Lessons Learned: Robert Hoyt, Esq.

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From a legal standpoint, we need to get creative to help the government do what they need to do to fight the crisis while respecting the word of law.

Bear Stearns was in trouble and J.P. Morgan was ready to buy it, but valuing the assets that Bear Stearns held was an impediment. To meet this challenge, the government loaned money to a legal entity that held these assets, which, in turn, secured the loan. J.P. Morgan was able to complete the transaction and prevented bankruptcy for Bear Stearns. The same was not true for Lehman Brothers, as the only suitor, Barclays, pulled out of the deal and there were no other buyers. A government loan would not have solved their problems because Lehman Brothers was undercapitalized and a loan would only lose tax-payers’ money. Hoyt said,

In the case of Lehman Brothers, we had the ability to support a private market transaction, but the transaction had to be there. It was not within our power to create the transaction or simply write a check.

The case with government-sponsored enterprises (GSEs,) was different in the sense that the government could intervene with Fannie Mae and Freddie Mac. In the summer of 2008, Congress amended the regime for them and gave the government the authority for their conservatorship or receivership.

We need to find sustainable legal solutions and programs.

Article 13(3) of the Federal Reserve Act, which gave the Federal Reserve the authority to make extraordinary loans, was used to help with many of the rescues at that time, such as Bear Stearns and AIG. “We figured out a way to use 13(3) effectively to fight the crisis,” Hoyt said.

However, Hoyt and his team decided it was not very sustainable, both legally and politically, to continue using this article and realized that they needed Congress’s approval to reach a sustainable program to help fight the crisis. This paved the way for TARP.

The TARP was in the amount of $700 billion. The idea of the executive branch of the government committing this much money without approval from the Congress did
not seem in the spirit of the Constitution. Furthermore, this was all happening in the midst of a presidential campaign, and the idea of bailouts was controversial. It was not ideal from a political perspective to continue with section 13(3) without approval from Congress.

We need more tools, legally, to fight a potential future crisis than we have now, at the time of this interview (November 25, 2019).

The government cannot make laws to prevent a crisis but can make laws to effectively fight it. However, in the aftermath of the crisis, Congress amended Section 13(3) of the Federal Reserve Act, which was used very broadly to fight the crisis and help institutions. In its new form, this article cannot be used in the same way it was used during the 2008-09 financial crisis. The Exchange Stabilization Fund and the Systemic Risk Exception were similarly amended, preventing them from being used as they were during 2008-09 to fight the crisis.

So, the Congress, in the aftermath of the crisis, took away the tools that had worked and did not replace them with new tools. They did approve reforms intended to make another crisis less likely. But if there is another financial crisis, whoever is in my seat will have a much more difficult time because there will be fewer tools available.

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