Federal Reserve Board Oral History Project

Interview with

Michael Bradfield

Former General Counsel, Board of Governors of the Federal Reserve System

Date: October 20, 2011, and July 18, 2016

Location: Washington, D.C.

Interviewers: For October 20, 2011, David H. Small, Richard Ashton, and Nick Burk; for July 18, 2016, David H. Small

Editor's note: Michael Bradfield died before having the opportunity to edit and revise this interview transcript. Light editing was done to the transcript, but no other changes were made.

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.

Contents

October 20, 2011 (First Day of Interview) 1

Educational Background 2

At the U.S Treasury and in Private Practice 3

Joining the Board Staff; Penn Square and Continental Illinois 11

Bank Holding Companies and Waivers of 23A 16

Banking Regulation 18

William “Bill” Taylor 20

Mexican Financial Crisis 21

Hunt Brothers 23

The Bush Task Group on Regulation of Financial Services 25

Section 20 of the Glass-Steagall Act and “Principally Engaged” 26

The Volcker Rule 29

The Bank of New York Software Glitch in November of 1985 30

Sumitomo and Goldman 31

The 1998 Merger of Citicorp and Travelers and the End of the Glass-Steagall Act 32

Nonbank Banks and the Dimension Corporation Case 33

Irving Bank Corporation and Banca Commerciale Italiana 35

1987 Stock Market Crash 36

July 18, 2016 (Second Day of Interview) 38

Interstate Banking 41

The Dodd-Frank Act and the Volcker Rule 48

The Melcher Case and Federal Reserve Independence 54

Working with Paul Volcker and Others 58

October 20, 2011 (First Day of Interview)

MR. SMALL. Today is Thursday, October 20, 2011. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. We are interviewing Michael Bradfield, who was general counsel at the Federal Reserve Board from July 1981 to February 1989. I am David Small of the FOMC [Federal Open Market Committee] Secretariat. I am joined by Richard Ashton, deputy general counsel of the Board, and Nick Burk, a research assistant in the FOMC Secretariat. This interview is taking place at the Board of Governors in Washington, D.C. Mr. Bradfield, thank you for joining us.

MR. BRADFIELD. It's a pleasure to be here. I am very pleased to be able to make a contribution to the Oral History Project of the Federal Reserve. I think it's a very useful and important project, and, as I've said, I'm very happy to participate in making it as complete as possible.

MR. SMALL. And Rich is here, who you know and worked with.

MR. BRADFIELD. I had the pleasure of working with Richard Ashton for all that period of time, and I greatly respected his contributions. He was of great assistance to me. We had lots of litigation and other related problems, and I depended upon him a great deal in carrying out my responsibilities.

MR. SMALL. There was a lot of congressional interest in high interest rates, and that brought questions of oversight and public interest and scrutiny.

MR. BRADFIELD. The Fed is right on the top of the agenda as the only agency in the financial area that has the flexibility and capability of influencing events.

Educational Background

MR. SMALL. But let's start a little earlier. Let's start with your family background and your path through education to arriving at the Treasury.

MR. BRADFIELD. I grew up in a small town in a very remote part of Queens, New York. I went to a public grammar school and public high school there. Then I went to Union College in Schenectady, New York, and I spent the junior year at the St. Andrews University in Scotland. Then I went to Columbia Law School.

MR. SMALL. What was your undergrad major?

MR. BRADFIELD. My undergrad major was history. After that, I took a combined course in law and international relations. I got a master's degree in international relations from the School of International Affairs at Columbia University. I started in 1956 and graduated in 1960—getting two degrees at the same time, the L.L.B. and a Master of International Affairs.

MR. SMALL. So you've always had a strong international interest.

MR. BRADFIELD. Yes, dating back to the year that I spent at St. Andrews University. Prince William went to St. Andrews. That's where he met Catherine. It was a lot different then. At that time in the United States and in Scotland, the women were segregated from men. Now everybody's together at St. Andrews and everywhere else in the world.

Also, I did a lot of international law studies at Columbia. One of my professors, Richard N. Gardner, who is just retiring now as a professor of law at Columbia, recommended me to a law firm in Washington. It was called Pehle, Mann, Riemer, and Luxford. John W. Pehle was the head of economic warfare at the Treasury during World War II, and Ansel Luxford was the assistant general counsel for international affairs. Luxford was favorably mentioned by Keynes in his closing address at the Bretton Woods conference as one of the great contributors to the success of the Bretton Woods conference. So I got a basic training in international financial matters.

MR. SMALL. This is at the level of government treaties and such, as opposed to corporate law at the international level?

MR. BRADFIELD. Yes. It was public international law rather than private international law. This is intergovernmental relations. I had also applied to the Treasury. And I applied to the Federal Reserve Bank of New York. Apparently, I said something to the general counsel at the New York Fed in the interview that offended him. He was a curmudgeon. I might have wound up at the Federal Reserve Bank in New York if I had kept my mouth shut.

I interviewed at the Treasury, and at that time they told me they didn't have a place for me. Two years later, the general counsel of the Treasury called me up and said, "We have an opening, and we'd like you to come." That was after working for these ex-Treasury guys. One of their clients was Rommel's wife. They represented her claiming assets in the United States. I worked on all kinds of international problems—some of the problems relating to assets that affected economic warfare after World War II. I think I have international public law in my DNA.

At the U.S Treasury and in Private Practice

MR. BRADFIELD. I joined up with the Treasury in March 1962. I spent 13 years at the Treasury and eventually succeeded to the position held by Ansel Luxford, as assistant general counsel. That was the time of the critical balance-of-payments issues for the United States when France and the Netherlands were buying gold and the interest equalization tax [was enacted].[1] I

[1] Editor's note: The interest equalization tax was implemented in July 1963 to make it less profitable for U.S. investors to invest abroad by taxing the purchase of foreign securities. The purpose of the tax was to reduce the balance-of-payments deficit.

joined the Treasury just when the Group of 10 was being formed, and I worked on Group of 10 matters all during that period.

I met Paul Volcker in that period when he came down from New York on one of his early stints as a Treasury Department official. When he came, I prepared a memorandum to him on gold. He was tremendously impressed with that memo. He said, “That’s excellent work you’ve done.” So I’ve been working for Volcker [laughter] since then. I worked on the establishment of the SDR [Special Drawing Rights].[2] A lot of my time was taken up with U.S. relationships with the International Monetary Fund [IMF]. I also worked on the World Bank–U.S. relationship, because the Treasury is in charge of U.S. relations with the international development banks. I negotiated U.S. participation in the African Development Bank [ADB]. I went to Abidjan and spent about two weeks negotiating with the president of the African Development Bank on U.S. participation.

I did a lot of work on expropriation. I drafted the Gonzalez Amendment, which was very controversial at that time. It said that if a country was expropriating U.S. property without compensation, the U.S. executive director [of each multilateral development bank and international financial institution] had to vote against loans to that country. That would be a very popular position today. [Laughter]

MR. ASHTON. Was that aimed at Cuba?

MR. BRADFIELD. No, this wasn’t Cuba. A lot of it was Peru. I did a lot of negotiating with the Peruvian government on expropriations they did—Exxon expropriation. That was particularly when George Shultz was Secretary of the Treasury. He was very interested in obtaining compensation. Because of the Treasury’s role with the international development

[2] Editor’s note: The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries’ official reserves.

banks, including the IADB [Inter-American Development Bank], I got an award from George Shultz. I still have a picture of him giving me this award for the successful negotiation with the Peruvian government.

I left the Treasury in 1975 when I formed a law firm, an eponymous law firm: Cole, Corrette, and Bradfield. Corrette was the general counsel of the Export–Import Bank, and Cole was the international tax counsel at the Treasury. We formed the law firm. My first client was Marcona [Mining] Corporation, which had been expropriated by the government of Peru. Marcona was headquartered in San Francisco. Schultz had contacts in San Francisco. He told the Marcona Corporation to come to me. I then negotiated for them and got them compensation for their mine in Peru.

One of the funniest things is that we had a big dinner, and we were able to get the State Department to intervene on our behalf. Carlyle Maw had been an undersecretary of state and was the managing partner of Cravath, Swaine, and Moore. He was a fantastic negotiator. I'll give you an example of Carlyle's diplomacy. Mark Feldman was an associate legal advisor in the legal advisor's office at the State Department. There's a lot of interaction between the international people at the Treasury Department and the State Department staff. Maw called me over [to the State Department] to attend some meeting on an issue. I came into the room. Mark Feldman was there, and he said, "What are you doing here?" Later Carlyle Maw came in and said, "Hey, Mike, we're so glad to see you. I know you can help us."

He worked his magic on the Peruvians. We took people to the 1789 Restaurant [in Washington, D.C.] to celebrate. They had the Marcona people. The Marcona people got drunk and insulted Maw, saying, "You should have bombed Peru." [Laughter]

MR. SMALL. During your time at Treasury, a major event occurred on August 15, 1971, at Camp David. Do you have any recollections of the events leading up to that?

MR. BRADFIELD. We were then experiencing inflation and stagnation—"stagflation" I think was the term. There was great pressure on the value of the dollar. David Kennedy got essentially fired [by President Nixon] as Secretary of the Treasury. There was a lot of talk then about devaluation of the dollar, and it seemed to me that nobody would want to take the job of Secretary of the Treasury because it would mean effectively working on the devaluation of the dollar. John Connally took the job, and he was a man with a mission. He was the most forceful personality that I've ever met. Paul Volcker was the undersecretary for monetary affairs. For some time, Paul had been working on a plan to deal with the problem. Connally was absolutely convinced that the rest of the world was taking advantage of the United States and that the problem needed to be corrected, and he was going to do it.

MR. SMALL. You say that John Connally was on a mission. He was on a mission to devalue?

MR. BRADFIELD. He was on a mission to correct the imbalances. Let's put it in today's context. In a sense, today is very much like the 1970s, because it was a reflection of a long period of imbalances, and what was needed to readjust. And it was very much easier to readjust [in the 1970s], because you didn't have a European Union or a euro. The euro really stands as a major obstacle to international adjustment. Going over this stuff last night—I won't tell you what it is, but I've developed a plan to deal with all the problems.

MR. ASHTON. So you're now a man on a mission?

MR. BRADFIELD. I'm a man on a mission. And it seems like Christine Lagarde is just the person to replace John Connally in today's world. But that was the situation.

MR. SMALL. But there was this Volcker Group, right?

MR. BRADFIELD. Yes.

MR. SMALL. What was that about?

MR. BRADFIELD. Well, Volcker was very interested in assuring that we were in compliance with the requirements of the IMF agreement. Remember, there was a par value system, and you needed the approval of the IMF to change your par value. Those were the basic rules. The United States complied with this requirement by converting [the U.S. dollar] into gold, so, in a sense, we wanted to stop convertibility. In effect, you abandoned the method by which you complied with the Fund rules. So there was an incompatibility. One element of what needed to be done was incompatible with the existing rules. Eventually, what came out of it was a managed float.

Volcker was very interested in maintaining as much compliance with the Articles of Agreement of the International Monetary Fund as possible.

MR. SMALL. Do you remember the positions staked out by the Fed in general and, in particular, by the Board and the New York Fed?

MR. BRADFIELD. I don't think the Fed counted for much with John Connally. In the whole period of time that I was there [at the Treasury], the Fed was quite a minor player. Where the Fed did play a role was through the Federal Reserve Bank in New York, with the foreign exchange swaps. Charlie Coombs [at the New York Fed] was in charge of that. Coombs was influential in helping to keep the system going through swaps. As to the future of the system, the Fed did not play a major role. There was nobody from the Fed at Camp David.[3]

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[3] Editor's note: President Nixon convened a meeting at Camp David on August 13, 1971, to consider changes to economic policy. Chairman Burns attended that meeting. A package of measures, including the suspension of convertibility of the U.S dollar into gold under the Bretton Woods Agreement, was announced on August 15, 1971.

I was just host to Dewey when he was here for the IMF meetings. He's 93 now. He's still teaching a class. [Laughter] At least some of the times he's still making sense, which is remarkable.

Dewey was the [Board's] representative [on international issues]. In November 1963, Dewey went over to the Board. Then [after Dewey], Henry Wallich was the international Governor. Dewey had very good relations with Bob Roosa. By 1965, I think, Bob Roosa was gone. Bob Roosa was a brilliant undersecretary of monetary affairs.

So the Fed was represented [at Camp David] with Burns. Burns was very much against the end of convertibility [of the dollar into gold]. I went for a walk with Volcker and Burns at Camp David the evening that the decision was made by President Nixon to endorse the Connally program of devaluing the dollar and going off gold convertibility. Burns was saying, "This is a terrible day."

MR. SMALL. What was Volcker's view?

MR. BRADFIELD. Oh, this was Volcker's plan. What Connally added to this plan was the surcharge. The surcharge, in effect, devalued the dollar on [the] current account unilaterally.

MR. SMALL. This was a surcharge levied on—

MR. BRADFIELD. On imports. So it gave Connally negotiating power. He said, "You can agree with me on revaluation of the Deutsche mark and the Japanese yen, or we can keep the surcharge in effect for a long time and, say it's always a 15 percent surcharge, if you feel very aggressive about your position, we could raise the surcharge." That was a genuine international negotiation on exchange rates, and everybody participated—everybody who counted. The Chinese weren't players at that time, but the French played a major role, the British, the Germans. And, of course, then what Connally hated was [that] the Dutch and Belgians were also very influential because they were so small: "Who are these little countries telling me what to do?"

MR. SMALL. Was one of the problems similar to today, in that you had these countries that ran a surplus, and whereas the markets can force a country that runs a deficit to devalue, on the surplus side there's just not a good mechanism for forcing countries to revalue?

MR. BRADFIELD. The United States was arguing that there were responsibilities with surplus countries. That was a whole ideological argument about where the responsibility for adjustment was lodged.

MR. SMALL. Volcker had a reserve tax or something. He had some mechanism?

MR. BRADFIELD. I don't remember that. That doesn't mean that it isn't true, but I don't remember it as a factor in negotiations. The negotiations were on how much the dollar was going to be devalued and how much the appreciation would be [for other currencies]. The International Monetary Fund, led by Pierre-Paul Schweitzer, proposed a small adjustment—like, a 5 percent adjustment. Connally blew this guy off the table and said, "What you say is irrelevant. I don't want to hear from you anymore." And in the negotiation, we had adjustments of somewhere around 15, 16 percent for the Deutsche mark and the Japanese yen. So, yes, a long answer to your shorter question is, the situation [today] is acutely like that, in terms of what are the responsibilities of surplus countries.

And I think there is a recognition now. Yesterday, Martin Wolf had a column in the *Financial Times* in which he said, "Those people who are stupid enough to make these loans can hardly complain now that they don't get paid back in full."[4] Which is basically saying—he says it more elegantly—that this is an imbalance that has developed over a long period of time and to

[4] Editor's note: Martin Wolf (2011), "There Is No Sunlit Future for the Euro," *Financial Times,* October 18.

the advantage of both the creditors and the debtors. So the adjustment requires an effort on both sides. I can't understand why the U.S. Treasury today doesn't make a bigger effort than it has. That's one of the great failures of the Obama Administration. It would have been very positive from the political point of view, and it's the right thing to do.

MR. SMALL. You're talking about debt write-downs?

MR. BRADFIELD. I'm talking about a multilateral exchange rate adjustment.

MR. SMALL. Bring China to bear?

MR. BRADFIELD. China, Japan, Germany, oil-exporting countries. I don't think you can single out China. This is a mistake to say the culprit is entirely China. If you look at what's happening in the euro zone now, what you have there is a repeat on what's happening elsewhere in the world. All these issues are related, in that they are maladjustments that have occurred as a result of surpluses and deficits that are generated by countries following policies that produce those results, both the surpluses and the deficits.

MR. SMALL. To what extent did you see in the 1960s, leading up to change in the Bretton Woods agreement, that the United States was running an easy monetary policy and pumping out dollars? There is the famous 1965 discount rate increase by the Fed that the Johnson Administration resisted.

MR. BRADFIELD. We ran the Vietnam War without taxing for the cost, because you're running an unpopular war, and you can't ask for that [higher taxes] because the people won't pay for a war that they don't like, which is somewhat of a repeat of Iraq and Afghanistan. And, sure, you run into big economic difficulties. The problems of 1969 and 1970 were a direct result of the lack of [a] tax-financed Vietnam War. So, yes, I think that your description of the problem is right on.

MR. SMALL. What about the domestic financial sector? Those things were pretty stable.

MR. BRADFIELD. I don't know.

MR. SMALL. We didn't have a lot of crises, a lot of bank failures; the investment banks were small. But the financial sector wasn't a huge worry, is that right?

MR. BRADFIELD. Well, that's not entirely right. We had Penn Square in the 1980s. If we'd look at the FDIC's banks that failed, you really won't find any.

MR. SMALL. There was Herstatt Bank [in Germany].

MR. ASHTON. Franklin [National Bank] in 1974.

MR. BRADFIELD. So that's when you begin to see some of the reflections, and these other things that come along are [the] beginning of reflections of imbalances growing in the financial system. But in the 1960s, I think it was pretty safe-and-sound banking.

MR. SMALL. So what changed? Was it the liberalization that allowed banks to get into more things? Was it the economic environment? Was it capital markets opening up, credit escaping the banking system and out into the markets?

MR. BRADFIELD. You can't say one thing. I think it's all of that. I don't think things really got out of hand until the 1980s. And that was a slow evolution of things.

MR. SMALL. When in your career did you start focusing on, or running more into, issues of domestic financial stability?

MR. BRADFIELD. I didn't have any focus on that at the Treasury or in private practice. I came to the Board in July 1981.

Joining the Board Staff; Penn Square and Continental Illinois

MR. SMALL. Why did you come to the Board?

MR. BRADFIELD. Volcker wanted a general counsel that he had confidence in. That's why I came to the Board.

MR. SMALL. And you had a learning curve on the domestic regulatory side?

MR. BRADFIELD. Yes, I had a learning curve on the domestic regulatory side.

MR. SMALL. Do you remember your first big crisis?

MR. BRADFIELD. Yes. Penn Square. You had all the bankers in the Board Room being asked what they were going to do, and they were saying, "I couldn't do anything."

MR. SMALL. Penn Square was a small bank in Oklahoma that was tied in with Continental Illinois.

MR. BRADFIELD. It was tied in with Continental. It sold tax shelters, and Continental was involved with them in that. But nobody knew what their assets were or what their liabilities were, so nobody would touch it.[5]

MR. SMALL. What was Volcker's leadership style or philosophical framework in how you deal with crises?

MR. BRADFIELD. Bill Wiles, the Board's Secretary, used to call Volcker and me "crisis junkies." Volcker was intent on preserving the stability of the banking system. And he certainly wanted a solution to Penn Square. He said to put the pressure on the banks to come up with them [solutions], but because [of] the big potential [for] litigation, potential forward liabilities, there were no takers, so it [Penn Square] had to be liquidated. And the same thing with Continental Illinois. With Continental Illinois, our biggest problem was the Treasury

[5] Editor's note: Penn Square originated billions of dollars of speculative loans related to gas and oil exploration, and Continental Illinois purchased around $1 billion in participations in those loans. Losses on those loans resulted in the failure of Penn Square and large loan losses for Continental Illinois and some other banks. For further information, see Federal Deposit Insurance Corporation (1997), "Continental Illinois and 'Too Big to Fail'," chapter 7 in *History of the Eighties: Lessons for the Future,* vol. 1: An Examination of the Banking Crises of the 1980s and Early 1990s, pp. 235–57 (Washington: FDIC).

Department, which wanted no assistance to go through the holding company. The FDIC wanted to be able to, in a sense, take shares from the holding company, take equity in the holding company, so that they could sell it to somebody else, which they eventually did.

MR. SMALL. Continental's problem was that it held a lot of Penn Square paper, and then there was a run on the bank?

MR. BRADFIELD. No, I think it was because they held a lot of bad dollars [loans].

MR. SMALL. Penn Square's and otherwise.

MR. BRADFIELD. Penn Square's and otherwise.

MR. SMALL. But then they [Continental] had a funding problem. They funded heavily in the short-term markets.

MR. BRADFIELD. Yes. And, like Bear Stearns, there was a run.

MR. SMALL. Volcker was not hesitant to get the bankers together and knock some heads?

MR. BRADFIELD. I think with Corrigan they put together, through J.P. Morgan, a facility—for, I think it was, $100 million—with which, in effect, they guaranteed the banks that they would tell them if it [Continental] was going to be closed [so] that they could pull their money out.[6]

MR. SMALL. I can imagine a scenario where Volcker is pushing a public policy view on them but the banks have their legal obligations to their shareholders, and the Board's lawyer is getting very nervous about, where is the line here? Is there an issue here?

MR. BRADFIELD. The Fed told the banks that they would take them out if the bank [Continental] was going to be closed.

[6] Lewis T. Preston, chairman of Morgan Guaranty Trust Company, negotiated a $4.5 billion line of credit for Continental from 16 major New York banks, which was announced on May 14, 1984.

MR. ASHTON. So the Fed would cover any losses that the syndicate members suffered?

MR. BRADFIELD. No, that they [the banks] would, in effect, be able to withdraw their money and the Fed would have to replace it.

MR. SMALL. The Fed would replace the funds through the discount window?

MR. BRADFIELD. Yes. I negotiated with the FDIC their agreement to take out the Fed. I think it was over $7 billion that the Federal Reserve Bank of Chicago had out to [Continental] through the discount window, and the FDIC agreed that they would take out the Fed.[7] Silas Keehn, the president of the Federal Reserve Bank of Chicago, wouldn't put the money in [Continental] until he had the agreement from the FDIC that they were going to take them [the Chicago Fed] out.

MR. SMALL. By "take them out," you mean make them whole?

MR. BRADFIELD. Yes. The way it usually works is, the Fed takes all the collateral, so the FDIC doesn't really have a choice. It doesn't pay for the FDIC to just not pay off the Federal Reserve, because—

MR. ASHTON. That's right. And Jack Murphy, who was [William M.] Bill Isaac's [Chairman of the FDIC from 1981 to 1985] general counsel, always brings that up, about how the Fed grabbed all the collateral right out from under the FDIC's nose, and we had everything and the FDIC had nothing, and they had to deal with us.

MR. BRADFIELD. The Congress then went and fixed that [through FDICIA, the Federal Deposit Insurance Corporation Improvement Act of 1991]. Bernanke made a statement in which he said the Fed can't lend to a bank that's in trouble on an individual basis anymore, but

[7] Editor's note: Continental borrowed $3.6 billion from the discount window at the Federal Reserve Bank of Chicago on May 11, 1984, putting up $17 billion in collateral. On May 18, 1984, the FDIC announced that it would extend support to all depositors with accounts in excess of $100,000 and to the bank's general creditors.

we can do it on a generalized basis. Well, that's what he did in the last several years. So I don't think there's been much of a change in what the situation is with respect to lending. I'm sympathetic with that. I'm for maintaining financial stability. But that also implies a certain level of regulation, which wasn't evident. Also, if you're going to lend to people in those circumstances, you've got to have terms and conditions that are going to protect your interest and the public interest. I don't think that was done in 2007 through 2010.

MR. SMALL. Was a lot of the Legal Division's time in the Continental episode spent writing the collateral agreements? What were your calls to action?

MR. BRADFIELD. One, in working with Bill Taylor, was monitoring what's going on. And, as I remember, in—was it in Continental?—that they had an agreement with the OCC that they wouldn't fund a subsidiary that was engaged in some kind of activity—

MR. ASHTON. Some sort of futures subsidiary.

MR. BRADFIELD. Yes. Bill and I agreed that they could break that agreement and that they'd go ahead and fund it. There was a lot to do in monitoring and following the situation and reacting to latest developments. Then there was this whole question of lending. The Board wasn't involved. Well, to some extent, the Board was involved. Certainly, the president of the Federal Reserve Bank in Chicago and the FDIC, there was a lot to do there.

The Treasury was driving us nuts with this: Peter Wallison [general counsel from 1981 to 1985], and there was an undersecretary for financial—not undersecretary, assistant secretary, whose name I forget. They had a policy objective. They wanted to set a framework in which there would be no regulation of holding companies—so you don't have to regulate holding companies, you only have to regulate banks.

MR. SMALL. This is the Reagan Administration?

MR. BRADFIELD. This is the Reagan Administration.

Bank Holding Companies and Waivers of 23A

MR. SMALL. Did the bank holding company structure work, in the sense that you could have the [commercial] bank walled off within the holding company—there wouldn't be capital sloshing from one part to the other?

MR. BRADFIELD. When I was there, it worked. [Laughter] I'm appalled that all the waivers of 23A that the Federal Reserve adopted—23A limits the credit extensions by a [commercial] bank to its holding company and its subsidiaries and affiliates. Five percent to anyone and 10 percent to all. That's a good law. And when I was there, I don't think I granted one [waiver], not one. [Laughter] With Scott, I counted, like, 57 or something like that. This is in exactly the situation where you shouldn't do it. If you do it in that situation, what's the point? What's the point of having it?

MR. SMALL. Is it a counterargument that if you have this subsidiary that has the bank holding company name on it—say, Chase—and the subsidiary is going belly up, the market is just going to see the [bank holding company's] name "Chase" and take revenge on the commercial bank, the markets don't distinguish? And if one part of the holding company goes down, it's a run against the whole thing? Is that the argument for these exceptions?

MR. BRADFIELD. I'm sure that that is the argument for the exceptions. But if you grant the exception, then you have vitiated the rule. Then the market knows, and the staff, the managers, know that when push comes to shove, they can use the subsidiary to do what they please, and all this regulation of banks doesn't matter.

Say, we can't have banks that have assets that are a multiple of the gross national product of Britain, which was what they had. And Switzerland's come to the same conclusion. So there's a Vickers Commission which has just produced a report last month, which in its final version says they're going to ring-fence the retail bank—and the one that serves individual customers and businesses—but outside the ring fence you can engage in all kinds of other activities.[8] In a sense, the interactions between the two are limited in the separate legal entities. That's the way they're going to protect the taxpayers of Britain, because the bank is going to be—in effect, the same objective of the Volcker rule is being accomplished in a different way.

MR. SMALL. In some sense, there's nothing outside the ring [fence] that's too big to fail. You could just let it go.

MR. BRADFIELD. Yes, that's exactly right. And if that wall is permeable, then they haven't accomplished anything. Now, I think that's the potential. And the report leaves open to a great deal of interpretation the regulatory rules that would have to be adopted to enforce the ring fence. And if it's not done, they don't have a ring fence. They have a sieve, not a fence.

MR. ASHTON. One of the big issues that I remember coming up when you first came [to the Board] was an issue about control. Remember the stakeouts and the—

MR. BRADFIELD. Yes.

MR. SMALL. What were those issues?

MR. ASHTON. Around the time that Mike became general counsel, some of the banks were trying to get around a lot of the restrictions in the Bank Holding Company Act by, in essence, taking nonvoting equity, because they [the banks whose equity was being purchased] were in locations that they [the banks purchasing the equity] couldn't acquire and saying, "Well, we don't control them, so the geographic restrictions don't apply." I remember that was one of the first things that we looked at when you came. A policy statement was issued.

[8] Editor's note: The Independent Commission on Banking, headed by Sir John Vickers, proposed fundamental reforms to banking in the United Kingdom in a report published in September 2011.

MR. BRADFIELD. Yes. I think I identified control as the crux of the Bank Holding Company Act. If you don't administer control as vigorously as provided in the statute, you don't have anything. That was certainly a motivating consideration. I think I identified the right thing. [Laughter]

We worked hard. And the staff—Virgil Mattingly, Rich Ashton—were enormously helpful, and they believed in it too. I was more extreme than anybody else, but I think that was the right thing to do. [If] you want to have a bank holding company act, you have to apply the control concepts rigorously. If you don't, you don't have anything; you just have the paper form, and you don't have the reality of the separation [of the entities within the holding company].

MR. SMALL. Is the fundamental economic underpinning for enforcing a bank holding company [law], as opposed to deregulation and let markets work, the deposit insurance and letting institutions play with government-guaranteed money? Or is the central underpinning that commercial banking has ties with small businesses, and they can only get credit from banks?

MR. BRADFIELD. I think it's both.

MR. SMALL. This may go into "banks are special."

MR. BRADFIELD. That's the fundamental aspect of the argument. But it's also—which the Bank Holding Act is supposed to be all about—the concentration of resources. And that's gone really by the boards, I think.

MR. SMALL. That a holding company can bring together expertise and—

Banking Regulation

MR. BRADFIELD. No, but there's an aggregation of capital that really has the economy by the throat, can choke it to death. That's what grabs me, that aspect of it. When it [a bank holding company] gets so big, is it really possible to regulate it? What the agencies are forced to adopt is a sort of a metric system. You look at various aggregate data to determine whether they're going off course. You don't look at individual loans. You don't look at trading desks. And so if they become very large, it becomes difficult to regulate. That's one aspect of it.

The other aspect of it is, if they become very large, you mix banking and commerce. We were under a great deal of attack from the Reagan Administration on the question of mixing banking and commerce. The "nonbank bank" idea was like the camel's nose under the tent for that. Volcker was a strong supporter of maintaining separation of banking and commerce. Nobody seems to pay so much attention to that anymore. In America, we have a history of lots and lots of banks, and no banks that are controlling the whole economy. It's not like the Netherlands, where there are, like, two banks, and the United Kingdom, where there are five banks. We've had tens of thousands.

MR. SMALL. But it's certainly become more concentrated recently.

MR. BRADFIELD. Oh, yes, and that's a big change.

MR. SMALL. You mentioned earlier that if Continental had to go down [fail], then some of the other banks would go down with it. Does a regulator get captured by the same fear for the too-big-to-fail institutions, in that if they go down, then the economy goes down, and "This can't happen on my watch"?

MR. BRADFIELD. If a bank goes down, the regulators are criticized, so that there is a desire to see that they don't fail. But also maintaining financial stability is a major role of a central bank, and it's a major role of supervision. That's terribly important—as you see, the costs of instability are enormous.

MR. SMALL. Do you think the Federal Reserve System works well for regulation and supervision—these 12 Reserve Banks and the presidents in each District, but with the Board here in Washington, D.C.? For example, Continental goes down. Who's brought out onto the carpet to say, "Hey, look"?

MR. BRADFIELD. I don't find fault with that aspect of the System. On the whole, it can work well. I don't think it did work well under Greenspan. Greenspan undermined the System and replaced all the Bill Taylors with free market economists.

William "Bill" Taylor

MR. SMALL. Bill Taylor was the head of the Banking Supervision and Regulation Division at the Board [from 1985 to 1991].

MR. BRADFIELD. Bill was the quintessential guy who started in the Federal Reserve as an examiner and worked his way up and cut his teeth visiting banks and examining loans. He really knew how banks operate.

MR. SMALL. Bill Taylor's no longer alive. Do you have any memories of him that capture his essence as a regulator and who he was and how his approach worked?

MR. BRADFIELD. I have lots of remembrances of things we did together. Bill had a very fine sense of humor. He was always enormously well prepared. If there was a problem in a particular bank or in a particular area, Bill would have all the data that you could possibly think about needing. He was a tough guy. He could go to Bank of America and tell them that they have to change their CEO, and did. He knew banking, and he was a very effective, understanding, and capable regulator. He was highly respected not only among the regulators, but [also] among the people who were regulated. He was fair and extremely capable. He knew what he was talking about. Bill and I worked on the—what do they call those?—the state [insured] savings and loans [S&Ls].

And so there was a big crisis in Maryland. Bill Taylor and I went to see the Governor of Maryland, Harry R. Hughes. We sat with him for two or three weeks, every day, advising him. They really took to Bill. Everything he said that they should do, they did, to Bill's credit and to the credit of the Governor. Benjamin Cardin was the speaker of the Maryland legislature.

MR. SMALL. And he is currently the junior U.S. Senator from Maryland.

MR. BRADFIELD. Yes. He backed Hughes 100 percent. I've always admired him for that when he could have, for political reasons, made a big fuss. They took full responsibility for what the [savings and loans] had done, prosecuted them, and made depositors whole.

Mexican Financial Crisis

MR. SMALL. Early on in your tenure there it was the LDC [Latin American Debt Crisis], the Mexican financial crisis. Was that just Ted Truman and the Division of International Finance, or were you involved?

MR. BRADFIELD. I was involved. Ricki Tigert was the assistant general counsel. We negotiated the agreements with the Bank for International Settlements. We put together a consortium that provided lending to indebted countries. The practice was to have agreements, rescheduling of the private debt. And these committees were formed.

MR. SMALL. "Rescheduling of the private debt"—meaning the debt that the government of Mexico had with private banks?

MR. BRADFIELD. Yes. As part of rescheduling, they had these committees, and they then had to get everybody to do—what they're now calling for Greece is a rescheduling of Greece's debt. This was rescheduling. In effect, there was new money to pay off the old money at lower interest rates. In Greece they're talking about writing down the debt, which only happened later with Brady bonds, and debt was written down. In the first half of the 1980s, it was "rescheduling" rather than "write-downs." The interest burden was lessened but not the principal. The principal was not written down so that the banks wouldn't have to write down the loans on their books, which they couldn't afford to do at that time. The capital exposures were very high—in some cases, exceeding capital.

There were very complicated negotiations and issues about what the governments were going to do. I worked closely with Ted Truman. They wanted to get all the banks to participate, and I would call banks and tell them how important it was for the stability of the system for them to participate.

MR. SMALL. Is that different now? Then there were a limited number of banks who held debt, and you had a finite phone list of who to call. But now that debt is out there sloshing around in markets—you don't know who to call and how to do a negotiation.

MR. BRADFIELD. Yes, it's been securitized. It's the bonds now, not loan agreements.

MR. SMALL. So it's harder to get everyone into agreement?

MR. BRADFIELD. Yes. Changes have been made over the last five years in the text of these agreements to allow a committee of bondholders much more flexibility in adjusting the [terms of the agreements]. They had an agreement for 21 percent reduction in private debt. But now the Germans are saying, "We need 50 percent," and the French and the ECB are saying, "We don't want anything. Everything that has to happen is voluntary." The 21 percent is "voluntary."

MR. SMALL. Did the Mexican debt crisis cause tensions or frictions between Volcker and the Reagan Administration in free market discipline versus forbearance?

MR. BRADFIELD. Volcker would barely talk to Undersecretary for Monetary Affairs Beryl Sprinkel. But Beryl Sprinkel really didn't do anything. Eventually Tim McNamar was the Treasury participant, and McNamar supported Volcker 100 percent.

MR. SMALL. What were Volcker's relations like with Don Regan and Jim Baker?

MR. BRADFIELD. The relationship with Don Regan was cordial but tense. There was more collaboration with Jim Baker. I would call it "cordial, but at arm's length."

MR. SMALL. Was some of this over foreign exchange intervention versus just a free float of the dollar? Was it free markets versus central bank management?

MR. BRADFIELD. I don't think so. Remember, Baker was involved in the Plaza agreement, which was another multilateral readjustment in the value of the dollar. I don't think there was much in the way of policy differences. To the extent there were policy differences, it was on domestic interest rates.

MR. SMALL. One of the stories is that Jim Baker was possibly involved with the discount rate revolt against Volcker.

MR. BRADFIELD. That was over domestic interest rates. It didn't have anything to do with international. Baker was very sensitive to domestic pressures on the economy, on foreign imports. He told the foreigners—the Japanese and the Germans—they were going to have import controls [and] they were going to have tariffs if they didn't adjust exchange rates. Volcker was a participant in the Plaza Accord, and I think he was in total agreement.

Hunt Brothers

MR. SMALL. Do you remember anything in particular about the Hunt brothers?

MR. BRADFIELD. The original deal with the Hunt brothers was in the late 1970s—1979 or something like that—when the silver market and the corner[ing of the market] developed, and the banks that were financing the Hunt brothers ran into trouble. In effect, the Fed bailed them out.

MR. SMALL. The Hunt brothers were going to drag the banks down with them, so the Fed extended those banks discount window loans?[9]

MR. BRADFIELD. I don't remember that. That was before I came to the Board. But as a condition for this, there's all this silver piled up in these warehouses in Delaware. And the Hunts had promised that they would sell the silver, but they didn't sell it. Finally, the Hunts ran into financing difficulties, and they wanted to get bailed out again and have their debt extended. So we negotiated, sort of, the right to sell the silver if they didn't sell it.

I negotiated with two of the—who was the heavyweight boxer's son?—I forget his name. The Hunts had these high-profile lawyers. I negotiated an agreement with them to sell the silver—that if they didn't sell the silver, we could sell the silver. We could appoint a trustee who would sell the silver. But that never had to happen, because the Hunts sold the silver.

MR. SMALL. Someone might ask: What is the general counsel of the Federal Reserve doing in this area? Is it financial stability that got you involved? Why were you concerned with some guy holding silver?

MR. BRADFIELD. The Hunt brothers had a financial stability agreement, which the Federal Reserve is part of, that they would do certain things. They wanted to get out of that agreement where they wanted an extension of that agreement so that they could get financing that wasn't available to them otherwise. So we amended the agreement and forced them to carry out their original deal.

[9] Editor's note: The Federal Reserve did not extent discount window loans to the Hunt brothers.

MR. SMALL. Is there a tough edge to this from Volcker, Bill Taylor, or you about moral hazard—that you've got to make sure they feel the pain?

MR. BRADFIELD. I'm not sure that was a factor in this particular deal. We had an agreement, and it was important from the point of view of the stability of the silver market, but there shouldn't be somebody holding that concentrated accumulation of silver. That was the whole purpose of getting them to sell it in the first place. And they welched on their deal, and we forced them to carry out what they had agreed [to do].

MR. ASHTON. The mysteries of the Hunt family was complex. The family had complex internal agreements about who was going to take the gains and losses.

The Bush Task Group on Regulation of Financial Services

MR. SMALL. In that same era, early in the mid-1980s, there was the Bush Task Group.[10] That had the potential to very much change the mission of the Fed on the regulatory side.

MR. BRADFIELD. What stands out for me in that is Richard Breedon [Chairman of the Securities and Exchange Commission (SEC) from 1989 to 1993], who I called "King Richard." He was the quintessential high-handed, imperious White House operator. I'm trying to find less contentious words. [Laughter]

MR. ASHTON. You can cross them out in the transcript. [Laughter]

MR. BRADFIELD. He was imperious about the whole negotiation. It was his project. We would have these long series of meetings in which this was all discussed. I participated on

[10] Editor's note: Vice President Bush's Task Group on the Regulation of Financial Services was formed to make recommendations to simplify the regulatory structures of the financial services industry. The task group consisted of the heads of the federal regulatory agencies, the Attorney General, the Director of the Office of Management and Budget, and others.

behalf of the Federal Reserve. Then Richard came up with his plan. He wanted to take the Fed out of supervision, period.

MR. SMALL. Did he want to put supervision under the Treasury?

MR. BRADFIELD. No, I think he wanted a federal banking regulator. He had what he called his "spaghetti charts," which showed all the agencies and the interrelationships among the agencies. Well, you know what happened in the end.

MR. SMALL. But during the process, did you have marching orders from Volcker: "This is where we want to come out"? How much of the general outline of the goal did he specify for you?

MR. BRADFIELD. I didn't want any change at all.

MR. SMALL. But that was very much at risk—seemingly at risk at that time.

MR. BRADFIELD. It all worked out fine in the end. Don Regan came to the meeting and said that he didn't want the OCC to be incorporated in any new structure, that the Treasury would continue to have the OCC as an agency under the Treasury Department.

MR. SMALL. He was against losing turf.

MR. BRADFIELD. Yes. So when he wouldn't give up any turf, the whole thing collapsed. This was in a meeting with Vice President Bush.

MR. SMALL. At the very last minute? Was he close to expecting sign-offs?

MR. BRADFIELD. I think so. The Fed dodged a bullet.

Section 20 of the Glass-Steagall Act and "Principally Engaged"

MR. SMALL. What's the timeline of when section 20 underwriting and "principally engaged" rose into prominence?

MR. BRADFIELD. Citibank is the one that really pressed forward with arguing that bank holding companies should be able to engage in certain elements of underwriting.

MR. ASHTON. It seemed like it lasted the whole decade. There was litigation going on almost all the time.

MR. SMALL. Rich, were you involved in this?

MR. ASHTON. The litigation was my responsibility.

MR. BRADFIELD. Yes, but it started with Bankers Trust and commercial paper.

MR. ASHTON. Yes. Neal Petersen, the Board's general counsel from 1978 to 1981, had done that. We said that commercial paper was not a security for Glass-Steagall [Act of 1932] purposes.

MR. SMALL. Could you give me the context of the phrase "principally engaged"?

MR. ASHTON. Commercial paper was not secured, which meant that banks could underwrite it any way they wanted, because the Glass-Steagall prohibition on unrated securities wouldn't have applied. That started before Mike came to the Board as general counsel. That was challenged by the securities industry. The case later went to the Supreme Court, where they ruled against us.

MR. SMALL. You were arguing that commercial paper—

MR. ASHTON. Was not a security, and, therefore, banks could underwrite it. We had taken a deregulatory approach. Then the question became, is there some other way to do it? They looked at the actual 1933 language in [the] Glass-Steagall Act [section 20], which said affiliates could not be "principally engaged" in underwriting and dealing in securities. So the question was: Was there some level of underwriting and dealing that would be permissible before it hit the "principally engaged" limit? That gave rise to, first of all, what does "principally" mean? Does it mean 50 percent, 25 percent, or something less?

MR. BRADFIELD. It was only when the Seger, Johnson, Angell, and Martin group of Governors came on board that there were enough votes to approve it.

MR. SMALL. "Approve it," meaning raise what "principally engaged" meant from, say, 5 percent or more to 10 percent or more?

MR. BRADFIELD. The issue was to interpret what section 20 meant and to authorize, in effect, subsidiaries of holding companies to engage in a certain level of underwriting and dealing activity [in securities]. Volcker and Emmett Rice voted against it, and the others voted for it. And I put the proposal to the Board with a recommendation to approve it.

MR. SMALL. So Volcker and you were on opposite sides?

MR. BRADFIELD. Yes. That was the only time. The only reason I did that is because the votes were there, and it was going to get adopted and should be adopted as something that the Fed could live with.

MR. ASHTON. There were a lot of conditions put on the approval.

MR. BRADFIELD. Yes, a lot of conditions and limitations. I tried to write the rules so that the 5 percent was 5 percent of their dealing in [the] securities that national banks could also underwrite and deal in. The section 20 affiliate could engage in underwriting and dealing in securities like U.S. government securities, which Glass-Steagall allowed them to underwrite and deal in, because national banks could do that. The volume of underwriting and dealing in those securities would be the measure of what they could do in non-eligible securities. It was originally set at 5 percent. Greenspan and Virgil Mattingly [Board general counsel from 1989 to 2004] raised that, I think, to 15 percent and then to 25 percent and then—

MR. SMALL. Is this the path to tossing out Glass-Steagall?

MR. BRADFIELD. That was the path to ending it. The Gramm-Leach-Bliley Act of 1999 repealed the provision. I'll take the blame for starting down the primrose path.

MR. ASHTON. Our job was to defend whatever the Board approved. There were lengthy meetings on the section 20 proposals. The other Governors would say, "Let's approve this." And Volcker would say, "Maybe you should have more restrictions like this." And they would agree to add all these firewalls and restrictions. We'd have another meeting, and Volcker would want even more restrictions. I think the feeling was that if the majority agreed to enough restrictions, Volcker would vote for it. But after they agreed to all the restrictions, Volcker ended up voting against it. At that point they had agreed to them, so they were stuck.

MR. BRADFIELD. I put in all the restrictions that the SEC had suggested. Yes, Volcker said he didn't agree with the basic interpretation.

The Volcker Rule

MR. SMALL. So what's the overlap between what Volcker wanted on section 20 with what he wants on the Volcker rule? Are they distinct?

MR. BRADFIELD. They're distinct. In the Volcker rule, he's not talking about underwriting. Now, if you ask Volcker whether you should reinstate Glass-Steagall—and that was at least in play in Dodd-Frank [Wall Street Reform and Consumer Protection Act of 2010]—he says he never endorsed that.

MR. SMALL. Does the intellectual foundation of the Volcker rule go back to Volcker's and Corrigan's view that banks are special?

MR. BRADFIELD. In a sense it's involved in that, but what he [Volcker] is saying is that taxpayers should not be responsible for these activities that have a heavy element of speculation, and that this kind of betting and proprietary trading shouldn't be subsidized by the government with deposit insurance and the federal safety net. That's what he's saying.

I was listening to Ron Suskind's book *Confidence Men: Wall Street, Washington, and the Education of a President* while I drove from Mercersburg in the rain last night. In one chapter in that book he articulates Volcker's take on this whole issue as he was telling it to President Obama. I think that's the most articulate explanation of that approach, of that philosophy, that I've ever heard or read. I've never seen it as clearly stated. You know, Volcker writes wonderful speeches. I've never seen it so articulately explained, and so I recommend that to you.

But that's the point. The point is, speculating in at least what I would characterize as "socially questionable" products shouldn't be subsidized by the taxpayers. The taxpayers shouldn't support that. And it's important that the "banks are special" is the part that Volcker wants to isolate, and he's very articulate in explaining those functions: payments functions and the stable repository of ordinary people's funds and business funds—so, the stability of the payment system; a depository for funds that's stable and that people can rely on without, in a sense, the taxpayers paying for that; and providing the allocation of resources and capital for business use. Those three functions ought to be of a utility and [be] present as a fundamental aspect of the economy. The activities that Volcker would exclude, he says, are not necessary for that and they shouldn't be at the cost of the taxpayers.

The Bank of New York Software Glitch in November of 1985

MR. SMALL. In 1985, a computer glitch at the Bank of New York threatened to disrupt the payment system.

MR. BRADFIELD. That was embarrassing. The Federal Reserve Bank of New York handled that.

MR. SMALL. That incident demonstrated the fragility of the payment system.

MR. BRADFIELD. Yes. There was a technical glitch, and the bank [Bank of New York] had to go to the discount window to borrow $23 billion. But that was all handled by the Federal Reserve Bank of New York. I don't remember any big consequences flowing from that other than the Bank of New York fixing the glitch.

Sumitomo and Goldman

MR. SMALL. What about Sumitomo–Goldman in the mid-1980s?

MR. BRADFIELD. Sumitomo–Goldman was a case of Goldman [Sachs] needing capital. Goldman made a complex deal with Sumitomo, which tied the two together and, at least under our interpretation, resulted in Sumitomo having an element of control over Goldman as a practical matter. Even if it's done carefully by Sullivan and Cromwell to get around all the technicalities of Glass-Steagall, the end result was a substantive violation of Glass-Steagall.

MR. SMALL. Because Sumitomo was a commercial bank operation and Goldman was an investment banking and brokerage firm?

MR. BRADFIELD. Yes. So, with Virgil Mattingly's help, we developed the case that the end result was a violation of Glass-Steagall, and [we] imposed conditions on the deal that took the joy out of it for Sumitomo. Goldman got the money it wanted and was really happy. To the extent that we insisted on terms and conditions, which limited Sumitomo's influence, we were helping Goldman. That wasn't the intention. The intention was to limit this as a precedent and to limit Sumitomo's actual ability to influence Goldman.

MR. SMALL. This was an era when Japanese banks were doing phenomenally well, and they were capable of buying up huge parts of—

MR. BRADFIELD. Yes. And the reason why I think this case of Goldman and Sumitomo is important is because the Federal Reserve should have done the same thing in the Citi and Travelers merger. If I were here then, that [merger] wouldn't have happened. I don't know, Greenspan would have fired me by that time—but that wouldn't have happened. You asked about milestones along the way to how we got where we are? That's a big one.

The 1998 Merger of Citicorp and Travelers and the End of the Glass-Steagall Act

MR. SMALL. Citi was a large commercial bank, and Travelers was an insurance company.

MR. BRADFIELD. Or, Travelers bought Citi.

MR. ASHTON. There was a technical issue about whose charter was actually going to survive.

MR. BRADFIELD. It was to get the two-year grace period to divest prohibited assets.

MR. ASHTON. Yes.

MR. BRADFIELD. Travelers was buying Citi. As a new bank holding company, Traveler's had the right to a two-year grace period before it either had to divest or conform. That's what the Bank Holding Company Act allowed.

MR. SMALL. If they're in different parts of a bank holding company and there was a firewall between them, what was the legal issue?

MR. BRADFIELD. Well, it was combining banking and commerce, and that was not a permissible activity for a bank holding company.

MR. ASHTON. Right. At the time, under Garn–St. Germain [Depository Institutions Act], insurance was clearly forbidden to bank holding companies. It was an express prohibition, except for a few exceptions.

MR. SMALL. So how did the Board allow it if the law prohibited it?

MR. ASHTON. We would have had an issue if Gramm-Leach-Bliley hadn't passed within two years, because they had two years either to get the law changed or, at the end of two years, they would have had to conform. They would have had to divest the bank or divest the insurance company.

MR. BRADFIELD. They [the Board] should have told them "no" right then and there. Then you probably wouldn't have had Gramm-Leach-Bliley become law in 1999.

MR. SMALL. So the slippery slope began under your stewardship? [Laughter]

MR. ASHTON. After you left the Board in February 1989.

MR. BRADFIELD. Yes, I have to take the responsibility for the section 20.

MR. SMALL. If you could do that differently now, would you have cozied over to the Volcker position more?

MR. BRADFIELD. If "principally engaged" had stayed at 5 percent, I think that it would have been different. But I was naïve to think that it would stop at 5 percent.

Nonbank Banks and the Dimension Corporation Case

MR. SMALL. The Dimension case involving the Board went to the U.S. Supreme Court. What was the issue?

MR. BRADFIELD. It was the issue of "nonbank banks." Dimension was taking NOW accounts but not demand deposits. The law was that if an institution didn't both make loans and take deposits payable on demand, then it was not a bank, so then anybody could own an institution that didn't take demand deposits.

MR. SMALL. Because it wasn't a bank.

MR. BRADFIELD. It wasn't a bank. That was the issue in that case. And it was a straight-out case of banking and commerce.

MR. SMALL. Someone wanted to acquire someone?

MR. BRADFIELD. Dimension Corporation had acquired somebody.[11]

MR. ASHTON. Oh, they had, yes, because the OCC had blocked it.

MR. BRADFIELD. We adopted a regulation that said you can't do that [use the "nonbank bank" loophole to make the acquisition].

MR. SMALL. The particular was, they acquired someone that had a type of liability that they claimed was not a deposit, so this is all permissible.

MR. ASHTON. Not a demand deposit. It was FDIC-insured, but it was not a demand deposit.

MR. SMALL. And then you went in and said, "Oh, but it is a demand deposit."

MR. BRADFIELD. I don't remember what the words were. Rich probably had a big hand in drafting the regulations. We drafted a regulation that said "You can't do that." The Board approved the regulation. The case went to the Supreme Court, and we got crushed,

[11] Editor's note: In December 1983, the Board amended Regulation Y to include NOW accounts as demand deposits and to broaden the definition of commercial loans. The amendments were intended to address the proliferation of nonbank banks. Dimension Financial Corporation applied to the Federal Reserve to acquire 31 national banks in 25 states, indicating that those institutions would continue to accept demand deposits but would not make commercial loans. When the Board approved only 4 of the acquisitions, Dimension challenged the Board's ruling in court. Several bank holding companies joined the case, seeking a ruling on the Board's decision to include NOW accounts as demand deposits. The Supreme Court ruled that the revised definitions of demand deposits and commercial loans in Regulation Y were not reasonable interpretations of the Bank Holding Company Act.

because the Reagan Justice Department supported Dimension. I don't understand why we didn't get any votes for it.

MR. ASHTON. Because the Justice Department was on the other side. Mike argued the case for us in the Supreme Court.

MR. BRADFIELD. Then the Congress passed the law for which we had lobbied.

MR. SMALL. Where does that place you in the pantheon of general counsels who argued before the U.S. Supreme Court?

MR. BRADFIELD. I am the only one.

MR. ASHTON. The Justice Department lawyers who appear before the Supreme Court appear in morning clothes, and so, to convey the impression that we were still part of the government, Mike went out and rented a morning suit for the argument.

MR. SMALL. That didn't carry the day, though?

MR. BRADFIELD. Didn't carry the day. But, in the end, we carried the day because the Congress changed the law, which grandfathered those nonbank banks that had already been established but prevented any new ones.

MR. SMALL. What law was that?

MR. BRADFIELD. The Competitive Equality Banking Act of 1987.[12]

Irving Bank Corporation and Banca Commerciale Italiana

MR. SMALL. [Do] you want to talk about Irving and Banca Commerciale Italiana?[13]

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[12] Editor's note: The Competitive Equality Banking Act of 1987 redefined the term "bank" in the Bank Holding Company Act to include any institution whose deposits are insured by the Federal Deposit Insurance Corporation as well as any other institution that accepts demand or checkable deposit accounts and is engaged in the business of making commercial loans.

[13] Editor's note: Banca Commerciale Italiana sought to acquire a major stake in Irving Bank Corporation. Bank of New York engaged in a hostile takeover of Irving. Banca Commerciale withdrew from the takeover battle after the Federal Reserve ruled that the Italian government agency that owned most of the bank's stock would have to disclose financial information about all of its operations.

MR. BRADFIELD. That was a banking and commerce issue. Banca Commerciale was owned by an Italian government agency that was deeply involved in commerce in Italy, and this Italian bank was in a battle with the Bank of New York for Irving. And they [Irving] threw a lot of poison pills and contesting poison pills. Meanwhile, Irving was eroded. So I thought, one, there had to be a conclusion—don't leave them standing that way. And, two, I didn't want an Italian company—they were in big infrastructure, power and oil and—

MR. ASHTON. I think they owned Alitalia.

MR. BRADFIELD. I'm sure they regretted that—in effect, controlling a bank in the United States. [Laughter] So we aggressively interpreted the International Banking Act and our regulations, Regulation K, and said they can't do it.

1987 Stock Market Crash

MR. SMALL. Soon into the Greenspan era, you had the stock market crash.

MR. BRADFIELD. We met early in the morning the day following the crash. Greenspan was in Dallas, Texas. He has the famous quote. We said to him, "The market's down 504," or something like that, "five-oh-four." And he said, "Oh, that's not so bad." He thought it was five dollars and four cents. [Laughter] I guess it was Manley Johnson; Wayne Angell; the Chairman; [Jerry] Corrigan, who was the president of the Federal Reserve Bank of New York; and me on the phone. Corrigan suggested a short, punchy statement. I drafted it, we put it out, and it had a very positive effect. I think I had done an earlier, longer draft earlier that morning.

MR. SMALL. Do you remember a sense of the emotions, of the concern for the economy, where things were headed?

MR. BRADFIELD. From that experience, I could understand how people were feeling in 2007 and 2008. The Federal Reserve is the agency of the government that has the resources and the guts to use them. And I think that's important to have.

MR. SMALL. Greenspan wasn't here in Washington, D.C., that day, but did you get something of an initial measure of the guy in the subsequent days?

MR. BRADFIELD. He was on the phone. We talked to him on the phone, and that morning he approved the statement. He was a lot different from Volcker.

July 18, 2016 (Second Day of Interview)

MR. SMALL. Today is July 18, 2016. I am David Small of the FOMC Secretariat. This is an interview that is part of the Federal Reserve Board's Oral History Project. This is the second of our interviews with Mike Bradfield, who was the general counsel here. Thank you for coming back.

MR. BRADFIELD. It's a pleasure to be here and to be able to participate in this oral history program, which I consider to be a very significant and very desirable activity for the Federal Reserve.

MR. SMALL. Thank you for your contribution. We left the last interview off just starting our discussion of the market crash in 1987 when Chairman Greenspan was quite new to the job. The market crashed abruptly, and he was a bit surprised to find out how abruptly, as you mentioned, when he arrived in Dallas. I thought we'd talk about some of the response to that crash, what activities you participated in the Fed response.

MR. BRADFIELD. Well, as I remember, there was, of course, great concern here at the Board. The Chairman had left to go to Texas. We knew that the Federal Reserve needed to do something, and I came in very early in the morning and drafted something, and Manley Johnson took the lead in contacting both Chairman Greenspan and Jerry Corrigan.

MR. SMALL. Would this have been before the markets opened?

MR. BRADFIELD. This is well before the markets opened. We were talking, I think, at eight o'clock in the morning. I had drafted a statement, and this statement was discussed on the telephone with Corrigan, Johnson—and I was trying to remember the name of the third Governor from Kansas.

MR. SMALL. Wayne Angell?

MR. BRADFIELD. Wayne Angell, yes. And the three of us were on the phone with Corrigan and Chairman Greenspan. Corrigan suggested language for the statement, and Chairman Greenspan approved that language. I went back to my office, and the telephone call concluded on that statement that the Federal Reserve stood ready to provide necessary liquidity to the market. And I finished the statement, and I brought it to Joe Coyne [assistant to the Board for public affairs from 1968 to 1998], who was in the office by that time, and it was put out on the wire.

MR. SMALL. But that was quite uncharted territory: how much more the market might go down, what you were in the midst of— I mean, because the previous day's decline was very steep.

MR. BRADFIELD. Yes, like 500-something points, 504, something like that. Yes, I thought we were very, very concerned that the potential ripple effects of a further decline in the market. I wanted to say more. I can't remember what I said, but I had a whole paragraph, and Corrigan's was one or two sentences. But the consensus of the meeting was, that was enough, and it proved to be correct, that that was—

MR. SMALL. You [the Fed] put a lot of reserves in.

MR. BRADFIELD. Yes, well, that was the follow-on that was done in further coordination between Corrigan and Greenspan.

MR. SMALL. Correct me if I'm wrong, but everything was done within the standard powers of the Fed Reserve. You didn't go into the emergency and "usual and exigent" powers that the recent crisis did. You did standard operating procedures. Maybe a magnitude more extreme, but the tools you used were the regular tools. Is that correct?

MR. BRADFIELD. That's correct, and it was never necessary to consider that. We didn't have—as if there were banks that we would have been able to lend to. Certainly, no consideration was given to intervening in the stock market. That really would have been radical. If it had gone down another 500 points, maybe we would have considered that.

MR. SMALL. Investment banks weren't that huge or at risk at that point?

MR. BRADFIELD. Yes, and certainly at that time, they were still—were they still partnerships? When did Goldman become a—

MR. SMALL. My guess is that it was in the 1990s, later on.[14]

MR. BRADFIELD. Yes. So I don't think that they had the kind of positions that they had in 2007. And so, since the statement and the provision of reserves did the trick, there wasn't any need to consider any bankruptcies and systemic effects. The systemic effects weren't there, and so there was no need to contemplate legislation or special programs. We did what the Federal Reserve does in the normal course.

MR. SMALL. It must have been a little strange in that, within the previous few months, you had switched Chairmen from Volcker, who had spent a large part of his career in the Federal Reserve and was a very experienced hand. He'd been president of the Federal Reserve Bank in New York. Now you have this new guy, Greenspan, who did not come up through the Federal Reserve. There must have been, at least initially, some kind of looking at him: "What do we have here?"

MR. BRADFIELD. Well, certainly, people were skeptical, in the sense of "Well, how is he going to react to all this?" Not skeptical, but interested in how and whether he would react to the situation. And I think what the Fed did for that period of time was to act decisively and show

[14] Editor's note: Goldman Sachs became a publicly traded company in 1999 and a bank holding company in 2008.

that—and certainly the market was satisfied—Greenspan was not someone who would apply some free market principles to prevent the Federal Reserve doing what it needed to do.

MR. SMALL. That was one of his first great accomplishments as Chairman. I mean, in far as his public—

MR. BRADFIELD. Well, I may be being [a] Volcker chauvinist, but it was the Federal Reserve that did that. And Greenspan was just a new boy on the block—and he went along with it, but it wasn't his initiative, it was the initiative of people who were there already. I give Corrigan the credit for asserting the basic principles of why the Federal Reserve exists and did what was necessary to stabilize a market which was obviously overreacting to a situation which needed a steady hand in order to wake people up.

Interstate Banking

MR. SMALL. It turned out well. Let's switch gears a little bit. There is a pretty long timeline of interstate banking and how that got expanded. Maybe people today forget what the state of banking was back then, and how fragmented it was, and the process and issues that led up to it.

MR. BRADFIELD. Well, this was certainly the period in which there was the rise of the money market fund, which the banks saw as a huge competitive disadvantage—that they [money market funds] could pay anything they liked on their accounts and were vastly increasing their deposits.

MR. SMALL. Without holding reserves.

MR. BRADFIELD. Without holding reserves, or without being subject to any prudential supervision. And so banks were very, very anxious to—and to have a presence everywhere in the United States. And banks were very, very anxious at that time to overcome the limitations on interstate banking established by the Douglas amendment.[15]

MR. SMALL. I had not heard it stated that way before, that the advent of money market funds was a spur—

MR. BRADFIELD. Well, I think it was—I'm mentioning one important factor. They were all so worried about foreign competition, Japanese [bank] competition. They were worried about competition from S&Ls, and they saw a great opportunity in being able to diversify geographically. And so we were faced—all during the period until the Riegle-Neal Interstate Banking [Act] in the late 1970s—with efforts by banks to effectively achieve control over other banks and other jurisdictions in innovative ways. And they also wanted—one thing that comes to mind is, Manufacturers Hanover came to us. I remember meeting with Volcker with the chairman of Manufacturers Hanover, and they wanted to acquire the Empire State Building. They would own 99 percent of the equity, and another partner would have 100 percent of the voting rights. We said to him, "You must be out of your mind."

MR. SMALL. That sounds very odd, but the rationale was, I take it—correct me—that you were mixing banking and commerce—

MR. BRADFIELD. Yes.

MR. SMALL. —and by having none of the voting rights, Manny could say, "We're not mixing the two, because we don't control them."

MR. BRADFIELD. Yes. Well, the issue is control. That's also what was in the interstate banking area—that bank holdings sought, in various ways, to make financial

[15] Editor's note: The Douglas amendment to the Bank Holding Company Act of 1956 prevented banks from acquiring banks across state lines. In 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act repealed the Douglas amendment, allowing nationwide banking irrespective of state law.

arrangements with other banks that would—where they would provide most of the equity but not the voting rights, and we resisted that. So that was one part of this whole thrust by the banking system to both expand jurisdictionally and expand activities. And so the whole thrust in the direction, which led to Bank of America/Schwab, was, how could they get into other activities—in fact, increase the list of admissible activities—without running into conflict with the no [mixing of] commerce and banking and without running into conflict with the Douglas amendment? And so that was the overwhelming thrust of what was happening in the whole period of [the] 1960s and 1970s. It really culminated in the 1999—the Gramm-Leach-Bliley [Act of 1999].

But that's the history of that period in banking, which is, we had a regulatory regime that was founded in the Bank Holding Company Act and which aimed at both interstate banking at one side and, two, at preventing banks from engaging in commercial activities. The banks were resisting those two limitations on their activities in every innovative way in which they could, and we were resisting in every innovative way that we could.

The nonbank banks were a part of this. There's another way of being able to engage in any activity that you want and still own a bank, because they weren't engaged in both taking demand deposits and making commercial loans.

MR. SMALL. They were just doing one of the two.

MR. BRADFIELD. One of the two. But that's using NOW accounts that were in the demand deposits.

MR. SMALL. But then this gets a lot more complicated, I think, because you have [in] the late 1970s a rise in interest rates, and you had asset investment restrictions on S&Ls, you had inverted yield curves, right? So the saving and loan industry took a great hit, because the interest rates they were earning on their assets were fixed. And then you start relaxing the restrictions, and you get the S&L crisis, if I—

MR. BRADFIELD. So the same thing happened to banks. All the money was going out to the money market funds. The same thing was happening to banks, but banks did not have the fixed assets. The savings and loans were locked into the home mortgages, and so they were much more vastly affected by the rise in interest rates. That was a contributing—I'm not suggesting in any way that wasn't also a contributing factor. This all peaked at the beginning of the Reagan Administration. The disintermediation, on the one hand, and the pressures for interstate banking and new activities where they're saying, "That's the only way that we can make money now, is to"—that's what the S&L said—"is if we can make commercial loans and our holding companies can be in the securities business."

MR. SMALL. But on the asset side, they started to get into many different types of assets other than just mortgages?

MR. BRADFIELD. Yes. And it didn't work well at all. Well, because they, in a sense, were poorly managed. They didn't have any experience. And when that happens, you wind up with the most speculative investments. And when you do that, that's a problem.

MR. SMALL. But they had deposit insurance.

MR. BRADFIELD. That makes the problem worse. That was, in a sense, the quintessential—they could raise money, and they did raise money with selling $100,000 deposits. Broker deposits were a vast source of money, which is, in a sense—you're passing the risk on to the government, and the—if they had won the bet, they would have walked off with the profits, and if they lost, they would pass the losses on to the taxpayers. And they did. It [was] something like $350 billion?

MR. SMALL. That was the Resolution Trust [Corporation]?

MR. BRADFIELD. Resolution Trust. The regulators were captured by the industry in the S&L situation. They had been captured by the industry, and the industry only encouraged them to continue what they were doing. Alan Greenspan was writing memos saying that Keating was a great man doing wonderful things, and they would never lose any money. It didn't work out that way.

MR. SMALL. So, when the crisis hit, and you understand there's huge losses and the S&Ls are in big trouble, then at some point the federal government has to get organized and make a decision, and act or not act. Do you remember how the government acted? Whether it was decisive, whether it was timid, whether it was proper on certain dimensions? How—

MR. BRADFIELD. Yes, I remember very well. Under the Federal Home Loan Bank Board [FHLBB], as it was constituted at the time—the Reagan Administration came into office—was very accommodating. I think they were accommodating before that, but they were very accommodating, and they changed the capital requirements, and they changed the accounting requirements in order—so that the institutions could continue to operate, even though they were insolvent. Banking continued operating forever, as long as it had cash flow. And they didn't make them show that they were insolvent, and the cash flow continued because they could take insured deposits, and they did. And it wasn't until—well, I can't remember the name of the guy who replaced Danny Wall. Danny Wall was a political appointment; he was a Jake Garn staffer. And before him, I forget the name of the guy who was the Chairman [of the FHLBB], who was the quintessential—

MR. SMALL. Was [Spragen] there yet?

MR. BRADFIELD. No. I would remember the name, but we mentioned it. I knew the general counsel, Tom Vartanian. He was the one who was provided all the legal justification for all the machinations to adjust the regulatory regime to allow insolvent institutions to continue to operate.

MR. SMALL. How did it come to the point that the taxpayer had to pony up funds? That the taxpayer funds were spent to become—

MR. BRADFIELD. Oh, that was—the taxpayers' funds weren't spent until FIRREA [the Financial Institutions Reform, Recovery, and Enforcement Act of 1989].[16] In FIRREA, they blew the whistle and said, "You can't do this anymore. We're going to close you."

The Congress did that through FIRREA, but it was George Bush who said, "This problem has to now be reconciled and settled, and the insolvent institutions dealt with." And I thought that was a gutsy move, and they did a good job. Bill Seidman [Chairman of the FDIC from 1985 to 1991] did an excellent job. Bill Taylor [Chairman of the FDIC from 1991 to 1992] did an excellent job as one of the leaders of that organization. And the Congress provided the money.

MR. SMALL. So we've talked a little bit about resolving some of these institutions. One small area, I think, that doesn't get much emphasis has to do with bankruptcy for a bank versus a normal corporation and, in particular, some of these repurchase agreements and what their role is under bankruptcy, and how, to some people, that looks a little odd, that these repos escaped the automatic stay, as I understand it. We might be getting in the weeds a bit here, but I think maybe a few people might appreciate this. Do you remember these issues and—

[16] Editor's note: The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 established the Resolution Trust Corporation to close hundreds of insolvent thrifts and provided funds to pay out insurance to their depositors.

MR. BRADFIELD. It started out sort of innocently enough with [the] Drysdale Government Securities failure [in 1982]. And that was applied only to Treasury securities. It didn't apply to other types of securities until, in the period [from] 2000 to 2005, this legislation from—it's an initiation in the 1980s—it was gradually expanded to all qualified financial instruments, which is a very long list of derivatives and other kinds of securities.

MR. SMALL. So let me just see if I understand this. I'm a private-sector financial, or some entity that has money, and I lend money to a bank under [a] repurchasement agreement, and I get some securities under that. And then the bank declares bankruptcy in the middle of the night.

MR. BRADFIELD. Yes.

MR. SMALL. A lot of depositors have their money locked up into that bank, until that bank goes through bankruptcy. But I, as a repo guy, get to sell off the security, and I get to walk away with my money, safe and sound. Is that—

MR. BRADFIELD. Yes. It's also for a broker-dealer, or—the major users of repo financing were broker-dealers.

MR. SMALL. What problem does this cause, or what incentive problems does this cause for the system?

MR. BRADFIELD. Remember, most of these repos are overnight. So, if the market loses confidence in the "borrower"—and we're using "borrower" in quotes—the technical language is, this is a purchase and sale. [If] the market loses confidence in the buyer, they don't renew the loan. A company like Bear Stearns or Lehman Brothers can, within a week, lose all their liquidity. And they are unable to service their debt, and they go bankrupt. This potential is enormously destabilizing to the financial system. It was that process that brought the system down, and it also was employed against WaMu and IndyMac. They lost their funding.

MR. SMALL. But does it also get into "too big to fail" in the sense that, as an institution, the borrower is getting maybe a little riskier. If I'm lending to a straight debt contract, I say, "Well, I'm going to charge you a risk premium." If I lend to you under repo, I say, "I don't care. I can always get my money out." So, does it allow a risky institution not to pay risk premiums so much and to grow a little more?

MR. BRADFIELD. Oh, yes, I think that financed the massive misallocation of capital in the run-up to 2007. The system failed because capital was invested in housing when the housing market couldn't absorb it. They were lending to people who weren't eligible to pay their mortgages—they didn't have the resources. And then there's those instruments [that] were being rated as triple-A by the rating agencies, and they were being financed by Lehman Brothers, and by Goldman, and by Morgan Stanley, Bear Stearns, with overnight funding. It took various forms. Commercial paper, money market funds—they were buying this paper, the bank's paper, and suddenly the market realizes that people can't pay these mortgages, and they're not worth the value that they had given for them. And so, a lot of these mortgage-backed securities that they were repo-ing—and so they lose their liquidity, and they'd be—bankruptcy is the logical alternative.

The Dodd-Frank Act and the Volcker Rule

MR. BRADFIELD. That's one of the major aspects of the present system that still needs correcting. And in a speech last Tuesday, Governor Daniel Tarullo said that addressing this problem with respect to the nonbank financial institutions was an essential requirement to fulfill the mandate of Dodd-Frank, which is a very, I think, powerful, very insightful speech given by the Governor.[17]

The contribution that the Federal Reserve is making to a more stable economic financial system is important—and continuing. For the record, I think that Governor Tarullo has done an excellent job in leading the Federal Reserve in its implementation of Dodd-Frank. He deserves a lot of credit for the improvement in stability that I think the Dodd-Frank law has facilitated.

MR. SMALL. Since you started Dodd-Frank, we can't let you off without talking about the Volcker rule. What are your views on it?

MR. BRADFIELD. My views on it are that it's an important and significant improvement in the law applying to bank holding companies. The basic purpose of the law was to prevent banks from engaging in proprietary trading—in fact, speculating in assets using the depositor's money and, indirectly, the taxpayer's money. The law has been, I think, made unnecessarily complex and difficult to administer, but it's still making a positive contribution, and we have a stronger, more stable system as a result.

My great story is that Volcker had come up with this, and I made the first draft of the legislation to give it a concrete form, and he was having very great difficulty getting the attention of the Treasury and the Obama Administration. I heard on the radio that Vice President Biden had made some positive comments about the Volcker rule. I called Paul and said, "Paul, call Biden. I think he would be receptive to your talking to him and getting Administration support." He did that, and Biden responded, and it carried on from there. And he got the President's strong support. It's the President who gave it the name "the Volcker rule."

[17] Editor's note: Daniel K. Tarullo (2016), "Opening Remarks," speech delivered at the Center for American Progress and Americans for Financial Reform Conference, Washington, July 12.

MR. SMALL. What do you think about the Financial Stability Oversight Council and designating institutions, whether they're banks or not, as systemically important? There have been responses in the private market by institutions [that] have been designated. They don't particularly like that extra—

MR. BRADFIELD. I'm glad you mentioned that. I just completed a brief containing the amicus curiae views of Paul Volcker and Chairman Bernanke, Ben Bernanke, supporting the position of FSOC, that it should be able to designate MetLife as a company subject to enhanced supervision by the Federal Reserve, because it could have systemic effects if it were to experience severe financial distress. And so I'm a rather enthusiastic supporter of that legislation.

MR. SMALL. But there have been some market responses. For example, I'm thinking of, if I have this right, GE Financial.

MR. BRADFIELD. Well, that's accomplished exactly what it—

MR. SMALL. This is a good thing.

MR. BRADFIELD. This is a good thing. They said, "We don't want to mix banking and commerce anymore. We want to be in commerce. We want to build airplane engines and make toasters. It's too complicated, and we lost too much money in running GE Capital." When I was in private practice, I represented GE Capital on specific matters, and they were in everything. I think that it was a good thing. They sold a lot of it to Wells Fargo, and whether Wells Fargo has the ability to manage it, I don't know. But it's better that it's now under a company that is subject to prudential supervision than it was when it wasn't subject to prudential supervision.

MR. SMALL. Back in the early 1980s, investment banks weren't so large. Some of them are quite huge now, and one thing that's happened in the interim is, they switched from being partnerships to limited liability. So could you explain that difference a little bit and then indicate whether you think that was an important change for some of the growth that we've seen? Or are there other factors behind the growth?

MR. BRADFIELD. The question is the change from partnerships to corporate entities—limited liability corporate entities—and the effect on the financial system. And my response to that question is, it's had an enormous impact. It changed those companies from conservative, careful allocators of capital to gambling companies. Now they gamble with other people's money, and before they helped to invest other people's money with very careful analysis. And I think that has had terrible consequences for the stability [of] the U.S. financial system, and I don't think that it has done much for growth. I think it's done a lot of damage, in terms of what they call the "financialization" of the American financial system, or the American economic system, and has enhanced income inequality and contributed to the problems we now have with a major segment of the economy disaffected.

MR. SMALL. So just to review at a very general level: With limited liability, the people running the company or owning it have at stake the equity that they put into the company. They could be wiped out, but they lose it. With a partnership, they could lose all that plus their own personal wealth—their house, the kid's college funds. Is that the difference?

MR. BRADFIELD. Yes, that's the principal difference. The moral hazard issue is, you now give incentive to managers to take risks that they wouldn't take before if their own money was at risk. Now they have a one-way ticket: They win if the stock goes up, and they don't lose if the stock goes down. And, until now, this has been a profitable business. Now it's less profitable, but before, it was a very profitable business, and so it attracted investors who were willing to put their money at risk, because it looked like it was a business that would produce profits—and large profits.

MR. SMALL. Is there any feasible proposal out there to restrict the use of limited liability, to make these entities be more conservative in the way they were?

MR. BRADFIELD. I haven't heard of any legislative proposals that would do that. In effect, the Volcker rule has a major impact, in that it prohibits these organizations from, in effect, using taxpayers' money to compensate them for their losses.

MR. SMALL. So, if you could legislate one or two key changes to the financial system, are there a few issues that are really high up on your list?

MR. BRADFIELD. I have a plan, and that's short-term funding under this maturity "transformation" is the right word: The process of using short-term funding to fund long-term assets. That's in banks' DNA. That's what banks do. Because that's an inherently risky business, they have to be regulated, and they have been regulated over the ages—either self-regulated or regulated by governments to require adequate capital and to restrain excessive risk-taking and adequate liquidity to assure that when they do get into trouble, that they have sufficient resources available to meet their obligations.

Now, nonbanks—financial companies, hedge funds, finance companies, mutual funds, broker-dealers—have no or inadequate prudential regulation and shouldn't be taking the inherent risks of borrowing short and lending long because of its impact on financial stability.

And so, I would prohibit large borrowers from using short-term financing to finance their activities. I would put limitations on money market funds, which are essentially in the business of borrowing short and lending long without adequate prudential supervision or requirements for capital and liquidity. And [I would] say that they could only lend long if they borrow long, only lend short if they borrow short. Or put it the other way—if they borrow short, they can lend short. But they can't borrow short and lend long. That may put them out of business, but—

MR. SMALL. Thinking of a life insurance company, for example, would—

MR. BRADFIELD. Well, life insurance is entirely different, in that they have long-term liabilities, and I don't think that they could premium income. But [for] companies like MetLife and so many other businesses and so many financial insurance products that are subject to runs, [I think] that it's entirely appropriate for them to be subject to Federal Reserve prudential supervision. Four companies have been designated: MetLife, Prudential, AIG, and GE. But GE has now been freed up. It's obviously appropriate that they all should be subject to prudential supervision, because they are engaged in businesses that are subject to runs.

And I think that if you do that, then—and you repeal the waiver of the automatic stay in bankruptcy—you should do both. If you do that, then you can allow these banks, these financial entities, to fail, and they can be resolved in the bankruptcy system without causing systemic risk because they're not subject to runs. That's where the risk is. And the bankruptcy is subject to runs, and that has ripple effects throughout the system.

MR. SMALL. Do you like to mark-to-market accounting? That gets into runs a little bit, in the sense—

MR. BRADFIELD. It depends on who it is for. If you have effective supervision, it doesn't make sense to have mark-to-market accounting for banks. If you don't have effective supervision, then you have to recognize that mark-to-market accounting makes you recognize the losses. If you're a bank, and that's your business—is to get repaid over a long period of time, it makes less sense to recognize the losses to debt. One, they may not turn out to be losses, and sometimes the bank can lend you more money and say, "OK, you encountered a problem, I'll lend you more money if you come up with the plan that looks like it's going to fix your business," then that seems to be a positive element in banking. But I don't—and because you're making the bank have adequate capital so that they can absorb the losses, and they have adequate liquidity that they can—when I can pay, and I've got—and you have to pay somebody else, and I borrowed from you, and I can't meet the payments, I ought to have enough liquidity on hand so that you can pay your obligors without going bust and causing systemic risk.

MR. SMALL. People have argued [the] mark-to-market economy made the last crisis much worse.

MR. BRADFIELD. Yes, well—but I don't have much sympathy for the investment banks.

The Melcher Case and Federal Reserve Independence

MR. SMALL. OK, so, let me just, before we wrap up, end on a Federal Reserve note. Melcher v. the FOMC is a legal case that brings to [the] front the Federal Reserve and independence and the role of the Federal Reserve in governance and public policy. Could you speak to that case, of what the issue was?

MR. BRADFIELD. Well, [Senator John H.] Melcher's case, in a sense, put the position of all the presidents of the Federal Reserve Banks at risk. He basically said, "You have to be appointed by the President with the advice and consent"—Melcher said, "You have to be an officer of the United States and appointed by the President, with the advice and consent of the Senate." And if that position [had] prevailed, these guys would be out on the street.

MR. SMALL. Because they were not appointed by—

MR. BRADFIELD. They're not appointed by the President, and they weren't approved by the Senate. So that was very high risk for the Reserve Banks. They were very worried that the Board was going to sell them out. And [Ernest T.] Ernie Patrikis [general counsel of the Federal Reserve Bank of New York from 1987 to 1995] was the leader of the Reserve Banks who—

MR. SMALL. He was up at the New York Reserve Bank.

MR. BRADFIELD. Yes, with the leaders of those who were very concerned that the Board wasn't sufficiently protected. And, of course, the Board was worried that the Justice Department would not be assiduous in its defense of the Federal Reserve. And so, to our surprise, we got a really good decision in the District Court [United States Court of Appeals, District of Columbia Circuit], which said that the Reserve Bank presidents don't have to be appointed by the President and approved by the Senate.

MR. SMALL. Was that because of what the Constitution says about the Congress having the power to print money, and what—

MR. BRADFIELD. No. It says if you're a principal officer of the United States, you have to be appointed by the President and approved by the Senate.

MR. SMALL. So the ruling was, Bank presidents are not principal officers?

MR. BRADFIELD. I forget now exactly the terms of this decision in the District Court, but the District Court said—and, of course, they were worried. The Reserve Bank presidents were worried about not being principal officers, or they weren't officers of the United States.

MR. SMALL. Because you sort of won at the District Court level.

MR. BRADFIELD. They won at the District Court level, and we were so worried about the Justice Department that Volcker made a treaty with the Solicitor General that if we weren't satisfied with the representation of the Justice Department, we could have our own lawyer.

So, I'm trying to—I can't remember the name of the Justice—the head of the civil division argued the case [Richard K. Willard, Assistant Attorney General]; a man named Grasty Crews was the lawyer for Melcher. Melcher was the last in line of several other suits that had been thrown out on standing grounds. So Grasty gets up—this is a three-judge court with Judge Starr as the presiding judge, and you get a half an hour. He talks for about 20 minutes about gold and the importance of gold and why the gold should be the standard of value for the dollar. And about 20 minutes through his presentation, Starr says to him, "Mr. Crews, you didn't address the basic question in this case, which is standing." Crews couldn't say a straight word after that. And then the decision of the court came down later, in which the court determined that Melcher didn't have any standing, and, in effect, nobody has standing to challenge the service of the Reserve Bank presidents. The only remedy for that is to pass a law. The Reserve Banks were delighted.

Paul Volcker still thinks that the District Court decision was good law, but it has no precedential value. I think he liked that they could serve without being subject to presidential appointment and approval by the Senate. That's what he liked.

MR. SMALL. Are there other topics you would like to discuss?

MR. BRADFIELD. Whether the Fed gets paid back for its discount with the loan first when the FDIC takes over a bank. In these purchase-and-assumption transactions, that was important. The Fed wouldn't lend unless they were sure that they could be paid back, and the Reserve Bank would take a lien on everything in sight. And then the FDIC took over, and then there would be nothing for them.

MR. SMALL. You and Rich Ashton talked about this very briefly in that first interview. But I think the way it was phrased was, the Fed goes in first and takes all the good collateral, then the FDIC—

MR. BRADFIELD. Takes all the collateral. They take anything that could move and everything that can't be moved. [Oliver] Ollie Ireland [associate general counsel at the Board from 1985 to 2000] was very good at that. The FDIC hates that.

MR. SMALL. But now the Fed—there are limits on the Federal Reserve about lending to undercapitalized institutions to prevent that, right?

MR. BRADFIELD. Yes. And they don't have that requirement anymore. The Fed takes what lending—but there's no obligation on the part of [the] FDIC to pay back the Federal Reserve.

So, in Continential Illinois, the president of the Reserve Bank of Chicago wouldn't lend to Continental unless Isaac agreed to pay him back, and I negotiated a letter from Isaac to Silas Keehn that satisfied him, and you got the loan. That requirement stuck in the craw of the FDIC, and they finally got legislation which fixed it.

There is also the issuer of the supervision of international lending. That was a response not only to the Mexican crisis, but for the LDC debt crisis of that period of time.

MR. SMALL. What problem did it address?

MR. BRADFIELD. It gave authorization for capital requirements for banks. That was the biggest problem it addressed. It was the first legal authorization for the regulators to require capital requirements.

MR. SMALL. The regulators in the United States to post capital requirements on foreign banks operating here?

MR. BRADFIELD. No, on U.S. banks. We didn't have any capital requirements on banks until that time. And, of course, regulators monitored bank capital and could advise that a bank ought to raise more capital, and a bank couldn't get a charter unless it had so much capital. But this was legal authority to establish capital requirements. The Congress—it was Senator Heinz and Senator Proxmire—wanted to put limits on lending to foreign banks—foreign countries, foreign banks. And Volcker said, "No, that would be a terrible thing to do. I'll negotiate capital requirements with foreign banks," and he got authority to do that. And that was a big result of the process that resulted in ILSA [International Lending Supervision Act of 1983].[18]

MR. SMALL. So this was a precursor to Basel I and Basel II?

MR. BRADFIELD. Basel I, yes. And then we set out to negotiate capital requirements with the United Kingdom, and Bill Taylor was our negotiator.

MR. SMALL. That's when the United States and the United Kingdom sort of announced, "We've got a plan. Do any of you others want to join in?"

MR. BRADFIELD. Yes. Well, then we said, "We've got a plan." And they said, "Oh, count us in." [The] Japanese and the Europeans—they didn't want to let in the Japanese, because the Japanese wanted to count their equity stock holdings as capital, and they made a deal that they could count, I don't know, 50 percent or something like that.

Working with Paul Volcker and Others

MR. BRADFIELD. To change focus now, working with Paul Volcker was the highlight of my career—smartest, most foresightful, most intelligent person that I ever worked with. Can

[18] Editor's note: To implement several sections of the act, the Federal Reserve adopted rules to require banking organizations to maintain special reserves, out of current income, against the risks present in certain international loans or other international assets, and to require their submission of quarterly country exposure reports.

see every side of every problem, and sometimes slow to make up his mind, but the results are really good.

MR. SMALL. He had a very limited number of people he interacted with, I understand. I mean, you, Taylor, Corrigan—it wasn't big staff meetings that he had.

MR. BRADFIELD. Correct. Those meetings were interminable. He kept very good contact with Board members. The Republican appointees, at least some of them, were hostile—like Martha Seger and the Vice Chairman, Preston Martin. But Manley Johnson became a great admirer, and Wayne Angell, too.

MR. SMALL. After he left the Board, he became a little less visible for a while, but then the great crisis—

MR. BRADFIELD. He was one of those guys with a TV program. And John Connally was the most charismatic person that I've ever worked with.

MR. SMALL. In terms of presence—walking into a room?

MR. BRADFIELD. He'd put your arm around you and say, "How's it going, Mike?" It was like the sun coming up.

MR. SMALL. Both Volcker and Connally, I understand, could be quite forceful.

MR. BRADFIELD. Connally is a different guy. Very aggressive and commanding. Volcker can be—he'd want his own way and insist on it. There are just different characteristics. I'd rather work with Volcker than with Connally, but Connally was a phenomena. Once, about some trade problem, and the Treasury was being asked to comment on some trade bill, and I thought it was a terrible idea. Peter Flanigan was the guy in the White House who was in charge of this. And I went to Connally and said, "I was going to tell Flanigan that this wasn't a very good idea." He said, "You tell him that I am unalterably and unequivocally opposed."

I'll tell you another Connally story. Connally was testifying on the Lockheed [loan guarantee], and Connolly was testifying before Proxmire, and we had done all this briefing for him, and Proxmire asked him a question which was not in the briefing. Connally rose half out of his chair, banged the table and said, "Mr. Chairman, I covered that problem in my opening statement, and I'm not going to go over it again." He hadn't covered it. And Proxmire was intimidated: "Okay, I'll go onto my next question." That's the kind of guy that Connally was. Connally had his ideas. He came to the Treasury. He knew exactly what he was going to do.