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Yale Program on Financial Stability
Lessons Learned

Sarah Dahlgren

By Alec Buchholtz and Rosalind Z. Wiggins

Sarah Dahlgren was the Executive Vice President and head of the Financial Institution Supervision Group at the Federal Reserve Bank of New York (FRBNY) during the crisis and instrumental in the rescue of American International Group (AIG). This Lessons Learned summary is drawn from a March 22, 2018, interview in which she gave her take on how central bankers can prepare for future crises.

Expect to negotiate: Big programs call for back-and-forth.

The AIG rescue proceeded in multiple phases and eventually involved not only FRBNY, but also the Treasury Department. In November 2008, Treasury used funding from the Troubled Asset Relief Program (TARP) to inject $40 billion into AIG. The money went mostly to pay down an FRBNY lending facility. Determining that figure required negotiation. "I think the sets of conversations went like—'If I could have gotten $50 billion, we would have gotten $50 billion,'" Dahlgren recalled.

> So, one of the lessons, at least for me, from the crisis is—the sets of conversations that you have to have with policymakers along the way, the first answer is always no. And so, you go back and redo your analysis, and you rethink and say, "Okay, I need to present to them two options." And then the next answer is no.
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> It's a constant back-and-forth to make sure we get the right thing. I'm positive that we started with a higher number. And then it got to—"What can we reasonably do? What makes the most sense?" I think it really was a back-and-forth dialogue across all the principals saying, "What's the right answer here? And what's the right mix?"
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> Were we comfortable with the risk? Nobody was happy with anything. But how do you coalesce around something that is the best package, with as much risk managed as you possibly can, and achieve your objectives?

Complications can arise: Unexpected parties may have a stake.

AIG Financial Products—the subsidiary that was the source of many of AIG's problems—relied on the parent company's sterling credit rating to issue the credit default swaps (CDS) that eventually turned toxic. The rating agencies had a continuing interest in the status of the AIG bailout. Dahlgren said those companies "were not originally on my radar, but they turned out to be a pretty important component of the process." She said,

> Within a week of my taking over the project, each of the major ratings agencies called me wanting to know all types of information. Because the agencies considered the government's actions and intentions critical to the company's health, it became essential that we address their concerns.

Dahlgren's team joined the AIG representatives when they met with the agencies. "We were in the room and responded to questions," she said. "We were there because what the Fed was thinking about doing was so central to what the rating agencies were concerned about."

Communication is key: The public demands information.

The Federal Reserve System, including the FRBNY, long operated in relative anonymity. “We weren’t used to sharing information,” Dahlgren said. “We were a closed society.” The mindset was, “we do monetary policy, and nobody needs to know what that is,” she said. That changed with the financial crisis, when billions of dollars in public money propped up private companies. She recalled,

> The idea of communicating to the public and with Congress wasn’t on my radar until all of a sudden, there was enormous backlash. You’ve got enormous compensation issues and a whole bunch of things that we didn’t really anticipate.

Dahlgren’s team turned to the FRBNY external communications office for support. The head of that office added a staffer dedicated to AIG to work directly with Dahlgren. She said,

> We were thinking through how do we communicate and provide press releases around big events. How do you make sure the media understands what we’re doing and why we’re doing it? I think that was really important, thinking through your communication strategy, to never assume that everybody understands the facts or reads everything. You really need to spend some time on your communication.
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> There wasn’t a lot of concern going into the crisis that the Fed was lying to anybody. With a few exceptions, the Fed did its job, and nobody questioned its motives. We believed, “we’re the central bank and everybody must understand what we’re doing and why we’re doing it.” We completely underestimated our level of support. The level of anger that then occurred as a result of all of the actions that the Fed took was a surprise. It didn’t occur to us that people would think that we were lying to them or that we were doing something nefarious. It was because we weren’t used to sharing information.

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