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# Lessons Learned: William B. English

Sandra Ward

# Yale Program on Financial Stability
# Lessons Learned

## William (Bill) B. English

By Sandra Ward

*Bill English, a longtime veteran of the Federal Reserve Board, served as deputy director of the Division of Monetary Affairs from 2008 to 2010, a position that put him close to many of the critical decisions made in response to fast-moving developments at the height of the Global Financial Crisis (GFC) and the subsequent recession. In 2010, he was elevated to the post of director of the division and secretary to the Federal Open Market Committee (FOMC). Since 2016, he has been at the Yale School of Management, where he now is the Eugene F. Williams, Jr., Professor of the Practice. This "Lessons Learned" is based on an interview with English in February 2019. The full transcript can be accessed [here.]*

**Policymakers need to take fast, aggressive action at the first sign of a crisis and stay on alert, even though events may vacillate between calm and disturbance.**

In a deeply interconnected international financial system, a single challenge from a credible source is enough to lead investors to question the presumed safety of a class of financial assets. Such questioning can act as a spark, or an ember, and trigger the onset of panic. English discussed how in early 2007 the Fed recognized stress and related volatility in the housing markets but was operating in an uncertain environment characterized by periods of calm. He explained:

> Starting in early 2007, there were some problems in mortgage markets, particularly with subprime mortgages. There was a lot of volatility in February and March, but it seemed to settle down after that. There were some investment funds that were heavily invested in mortgage-related assets, including a couple of Bear Stearns' that closed early in the summer. That was a surprise and generated a certain amount of market reaction, but basically everything seemed okay. We were aware, certainly, that the housing market was in a big slump, and there was likely to be a protracted slump because there were going to be losses on mortgages, but market functioning seemed, except for these periods of volatility and reduced liquidity, to be okay.
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> The big event [in the GFC] was the August 9, 2007, announcement by BNP Paribas that their investment funds were heavily invested in US mortgage assets and weren't going to redeem shares anymore, because they didn't know how to value the mortgage assets. That seemed to set things off in a way that rippled through the financial sector. Immediately after the announcement, there was a big slowdown in liquidity provisioning, largely in Europe, but also in the US. The European Central Bank [ECB] had to go in and add a lot of liquidity to keep their money markets functioning on the 9th and 10th [of August], and the Fed did the same. It was immediately clear that there was a big problem. But what we didn't know at that point, of course, was how big a slump it would be and how long it would last . . .

> The way we read it at the time was that there were going to be significant losses on mortgage-related assets. That was reducing the liquidity of mortgage-related assets, and that was creating funding problems at banks. Nobody quite knew where the losses were going to end up, and people became much less willing to take mortgage-related assets as collateral, and there were funding problems. These problems were quite widespread, because, again, nobody quite knew who was exposed to these mortgages. The extent of the problems for the valuation, liquidity, and loss potential of the mortgage assets became apparent when BNP said, "We can't value these securities, so we can't sell them." I think a lot of banks started questioning their counterparties and wondering which ones were okay and which ones might not be okay, and whether they wanted to lend to them or not. There was a real pulling back from providing what had been routine short-term liquidity among banks and other large financial firms.

Because of the unique and uncertain nature of crises, regulators may often be confronted with making choices without complete information and without being able to accurately predict the outcomes. At the time, said English, the Fed's experience with crises was limited, and the governors were obviously cautious. That caution included unfamiliarity with the new tools they were being asked to deploy.

Still, when asked if regulators should have acted earlier and more forcefully, English agreed:

> If we'd known then what we know now, yes, absolutely. [Regulators] should have moved faster to provide liquidity support, should have moved faster to move rates down, should have used forward guidance more aggressively, and should have had a larger, longer purchase program straight away. But the problem was they didn't know how big the problem was going to be. This was an unprecedented event. They were consistently surprised by how bad things got and how slowly the economy bounced back. They also didn't quite understand how to use and calibrate the new tools and were worried about some of the risks associated with those tools, such as the possibility that some unexpected risk would emerge. As they got more comfortable with the tools, they used them more aggressively.

**Staying fully engaged at the early stages of what may become a crisis will enable regulators to gather needed information and to prepare tools that might be used to arrest it early on.**

Even if they don't get used immediately, having tools prepared allows for faster deployment if they are ultimately needed, and that can be important. This was illustrated by the Fed's early efforts to address liquidity strains in fall 2007. The Term Auction Facility (TAF) was "developed in a hurry in August and September" and discussed at the September meeting of the Federal Open Market Committee along with swap lines, under which the Fed would provide US dollars to the ECB, which would then on-lend the currency to banks in its jurisdiction. He described the discussion:

> At that point conditions seemed to be improving. There was the sense that maybe there was a one-time adjustment that had to be made, but that the worst of it was over, and things would continue to improve. The committee decided to not go forward with the two programs in September, but then conditions deteriorated again later in the fall, and they went forward with them in December.

**Unprecedented circumstances may require unprecedented responses. Regulators should be prepared to examine and deploy all possible solutions and to consider new tools.**

While acknowledging the inclination of the Fed to move with caution and deliberation, English urged boldness. Crises, by their nature, are going to be unique and may require unique uses of existing tools or the design of new tools. He cited the Fed's use of its emergency lending authority as an example:

> The Term Securities Lending Facility [TSLF] was approved under Section 13(3) of the Federal Reserve Act, which was the Fed's emergency lending authority to nonbanks. That was the first time in the crisis that 13(3) authority was invoked and extended. It had been invoked a few times back in the 1960s and '70s but had not been used. The last time 13(3) authority had been used was in the Great Depression. While the TSLF was the first use of 13(3) authority, [the Board] voted again to invoke it to allow the "back-to-back" loan, as we called it, to Bear through JPMorgan. That got Bear to the weekend, but they couldn't have opened on Monday. They arranged the merger with JPMorgan Chase over the weekend, which meant that Bear's creditors and counterparties could step back in again and do business with Bear because it was now going to survive. JPMorgan was seen then, and throughout the crisis, as a strong pair of hands.
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> In March, we had the TSLF, Bear, and, immediately after Bear, the Primary Dealer Credit Facility [PDCF], which was another lending facility for the primary dealers. The PDCF allowed them to obtain collateralized funding on short notice. It was essentially like the discount window is for banks: a method of obtaining liquidity if you need it to make payments and avoid default on a given day. By the end of March, we were providing credit to primary dealers in similar ways to how we provided credit to the banks.

English also discussed how the Fed considered solutions that other countries had used. He said looking to other such examples can expand the possible tools that a central bank can deploy in the current situation.

> The Japanese have shown you can do very large asset purchases. The Swiss and others have shown that you can take rates negative, and you can convince people that they're going to stay negative for a while. The Bank of Japan induced monetary policy to push the 10-year government bond yield in Japan negative. The Bank of Japan, Bank of England, and the ECB also used targeted lending programs. At the Bank of England, it was called "the Funding for Lending Scheme." The idea was that if banks did more

> lending to households and businesses in the UK, the Bank of England would finance some of those loans at a very low interest rate. They would, by offering cheap financing for additional lending, induce banks to reduce the rates at which they were extending loans and encourage them to lend more. The Bank of England's analysis suggests that was reasonably effective in getting additional bank lending in the UK.
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> This was another program we talked about but never felt the situation was such that it was appropriate to do it. In a future situation, you could. There are other tools that could be used, and the tools that were used could be used with greater vigor.

**Ensuring a forceful response often involves taking known and unknown risks.**

In a crisis, there may be no easy answers and limited workable solutions. Although it was known that the Japanese had used quantitative easing (QE) successfully, English said, there was still hesitation at the Board in considering QE to combat the recession that followed the worst of the crisis, because it was unknown what the results would be.

> The issue of financial stability was particularly acute at the start of the open-ended purchases [QE] that began in the fall of 2012. There was a lot of concern. If you go back and look at the transcripts of FOMC meetings, there were a lot of FOMC participants who were worried. There had been another big round of purchases, even lower longer-term interest rates, and new forward guidance which may have pushed back expectations regarding the timing of liftoff. People were quite worried about reaching for yield and too much risk-taking. At the time, what they put in the FOMC statement was that they would adjust the purchase program in light of their assessments of the costs and benefits of the program. One of the costs was certainly the financial stability risks, and, to illustrate these, the staff produced a couple of briefings on indications that the purchase program was causing reaching for yield behaviors and undesirable risk-taking.

While risk-taking may be necessary, English described how the Board tried to moderate this risk:

> On some level, we wanted additional risk-taking. Risk spreads had widened out a lot during the crisis, and investors had become quite risk averse. Some additional willingness to take on risk was part of the idea behind the monetary policy. But we were worried there would be excess risk-taking, so we spent a lot of time looking at insurance companies, pension funds, and banks to see if there were indications that they might be taking on excessive risk. We didn't see it at that time, but we continued to worry about that. The Federal Reserve Board had by then created a small financial stability office, as it was called then. As it grew, it eventually became the Financial Stability Division, and it's still there. One of its initial responsibilities was to worry about this issue . . .
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> [The FOMC was aware that] it was in uncharted waters and didn't know exactly how things would play out. They were always careful of how they worded their

> communications, to ensure that they would have room to change tack if some risk emerged that hadn't been contemplated. Fortunately, that didn't happen.

**Coordination of fiscal and monetary policy is imperative, especially at the zero lower bound.**

> [In the GFC], fiscal policy was a lost opportunity. When the federal funds rate has hit essentially zero and long-term rates are very low, fiscal policy is cheap and effective. A more expansive use of fiscal policy, I think, could have improved the economic outlook faster. Ben Bernanke advocated for policies of near-term fiscal expansion in conjunction with a plan to help the economy get back to potential, and to deal with increasing deficits in the near-term, but that was too politically difficult. What else could have been done? There was a whole lot of work done at Treasury with mortgage refinancing, renegotiating mortgages, and refinancing underwater borrowers at lower rates after they had fallen. Ultimately, the Treasury figured out how to do that in a way that was helpful, but it took them a couple of years. You'd hope they learned from that experience and could do better another time.

**Cooperation among national monetary authorities is key to combating global, systemic banking crises.**

One thing the GFC certainly confirmed is that large systemically important financial institutions do not limit their operations to one country. They are very broadly structured, operate across state lines, and trade in numerous currencies around the clock. These structures make them subject to regulations of various governments. Understanding these structures means understanding that the best solutions will be coordinated ones. English described the value of such cooperation:

> We made significant efforts to work with other central banks, as well. Much of the funding problems stemmed from foreign institutions, and so there was a lot of discussion with the European Central Bank and Swiss National Bank over how to provide dollars through the swap lines. An additional concern was how the swap lines would relate to the way the Fed was going to provide dollar funding through the Term Auction Facility in the US. The discussions resulted in a joint announcement about the introduction of the TAF and the swap lines, in which the Fed and ECB stated that they would run TAF and euro-area auctions in parallel ways to coordinate the international response to the crisis.

According to English, these coordinated programs and communications were largely successful:

> Ultimately, it took a lot to settle markets down, but it did seem to help when those announcements came out. People at least knew that the central banks were talking and working together and trying to figure out how to address the problems that had arisen.

"From 2007 to 2009," said English, "the sense that all the central banks were working together seemed to help with financial market confidence and business confidence." This sentiment has been echoed by other regulators and commentators, and the swap lines and TAF were some of the most-used tools that helped to stem the crisis.

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