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Yale Program on Financial Stability
Lessons Learned

Timothy Massad

By Yasemin Sim Esmen

Timothy Massad was assistant secretary for financial stability at the US Department of the Treasury between 2009 and 2014. He oversaw the $700 billion Troubled Assets Relief Program (TARP), which was passed by Congress in October 2008 to enable the Treasury to buy assets of and invest in banks and companies to stem the financial crisis. Massad was involved in the implementation of TARP as well as its winding down; it ultimately invested $439 billion. This "Lessons Learned" is based on a phone interview with Mr. Massad.

There is no "one size fits all" when it comes to establishing policies to help troubled institutions, so policymakers need to be creative.

Implementation of TARP was applied to a variety of institutions of varying sizes and in varying fields. These included AIG, banks, and the auto industry. Massad recalled,

> When I first joined, I remembered there would be a day when I would go from meeting on whether AIG would fail, to whether Citibank was in trouble, to how we were going to deal with the auto industry and the bankruptcies there, and then someone would say, "Well, the State of California might defer some of its debt. Can we do anything about that?"

According to Massad, each type of entity needed its own plan of rescue. Stress tests provided some hope for the bigger banks that could raise capital, he remembered. However, there were still other large institutions, housing foreclosures, and smaller banks. There were provisions under the law that deterred smaller institutions, troubled as they might be, from taking the TARP money. One example of these provisions was the compensation restrictions brought on in 2009 that aimed to prevent big banks from paying large golden parachutes to executives that might have caused their troubles in the first place. According to Massad, these provisions might have unintended consequences:

> However, the law also applied these prohibitions to small institutions. When you applied a prohibition on severance to the top 10 employees, or a prohibition on bonuses to the top 25 employees, in the case of a small bank, that could mean the secretary could not be given his or her pension. So, a lot of smaller institutions did not want to take a lot of money as we got further and further into 2009. Those provisions also made it very difficult to set up a small business lending program.

A similar challenge presented itself in housing mortgages, said Massad. The Treasury knew they did not have the funds to buy all the troubled mortgages, so they were working through the big banks as those institutions were servicers of those mortgages. However, those big banks were unprepared to deal with the crisis that faced the country.

> As servicers, they were used to collecting payments and sending them off to investors. In the crisis, though, what we needed was the ability to deal with people individually, figure out what their individual circumstances required in terms of modifying their mortgage. The big banks were totally ill-equipped to do that. So, it took us a long time to get them into shape, where they could execute on the mortgage modification program.

We need an aggressive fiscal policy to ease the strains of the crisis on people.

One challenge that policymakers had to contend with was the perception that what they were doing was to help Wall Street only. Main Street and individuals suffered as well, and most could not be helped via the TARP program, Massad reflected. But, he explained, it was critical to stabilize the financial system first:

> The way we looked at that was, the financial system is like the circulatory system of the human body. We had to stabilize it. We had to deal with the heart attack, and we had to deal with that failure to keep the economy from going into an even deeper recession.

Asked what he would do differently if he could do it all over again, Massad said that it would be to come up with a much more aggressive fiscal policy that could cushion the impact of the crisis on Americans.

> There was simply not enough done to help people who lost their jobs, who were struggling to keep their homes and so forth. The TARP legislation talked about helping homeowners, helping adversely affected populations, but it did not give us any specific authority to do that, and we were limited by the [need to stabilize the financial system]. So, in the case of housing, as I noted, we had to create a mechanism to provide assistance that relied on the big banks and servicers, and because of that we had a lot of challenges in actually getting money to people.

In comparison to the government's efforts in the Global Financial Crisis of 2007–09, Massad believes the Coronavirus Aid, Relief, and Economic Security (CARES) Act passed on March 27, 2020, to help Americans deal with the economic difficulties brought on by the Covid-19 pandemic, has been very useful:

> I think the direct payments to individuals and the foreclosure and eviction moratoriums in the CARES Act were the types of things needed. That would have required legislation, of course, and we did not have the authority to do that, but I think that is the kind of action we needed in this crisis.

Besides reducing suffering experienced by citizens, this approach can also help the economy recover faster, Massad believes. Payments that were sent to individuals were often used to make expenditures that helped support the economy.

Finding the right people for the job and putting politics aside are keys to getting the job done right.

> TARP meant that the Treasury Department, essentially, had a portfolio of investments that rivaled any private equity firm, any investment firm, and probably any sovereign wealth fund. We were the largest investment portfolio around.

The size of this portfolio brought management challenges. One of these was to create the right culture to ensure teamwork and cooperation. This was especially important during the time of a presidential transition.

> [Treasury Secretary Hank] Paulson would not ask people what party they belonged to, and a lot of the people that worked in the Treasury under Secretary Paulson continued to work with us under the Obama administration. It was a culture of very high integrity. We enforced that in lots of ways.

Massad said that to meet the challenge of hiring the right people, they concentrated on hiring team players that were also hard-working self-starters. These people came from both the private and public sectors, from other agencies, or worked as private contractors.

Another challenge was to define the government's role:

> . . . we recognized that we were reluctant shareholders for these [companies that the government invested in]. The fact that we had more than $400 billion in investments was simply because of the financial crisis, and it was important to wind that down as quickly as we could, and also recognize in the meantime we should act as reluctant shareholders.

This meant that the Treasury was not going to manage these companies. They simply made sure that there was the right management and directors in place to run these companies and left their management and restructuring to them. Although the Treasury held voting rights due to the shares they held, Massad explained that the government limited their voting to four issues: the election and removal of directors, charter and bylaw amendments, major corporate transactions (such as mergers), and the issuance of securities.

It is also important to know when to unwind a program like TARP.

The TARP also needed to be unwound, said Massad, which was a bit of a challenge as there was no precedent.

> Our overall philosophy about that was that we should unwind the investments as soon as practical, consistent with stabilizing the financial system, and preventing taxpayer losses and maximizing returns.

Part of the reason behind the Treasury wanting to get out as soon as it was feasible, explained Massad, was because of the belief that the financial system and the economy should function without the government as a shareholder.

> The fact that we were a shareholder, again, was due to the financial crisis, and it was important from the standpoint of the health of the system to get the government out. At the same time, we did have a duty to prevent losses and maximize returns.

Stress tests proved to be the first step toward unwinding the investments. When the results of the stress tests showed that a number of banks had sufficient capital, they were allowed to exit TARP through a process.

In a crisis situation, it is important to apply the lessons learned from previous crises but keep flexibility. However, to effectively resolve the crisis, we first need to find a solution to the underlying problem.

The 2007–09 Global Financial Crisis was essentially a financial crisis at its roots, explained Massad, and could be fixed via financial policy, such as recapitalizing the system and providing broad-base guarantees.

> Those actions stopped the panic, they gradually led to the private markets being willing to put private capital back into the system, and those things also gave us time to restructure institutions that were in severe trouble.

In contrast, the crisis of 2020 has its roots in a public health crisis onset by the COVID-19 pandemic, which according to Massad "could lead to a financial crisis, if we don't manage it properly." When faced with the crisis, the Federal Reserve and the Treasury used the tools that were created in the 2007–09 crisis to provide liquidity and backstops to financial markets. According to Massad, their actions are not the cure, but they have been effective although a more effective powerful approach is needed to solve the underlying problem and help Americans more:

> They have added to those [tools from 2007–09 and] they have done more. That has calmed the markets and it prevented the situation that we had in March of [2020] from escalating into a financial crisis.
>
> All of that stopped the panic on Wall Street, reassuring the markets. It is very different from 2008–09, because that does not stop the problems, that does not cure the underlying crisis, which is a public health crisis. Financially, the possibility of a financial crisis here is just a product or a symptom of the underlying problem, or the real problem, which is the public health crisis. Until you fix that, until you manage that better than we have, there is a risk.

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