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Lessons Learned: Thomas C. Baxter, Jr., Esq.

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By Alec Buchholtz and Rosalind Z. Wiggins

Baxter, who was General Counsel of the Federal Reserve Bank of New York during the financial crisis of 2007-2009, gives us his take on how best to prepare for future crises.[1]

During a crisis, it is important to have the right people working within an agency or department, especially those with crisis experience.

One of the most important aspects of how to fight a financial crisis is ensuring you have the right people installed in leadership positions across an institution. The Federal Reserve was lucky to have had in employ professionals who had lived through the Savings & Loans Crisis of the 1980s, the rescue of Long-Term Capital Management in 1998, and the market turbulence following the September 11th terrorist attacks. Throughout the crisis, the Fed was able to draw upon the knowledge of these experienced professionals to help guide the Federal Reserve and its banks through the Global Financial Crisis. They helped prepare others who may not have had similar first-hand knowledge for how to handle the organizational challenges and time pressures encountered during a crisis.

No matter what you call it, having prior knowledge of the tools and scenarios that would be available in a crisis and some preparation is a valuable resource.

Whether you call it a "doomsday book" or just a crisis playbook, knowing what types of interventions have been used, and could be used, in a crisis *before* the crisis happens is a very useful resource. Before the 2007 crisis, we at the Fed had thought through how we would respond to various scenarios and had defined disciplines for implementing such responses. We drew from our experiences after the 1987 market crash, then the Long-Term Capital Management in 1998 near-failure, and the September 11th turmoil, when the stock market was closed for days. We memorialized the actions we took and then we went through a series of "war games" to simulate what we would do in certain situations. I think this type of exercise is a really useful thing for people in central banking who are charged with the responsibility for maintaining financial stability. It's important to think through the what-ifs, put them down on paper, and try them out, before you get yourself into a situation where you have to respond.

In a crisis, time is of the essence. Adapting or redeploying existing programs can save valuable time.

In normal conditions, it usually takes weeks or months to perform the drafting, planning and logistical work necessary to create a new lending program. In the midst of a crisis, however,

[1] *Lessons Learned are distilled from interview(s) with the principal conducted by YPFS.*

that time frame is compressed into days or even hours as panic spreads and companies and markets near collapse. The ability to adapt a previously used facility or operating program to new uses could save valuable time. A crisis is not the time to "reinvent the wheel."

The $85 Billion Revolving Credit Facility that the Federal Reserve Bank of New York (FRBNY) entered into with American International Group (AIG) was modeled on the term sheet that a private consortium had been working on before the Lehman bankruptcy constrained them to abandon their efforts. This term sheet provided the Fed with a template constructed by one of the country's leading experts in syndicated lending and enabled it to more expediently craft an unprecedented loan that avoided collapse of the insurance giant and protect the taxpayers' interests. Another example occurred when the FRBNY sought to address AIG's securities lending program (one source of the rapid consumption of the $85 Billion loan) by purchasing the mortgage-backed securities held by the program. AIG could not use the Term-Securities Lending Facility (TSLF), which the Fed had previously created to purchase similar assets from banks and primary dealers. However, relying on the TSLF, the Fed created a separate securities lending program for AIG, implementing in a much shorter timeframe, a project that could have taken months.

In working with large, complex organizations government agencies need to be aware that such organizations may operate across multiple jurisdictions and be subject to many regulators.

The businesses of many large institutions operate subject to different regulating authorities and across different jurisdictions at the state and foreign level. Federal agencies helping these complex institutions must consider the regulators of these entities in the various jurisdictions, all who will have an interest in the entity and how the Fed's role impacts it. It is important to note also that these regulators will have varying ranges of influence, sophistication, and capabilities that they will deploy to enforce their laws, and protect their reputations and their taxpayers.

In the case of AIG, the Federal Reserve had to work with a variety of state insurance commissioners since many of the assets that AIG owned, posted as collateral with the Fed, or were bought by the Fed, were held across different states. Additionally, there was disagreement between the Fed and the state insurance commissioners about jurisdiction over the AIG Credit Facility Trust (AIG Trust). Through the AIG Trust the government held a controlling interest of AIG equity. We were able to come to agreements that enabled the Fed to provide the support needed by AIG while protecting itself and the taxpayers in an acceptable manner. The AIG Trust was formed as a separate trust managed by independent trustees.

Maintaining stability and protecting the taxpayers' interests should guide decisions about when to sell assets the government owns.

While it might seem beneficial for the government to exit an investment quickly, the decision is more nuanced than that. The trustees of the AIG trust originally thought that they would plan to sell the AIG stock soon and be done. But it became clear that to do so would engender a significant loss. Therefore, the trustees had to focus on ensuring good governance and strengthening the Board of Directors to monitor the investment until it could be sold. Exiting a government investment should be done in a manner that is safe for the company and for financial markets, and the process requires patience, not only on the part of the government and the company, but also from the taxpayers.

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