Lessons Learned: Neil Barofsky

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Neil Barofsky served as the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) from 2009 until 2011. Barofsky, a former prosecutor, established and supervised the audit division that monitored the financial assistance provided as part of the $700 billion TARP. This “Lessons Learned” is based on an interview with Mr. Barofsky in September 2021; the full transcript may be accessed here.

For any program like TARP to have the impact that Congress intended, the administering agencies must completely understand Congress’s intent and care about implementing it.

TARP was adopted to stabilize the financial system so as to protect home values and savings and to preserve homeownership, jobs, and economic growth. The extension of credit, including lending to homeowners and small businesses, had been severely restricted before TARP’s adoption. Stabilizing the banks’ capital positions was intended to restart the flow of credit to help homeowners refinance and modify mortgages and avoid foreclosure, as well as to restart lending to small business.

The role of the SIGTARP, similar to that of any inspector general (IG), was to ensure that the administration and Treasury were using the TARP funds as intended by Congress and to prevent fraud. On this score, Barofsky counts one failure and one success.

Well, TARP was supposed to do two things. And I don’t know if I would say that one was primary and one was secondary. That bill does not pass Congress, Treasury does not get that $700 billion, but for its commitment to not just help the banks, but to help people. I put the two goals on the same plane.

“It got an A+ by saving the banks,” according to Barofsky. But he considers this only a partial success. “People say: ‘Wasn’t TARP a ringing success?’ No, TARP was not a success, TARP was a failure, because TARP failed to do one of its primary goals, which was to help homeowners and restore lending to small businesses.”

According to Barofsky, when the administration and Treasury shifted gears from buying toxic assets (bad mortgages) to investing in the large Wall Street banks to stabilize them, it jeopardized TARP’s other goal. The problem, said Barofsky, was that when the money was distributed to the banks, necessary precautions were not taken to ensure it would be used as intended:

When they gave the money to the banks, they didn’t put any requirements or incentives for them [to help homeowners and small businesses]. Zero. And so, what happened, none of the money that went to the banks went to help small businesses or homeowners. [In effect,] zero matchup of what you want and what actually happens.
In practice, the banks used the funds to stabilize operations, acquire other distressed institutions, and address other operational goals while tightening credit. In that respect, the TARP was a failure, said Barofsky, because it did not achieve one of the goals stated by Congress, even though it did succeed in stabilizing the banks.

Barofsky asserted that many regulators retroactively and falsely have rewritten history to claim the TARP’s focus was only to stabilize the financial system and not forestall the foreclosure crisis. Officials in Washington failed homeowners, he said, because they didn’t have sympathy or empathy with the households losing their homes; they didn’t know any of them, so it was easy to picture them as irresponsible people who got in over their heads and deserved to be foreclosed. That was the basis of many “moral hazard” arguments raised by officials and regulators with respect to mortgage assistance for homeowners.

In Barofsky’s view, that approach evolved into the narrative that the government bailed out the banks and left the people adrift, leading to growth of movements such as Occupy Wall Street and the rise of populism, which have had broad and long-lasting impacts on the country. Barofsky explained:

I think if they [government officials] had a more people-focused approach that took the responsibility to help struggling homeowners and put that on par with their passion for rescuing the biggest banks, we wouldn’t have seen the transformation, the political results that resulted in the election of President [Donald] Trump. I put that squarely on [the administration and the Treasury Department’s] doorstep for those decisions.

Despite his dour view on the success of the TARP in achieving its goals, Barofsky does believe the SIGTARP office was able to do a “very, very effective job of limiting losses to fraud” under the program. The office did this by being tenacious and by relying on the bipartisan support that backed its efforts. “Even our harshest critics, including both secretaries of Treasury that I worked with, Paulson and Geithner, both acknowledged we did a very good job of deterring people from taking advantage of the program, of committing fraud,” said Barofsky.

**Effective independent oversight requires bipartisan support to succeed.**

Arriving in Washington with no previous experience, Barofsky consulted with other inspectors general, who often told him there are three kinds of IGs: lapdogs, watchdogs, and junkyard dogs. The first one cozies up to power and is ineffectual, while the third one tears everything down. A watchdog, the trope concludes, is somewhere in between the two. The exception to that advice was the IG at the Housing Department, Ken Donohue, who told Barofsky not to be afraid to use his authority like a junkyard dog to get the job done.

This is a common problem of oversight, said Barofsky. Many IGs in Washington fail as watchdogs because they fear the people they are meant to police. Barofsky noted that President Trump fired IGs who disagreed with him during his administration:
I lived in constant fear of being fired. And I had other IGs come up to me and say to me, “Neil, I really admire what you’re doing. I wish I could do that, but I can’t, because I’ve got kids who are going to college, and I need this job and I can’t afford to take that risk of getting fired.” I get that.

Using their platform to make issues public is a powerful tool for IGs, but only if they have bipartisan support, Barofsky explained:

One time I had a meeting with the assistant secretary who was responsible for TARP. His name was Herbert Allison, and he was complaining to me about one of my reports and the fact that I spoke about it publicly in Congress and gave an interview on cable television. I said to him: “This is what I do. I’m not in the room with you. When you guys are deciding what to do, when you’re making the plans, you don’t invite me to those rooms, into that room for that decision-making. I’ve got to do whatever I can to try to influence and protect taxpayers and protect these programs. And for me, that means I’ve got to go to Congress. And for me to get Congress to pay attention, sometimes I’ve got to go on TV. And that’s the reality.” In other words, since I wasn’t in the room where the decisions were made, I went on TV so that Congress would pressure the administration to pay attention to our concerns. Herb’s response was: “You may not be in the room, but your voice is heard. In fact, your voice is probably the biggest voice in there as we’re making these decisions.” It is how an inspector general can have an impact.

But at the end of the end of the day, said Barofsky, administrations need to listen to IGs, and that can only happen with bipartisan congressional support. Barofsky said his office was able to operate and actually accomplish some things because Congress was united in trying to stave off the crisis. He noted:

That sounds like a “unicorn” in 2021. Bipartisan congressional support for something? But it was a different time, and we did. That really made all the difference in the world.

Look, there was nothing particularly intimidating about me and my deputy, Kevin Puvvalowski, as we demanded the documents and pointed to the statute and said that we needed this material. We were pretty easy to say no to. But we carried the cudgel of being able to go to the chairs of the committees that oversaw those agencies. So whether it was Senator Max Baucus, who at the time was the head of the finance committee, which had oversight over Treasury; whether it was Senator [Chris] Dodd or Representative Barney Frank, who had oversight over banking and financial services, they had our back.

Unfortunately, Barofsky said, the experience of the Special Inspector General for Pandemic Recovery (SIGPR) shows the lessons of 2008 were not applied when developing the response to the COVID-19 pandemic. Lacking bipartisanship, SIGPR didn’t get the congressional support the office needed, and the Treasury Department decimated its jurisdiction. “I wish them the best,” Barofsky commented, “because they have an important role to fulfill, but the
mandate has been whittled down pretty significantly. I think that agency is in a very, very
difficult spot.” To make IGs truly independent, said Barofsky, Congress would need to act,
and that would require bipartisan support. He asserts that statutes should provide that IGs
can only be fired with cause and should mandate better mechanisms to make sure they can
get the materials and documents they need.

**The wrong balance of the speed of distribution against the ease of use of a program can result in misdirection of funds and increased fraud.**

Speeding the delivery of funds to stave off a crisis can be at odds with establishing strong
oversight, said Barofsky, and in some measures can be understandable. But, he cautioned,
without some guardrails, money is not only lost to fraud, but it may also be misdirected. He
pointed to the banks’ lack of direction for use of hundreds of billions of TARP funds. He thinks
that a similar miscalculation was done with the CARES Act’s Paycheck Protection Program,
designed to deliver funds meant to encourage businesses to retain employees during the
quarantine shutdown. The same dynamics seen in TARP in 2009 replayed in 2020, Barofsky
explained:

> They just did it again. They shoveled all this money out, and they gave it to the banks
> who were responsible for distributing it, but they didn’t give them any incentives or
> requirements to direct it to the truly needy small businesses, the minority-owned
> businesses, the women-owned businesses, the true mom-and-pop stores, nothing. In-
> stead, they said, “go and give this money out.” And because it was a limited amount of
> money, the banks—and I don’t fault the banks for this, to be honest with you—they
gave it to their biggest customers, who technically qualified, whom they already had
> onboarded and already had relationships with. Because, frankly, that was the cheap-
> est, easiest way to distribute the money. But as a result, a lot of those underbanked,
> traditionally mom-and-pop, traditionally Black-owned businesses, women-owned
> businesses got left behind. That was just a complete repeat of the mistakes that were
> made during TARP that were ignored here.

Barofsky cautioned that the banks need clear directives and credible incentives to force them
into distributing taxpayer funds in a manner consistent with the congressional intent em-
bodyed in the legislation. Even given the dire circumstances of the COVID pandemic, he
pointed out, there were options between the loose application process that was used and a
totally strict, time-consuming one. Administrators could have thought through the balance
more carefully.

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