

# Federal Reserve Board Oral History Project

Interview with

**Mark W. Olson**

Former Member, Board of Governors of the Federal Reserve System

Date: January 14, 2014

Location: Washington, D.C.

Interviewers: David H. Small and Adrienne D. Hurt

## 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. SMALL. Today is Tuesday, January 14, 2014. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. We are interviewing Mark W. Olson, who was a member of the Board of Governors from December 7, 2001, to June 30, 2006. I am David Small from the FOMC (Federal Open Market Committee) Secretariat of the Board's Division of Monetary Affairs. I'm joined by Adrienne Hurt, an officer in the Office of Board Members. This interview is taking place at the Board.

Governor Olson, thank you for joining us.

MR. OLSON. Thank you, David and Adrienne.

## **Background in Financial Services**

### *Family Banking Background and College*

MR. SMALL. I thought we might start briefly with a little background.

MR. OLSON. My father and grandfather were both bankers, and they both were involved in chartering banks. In the mid-1890s, my grandfather chartered a small bank in Minnesota that still is an independent state bank. In 1957, when I was an eighth-grader in Fergus Falls, Minnesota, my hometown, my father chartered a bank.

My father put together the capital to charter a bank, and he was deciding some very fundamental things about the structure of the bank. First, the bank organizers had to get approval for the capitalization. They were aiming at 8 percent of what they anticipated would be the initial bank size. Because they thought the initial bank size was going to be about \$2 [million] to \$3 million in assets, they arrived at a capitalization of \$250,000, which the state approved. But the FDIC said that wasn't quite enough—they needed another \$25,000. So they capitalized the bank initially at \$275,000, and they were granted the charter. As an eighth-grader, I was

fascinated by what my dad was doing. That was my first lesson in capital adequacy. But at the time, I didn't realize the impact that would have going forward.

Second, they had to decide whether to be a state bank or a national bank. That decision was driven, in part, by the fact that my dad was also a stockbroker. He had his own small brokerage firm in Fergus Falls. Therefore, he was under Glass-Steagall. So I also got my first lesson in Glass-Steagall as an eighth-grader. He was ineligible to be an officer or a board member of that bank unless it was a state-chartered bank. So very early on in my life, I was introduced to some pretty basic concepts on the banking industry.

My choice of college was also influenced by my father. His parents, my grandparents, were Norwegian immigrants. My grandfather had only a fourth-grade education, but he had been involved with chartering a bank by his age [of] 35. He moved the family to Northfield, Minnesota, to remove any ambiguity about where my dad was going to go to college. He was going to go to Saint Olaf College, which was the dominant Norwegian Lutheran school in that part of the world. That's where my dad went. That was my default choice all through high school, and that's where I went.

In many respects, it was a very good choice for me. I started out thinking that I would be prelaw and was a political science major for the first two years. Then I made one trip to the law school and decided that I may or may not ever be a lawyer, but I sure wasn't ever going to go to law school. So I changed my major to economics, and that changed a lot. I took a course in money and banking, where there was a heavy focus on the role of the Fed. And, as I remember, I did a paper on all the factors involved in the chartering of a bank. So, as a college student and in this paper, I went back and reviewed the process of chartering a bank, something my father and grandfather had been involved in.

In the course of my economic study, I took macroeconomics. The course was entitled National Income Theory. That was the title used back then. I haven't seen that term used in many years. Maybe the worst professor that I ever had was teaching it. He was a nice guy but not a very good instructor, and he didn't last long. On the other hand, the microeconomics teacher that I had was an excellent teacher and was my adviser. It was probably the only class in which I really thought that I dominated the class of some pretty good students. And I had a strong sense that this was where I belonged.

The school year was divided into two four-month semesters, with a one-month interim in January. Thus, it was referred to as a 4-1-4 program. I created a mutual fund on paper during that interim. That was my project. My dad had done some work in the mutual fund industry, so I worked with him to help define what I was doing. It was a specialized mutual fund that was focused on the value of ownership in life insurance stocks. I learned a lot in the process of creating that mutual fund and thought that I might be interested in that aspect of the securities business as an alternative to banking.

MR. SMALL. Did your dad view the securities business and the banking business as two totally different worlds?

MR. OLSON. In his mind, they were a component of the same business. As a matter of fact, he had a brokerage business in the same office where they had insurance and real estate.

In the 1920s, he started his career in the bank his father had helped charter. If you were starting in the banking business, for the first several years of your career you were making general ledger journal entries, which my dad had no interest in doing. Like his father before him, he was very good at sales, so he wanted to be in an environment where he was more people oriented and more sales oriented. That moved him out of banking initially and into securities,

real estate, and insurance. But then he came back to the banking industry in his 50s. He did not run the bank, but he was the largest shareholder and was the chairman of the bank.

I was getting a broad view of the financial world through my father. My wife grew up in a medical family—her dad was a medical doctor, and her mother was a nurse—and she has an excellent visceral feel of medical issues. I don't. Any time we have medical issues, she's way ahead of me. I have that same visceral understanding of many financial issues just because I grew up in that environment, so it was natural for me to move in the direction of finance and banking. Also, at college—for reasons that I didn't fully appreciate—I started to become identified as a leader. I was elected vice president of the student body, and I was elected co-captain of the hockey team. I didn't necessarily seek them, but leadership opportunities were coming my way.

I recognize that I'm tooting my own horn here. But from age 17 until today—and I'll be 71 in March—there have been very few periods of my life where I haven't either been the president, vice president, or board member of something almost continuously for 54 years. That's been a pattern for me.

MR. SMALL. There's a bit of a spectrum between being a captain of the hockey team and a Governor of the Federal Reserve Board.

MR. OLSON. There is. After college, I toyed with the idea of going to grad school, but I was anxious to get on with my life. So I immediately went to work for what is now U.S. Bancorp. Then it was the First National Bank of St. Paul, which was part of First Bank System. I worked there for four years both in retail banking and commercial lending. Also during that time I started to get active politically.

*Perspective of Banking Industry Working in a Bank*

MR. SMALL. In retail banking and commercial lending, were you on the asset side—the loan side—evaluating and making loans?

MR. OLSON. Yes, making loans. For two years I was essentially a division assistant in an area that did a lot of commercial lending. This was small business commercial lending.

MR. SMALL. One could say that the traditional world of lending and the modern world of lending by banks are very different because of the securitization that goes on in the modern bank. In the past, you knew you were going to hold the loan in your portfolio for the duration of the loan. The credit evaluation was much more stringent because the bank that made the loan was on the hook for the loan, whereas now they slice and dice it and sell it off.

MR. OLSON. It's a matter of perception. If you're talking about middle-market lending today for commercial lending, most of it is still portfolio lending. I don't think there is much of that where there is securitization or even shared national credits. There was some sharing of credits in those days. For example, in our bank, we didn't divide up the immediate Minneapolis-St. Paul market, but each of our groups had regional responsibility. The group I was in happened to have the West Coast.

So if a West Coast bank—at that time, let's say Bank of America, but more likely a Security Pacific—was initiating a credit, and it was looking for participants in that credit, there was a lot of sharing of that. But the lead bank would take a major share, like 15 or 20 percent of the bank, so there was still a significant risk exposure by the lead bank. But the lead banks were also looking for other banks to participate in the loan, so there was a fair amount of participation of national credits that would happen in that time. But I think today, especially of the largest institutions, the ratio is different. The ratio is higher in terms of the credits that are either

securitized or shared. But not all of the shared national credits are securitized. For many of them, you're just dividing up the loan itself. It is an undivided interest because, basically, you've got 10 percent of this loan that you're going to fund. And then they would manage the repayment, for example, accordingly.

The other thing that changed significantly over that period, when I was just out of college, was the securities industry increasingly developed its commercial paper market. That made a huge difference. Commercial paper reduced the cost to the largest borrowers because you would not be funding it off a deposit base, you'd be funding it off triple-A money that you can raise in the short-term market.

MR. SMALL. For example, IBM is funding itself in the commercial paper market and not through banks.

MR. OLSON. Yes, exactly right. For IBM, for example, [by] going through the commercial paper market, it didn't have the 8 percent capital charge that it would have paid by going through a bank, so funding through commercial paper could significantly reduce its borrowing cost. From an economic perspective, it was a very efficient way to finance large firms. But for the banking industry, it meant that its signature product, the 90-day commercial loan for the largest and the best commercial customers, significantly left the banking sector. So banks were looking much more toward the middle-tier market or were looking to make term loans that were funded in some way other than with commercial paper. So there I had a chance to observe the marketplace finding a substitute for a product (short- and medium-term loans to large corporations) that had been, up to that point, overwhelmingly dominated by the banks and was thought to be the banks' exclusive purview. The marketplace was finding an alternative to a product that had been exclusively issued by banks.

And it was Glass-Steagall, of course, that precluded the banks from moving into the securities business. So I came to view Glass-Steagall as a one-way valve. It allowed other entities into the banking industry without allowing the banks to move into theirs, which I thought was just fundamentally inappropriate. And as I got to evaluate the implications of Glass-Steagall moving forward, that was and remained my perception up until 1999.

*Bank Holding Companies*

MR. SMALL. How did bank holding companies come about?

MR. OLSON. There were a couple of reasons for bank holding companies. But first and foremost is that bank holding companies allowed for multiple ownership of banks either intrastate or interstate. The Douglas Amendment to the Bank Holding Company Act limited ownership across state lines.<sup>1</sup> Under that amendment, a bank could only own another bank that was across state lines if the first bank was invited in by the state in which the second bank was located. At that time, the only state that did that was New York, because it wanted to be invited to every party. But nobody wanted New York at the party. So there were no states that invited banks in. So, in effect, while the bank holding company allowed for ownership of multiple banks in state, it didn't allow for ownership across state lines.

Also, the McFadden Act specifically prohibited banks from branching across state lines, so the only opportunity for multistate banking was through a holding company. And, for many years, even those opportunities were very limited.

MR. SMALL. Did the combination of the development of the commercial paper market and the restriction against interstate banking increase the risk exposure of a bank? If a bank

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<sup>1</sup> The Bank Holding Company Act, specifically, section 3(d)—the Douglas Amendment—originally limited a bank holding company to owning banks only in the state where the bank holding company maintained its principal place of business unless the acquisition of the out-of-state bank was specifically authorized by the statutes of the laws of the state where the out-of-state bank was located.

wasn't making loans to big corporations that it lost to the commercial paper market, and if the bank couldn't diversify geographically, was this setting up banks to be less diversified and subject to greater risk, which is not good from a financial stability point of view?

MR. OLSON. Yes. For example, think of a Continental Illinois. The laws in Illinois specified that you could do banking only out of a single office. So Continental had a single office in Chicago and could only operate out of that facility, and yet it was a very aggressive commercial lender. It started buying loan participations out of banks like little Penn Square in Oklahoma City. But that just gave Continental a horrendous risk exposure that it should not have taken on.

MR. SMALL. It also gave Continental a risk exposure on the funding side because it couldn't pull in enough deposits to fund itself. That led Continental to fund itself in the commercial paper market.

MR. OLSON. Exactly. Even more so. Continental Illinois did not fail because of asset quality. It failed because of funding. It could not maintain its funding. It happened literally overnight.

MR. SMALL. This is what I've learned was called the first "silent run," because wholesale money was leaving electronically and not leaving because depositors were lining up at the teller windows.

MR. OLSON. Right. Now, there is one other benefit of a holding company for small family-owned or closely held community banks. A holding company that owned a bank could borrow through the holding company and could use the funds to facilitate the transfer of ownership either among one set of owners of the bank [or] to another set of owners. One of the

reasons you've seen generational transfer of community banks is because of the Bank Holding Company Act.

The body of case law surrounding bank governance issues all was done at the holding company level as opposed to the bank level. So, over time, for example, as banks went to the capital markets, it was the holding company that went to the capital markets. And then the holding company at various times was thought to be the vehicle by which banking was expanded into nonbanking products too, because there were limitations on the bank itself that did not apply to the holding company.

MR. SMALL. Why have bank holding companies? What public purpose do they serve? What problems did they address?

MR. OLSON. It's hard for me to know how much of it was intentional and how much of it was serendipitous. But, for example, you had one body of law that the OCC [Office of the Comptroller of the Currency] through regulation put together or the National Banking Act put together regarding national banks. Each state came up with a set of laws applying to the banks that are chartered in that state. And then you had the Bank Holding Company Act, which allowed for the ownership of such banks by a bank holding company and provided certain other exceptions to those state regulations in the case of state-chartered banks—or opportunities, depending on how you look at it.

I think that the most notable of the restrictions on banks was the so-called Glass-Steagall Section 20, which specified that banks could not be “principally engaged” in the business of owning securities. For 45 years that was simply interpreted as banks were not allowed to engage. Then one bank—my recollection was, it was Bankers Trust—asked the Fed to quantify

what “principally engaged” means, and the Fed said that it means 5 percent. That’s my recollection.

So all of a sudden you had bank holding companies that now had 5 percent ownership of a securities firm that then went to 10 percent and then to 20 percent. That then facilitated a significant movement into security equity underwriting by bank holding companies not because there was a change in the law, but because there was a different interpretation of the law. Then, ultimately, the Gramm-Leach-Bliley Act (also known as the Financial Services Modernization Act of 1999) did not fundamentally allow for new opportunities so much as it codified what had already happened in the marketplace. I don’t ever remember that there was a lot of coordination on that subject.

Coming back to the point, you may remember that somehow it worked the other way, too. At one point, the Comptroller thought it was consistent with the National Banking Act for banks to be able to take one-half of an equity option in an option derivative transaction. The Fed looked at it and said, “We think that’s a violation.” Ultimately, that was an initiative that you could conduct in the bank itself but you couldn’t conduct at the fed level. I think we ultimately changed our rule, allowing for that to be done in a holding company.

So at one point it started to look like the vehicle of choice for what would be the most exciting entity was the holding company. Then a couple of things happened simultaneously, one of them being the expansion of the biggest banks. Then you have the Office of the Comptroller of the Currency’s interpretation of preemption, where the federal regulations trump state regulations.

The preemption decisions were coming down. The Office of the Comptroller of the Currency, which oversees national banks, was issuing standards under which federal banking

regulation could preempt state banking law, and any bank that had a significant retail presence, a multistate presence, en masse converted to a national charter if they didn't already have one in order to take advantage of preemption.<sup>2</sup> So we've seen a certain amount of charter arbitrage going on as a result. I think that has now been narrowed. But that happened for a while in part because of the differing options available through different charters.

*Perspective on Banking Industry from Working on the Hill*

MR. SMALL. You worked for a Republican congressman.

MR. OLSON. When I was at First National Bank of St. Paul, I was also becoming active politically. I'd just been made an officer of the bank in 1969 at a young age. But by 1970, being young and single, I was looking for other things to do.

I left the bank and went into politics, initially on the campaign staff of a man running for governor of Minnesota. Then I worked for William "Bill" Frenzel (former U.S. Congressman). I managed his first campaign running for the Congress, which he won. I went to Washington, D.C., with him, and he was assigned to the House Banking Committee. So there I was working for a member who had a lot of banking background. I was the banking "LA," legislative assistant, of a member of the Banking Committee. I was astonished at how little the Banking Committee understood banking and how little the banking industry understood the way Congress worked.

That was my first exposure to higher-level banking industry public policy. That was 1971. And I've spent the last 44 years essentially right at that point—the confluence of financial institutions and public policy—and I've been there ever since. And I've never for a day tired of

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<sup>2</sup> When state law and federal law conflict, federal law displaces, or preempts, the conflicting state law pursuant to the Supremacy Clause of the U.S. Constitution.

that. I've really enjoyed working in that space and developing that space from many different perspectives. That was very key, at around age 27, to be able to be in Washington watching every committee meeting chaired by Wright Patman for two years.

MR. SMALL. Was lobbying by the banking industry intense?

MR. OLSON. It was active.

MR. SMALL. While on the Hill, how much did pressure from, or interaction with, the banking industry on specific issues differ from when you were a Board member?

MR. OLSON. Well, let me tell you, a big difference. When Arthur Burns used to testify before the House Banking Committee, if you were, let's say, a banker and you wanted to sit in the audience, you could stroll in as he was about to testify because the room would be maybe one-fourth full. Ten years later, when Paul Volcker would testify, if you wanted to sit in and listen, you had to have somebody standing in the hallway for two hours in order for you or your group to get a seat. That's just a different level of intensity of how much banking issues became lobbied, in significant part because it was then, and to a significant part [is] today, a zero-sum game. The Congress was essentially deciding which industry could offer which products. And because of that fact, there was a lot at stake. The securities industry was on one side. The banking industry was on one side. The insurance industry was on another side. And they each had major stakes. So there was a lot of lobbying going on. And, over time, it got much more intense.

In those days, you also had a handful of banking leaders who were very good at representing the industry. David Rockefeller comes particularly to mind. He was very well regarded, very well received. He was very comfortable in Washington, D.C. And Chase Manhattan had a strong presence. There haven't been many bankers like that that have been

willing to assume that role and did it well. There were others, too, but David Rockefeller perhaps most notably.

MR. SMALL. Did you get a sense of a philosophical difference between Burns and Volcker on regulation, crisis management, or financial contagion?

MR. OLSON. Not really, in part because we hadn't seen many crises at that point. I think the Fed was perceived to be an organization that thought of itself as the greatest among equals, especially when Burns was here. The feeling on Capitol Hill was that there was an arrogance to the Fed, because it thought of itself as the dominant regulator in Washington. And there was a certain amount of resentment at the FDIC [Federal Deposit Insurance Corporation] and at the OCC.

You also had people who were concerned about the Fed having too much power. I think that the perceived and actual opacity of the Fed at that time helped perpetuate the sense of mystery about the role of the Fed. The power of the Fed philosophically conflicts with a certain amount of populist concern about bigness, about size. And just as we continue to pass laws restricting our biggest banks, also there is concern about a dominant regulator like the Fed. So that has been very much the case.

Arthur Burns was one of the Chairmen who strongly understood that the Federal Reserve Act gave the Fed enormous power and responsibility, but what the Congress gives, the Congress could take away. And he was very careful to be a creditable communicator on behalf of the Fed. Paul Volcker was the same way. Each of the Chairmen that I have observed, and I've observed five of them pretty closely, has recognized the importance of credible communications with the Congress.

MR. SMALL. There was some tension between Arthur Burns and Wright Patman, who was chairman of the House Banking and Currency Committee from 1965 to '75.

MR. OLSON. Continual tension.

MR. SMALL. The issue of auditing the Fed came up. Do you remember some of those issues?

MR. OLSON. Well, what I remember specifically was with Wright Patman. Wright Patman was troubled by the fact that the Fed owned as many government securities as it did. And with no sense of embarrassment whatsoever, Patman would lecture Arthur Burns, saying that it would be the patriotic duty of the Fed to take all the government debt that it held on the balance sheet and just forgive it so that the federal government would have that much less debt.

Patman was unconcerned with how the Fed would then conduct monetary policy if it had no securities in its portfolio. Patman would tell Arthur Burns most every time that Burns testified that the Fed ought to give back all the U.S. government securities that it owned. It was mind-boggling that he would continue to say that. And people would just let him do that because they'd heard him say that quite so often. The other House Banking chairman that was probably more aggressive in terms of the demands was Henry B. Gonzalez (chairman from 1989 to 1995). He was the one who wanted the Fed to be audited. He was a stronger proponent of auditing the Fed than was Wright Patman.

In between, Henry Reuss was chairman (from 1975 to 1981). He had potential conflicts in a way that might not be allowed today. His family was a significant owner of the Marshall and Ilsley Bank in Milwaukee, and he was still a significant owner of the Marshall and Ilsley Bank and chairman of the House Banking Committee. I don't think that anybody thought that

presented a conflict of interest, because he clearly was not in the pocket of the banking industry.

But it's interesting that he did have that combined circumstance.

MR. SMALL. How many years did you serve on the Hill?

MR. OLSON. Two years in Washington. Then I went back to Minnesota and ran the district offices for Congressman Frenzel. I still monitored the banking legislation, but I wasn't attending committee hearings anymore.

*Advocacy Perspective of Banking Industry through Trade Association*

MR. OLSON. In 1976, my father died. The guy who was running our family bank needed to be replaced. He had health issues and other things. Our family did not have a majority interest, but we had the largest interest. So, at age 33, I was hired to go back and run the bank. I became president of the bank. So here I was, in a small town in Minnesota, running a bank, but I had a Capitol Hill background in the banking industry. So I immediately got involved in the American Bankers Association (ABA), at its request. And then, pretty young, I was first vice chairman and then chairman of the government relations council of the ABA. Then I became president of the American Bankers Association when I was 43.

MR. SMALL. You were the youngest ever ABA chairman.

MR. OLSON. I was the youngest ever. So now I had seen the banking industry as a banker. I had seen the banking industry as a policymaker from the legislative side. And then I was an advocate of the banking industry at the ABA.

At the conclusion of my ABA term as president, the timing was right. We sold our family interest in the bank, and I was hired by the old Arthur Young firm to come to Washington and head its regulatory relations. Ultimately, the firm became Ernst and Young, and I established its regulatory consulting practice.

At that point, I'm seeing the banking industry still from a different perspective. I'm seeing it as an adviser on regulatory issues. This is now the fourth perspective that I've had. You put that all together, and it was a pretty well-rounded look from a public policy perspective as well as an operational perspective of the banking industry.

### **Nomination to the Board of Governors of the Federal Reserve**

MS. HURT. How did you get on the short list of candidates for the Board?

MR. OLSON. In 1999, I retired from Ernst and Young and was invited to go back to be on the Senate Banking Committee staff to head the Securities Subcommittee. That subcommittee had jurisdiction of essentially the securities industry. I was working with the entire Republican Senate delegation of Banking Committee members. I didn't know the Senators, but I knew all their staff people real well. But I did get to know and work with Paul Sarbanes (D-MD), for whom I had a great deal of respect—which I think was mutual respect—and people on the Democratic side.

George W. Bush was elected U. S. President that fall. Because of my role on the Senate Banking Committee, I was asked to be on the transition team for Bush/Cheney in 2000 and 2001. And I was.

I was 56 years old and wondering what I was going to do next. Somebody said to me, "You ought to be the president of Ginnie Mae [Government National Mortgage Association]." So I made a couple of calls: "What do you think is going to happen with the presidency of Ginnie Mae?" There was a pause on the other end of the phone, and the person said, "Don't you know that you're being promoted for a Fed Governor position?" I said, "No, I didn't know that." The person said, "Yes."

The Board had not had a banker for a long time. Since John LaWare left (in 1995), there hadn't been a banker on the Board. I had two other things going for me. Number one, it had been 25 years since there had been anybody nominated out of the Ninth Fed District. David M. Lilly (Board member from 1976 to 1978) had been the last person. The other thing was that, when I joined Ernst and Young and was doing banking industry consulting, there were very tight independence standards, so I had no ownership of a bank stock and no revenue stream from the banking industry. Most retired bankers have one or the other—they either have stock or they have an ownership. So there were real independence and conflict issues. I had cleared those up years ago.

So here I was, a guy who understood the policy and understood Washington. There's an old adage; when you're a presidential appointee candidate—I used to hear it all the time—the question was always posed the same way: "Who's your advocate?" In my case, it was the Republican members of the Senate. The banking industry was also supportive, but I don't think that carried the day. It was much more the Republican members of Senate Banking. And some of my strong advocates were close to the people within the Bush White House who were involved in that decision. So that process started to move. And, ultimately, the nomination emerged.

MS. HURT. Did you have any hesitation about becoming a Board member?

MR. OLSON. I had none at that point. In fact, I was very much looking forward to it. I was fully retired. I was not wealthy, but I was financially independent, which meant to me that I had a retirement secured, and I had either paid for, or had figured out how I was going to pay for, my children's education. My family—my wife and I, essentially—said it will be a short-term financial risk, but it was worth doing.

The appointment took a year. I had left the Senate because my then-boss was defeated. I was a candidate for the Board. So for a year I couldn't do what I did for a living, which was consult to banks. It was just the process of getting ready, studying the issues and learning about the issues until such time as the nomination came through.

MS. HURT. What did you think of the nomination process?

MR. OLSON. It was a mystery. And to this day it's a mystery.

Clay Johnson III was President Bush's point person.<sup>3</sup> Clay was just a high-class person. Clay did the same thing for President Bush when he became governor of Texas. He was a close personal friend who Bush trusted. He looked out for many of the high-profile positions, appointments that the President made. He said to me, "I think the process is a mystery." And there seemed to be no two alike. Anyway, it moved forward.

The nomination hearing itself was a nonevent. Sue Bies and I did it the same day. Only three members of the Senate showed up. But that was the best of all worlds, because there's no upside in the hearing itself, there's only downside. From the nominee's standpoint, the less focus on the hearing the better. But that was also the time of the anthrax scare, so the Senate buildings had to be vacated for, like, two months.<sup>4</sup> There was a real issue getting the Banking Committee together so that it could vote. Once or maybe twice they called a meeting and couldn't get a quorum. So Sue's and my nomination couldn't move forward because the Banking Committee couldn't get a quorum.

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<sup>3</sup> At the time, he was the director of Presidential Personnel.

<sup>4</sup> Shortly after the September 11, 2001, terrorist attacks on the United States, letters containing anthrax spores were mailed to several locations, including the Senate. Several people at the U.S. Postal Service were killed or infected.

There was a ripple of opposition to the appointments by the real estate industry. The Realtors had a problem with me at one time because I'd advocated banks to have the ability to do real estate brokerage, and they objected to that.

By that time, Senator James "Jim" Jeffords from Vermont, a former Republican, had become an independent.<sup>5</sup> So the chairmanship in the Senate went from Phil Gramm to Paul Sarbanes overnight. But the good thing, from my perspective, was that I had a very good relationship with not so much Sarbanes as with his staff people, and I continued to have a good relationship with both Sarbanes's and Phil Gramm's staff.

I thought that the Sarbanes people are like him. They are gentlemanly and gentlewomanly people, just as he was. He did not bring the process to a halt or even fundamentally try to disrupt it just because there was a shift in control of the Senate. And that could have happened. It wouldn't take us long to think of some Senators that would have used that as an opportunity to turn everything on its head. But Sarbanes didn't.

MR. SMALL. Did the people in the Administration ask you about your views of monetary policy, regulatory policy?

MR. OLSON. Yes, they did. But they were far more focused on some of my personal characteristics: "Tell us about your family life. Tell us about your values. Tell us about things like that." Larry Lindsey talked to me at some length.<sup>6</sup> I think Larry vetted my monetary policy and thoughts on regulation. But, at the early stages, they were much more focused on what kind of a person I was. I took that to mean that somehow they had already gotten comfortable with my understanding or my grasp of the issues, especially, I think, after Larry had talked to me.

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<sup>5</sup> This change in party affiliation caused a shift in control of the Senate from Republicans to Democrats.

<sup>6</sup> Lawrence B. Lindsey was a member of the Board of Governors from 1991 to 1997. He was director of the National Economic Council from 2001 to 2002 and the assistant to President George W. Bush on economic policy.

Interestingly, President Bush talked most about monetary policy when I spoke to him. He probed that a little harder than did Lindsey or Clay Johnson, which surprised me.

MR. SMALL. What were some of the specifics?

MR. OLSON. I had asked a question of Clay Johnson. I can't remember that I used these words exactly, but, essentially, I asked, "Does the President respect the independence of the Fed, or does the President think that some of the direction on monetary policy should come from the Administration?" Clay thought about that for a minute and said, "What do you mean by that?" which told me he'd never heard the question before. That was probably all I needed to know.

President Bush specifically said, "We will not interfere with monetary policy decisions." But he asked what I thought about the issues and what I thought generally about the direction of the economy and the impact of monetary policy. It was pretty straightforward. At that point, interest rates had come down rapidly. We thought we were at the bottom of where interest rates would go in terms of the target. We did take interest rates down further, but it was a very soft economy. Obviously, the President was anxious to see the economy rebound. But between my interview with him and my swearing in, we had 9/11 and then the invasion of Iraq not long after that (in March 2003). In the meantime, we had all the disruption of Enron and WorldCom.<sup>7</sup> So there were a series of exogenous events that had a negative impact on the economy.

The whole Senate nomination process was slow. It was frustrating in that sense. Senator Jim Bunning (R-KY) put a hold on the nomination of Sue Bies and me for a while, but that was about a week and a half.

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<sup>7</sup> The story of Enron, a large energy company, and WorldCom, a telecommunications company, involved two of the largest corporate scandals, leading to bankruptcy, in U.S. history. In the case of Enron, it also led to the dissolution of Arthur Andersen, one of the largest accounting firms in the world.

MR. SMALL. Did you have any charge or mandate from the Bush Administration on supervision and regulatory issues?

MR. OLSON. No. I did not have a charge from the Administration at all. And until I was nominated, I had zero contact with the Fed. That only happened as a result of the nomination. But nobody vetted me to make sure that I would have this or that philosophy on supervision.

That was interesting, because one of the things that I had discovered in the course of my career—for example, when I went from being a banker to being on the staff of a congressman—is that when you change your hat, you change your view of the role of public policy. It doesn't mean you've made a fundamental change in your philosophy, but you see it from a different perspective. When you wear your public policy hat and you're a responsible person, as we all hopefully are when we come here, you see it quite differently.

I went through my briefings here at the Board for the nomination hearing. I had followed the Fed as a regulatory consultant, so I had a very thorough understanding of Fed regulations, banking industry regulations. We were about to go through the whole body of banking regs, discussing and vetting issues. And we were talking with the lawyers for the first time. I vividly remember that Virgil Mattingly, the Board's general counsel, looked across the table and said, "You know this stuff." And I said, "I do. But I don't know it from your perspective, the perspective of a regulator. I need to learn it again from that perspective. So talk me through these issues that I understand." That was during the process of helping prepare me for my confirmation hearing, and, more broadly, it was preparing me for my role as a Governor.

MR. SMALL. Were you at all wary of Fed staff—that either the lawyers are seen as wanting to control everything or that the supervision and regulation people had never been in a bank and were too theoretical?

MR. OLSON. I was looking for that. And I was looking for the extent to which I would be instructed on what my position should be, but that didn't really ever happen.

I did have one real concern. I wondered the extent to which my experience would be considered a threat when I came in here. I thought more that way. I had enough self-confidence to know that I wasn't going to be dominated by a staff person. What I didn't know was the extent to which my experience would be accepted as being valuable. Overwhelmingly, people said, "We're really happy to see somebody in here that understands what we're doing." That was overwhelmingly the case.

There was one negative, but it wasn't anybody's fault. It was more structural than anything else. When I was at Ernst and Young, in particular, and a proposed regulation would be put out for comment—let's use CRA (the Community Reinvestment Act), although I don't know that CRA would be the right example—I would read the proposed regulation and then I would call around. I would call bankers, lobbyists. I would call the Bankers Roundtable (currently the Financial Services Roundtable) and the ABA. And I would just bounce around ideas and questions: "What do you think this means? What is the impact going to be?" And I would get a very broad-based understanding of the impact of that regulation.

So when I got here, and we'd have a new regulatory proposal come out, I was intending to do the same thing. I was going to call around and get a lot of different opinions about what they thought about the proposal and what they thought the impact would be. Virgil said, "You can't do that." I said, "What do you mean, I can't do that? That's how you really know it." He

said, "No, everything you do you have to do through ourselves and our staff and the comment process." And I said, "This means that, as a Governor making these decisions, I'm not going to understand the proposal as well as I did when I was outside. That is really troubling."

Sandy Braunstein (director of the Board's Division of Consumer and Community Affairs) heard me say that a number of times. Edward "Ned" Gramlich, the Governor who chaired the Board's Consumer Committee, heard me say that a couple of times: "I'm really concerned that I know these issues less well as a Governor than I did as a consultant." That made me approach my understanding of it in a different way. It meant that I had to get more deeply involved. I had to engage with staff at a completely different level. And I had to engage with staff that could really help me see multiple sides of the issue.

MR. SMALL. When Virgil was saying that you may not make those calls, was that because of ethics law? It wasn't just his random call?

MR. OLSON. It was not his random call. There is a process by which the Fed can accept comments on proposals that are published for public comment.

MR. SMALL. There would be legal issues if you wanted to talk about it?

MR. OLSON. Exactly. So I was very concerned about that. I had to learn things in a somewhat different way than I had learned them before. Even when I left the Board, I still thought that, even after chairing that consumer affairs committee for about a year between the time that Ned Gramlich left and I left. I had that concern somewhat. Although when you're the Chair, you then have a lot more involvement with staff and have a lot more opportunity to stay current.

**First Impressions of the Board**

MS. HURT. You joined the Board in December 2001 along with Susan S. Bies. And you've given us some of your impressions. What were some of your other initial impressions when joining the Board?

MR. OLSON. I expected to find a distant, imperious group of people. I don't know why, but I did. That's what I expected to find. I found quite the opposite. I found an enormously welcoming environment at the Fed. The way I like to phrase it is that, with no exceptions that I can think of, when I came in as a Governor, the people that I worked with wanted me to succeed and wanted me to do well. And they were very happy to work with me and help me do well in the areas of monetary policy, which was not what got me here, and bank supervision, which did get me here. The overwhelming sense was that people wanted me to do well. I had been in political environments or corporate environments where you come into the environment and two-thirds of the people want you to do well and one-third want you to fall on your nose. I did not find that at all here. And I was very pleased to find that out.

I don't think that was the common perception of the Fed as being that welcoming a place for people that were coming in. There were a couple of people who were particularly helpful that way, starting with Roger Ferguson, who was just a tremendous mentor, and Don Kohn, both in his role on the staff and then as a Governor. They were two people in particular who went out of their way. Dave Stockton (former director of the Board's Division of Research and Statistics) and Vincent Reinhart (former director of the Division of Monetary Affairs) fall in that same category. And I would say, the two primary people in the Division of Banking Supervision and Regulation, Rich Spillenkothen (former director) and Steve Hoffman, who was behind

Spillenkothen at that time, were helpful. Steve went to the San Francisco Fed from there. So I really had a strong feeling that I was getting very strong input from people like that.

MR. SMALL. And they accepted input from you?

MR. OLSON. They did, yes. They certainly did accept input from me on bank supervision issues. I was looking for the help on the monetary policy issues. But for bank supervision, I thought that my role was well accepted and that my background was valued.

MR. SMALL. What about the analytic side of the Board staff? On the one hand, I could see it being seen as stale and too formal. On the other hand, I could see it being a little intimidating in that you might ask a question and, as a result, someone comes back with 18 regressions and 4 models, making you wonder what you had gotten yourself into here.

MR. OLSON. Larry Meyer really was a help on that, too. And John LaWare was, also. What John LaWare said to me, when I came in, is that nobody's going to look to you for guidance on the elements that make up the labor statistics or the Taylor rule. They're not looking for your help on that. Where you can be helpful is giving them real-world feedback on what is happening. Any time I would encounter something like the Taylor rule, I would immediately make sure that I understood what it was all about so that, even though I probably could not have done the construct on it, I understood the benefit of that. And there were many of those kinds of benchmarks that were common to monetary policy, for example, that I needed to understand in order to stay current with the dialogue.

Also, I came in thinking that I would be a monetary policy hawk, because I had seen and experienced the ravages of high inflation. I distinctly remember when Jimmy Carter became President in 1976; we were still in that very high inflation period, moving into an even higher inflation period. So in looking for someone to appoint to the Board, I hoped he understood the

destructive nature of inflation and put in a Chairman who understood it also. We don't need to look at the history with William "Bill" Miller; he was just the wrong person at the wrong time to be Chairman of the Fed (1978–79). But he was replaced with Paul Volcker (1979–87), and Paul changed the approach to monetary policy in a way that's one of the seminal events in monetary policy history.

I remember coming to the Board thinking that I was going to be a hawk because I'd seen what inflation can do to asset values. I'd seen what inflation can do to spending power. But I got here and discovered that I was a moderate not because my views had changed, but because several on the FOMC were to the right of me in hawkishness.

MR. SMALL. You're talking about the FOMC?

MR. OLSON. I'm talking about the FOMC. The Al Broadduses and people like that were to the right of me.<sup>8</sup> So I ended up being a moderate. I was delighted to see the extent to which a first threshold for conducting monetary policy was guarding against inflationary pressure. I came in thinking that I would definitely be a hawk on that issue but then needing to learn a lot.

I spent a lot of time talking to Mike Kelley about what he had done.<sup>9</sup> He was not a macroeconomist. He was a Harvard M.B.A. And he said, "There's a lot of common sense involved with this, and you can bring that perspective."

But what was really interesting was something regarding Charls E. Walker, who was a former undersecretary of the Treasury (1969–72). He is a longtime head of Charls Walker Associates consulting firm here. I had known him for a long time. He was a Ph.D. economist that taught at the University of Texas. He came to Washington. He had been on Nixon's

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<sup>8</sup> J. Alfred Broaddus Jr. was president of the Federal Reserve Bank of Richmond from 1993-2004.

<sup>9</sup> Edward W. "Mike" Kelley, Jr. was a Board member from 1987-2001.

Treasury team, and then head of the ABA for a while. Then he started his consulting firm. Charlie called me and said, "What do you need to know about monetary policy?" And he recommended a couple of books. I was reading a lot of books at that time. I said, "At a time when there was a fundamental shift in monetary policy, like October of 1979 when Volcker came in and made that fundamental change, quit looking at the movement of the funds [rate], and instead focus on the monetary aggregates. I'd like to know how that came about." He said, "No problem. I'll call Paul and we'll arrange it." Well, how many times have you heard somebody in Washington say, "I have access to this big person. Don't worry. I'll take care of it"? About two days later, Charlie called back and said, "Paul is going to be in town on Wednesday and wants to meet with you." So we met.

Paul was a delightful guy in that context and very happy to meet and talk. We got around to the question I had posed to Charlie, and I said, "How did you bring about the October 1979 change in operating procedures? What were the conditions that caused you to make that fundamental change?" Volcker said, "Easy. I needed four votes. I was getting three. So we were three and three. I could not move forward. The monetarists knew I really wasn't one of them. But the only way that we could move forward in the policy was to make a fundamental shift, and we started focusing on the monetary aggregates and controlling them and then allowed interest rates to go where they would. It was the only way that we could get the policy moving forward. Plus, I thought it was the right policy, so that's what we did."

Then I asked him, "What do I need to know about this process that I can learn from?" He essentially gave the advice offered by others. He said, "Just use your common real-world understanding of the economy and what impacts the economy, and learn everything you can. The Board doesn't need any more Ph.D. economists. There are roomfuls of them at the Fed.

You just learn from what they can help you with.” And, overwhelmingly, the people that were very supportive helped round out my understanding.

### The Bank Examination Process

MR. SMALL. Volcker has said publicly something like, “As Fed Chairman, I would give up 15 Ph.D. economists”—I’m making up these numbers—“for 1 good bank examiner.” What did you experience about bank exams from earlier in your career, being on the receiving end of them?

MR. OLSON. I have a very healthy respect for the examination process.

MR. SMALL. You were examined by state regulators.

MR. OLSON. State regulators and the FDIC. When I was at the First National Bank of St. Paul for four years, I didn’t really interact with the regulators, but I had a very healthy respect for the regulators that came in. They spent every day, all day, looking at loans at banks of similar size and similar complexity. They looked at all kinds of loans.

I still remember one FDIC examiner during my time as a bank president. He came in with the loan file of a guy who, in our hometown, was highly respected. The FDIC guy brought the file in and said, “It is my experience that this loan will fail.” I looked at the file, and I knew who the person was. I looked at the loan exposure we had and said, “This guy isn’t going to fail. I know him too well. But just to make the FDIC happy, I’ll take a second lien on more of his real estate just so that we can shore it up, and we ought to be fine.” He failed. The FDIC regulator saw it, and I didn’t. It reminded me of the value, number one, of that outside perspective, but, number two, the value of prudential supervision.

This was not as opposed to any other sort of approach to supervision or as opposed to the enforcement model, for example, of the SEC. These supervisors are people who come into an

institution with the idea, “We are going to look at what you’re doing here. We’re going to correct as much as we can while we’re here, give you the benefit of what we know, and we’re going to give you a clear understanding of what you need to do to make this bank healthy, either from a capital or asset quality or liquidity or management [perspective].” And so I came into this role of being a Governor with a healthy regard for the supervisory process and saw it as very valuable. That had been my experience.

### **The Role of the Central Bank in Supervision**

MR. SMALL. Should a central bank have both monetary policy and supervision policy responsibilities? Various arguments are made about the synergies between the two. What’s your views on this issue?

MR. OLSON. All things considered, at the very least, the Fed ought to be either engaged directly in or have access to the largest financial institutions where there is significant economic exposure—in other words, either the largest financial institutions or the institutions where there is a societal risk because of the size or complexity of the organization. Either the Fed ought to be examining those institutions or have access to the examination of those institutions. The supervision of smaller banks is less critical in monetary policy.

Also, there’s nobody other than the Fed that can look, for example, at the payment system, where there is potential significant risk exposure. I don’t know anybody that could do that if it wasn’t the Fed. So I think that there is a significant link between monetary policy and supervision from that perspective at a macro level.

MR. SMALL. The monetary printing press is, of course, at the Fed. In particular, the discount window and the lending-of-last-resort function come off that. Is that a tie-in, through financial crises, on why the Fed needs supervisory authority?

MR. OLSON. Yes, very much so. I think you can do the lender-of-last-resort [function] through the major financial institutions and the most critically important or systemically important institutions. That's where it really needs to be.

It's going to be very difficult to change the system we have now, but if you were looking at it just from a design standpoint, there ought to be a link at the very highest levels between the systemically important institutions and Fed supervision.

MR. SMALL. What about the discount window and "too big to fail"? Does the discount window allow either the bank itself or the lenders to the bank to think that the bank always has the discount window available to it, therefore the bank always has access to liquidity? Does that allow the bank to leverage up more than if it did not have access to the discount window? Is that part of too-big-to-fail?

MR. OLSON. Yes, it is now. I looked at too-big-to-fail. When I came to the Board, I reread FDICIA, the prompt corrective action of FDICIA.<sup>10</sup> And I don't think it could have been any more clear that the Congress and the policymakers had said, "We do not have a too-big-to-fail regime in this country. There is a process by which we can bail out the largest institution, but it's going to be a very difficult process to achieve, and it should be used only in an absolute emergency."

So all the time I was on the Board, I thought [that] if ever an institution comes before us and gives us the argument or presents us with a situation where we think that we're going to bail them out, I am probably going to vote against the bailout. But such a case did not arise while I was in government, although after I left there was Bear Stearns, and I think I would have voted

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<sup>10</sup> Subtitle D of Title 1 of FDICIA, the Federal Deposit Insurance Corporation Improvement Act of 1991, mandates that each appropriate federal banking agency take prompt correction action to resolve the problems of insured depository institutions.

for bailing out Bear Stearns, if I'd been here. So when I really got to look at the implications of that policy, I just thought it was necessary to do that bailout.

What I don't know now is if the changes under Dodd-Frank inhibit the Fed's flexibility or if it has come up with an approach that will work prospectively—remembering, as we all do, that each crisis is different. What we tend to do legislatively is to pass laws that fix the previous crisis.

### **Chairman Greenspan**

MR. SMALL. What were your views on coming to the Fed and working with Alan Greenspan, who was being called a "rock star" at that point? What did you see about his mystique, or what did you anticipate?

MR. OLSON. There was clearly a mystique about him.

There was no bigger highlight for me at the Fed than the Monday morning economic briefings. I think it was every two weeks. I looked forward to those. As I recall, we had three planned presentations: one on the state of the domestic economy, one on the international economy, and one on the financial markets. Different people would prepare and present.

The first thing I noticed is that Greenspan would conduct those meetings in a way that invited vigorous discussion about issues. He didn't want to say, "I know the answer. I'm Alan Greenspan. This is the answer. Let's move on." He really wanted there to be active debate, which was a healthy way of running the meeting. The staff needed to be really well prepared coming in, because they never knew where he was going to go with his questions.

It was healthy for the other Board members to gain a well-rounded perspective on what was happening in the economy. I remember that Dave Stockton and Karen Johnson (former director of the Board's Division of International Finance) used to go at it pretty aggressively with

the Chairman from time to time, particularly Karen on international issues, because both she and the Chairman had strong feelings, and neither one of them was about to yield to the other one on what their thinking was. But they did it in a respectful and professional way.

Also, Alan Greenspan was never demeaning. He treated people very well. And I liked to see that in him. I didn't know what to expect. I think there was the impression that he told us what we were all to think, and that we were all to just line up and drink the Kool-Aid and do whatever he had in mind. That wasn't my sense at all.

In the FOMC meetings, it was pretty subtle, but he was a consensus builder. That characteristic of his is underrated. He was a consensus builder in the sense that there were three parts to every statement released to the public at the end of each FOMC meeting. He used those three parts to the statement to reach a consensus. Plus, we were going to meet again in six weeks, so if he wasn't getting quite to the consensus he needed, he'd say, "Well, remember, we're meeting again in six weeks."

MR. SMALL. Sometimes the statements coming out of the FOMC are viewed as vague or general. Was that by design in consensus building, so more people can sign on?

MR. OLSON. Before I arrived at the Board, I used to read those statements and think, "Boy, can I ever be a big help when I get there. I can help with the writing of those statements to make them much clearer." Once I got here and I saw the way the markets would analyze every single word change, and every turn of the phrase, I recognized how important it was to maintain a certain amount of consistency. Every movement away from that consistency would invite interpretation—often in a way that you didn't want it to. So I then understood the need to have a formulaic approach to communication. I thought that then, and I still think that is important. Even the most subtle changes in wording are parsed carefully.

Bernanke did not exactly fall into a trap, but his experience as an educator led him to think that the more carefully he explained, the better understood it would be by both the markets and the general public. He's a brilliant educator and a brilliant speaker. But it didn't turn out that way. The more he spoke, the longer he spoke, the more questions it tended to raise. Over time, he developed an approach to communicating in which he found a way to reinforce the points that he was making without putting too many words into it. That's an important part of communicating monetary policy decisions.

MR. SMALL. Now that you've left the Fed and you're on the outside reading these statements, do they seem opaque to you? Do you understand them?

MR. OLSON. I'm on CNBC after almost every FOMC meeting. I now read the statements side by side, looking for those subtle changes and what they mean.

MR. SMALL. You now do what drove you crazy.

MR. OLSON. It drove me crazy before I got on the Board, but it didn't drive me crazy once I was on the Board. Michelle Smith (head of Public Affairs), Vince Reinhart, and Alan Greenspan would come up with precisely the right words.

### **Monetary Policy**

MR. SMALL. During Paul Volcker's term as Chairman (1979–87), there was high inflation, high interest rates. When you came into the Fed in December 2001, the world was quite different. The issue was whether you could get interest rates low enough. Having to take this issue seriously could be sort of shocking. Is that right?

MR. OLSON. Very much so. We were looking at the Japanese experience and [the] zero lower bound on interest rates, and we were talking about where the risks were in monetary policy. As we were getting into that issue, Ben Bernanke joined the Board as a Governor (in

August 2002). The juxtaposition of Alan Greenspan and Ben Bernanke being at the Board at the same time was really interesting. Alan had seen the application of monetary policy, and Ben understood the historic academic perspective. Then Don Kohn was helping me, at least as we were talking about the risks of the zero bound. We were all doing the evaluation in the context of knowing that there were very few data points in history that would help us understand what the risks were.

I think that we all bought into the fact that there would be a greater risk in not acting aggressively than acting aggressively to stimulate the economy. I did not see a lot of downside risk, if you assumed that the Fed was—and I assume still is—good at detecting inflationary pressure. The ability to detect inflationary pressure—wage inflation, in particular—allows you to then make an adjustment in monetary policy accordingly.

MR. SMALL. Because you could always raise interest rates?

MR. OLSON. That's right. I was comfortable that we could. And then, the phrase "for a considerable period," I absolutely remember when Bernanke—

MR. SMALL. And you got into the issue of not just getting the interest rate low, but of how long you were going to keep interest rates low.

MR. OLSON. Right. I remember very clearly that the phrase "for a considerable period" was Ben's suggestion, and Greenspan immediately latched on to it. That was an important step forward in monetary policy and helped inform the markets about what we were going to be doing going forward.

MR. SMALL. Indicating the Fed would keep interest rates low for some time raised concerns about asset bubbles, right?

MR. OLSON. You may remember, there were numerous discussions about the role of monetary policy and asset bubbles, including at the conference sponsored by the Federal Reserve Bank of Kansas City at Jackson Hole, Wyoming.<sup>11</sup> The overwhelming sentiment was that you can't attack an asset bubble with monetary policy. You'd use different tools, if you used any at all, to attack asset bubbles. We would be mindful of asset bubbles but would not attack them with monetary policy. That was the overwhelming sentiment. That was when we were coming out of the dot-com asset bubble. Now I think that, coming out of the real estate asset bubble after the fact, there is a sentiment that we ought to look at that sentiment a little bit more carefully and say, "Are we still comfortable with that sort of across-the-board belief?" But, at the time, there was a lot of talk, and there was an across-the-board comfort level on that subject, on bubbles.

Remember when Greenspan introduced the "irrational exuberance" comment around the dot-com asset bubble issue? The Dow at that point was at 6,000 when he made his irrational exuberance comment. Then the Dow leveled at about 9,000 after it went way up and came back down. Had we tried to interfere, had we tried to use monetary policy to attack a 6,000 Dow asset bubble, that would have been disastrous. So I was very comfortable with the notion that you don't use monetary policy to attack asset bubbles.

MR. SMALL. But you can use supervisory tools.

MR. OLSON. To an extent, you can use supervisory tools. But if it's an equity asset bubble, it's a very difficult thing to do, at least for the Fed to do. Maybe there could be other ways to do it. We've looked at credit controls and things like that. And there was no particular

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<sup>11</sup> Since 1978, the Federal Reserve Bank of Kansas City has hosted an annual economic policy symposium for central bankers, policy experts, and academics. [Editor's note: "New Challenges for Monetary Policy," a symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyo., August 26–28, 1999.]

value in using some of the other tools of limiting credit. Margin requirements and things like that were no longer thought to be effective tools for that purpose.

MR. SMALL. Not only did you have the problem of the zero bound, but you were faced with the prospect of deflation. That must have been somewhat shocking.

MR. OLSON. That was very shocking. When I was going through the confirmation process, one of the senators, I think it was Senator Bennett from Utah, said, "My target for inflation is zero." And when I got to the Board, Robert "Bob" Parry (president of the Reserve Bank of San Francisco, 1986–2004) very distinctly said, "My target for inflation is zero." By the time we had really thought through what a zero bound would do, nobody was saying that anymore. Nobody that I knew who was involved in monetary policy wanted to set zero as an inflation target for the possibility that we may be in a disinflationary environment.

## Communications

MR. SMALL. The FOMC expedited the release of its minutes. Did you think that was a good idea?

MR. OLSON. Yes. I am a proponent of better communication. Better communication and transparency has not only helped monetary policy, but it has helped reduce some of the mystery about the Fed. But I am an incrementalist in terms of transparency because you never can go back. Once you do something like expedite minutes and announce the vote or have a very explicit federal funds that you're aiming at, it's going to be there forever. So I am an incrementalist. But I think every single one of those increases in communications was positive.

MR. SMALL. One view that's sometimes put forward is that the Fed's release of FOMC transcripts, even though there is a five-year lag, inhibited open discussion at FOMC meetings.

Principals read statements. In FOMC meetings, was there the same free flow and debate that you talked about Greenspan promoting at staff briefings?

MR. OLSON. The FOMC meetings were much more collegial than I thought they would be. There didn't seem to be a lot of tension or hostility. Where there were differences of opinion, they were respectful. There was even a certain amount of humor that came through in the manner in which people communicated differences.

There were a lot of times where I thought, wow, interpreting a statement like that five years from now is going to be interesting. I didn't think that there were a lot of people that held back their opinions because of the five-year release. But these were professional opinions. You didn't have people taking gratuitous personal shots at each other or at people outside the FOMC. Everything that was said had a professional monetary policy component to it, not a political component. That's the nature of the group and the nature of the function. So I didn't think that knowing there was a release after five years was much of an inhibitor.

MR. SMALL. On the FOMC, is there any difference in the role that a Board member plays versus a Bank president? Do the Board members have to stick together?

MR. OLSON. Not that I saw. Nobody ever came to me and said, "We (the seven Board members) have to stick together on this monetary policy decision." During the time I was there, I only saw two Board members ever dissent. Ned Gramlich dissented a couple of years before I did, and then I dissented right after Hurricane Katrina. I thought that we didn't have enough information yet to make a decision. But it was classic. Vince Reinhart came around and was talking to us about what might happen. And I said to him, "I'm not real comfortable moving forward this time, because I'm not sure that it's clear enough. It's only two weeks after Katrina, and we just don't know."

MR. SMALL. Moving forward with a tightening of monetary policy?

MR. OLSON. Moving forward with the tightening. I wasn't sure that we had the information. We didn't move forward after the Iraq invasion because we were not as certain. This period reminded me of that earlier period.

I talked to Roger Ferguson, and I talked to Don Kohn. Don's point was that it was a defendable position, it was a genuine issue, and he couldn't quarrel with my thinking. Roger said, "If you're thinking of dissenting, at the very least you ought to go and talk to Greenspan." So I went in and talked to him for 45 minutes. He told me why he thought I was wrong. But he said, "I will never tell you how to vote." As it turned out, he was more right than I was.

I thought about it very carefully that night. Why am I doing this? Do I really think that this is the right decision? I came away saying, "I'm giving it exactly the same sort of a test or evaluation in my own mind that I always do, and I just don't think it's the right thing to do to go forward." So I did dissent. Both Don Kohn and Janet Yellen came up to me afterwards and said, "We're glad you did that," because it was a closer call than the unanimous vote would have suggested. I hate to put words in somebody else's mouth, but Don said, "That reflected that this was not a slam-dunk decision." And Janet said something like that, too. It's been eight-plus years, so I don't recall precisely what they said. And then, moving forward, I almost felt that Greenspan's respect for me was better after that. I thought he was more gracious, more open to me at that time. And I took that to be an element of respect.

MR. SMALL. How did you go about preparing for an FOMC meeting? Did you read memos? Did you talk to anyone?

MR. OLSON. I would do all of that. And John LaWare was really significant. Again, John was saying, "They're not looking to you for guidance on the components of the economy

and the relative movement of the various sectors of the economy. They're looking to a person like you for more of a hands-on approach."

So before every FOMC, I would call at least three bankers from around the country—usually a money center bank, maybe a mid-size regional, and maybe a small bank, although as time went on I did less and less with small banks. I would say, "Tell me what's happening in your marketplace and in your bank." Over time, I would sometimes go back to the same bankers, because you could tell the ones that were really good, that you could learn from.

For example, I remember talking to a banker in Chicago. I said, "What's happening in your bank that is different from what was happening two months ago?" He said, "The difference right now is that we are still not making many loans, but our credit applications are really picking up." That told me that, all of a sudden, there was a sense in the marketplace that demand was starting to build and that there was some momentum. It was one of the first signs that the period of economic lethargy was really lifting.

Or I would talk to Tom Renyi (former chairman and CEO of Bank of New York), for example, to get his sense of what was happening in the New York marketplace. That was completely different. David Coulter was at J.P. Morgan at the time. Those guys really had an understanding of what was happening in the marketplace. So that was what I would go back with. As I go back and reread the five-year transcripts and what I said—I have all of them—that was really what I tried to communicate, a sense of what was happening in the marketplace. Different people would do that different ways, but that was my contribution.

MR. SMALL. One view of a Fed policymaker is that you have this huge staff in Washington. You have Reserve Banks gathering information. You have a pretty good feel for the economy and where it's going. Or do you have just the "fog of war," just not a clue?

MR. OLSON. I had an excellent sense that we had a really good feel for what was happening in the economy. We would get the Greenbooks and the Bluebooks on Thursday, and I spent 8 to 10 hours over the weekend going through them very carefully. And I thought that looking at the various policy alternatives was helpful. It took me a long time to go through those books, in part because I would come to something and then I would have to stop and think about it for a long time or have to go back and read something else. Or I'd take a reference, and I would have to go back and read something else as a result of something that was being suggested. I thought that we had our finger on the pulse of the economy and that I personally had my finger on the pulse of the economy.

While golfing, when I was on the Fed Board, somebody in a golf cart who I never met before said, "You know what the real problem is." I said, "Yes, I think I do." I didn't wait for him to tell me what he thought the real problem was. I really thought I did.

### **Check Clearing**

MR. OLSON. One of the most significant things that happened when I was at the Board—following 9/11 and passage of the USA Patriot Act (in October 2001)—was that the Check Clearing for the 21st Century Act (Check 21) became law in 2003. All of a sudden, we were allowed to clear images as opposed to the physical items themselves.

In a very short period of time, we went from 45 different places where we cleared checks throughout the Fed System—I was amazed at how fast the Bank presidents put it together. They said, "We've got to start closing these facilities, because we're not going to need as many of them, and the imaging is going to come on fast." We went almost overnight from 45—I'm not

going to remember the specifics—to around 18 within a year. By the time I left the Board in June 2006, they were down to maybe 8 or 10. And what do we have now—1, 2?<sup>12</sup>

The other part of the process was dealing with the boards of directors of the 12 Reserve Banks. At the time, I chaired the Board's Committee on Federal Reserve Bank Affairs. We were redefining, from a governance perspective, the role of the boards of the 12 Banks. The Banks had gone from having 3,000 or 4,000 people working there—literally thousands of people's jobs went away in some of those Banks. Some of the Banks handled it very well. Atlanta, San Francisco, and Cleveland come to mind as doing a good job of recognizing that we needed to bring about that change. Members of Reserve Bank boards of directors were saying, "I spend a lot of time here on a voluntary basis, and you in Washington are fundamentally changing the business dynamic of this Bank. What is my role?"

We spent a lot of time on this matter. Louise Roseman (the director of the Division of Reserve Bank Operations) will remember that very clearly. Roger Ferguson got deeply involved in that also as Vice Chair. I remember going to a Dallas board meeting. They had allowed 45 minutes on the agenda for us to talk about what the changes meant for the Dallas Reserve Bank and its branches in El Paso and Houston. But that part of their board meeting went 3 hours before we felt we had dealt with it thoroughly enough.

MR. SMALL. What is the role of a Reserve Bank's board of directors? These are private-sector people. They're in private-sector banks, but they might have a role over bank supervision. A lot of outsiders would say, "Is this credible from a governance point of view?"

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<sup>12</sup> The Federal Reserve Banks provide check collection services to depository institutions. The number of checks written nationally had been declining since the mid-1990s as the use of electronic payment instruments grew. In addition, Check 21 removed barriers to the electronic collection of checks. Almost all checks processed by the Reserve Banks today are deposited and presented using the Reserve Banks' electronic check collection services. These changes have enabled the Reserve Banks to reduce their national check-processing infrastructure so that, since early 2010, they have been processing paper checks at one location nationwide, down from 45 in 2003.

MR. OLSON. They don't have much of a role in supervision, but they play a large role in providing feedback and outreach on monetary policy. That has been very helpful in the Banks that have a high expectation for the contribution of those board members in helping the Reserve Bank understand the economy of that region. Then you have people that will, in turn, be active in their relative communities, people who have an understanding of how the Fed works and are not necessarily cheerleaders for the Fed, but at least help the people in that part of the country understand the role of the Fed and the impact of monetary policy.

It goes back to the whole federalism philosophy that we have in the United States where, historically, all commerce was determined by the various states under state laws. There was an effort to avoid having the federal government be the dominant or strong entity. So there was an expectation that there were a lot of grassroots components to government.

MR. SMALL. Does having a board of directors at each Reserve Bank help when issues of Fed independence come up?

MR. OLSON. I think it does.

MR. SMALL. As a Governor, did you have much involvement with the new designs for currency?

MR. OLSON. Very little. John Snow and I went to Dallas for the introduction of the new \$50 bill, as I recall. And, as the changes in the currency were coming through, we were part of the discussion on them and part of the agreement on it. But I did not spend a lot of time on that issue.

MR. SMALL. A new college grad or master's or Ph.D. looking for a job might find it exciting to come to the Fed and work on monetary policy or on bank supervision and regulation. But there is another part of the Federal Reserve System, the clearance system, the underlying

plumbing of transferring funds. Would that be interesting to work on? Is that a fun part of working at the Fed that would attract people? Or is that just the backroom stuff that doesn't become important until a crisis comes?

MR. OLSON. There's been so much innovation in that field, and I think it's going to continue to come. Some of the exciting things that are happening in the marketplace are the private-sector alternatives to payment systems. Some of the real innovative things are coming now and have been coming for a long time.

To me, there is a real question of how you regulate some of the activities and, in particular, alternative currencies. It was interesting to me when Ben Bernanke came out and said that alternative currencies are something we ought to look at and pay attention to. You have the PayPals and the various alternative forms of clearing that allow for all of the changes and all the settlements of economic activity generally throughout the world. I'm not a techy person, so it's not the kind of stuff that I am good at understanding. My daughter is way ahead of me on all that stuff. But I think that's a very exciting area.

MR. SMALL. Both from the public policy and the private-sector perspective?

MR. OLSON. Absolutely. The intersection of what the public policy role ought to be on payment issues is an exciting subject.

## **Basel I and II**

MR. SMALL. What are your views on and your involvement in Basel I, Basel II?

MR. OLSON. Basel I was necessary because there was no international agreement on capital levels or the components of capital. You had extraordinary mismatches of capital requirements and, therefore, leverage requirements. There would have been huge issues if there

hadn't been some kind of agreement on capital levels and what sort of asset categories would require what levels of capital.

MR. SMALL. If you have low capital requirements in a certain country, that lets those banks fund themselves cheaper. Then they come to the United States and buy up banks here or make loans or invade our markets because they have a lower capital cost.

MR. OLSON. Exactly. For example, Japan not only had low capital ratios, it could own equities and allow for the appreciation in those equities to be considered capital. Not only did they have low capital ratios, but what constituted assets—the valuation of which they could include as capital—gave them an extraordinary ability to leverage. At one point, I think maybe 8 of the 10 largest banks in the world were Japanese. So without some sort of international agreement, there was going to be extraordinary mismatches and huge global risk to the economy.

Basel I made four crude classes, or “buckets,” into which assets were allocated for the purpose of assigning capital requirements. Certain assets required 100 percent capital, whatever the capital level was. Certain groups were 50 percent, certain 20 or 25 percent, and a handful of them zero. This was the first initiative of risk-weighting of assets in terms of what the requirement of capital was for.

MR. SMALL. But these four were along a spectrum of maturity and not default risk, or default risk and not maturity?

MR. OLSON. Default risk. But these were very political decisions. For example, residential real estate was given 50 percent. Where did that number come from? It was about halfway between 0 and 100 percent, best I could tell. But at least it was some sort of a start. Government bonds with a certain rating were zero. Those buckets were very crude. So if you

assumed that we needed a Basel I to begin the process, the limitations of that first initiative screamed for Basel II. You had to update it at some point.

We went into a process with Basel II where we really overstepped what needed to be done at the time and handicapped ourselves, because we decided that we needed to move to a value-at-risk model in the way we measured capital, which was not only too complex, but it was also too expensive. I went along for two or three years supporting the direction that we were going and got right to the end of the process. Finally, it hit me that we had built something that was too heavy to lift, and that it would fail.

We had a Board meeting to agree to put the Basel II proposal out for comment. At the meeting I said, "I no longer support what we have done here on Basel II, and I apologize. But because I have supported it all the way along, I am going to vote to put it out for comment. But I don't believe it's implementable, and I think that we're going to be back looking at a revision to Basel II." What really convinced me is that we had a paradigm that exceeded the capacity of every bank in the United States at that time to measure its risk exposure.

MR. SMALL. Not only couldn't we measure the risk, but banks themselves couldn't measure it adequately?

MR. OLSON. Banks themselves couldn't measure the risk because they were moving to a value-at-risk model and they really hadn't made all of the investment in all of the systems that they would need to make that transition. And I didn't think that we had made the case that that was the way that it needed to be done.

I said, "Once we pass this, for the first time it's going to get up into the C-suite levels, and you're going to have CEOs looking at it for the first time. And the reaction is going to be

very strong. I will vote to put it out for comment, but I think we're going to be back to working on and redesigning this. I don't think it's implementable." And then I left the Board.

I've said to a number of people, "I'm a golfer. If I had two mulligans, I would use one of them on Basel II, because I would start that approach all over again.

### **Unfair or Deceptive Acts and Practices**

MR. OLSON. The other one that I would use a mulligan on is Unfair or Deceptive Acts or Practices (UDAP). We should have used our UDAP authority. The Congress gave us the capacity to use it. When we saw some of the abuses that were taking place in the real estate markets in 2004, 2005, 2006, we should have gone after them. We should have used UDAP.<sup>13</sup>

MR. SMALL. You mean like no-documentation and teaser loans?

MR. OLSON. Not those so much as in markets where there was very abusive deception taking place. There were places where no-doc, low-doc, and alt-A were done appropriately, but there were a lot of places where it was just completely deceptive. Where you had a lot of that deception, I now think that we should have stepped in.

At the time, we thought that if we tried to go outside of what had been our historic bounds and tried to regulate lenders where we've never done that before, the congressional pushback was going to be overwhelming, and we were going to get shot down if we tried to do that. And that probably would have happened, but we should have done it. We had the authority. We saw the abuses, and we decided that it was something to be concerned about. We

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<sup>13</sup> At the time, the Federal Trade Commission Act authorized the Federal Reserve to identify unfair or deceptive acts or practices by banks and to issue regulations to prohibit them. The legal standard for an "unfair practice" is one in which it: 1) causes or is likely to cause substantial injury to consumers; 2) cannot be reasonably avoided by consumers; and 3) is not outweighed by countervailing benefits to consumers or to competition. The legal standard for a "deceptive practice" is an act or practice in which where: 1) a representation, omission, or practice misleads or is likely to mislead the consumer; 2) a consumer's interpretation of the representation, omission, or practice is considered reasonable under the circumstances; and 3) the misleading representation, omission, or practice is material.

ended up approaching it by making sure that those loans did not get put on the books of the institutions that we regulate. But the contagion effect of so many of those loans getting made was a huge issue.

So, if I had two mulligans, I would take them on Basel II and UDAP.

### **Major Accomplishments**

MS. HURT. You left the Board in June 2006. What would you consider some of your major accomplishments while at the Board?

MR. OLSON. The change in governance of the Reserve Banks. That was a major change that occurred while I chaired the Reserve Bank Affairs Committee. We preserved the essence of why you have boards of directors in the 12 Reserve Banks. Those of us on the committee at the time—Don Kohn, Sue Bies, and I—made a significant impact.

I think when I briefly chaired the Consumer and Community Affairs Committee that we were starting to hold hearings around the country on the impact of some of the HOEPA regulations.<sup>14</sup> And we were starting to bring public attention to them. I thought that had a positive impact.

I think I communicated to certain audiences the workings of the Fed in a way that put, into simple English, words that some of the others would have put into Fedspeak. Those were the things that I would take some credit for.

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<sup>14</sup> The Home Ownership and Equity Protection Act of 1994 (HOEPA) amended the Truth in Lending Act to provide additional disclosure requirements and substantive limitations on home-equity loans with rates and fees above a certain percentage or amount. In May 2006, the Board announced that it was holding four public hearings around the country (in Chicago, Philadelphia, San Francisco, and Atlanta) on the home equity market in accordance with HOEPA, which at that time directed the Board to periodically hold hearings to examine the home equity lending market and the adequacy of existing regulatory and legislative provisions for protecting the interests of consumers, particularly low-income consumers.

I was certainly a net beneficiary of having been on the Fed Board. It is the greatest job in the world, and I was very fortunate that it came my way at a time that it did. For anybody that ever serves on the Fed Board, there are multiple roles that you can have here. People who have the honor of being here ought to recognize that and fulfill it.

During the time I was on the Board, I think everybody that I served with had that same approach—certainly, Susan Bies and Ned Gramlich did. Roger Ferguson carried a huge load, especially when he was Vice Chair. And when Sue and I came on, he continued to chair both the Board's Supervisory and Regulatory Affairs Committee and the Reserve Bank Affairs Committee just because he believed, and I think accurately, that Sue and I needed six to eight months to get our feet on the ground before being asked to chair those committees. He did all the Vice Chair things and chaired those two committees. I think Susan and I looked at it afterwards and realized what a load he was taking when he took all this on.

### **Role as Administrative Governor**

MR. SMALL. What about the straight function of administering this institution?

MR. OLSON. I like that. When I became the Administrative Governor, a number of people came up to me and said, "That's too bad, you drew the short straw." I said, "Actually, no. I've managed before. And I enjoy the functions of management—personnel policy, dealing with some of the issues that come along, helping manage on a day-to-day basis." Greenspan said, "Let me know if you need me, and if I don't hear from you, I'm assuming everything is going to go well." And that was the way it worked. Rarely did he ever ask me to come in and explain something.

Occasionally, I would have a reason to brief him. But I learned my lesson about that. One time I wanted to get in to see him. Rita Proctor was working with me at the time. I said,

"Would you call and see if you can get me an appointment with the Chairman?" She said, "Okay, he's ready." But I wasn't! I just assumed that it was going to be, like, a week from Thursday or something like that, and that I would have plenty of time to get ready. So I had to go in there and fake that I was ready. I learned from then on that, when you ask for an appointment with the Chairman, he's going to meet with you at the first available minute. So I never asked for an appointment after that until I had all my ducks in order.

MR. SMALL. What are some of the challenges or issues administering essentially a government agency?

MR. OLSON. One of the biggest things that we did was to institute a system of when we do performance evaluations. That was done so differently here from almost anyplace else I had been, because you try to do those evaluations on some sort of a bell curve. You want to be able to recognize your top performers. And if we're using a system with ratings of 1 through 5, there should only be a handful that are 5s—5 being the best—and then a lot of 4s, and the largest number should be the 3s. And you shouldn't have any 2s and 1s, or very few 2s and 1s. When I first got here, everybody was a 5 or a 4. The argument was, everybody here is an A student. They've been A students all their life, and if you start giving A students 3s, we're going to have a riot on our hands.

Over a period of time, we did finally get in place a system where you had a much more normal distribution, and a satisfactory performance rating didn't mean you're getting a C. As we look at that whole process, I think that there is now less focus on putting everybody into a bell curve sort of an evaluation. You don't necessarily need to do that. But that was what we were trying to do at the time, and it was very difficult to get that administered.

I had seen that done well at Ernst and Young, and I thought that we moved closer to getting that done at the Board. The thinking was that you wanted to make sure that you were rewarding and recognizing your best people, your top people. In order to do that, you had to have some comparison base. If everybody is a 5, then why are you even going through the process? But it was interesting, because how can you tell 10 Harvard Ph.D.'s that 6 of them are getting Cs? That's how it will be interpreted.

I did like administration. We were making some decisions internally on buildings, mainly because we were being pushed out the walls. Also during the time, we had to beef up security following 9/11. We were looking at security issues at the Reserve Banks around the country. We were looking at single points of failure in our risk management. There were a ton of issues that we had to deal with. We could go an additional afternoon if we wanted, discussing all the issues we encountered. But those were the main ones. The size of the staff increased in part because of what we did with the security staff. I think we added hundreds of people just at the Board in Washington.

### **After the Fed**

MR. SMALL. You are now in financial consulting, and you do various types of services. Risk management, I assume, is one.

MR. OLSON. Yes.

MR. SMALL. Is the Fed, in its regulatory process, good for best practices and getting the private sector to institute them, or is the Fed simply government getting in the way of good practices?

MR. OLSON. I think the Fed is among the most realistic. Coming out of the crises that we had and coming out of a period where the regulators were beaten up so badly for having missed a lot of these issues, you still have elements of defensiveness or minimal risk-taking.

To put it a slightly different way, if you were a bank regulator today, you still have it in your head that there's no downside risk for being inflexible. So you have people in the field, in particular, where there's still a lot of inflexibility. That is less so at the Fed than it is at some of the other institutions. But there's still defensiveness in the federal regulatory community.

MR. SMALL. You mentioned that you had, I guess, fun being a Governor. Would it be fun to be a division director of monetary affairs or of banking supervision and regulation?

MR. OLSON. I thought it would be. I think they'd all be fun. But in a time of crisis, it's not much fun to be the head of supervision when banks are failing. There would be a sense of real satisfaction once you get through it all and you look back and see what you've accomplished. But on a day-to-day basis, when you are seeing banks fail and you are seeing people lose their jobs and you're seeing borrowers that are going under, that really is no fun. Just like it is no fun to be in a bank where you're having businesses and loan customers fail or where you're having some of your colleagues' banks fail. That's not fun.

## Conclusion

MR. SMALL. Are there any areas we didn't cover?

MR. OLSON. We've pretty well covered everything. The one I wanted to be sure to go over—and we did—was the only good thing that came out of 9/11 and the Patriot Act when, as a matter of policy, we understood that the process of clearing checks as opposed to clearing images

was not only cumbersome and unnecessarily so, it was fraught with risk to the economy. That transition was huge. And that was a major transition the Fed managed very well.