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Yale Program on Financial Stability
Lessons Learned

Michael Held

By Steven Kelly

Michael Held worked at the Federal Reserve Bank of New York (FRBNY) from 1998 to 2022 and served as its general counsel during the COVID-19 crisis. He met with the Yale Program on Financial Stability (YPFS) to share insights related to the Fed's crisis responses—particularly those during the pandemic. This Lessons Learned is based on an interview conducted with Held on June 12, 2022; the full transcript may be accessed here.

In addition to managing the financial markets aspects of any crisis, officials will also have to manage the impact of that crisis on their organization and employees to deploy the most effective response.

Held noted how, in the COVID-19 crisis, management of the New York Fed itself had to rapidly adapt to the evolving health crisis to make effective market intervention possible. The Fed had to assess the impact of the pandemic on it as an organization and on its employees. This was the first stage of the response. In this aspect of the New York Fed's response, as with financial interventions, playbooks from similar past crises proved useful. As Held described:

> The first thing we were obviously focused on in that period of time was our own employees and their safety. [. . .] We had playbooks in that regard from the SARS epidemic and other epidemics that were more localized. But we still had thought about some of this stuff—travel and that kind of thing. Obviously nowhere near the scale that the COVID pandemic turned out to be, but we started to think about that first, and when to send people home, just like every other employer.

Held said that much of the logistical preparation for the health crisis—particularly, instituting work-from-home protocols—took place in February and early March 2020. While Held expressed that the New York Fed wasn't as prepared operationally as its officials would have preferred, the early preparation positioned them so that "in that mid-March timeframe when things really hit, we were in relatively good shape to start doing the work we needed to do."

While cooperation with fiscal authorities can improve the effectiveness and the politics of crisis response, avoiding politicizing the crisis response can help maximize its effectiveness.

Held repeatedly highlighted the Fed's productive relationship with Treasury in implementing the Fed's emergency responses to the COVID-19 crisis. He said that Treasury's involvement, required by law to a degree it wasn't in past crises, did not politicize the crisis response. Following the Global Financial Crisis (GFC), the Dodd-Frank Act of 2010 (DFA) mandated that the Treasury secretary give prior authorization for the Fed's use of its Section 13(3) emergency liquidity authority. Held noted that some had been concerned that this would negatively politicize the Fed's crisis responses. However, he went on to say, he saw

"none of that occurred; I really mean that. Everyone was just focused on what needed to be done to address the issues."

He described the relationship between the Fed and Treasury as very close and collaborative. He shared that even "at the principal level, they were in the weeds." Held noted this was particularly helpful in the cases of Fed liquidity facilities that leveraged Coronavirus Aid, Relief, and Economic Security (CARES) Act funding, given Treasury's involvement in crafting the relevant CARES Act statutes. Held noted:

> Making sure that everything was on the right side of the line with respect to the CARES Act funding and that statute, it was critical to have Treasury there, and they were tremendously helpful in that regard as well.

Moreover:

> There's the [Treasury secretary] approval requirement in DFA, but a lot of these [facilities] had loss-sharing arrangements. So, if Treasury is taking the first loss, then they've got to be in the loop on anything that might impact that.

Held noted that if the Fed was altering an emergency facility, it would consult Treasury on any change that was "remotely material," even if it wasn't material enough to require a new vote by the Fed Board of Governors.

> There was a joint ownership of those term sheets. And yeah, how we might deal with particular counterparties and all that kind of stuff, that's either going to be strictly within the purview of the Reserve Banks or the Reserve Banks and the Board—largely around stuff like risk management. But anything that deals with the actual policy decisions that are being made with respect to those facilities—the kinds of collateral, or the way we're doing the purchases—we're all going to be consulting with Treasury on that.

Having knowledge from past crises can be of great benefit to fighting a new crisis. Yet, officials should not be "just fighting the last war." Since every crisis is unique, they should also be intentional about crafting responses specific to the new crisis.

Held shared how the lessons and experiences of the GFC allowed the Fed to announce several facilities quickly, even if they weren't yet ready to be operational. Officials aimed to achieve a positive announcement effect in the markets by simply announcing their intent to reimplement intervention facilities the Fed used during the GFC—and create new ones directed at additional markets.

He said the Fed's strategy to intervene "with force and alacrity immediately" was a lesson learned from the GFC and its experiences implementing numerous facilities. In that crisis, it was more typical for the Fed to roll out "one facility, tweak that over time, then another facility, maybe a couple of months later."

> Part of that is just having the benefit of having developed a lot of [liquidity] facilities during the GFC. We had things we could do immediately. We had things we could announce immediately, even if they weren't yet ready to go live. But we were very aware, or we were hopeful, that there would be an announcement effect. [. . .]
>
> We all staffed up much more quickly, and we went from zero to 100 over a weekend, I'd say.

Yet, officials were also intentional about trying to improve upon the responses to the GFC, and they were intentional about tailoring their responses to the unique characteristics of the COVID-19 crisis.

> There was also a feeling that, during the GFC, there was a lot of criticism on USG [the US government], not necessarily the Fed, about not doing enough to provide direct assistance to Main Street [the nonfinancial economy]. And so, I do think there was a desire to really think about where the effects were here so that we weren't just fighting the last war—meaning the GFC—and really trying to craft solutions that maybe built on what we did during the GFC, conceptually, but were getting the assistance where it was needed.

Held shared that this thinking also provided some of the impetus for the Fed's more novel, "real economy" facilities: two that purchased corporate bonds and one that purchased municipal securities.[1] The Fed had concerns about taking an ever greater role in financial markets, but the nature of the crisis, ultimately, largely outweighed these concerns, Held said:

> [Fed officials had] concerns about the slippery slope, and "are we supplanting the responsibilities of other entities within USG or the private sector?" . . . Really a lot of concern about that, but ultimately deciding that this is—again, this goes back to how I started our conversation: really thinking about this crisis rather than the last crisis—and thinking about what was needed.

A desire to tailor the response to contours of the COVID-19 crisis also drove some of the unique design features of the facilities. For example, while the corporate bond facilities were "a little bit more adjacent" to previous facilities, the facilities generally excluded bank debt from eligibility, despite banks' large share of the corporate bond market. Held noted that this restriction was driven by "really trying to focus the facilities on where we thought the issues were":

> The stuff that was done between the last crisis and this one from a supervisory and regulatory perspective left the banks in pretty good shape. They were resilient to what was happening in 2020, and so I do think a big part of this was really focusing on and helping to focus the facilities on really where the need was.

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[1] The Fed also created a facility to buy large shares of loans to midsize firms, but this facility operated out of the Federal Reserve Bank of Boston.

Using a special purpose vehicle (SPV) can assist policy makers in being transparent with respect to each intervention's accounting. This can be particularly important when the facility has received support from public funds.

In general, Fed officials had a desire to be transparent when it wouldn't impede policy. Generally, Held shared how he saw a shift in the Fed's attitude toward transparency between the GFC and the COVID-19 crisis:

> There really was a desire to be as transparent as possible. Whereas, I think we adjusted in 2008, but in the beginning, the approach was: Unless there's compelling reason to disclose, we're not going to disclose. And [during the pandemic], it was entirely the opposite: Unless there's a compelling reason not to disclose, and where we're allowed to . . . We have the disclosure requirements that were imposed after DFA, but we went beyond that here. And the reason was really wanting to be as transparent as possible, unless doing so would impair the facilities. And so that was another lesson learned.

Held noted that using an SPV for an emergency liquidity facility makes for better and more transparent accounting. This is especially important, he noted, when there is public money supporting the facilities:

> I think where there's no taxpayer money—don't get me wrong: All Fed money, I recognize, is money from the public—but the money coming from Treasury, that's where you really want to make sure there's clarity around how the funds are being used. And it makes for better, clearer accounting when it's separate facilities. You have separate financial statements. People would be looking for those. It's something that it's easy to point to with respect to each facility. So, it just provides a bit of clarity around what we're doing. [. . .]
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> For some of the other things, like the PDCF [Primary Dealer Credit Facility], obviously there was no funding coming in, so there was no need to have any sort of structure like that. It wasn't the way we had done it previously, so it didn't make sense to do it that way for that kind of facility. The MMLF [Money Market Mutual Fund Liquidity Facility] . . . had a guarantee. Again, there was no funding coming in, so there wasn't really a need to have an SPV for that kind of facility.[2]

Held also said that, while using a separate SPV for each liquidity facility sacrifices some "agility and flexibility" on facility design/use—given that risks are not pooled into one

[2] The MMLF, unlike the other facilities receiving first-loss protection from Treasury, indeed did not have an equity injection. Instead, it had a $10 billion credit guarantee from the core (non-CARES Act) funds in the ESF. However, some funds were provided: Treasury transferred $1.5 billion of the $10 billion from the ESF to a deposit account at the Fed. See the "Money Market Mutual Fund Liquidity Facility Credit Support Agreement": https://ypfs.som.yale.edu/library/document/money-market-mutual-fund-liquidity-facility-credit-support-agreement. The GFC-era predecessor to the MMLF, the AMLF, did not have any fiscal support from Treasury and, like the MMLF, did not use an SPV structure.

program—the differences between the various facilities and the desire to provide more straightforward and transparent accounting ultimately favored using separate SPVs.

Another factor that Held discussed concerning the decision whether to use SPVs was that officials aimed not to unnecessarily stray from past facility design.

Where possible, without impeding effectiveness, designing an intervention similar to past interventions can help markets understand it and enhance its effectiveness.

Held noted that where it was possible to structure something in the same way or similar to the way it had been structured in the GFC, they chose to do so, because that may help facilitate market understanding. This was especially important because officials were hoping for a large announcement effect from the facilities:

> There's a little bit of, "If it ain't broke, don't fix it," for something like that. It worked last time. If it's different, then that might cause confusion in our stakeholders about why it's different. As I said before, there's a bit of wanting to take full advantage of the announcement effect. So, to the extent it's similar, that can be helpful. And if it's different, then that can create confusion and can impair the announcement effect.

Dated: August 2023

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