINSON. That was 10 years.

MR. KLINE. So they became charges of the Board. Overnight it went from approximately 150 to 1,000 bank holding companies.

MS. CARTER. What did that mean for your work?

MR. KLINE. First, we started to separate the applications area between banking and nonbanking. So there were some staff splits. The main task was registering these companies and then dealing with the divestiture or the qualification of the nonbanking activities. Then the applications started rolling in for one-bank holding companies to become multibank holding companies.

MS. CARTER. Did section 23A of the Federal Reserve Act enter the picture at that point?

MR. MARTINSON. It was there, but it wasn't a huge issue.

MR. KLINE. It was later on.

MR. MARTINSON. When I first came here, the Board had a lot of concern about potential future competition. And they would look at—like Texas—they wanted to make sure there were, like, four big banks and four medium-sized banks. But you saw more of that than I did.

MR. KLINE. Looking back now, you can see how long ago the Board started to become more liberal, but at that time you didn't realize. It was a gradual change. As the multibank holding companies expanded—as they acquired banks—competition became a big issue.

The Board's Division of Research and Statistics had a group called Banking Markets. That's where they first started working on the analysis of the effect on competition of these applications. They would make their recommendation, we would make our recommendation, and the Legal Division would make its recommendation, and all of that information was put together for the Board. This was before the Community Reinvestment Act of 1977, which added another aspect to the application process. The competitive effect was a big discussion item at that time. I don't remember the order in which it came, but, somewhere along the line, bank holding companies could go across state lines, and so now you're starting to interject interstate banking.

MR. MARTINSON. Right, they had those regional compacts.

MR. KLINE. You remember more than I do. So now they started becoming more of a national issue, and there were a couple of other amendments to the Bank Holding Company Act of 1956. There were amendments in 1966 and 1970.[2] Then, somewhere in the early 1980s, we started dealing with the interstate branching and interstate banking. There had to have been an amendment, but I don't recall.

[2] The 1966 amendments to the BHCA extended coverage to religious, charitable, and educational institutions that control banks. The amendments also revised the standards used in ruling upon applications to form bank holding companies or to change their composition through acquisitions, mergers, or consolidations.

MS. CARTER. There was a lot of activity in the 1980s, with institutions starting to push the envelope. There were problems, and the only way to resolve some of them was to get an out-of-state suitor.[3]

MR. KLINE. There was some prohibition on intrastate branching. Some states didn't allow their own banks to branch, so that led to a great number of banks in a multibank holding company within the state, which was a pretty inefficient way of doing business.

MS. CARTER. So I guess it reflected differences in state laws before there was a federal law that made the umbrella change.

MR. KLINE. Apart from the legal aspects of this period, recall we're now talking about the end of the 1970s. Inflation was rampant, and the Board was dealing with that. At the same time, the thrifts were being allowed to do more commercial lending, and bank holding companies were making a lot of bad loans, so we hit the banking crisis of the early 1980s.

MR. MARTINSON. During the Burns chairmanship, the Board would announce these "go slow" policies, and all of these applications would come to a halt. The Board even denied one or two.

MR. KLINE. I don't remember the Board ever denying too many applications. There were a lot of applications turned away or proposals that never became applications. There was much more of that than actually allowing an application to be denied. One thing the division did quite well was require strong capital, almost from day one. And the application process resulted in an awful lot of capital being raised by the banking system that probably would not have taken

[3] Editor's note: The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 amended the Bank Holding Company Act of 1956 to authorize the Board of Governors to permit an adequately capitalized and adequately managed bank holding company to acquire existing out-of-state banks, subject to state age law.

place. We would suggest that if an institution wanted an application approved in a timely manner, it would be better to have strong capital ratios.

MS. CARTER. In later years, a lot more was delegated to the Reserve Banks. At this point, was it all handled here?

MR. KLINE. Initially, all applications were handled here. I don't remember when the first baby steps of delegation took place, but there was some. Then, gradually, that expanded. I don't have a timeline in my mind of when each step took place.

MS. CARTER. In dealing with applications, how involved were the Federal Reserve Banks?

MR. KLINE. When we handled an application, Reserve Banks did it, too. I think that still goes on today, unless the application is handled under delegated authority. The Reserve Bank prepared a memorandum that went to the Board as part of the Board package.

MS. CARTER. So they have been an integral part of the process.

MR. KLINE. Yes.

MR. MARTINSON. Usually, we try to get a common view, but occasionally there were applications where our recommendations would differ.

MR. KLINE. Yes. As I recall, most of the occasions where there was disagreement, it would tend to be on the competitive side. We were pretty much in harmony on the financial side. The Reserve Bank had a better handle on the condition of the bank than we did from looking at an examination report, so we relied heavily on them. And we gradually kept taking memos to the Board for expanding delegation of authority. I don't know how much delegation there is now; it's probably quite a bit.

With the thrift crisis and the banking crisis in the 1970s, the applications were much more critical. We had applications when a bank was going to fail. We processed an application basically overnight—and a lot of times well into the night. There was an awful lot of overtime spent by Board staff getting memos to the Board, so that, at the time the bank failed, there was already an application to take it over when the FDIC closed it.

Fed Chairman G. William Miller

MR. MARTINSON. G. William Miller was here a short time, from 1978 to 1979. Is there anything you particularly remember about him?

MR. KLINE. Miller came from Textron. He was a CEO and a very good manager. My dealings with him personally were in a few meetings where he'd come in with no coat on, and he'd talk about how things were. I thought he was very good in that atmosphere. I had no insight into what his problems were regarding monetary policy other than what I read in the papers or the scuttlebutt. That's where he had trouble. He would have been a good manager for the Board, but he didn't have the right skills or the insights into monetary policy that a lot of people probably believed he should have.

MR. MARTINSON. At that time, the Board had really strong Board members—Wallich, Partee.

MR. KLINE. One of the "big" issues that the Board dealt with during that period, 1978 to 1979, was smoking in the Board Room. [Laughter] Nancy Teeters and Partee were big cigarette smokers. Wallich smoked a pipe, and Volcker, when he arrived in August 1979, smoked cigars. It took a long time to get smoking completely eradicated. [Laughter]

MR. MARTINSON. I remember that Chairman Miller removed all the ashtrays from the Board Room, but after a while Board members started bringing back in their own ashtrays.

MR. KLINE. This is the one area where the independence of Board members showed itself. [Laughter] Here comes a Board member with an ashtray. They would do it very consciously. It was a message. It was funny. The idiosyncrasies of Board members sometimes showed up in the Board meetings.

MS. CARTER. Now smoking is completely banned.

MR. KLINE. A lot of the Board members had coffee or tea brought in during a Board meeting. This was pretty standard, to smoke and have a cup of coffee or tea. There was a table at the end of the Board Room. A server would bring in tea and set a little tray on the table. One particular Board member would, at an appropriate time, get up and walk to this table. He would pour the tea into his demitasse cup, and he would stand there at the table sipping the tea.

Changes in the Division of Banking Supervision and Regulation

MR. MARTINSON. During your tenure at the Board, there were several changes in the leadership in the banking supervision and regulation division.

MR. KLINE. Fred Solomon, as I mentioned earlier, was director when I joined the Board. He was succeeded by Brenton C. "Brent" Leavitt. Then John E. "Jack" Ryan became the director in 1977. After Jack Ryan, William "Bill" Taylor became director in 1986.

It was during this period, too, when the Basel capital meetings began. We started to diminish the value of capital by expanding what could be considered capital. That was not a good move, in my opinion, and, I think, others. The move away from common equity capital was too much. At first, it didn't seem bad. You had some "almost equity" capital; it was called tangible capital. But pretty soon some of that stuff was way out there, and I think that hurt.

MR. MARTINSON. So, back to basics would be better.

MS. CARTER. Do you remember anything about the transition from Ryan to Taylor?

MR. KLINE. Well, first of all, they had different styles. Jack was a good division director. He understood banking. He was laid back and casual about some things, but I would never have underestimated his intelligence or banking knowledge. The division functioned well under his leadership. Bill Taylor was a dynamo; he completely changed the dynamics of the division.

When Paul Volcker became the Fed Chairman in 1979, Jack was still here. At some point, Volcker developed a close relationship with the directors of Research, International, Legal, and Banking Supervision and Regulation. Mike Bradfield was the Board's general counsel. I'm not sure just how or when that group formed, but, certainly, those four functioned above the division director level in terms of the relationship with Volcker.

Rather than manage through the Board as a whole, Volcker managed through his senior staff. I wasn't privy to that, but I suspect that a lot of decisions were made before Board members were aware the decision was going to be made. Volcker was very much in charge. And because Bill Taylor was very close to Volcker, in that sense, the division prospered. We received budget money, and we expanded. In the early 1980s, we got our first PC (personal computer)—one PC. Bill wanted us to build a real technology area in the division, and one of his big charges was the database. This eventually led to the national information center on a more sophisticated scale, but he wanted the database available to the whole division. So we put together packages and either we took them to Bill or Bill told us to bring them. We went to the Board and got approval. So that expanded very quickly during the 1980s, and Bill was the driving force behind it.

MS. CARTER. Steve Schemering mentioned that when he started, there was one calculator, so you had to make your reservation to use the calculator.

MR. KLINE. Before PCs as such, there were word processors. And when Fred Solomon was the division director in the 1960s and early 1970s, everyone in the division who prepared memoranda had their own dictaphone.

MR. MARTINSON. I don't think that lasted too long.

MS. CARTER. And you had a secretary that would type everything.

MR. KLINE. Oh, yes.

Major Banking Supervision Issues Related to Applications

MS. CARTER. Do you have any memories about Continental Illinois and other big issues?[4]

MR. KLINE. I don't recall details. In Continental Illinois, there was a big flap with the Comptroller of the Currency. There was controversy between us and the Comptroller on how a bank could do nonbanking activities. The Comptroller was advocating the operations subsidiary, and we were taking the position that if the bank was in any way connected to it, the bank was going to be held liable. So if one of these subsidiaries, affiliates, however they were handled, got in trouble, our position was that it was going to come back on the bank. Continental was the first test of that, if I recall. We actually denied something, but I don't remember what.

MS. CARTER. Some kind of nonbank activity.

MR. KLINE. We denied Continental's holding company something in some manner, but I have no idea at this point what it was.

[4] Until the seizure of Washington Mutual in 2008, the bailout of Continental Illinois was the largest bank failure in American history. In May 1984, the bank became insolvent, in part because of bad loans purchased from the failed Penn Square Bank, N.A., of Oklahoma. The loans had been made to oil producers and service companies and investors in the Oklahoma and Texas oil boom of the late 1970s and early 1980s. The term "too big to fail" was coined during this crisis.

MR. MARTINSON. You were talking about raising capital. When some of the Texas holding companies got into trouble, the first efforts were to merge and raise capital.

MR. KLINE. Well, there were several big ones, and, as I recall, we approved a couple even though common sense suggested it would not work. But on the basis of them committing to raise capital, we approved applications that probably should not have been approved. It was an attempt to save the banks, but what happened was that the bigger merged bank failed. I remember Republic and First National.[5] There were a couple [of] others that got into that mix. They didn't have enough capital, and those commercial real estate loans were just overwhelming, not unlike it might be today.

MS. CARTER. In the late 1980s, early 1990s, some institutions were really pushing the envelope on what they were permitted to do. Citicorp and others came to the Board to try to do this and that. There was one case after the other.

MR. KLINE. Things really starting to perk after Volcker broke the inflation spiral. Volcker came in August 1979 and left in August 1987. Everything was rolling, and we fell into the trap of letting it roll without proper safeguards. This was a time when the nonbanking activities were expanding too. Bank holding companies were really putting pressure on for some of the broader-based activities. And, by this time, Citicorp had gotten bailed out through a large investment by Saudi Prince al-Waleed in 1991.

[5] Editor's note: In 1987, RepublicBank Corporation merged with InterFirst Bank Corporation, creating First RepublicBank Corporation. First RepublicBank failed in 1988—the largest bank failure in U.S. history at the time. NCNB Corporation acquired First RepublicBank from the FDIC in 1988 and, in 1991, changed its name to NationsBank.

MR. MARTINSON. While you were still here, the Board started approving the section 20s to allow banks to move gradually into investment banking.[6] Is there anything you remember about that?

MR. KLINE. I don't recall a lot of debate about it. There were questions about whether banks should be allowed to do it. And there were questions about various aspects of real estate involvement. There were benchmarks set that banks should not pass, but, gradually, they all seemed to have gotten passed. The thing is that everything was going so good; it was difficult to find a basis for a denial other than the permissibility question. Everyone just got caught up in the expansion. The repeal of Glass-Steagall, of course, was the killer.

Alan Greenspan

MR. MARTINSON. We've been through the Burns and Volcker area. In August 1987, Alan Greenspan became the Fed Chairman.

MR. KLINE. We went from a very civil, very nice atmosphere created by Martin to much more separation between the Board and staff during the Burns chairmanship. There wasn't the same kind of comfortable feeling. I imagine that those who were directly involved would feel that much more than me. Miller just didn't have a chance because of, as we discussed, his lack of experience in monetary policy matters. Volcker commanded respect. He wasn't tough on [the] staff in a general sense, although he could be pretty tough individually at times. But you had a lot of respect for what he was doing. I think most of the staff, especially those who were

[6] Editor's note: The Board of Governors may, on a case-by-case basis, grant prior approval to a bank holding company or a foreign bank to engage to a limited extent through a so-called section 20 subsidiary in underwriting and dealing in securities that a member bank may not underwrite or deal in directly (bank-ineligible securities). Such a subsidiary is called a section 20 subsidiary in reference to a repealed section of the Glass-Steagall Act that limited affiliations between certain securities companies and member banks.

directly involved, would have felt that Greenspan brought us back to the much softer, easygoing relationship between [the] staff and the Board.

MR. MARTINSON. Did you notice how the approach to supervision might have changed or not changed?

MR. KLINE. Greenspan didn't seem to be too tuned into us. Things were going good, and there really wasn't anything to command his attention. But almost the first day he was here, he went to Texas to make the speech to the American Bankers Association, and we had the stock market crash. But I never sensed that there was much interest in pushing supervision or regulation.

Volcker was hands-on. Volcker knew supervision as well as he knew the other aspects of the Board. I didn't detect or sense that Greenspan had that much interest in supervision and regulation, so long as it didn't get in the way of the banks being able to do what the markets wanted. And I don't know how much of that attitude, on my part, is coming from what I know now as opposed to what I knew then. It's pretty clear now that everyone eased off too much.

Reduction in Major Issues Involving Applications

MR. MARTINSON. For a while, almost all of the applications went to the Board, and the Board worked on them. Now, almost none go to the Board. How much of that change occurred before you left the Board?

MR. KLINE. Well, it had changed dramatically. One of the reasons I left was that applications processing was pretty boring. I'd been through a couple of crises where the applications meant something. You went to the Board, told the Board members the story, and after listening to you, the Board acted on what you were telling them. If everything's sailing along, there isn't much interest. I was already 65 and had my 30-plus years of service. And there was a difference in the management. I don't mean it in a bad sense, but, after you've been with Jack Ryan and Bill Taylor, Rich Spillenkothen's management style was just really different from those guys.

MS. CARTER. Is there anything else you want to talk about?

MR. KLINE. I was surprised that the number of commercial bank failures didn't peak until 1988.

MR. MARTINSON. Yes, there was a delayed reaction.

MS. CARTER. We had some big failures, but they just kept clicking along. And then the next wave was the S&L crisis, as I recall.

MR. MARTINSON. I think a big part of it was that things got good enough that they could go and address all the problems that had piled up, because some of those banks were pretty much walking dead men for a while before they—

MS. CARTER. Definitely the S&Ls.

MR. MARTINSON. Real estate peaked right at the end of problems.

MR. KLINE. The whole thing about the definition of banking, where the savings and loan associations gradually were not treated any differently than commercial banks, was a big switch. And, unfortunately, it wasn't handled very well by all the regulators.

MS. CARTER. That's when I came in. You had busted insurance funds, and [the] FSLIC (Federal Savings and Loan Insurance Corporation) was broke. We were running numbers for Bill Taylor on that. Then that got "resolved" after FIRREA (Financial Institutions Reform, Recovery, and Enforcement Act of 1989).

MR. KLINE. Bill was a good person to have at that time, because he was a mortgage banker guy. He really knew real estate.

MR. MARTINSON. Well, thank you for the interview.