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Yale Program on Financial Stability
Lessons Learned

Zoltan Pozsar

By Sandra Ward

While working as a senior trader and analyst with the Federal Reserve Bank of New York's Markets Group in 2008–11, Zoltan Pozsar became intrigued by the existence of a "shadow banking system" involving securitized assets. He dedicated himself to understanding the linkages of the then obscure and overlooked asset-backed securities (ABS) market and the role it played in keeping markets liquid and functioning. Pozsar's research laid the groundwork for the Term Asset-Backed Securities Loan Facility, or TALF, which was instrumental in restarting the flow of credit during the Global Financial Crisis. This "Lessons Learned" is based on an interview with Pozsar in September 2021. The full transcript can be accessed here.

Regulators must bring a broad and discerning view to crisis-fighting to be able to identify the unexpected and unfamiliar issues and connections that are fueling the fire or may spark the next one.

The Federal Reserve implemented many facilities to tackle the liquidity crisis that froze financial markets in 2007–09. Some of these facilities were the US dollar swap lines, the Term Auction Facility (TAF), the Term Securities Lending Facility (TSLF), the Primary Dealer Credit Facility (PDCF), and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF). Despite these initial interventions, Pozsar recalled policymakers' questioning why credit was "still not flowing to certain places, when [they had] already backstopped the banks, the primary dealers, and the money funds."

Pozsar came to recognize that focusing on lesser-known asset markets was the key to mapping out hidden channels through which credit also flowed through the system. He said, "Keep in mind, the problems [of the crisis] came in large part from the breakdown of the shadow banking system, but policymakers still didn't yet have that big, nice mental map of how this whole system fits together."

The asset-backed securities market created sources of funding for credit card loans, auto loans, and student loans, so it was a key component to the supply of credit in the broader economy. However, the Fed did not regulate this market, it was not well understood, and crisis responders had not yet attended to it. He noted:

> A lot of these [other crisis] facilities were pretty obvious, because you were looking out the window, literally, at some big banks and insurers across the street. When it comes to the ABS securities market, it's kind of amorphous. There's a lot of issuers, and they're not always obvious . . . The structured investment vehicles [SIVs] and asset-backed commercial paper conduits were the most important buyers of asset-backed securities, and both those markets had blown up.

This realization led Pozsar to write about the absence of an ABS backstop in an internal memo called "The Orphaned Asset Class." The "paper was the genesis for the idea of the Term

Asset-Backed Securities Loan Facility," said Pozsar. The facility was novel for the Fed, because it addressed a securities market that it did not regulate and that had a wide and diverse range of issuers and investors. Focusing on the ignored asset class proved critical and required creative thinking. Pozsar explained:

> The issue was that the buyer base that traditionally bought these instruments before the crisis didn't exist anymore, so there was nobody to sell to. You needed to create a facility that would bring in capital from different places. Then the Fed would provide funding. Once the capital and funding are in place, then the market can restart. TALF did that—pulling public and private capital together and turning that capital into balance-sheet capacity to buy credit with funding provided by the Fed.
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> Why was it so late in the game that this TALF facility came? Half of the market that you needed to have a well-functioning asset-backed securities market was already gone. The other half didn't involve systemically important financial institutions as issuers that are easy to identify, so this is not as obvious as backstopping Goldman or JPMorgan, or whichever company needed to be backstopped. So, it took time. But getting the narrative right that many small nonsystemic parts add up to one systemic system that needs to be backstopped was key.

Pozsar's work on the TALF was augmented by an additional project of mapping the "shadow banking system" and detailing its participants and funding networks. The project was extremely well received, and when his work was published in 2010 (under the title "Shadow Banking"[1]), it became the most downloaded paper in New York Fed history. Pozsar's work enhanced the ability of the Fed and other central bankers to understand and begin to regulate the risks posed by the shadow banking system. He talked about the benefits of this thinking with regard to tackling the COVID-19 pandemic:

> [T]he system we have today is much cleaner and much better regulated. These markets still live on the balance sheets of large financial institutions that are now subject to Basel III. You have more capital, less leverage, and more stable funding. In this COVID-19 crisis, not a single bank failed anywhere in the world, so that's a testament to the success of Basel III as a framework that fortified the system.

He cites these developments as lasting improvements that helped the Fed effectively address the economic impacts of the COVID-19 crisis on the shadow banking markets.

> The government did what was right, and they did it quickly. And on a much bigger scale. But again, they knew what to do. In 2008, they didn't even have a name for it. Now we call it "dealer of last resort." Markets freeze, you step in, and you start making markets in a central bank's balance sheet. Back then, the response was, "Market making? What?" It was very different. It was never done before because there was only the discount window. I remember the conversations with people that ran the

[1] https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr458.pdf

> discount window. They'd ask, "How are we going to do this? This is not what we were set up for." This was the old school.

Powerful leadership is a necessary requirement for successful outcomes.

While a lot of attention is given to the innovative funding mechanisms and facilities that ultimately led to resolving the financial crisis, what gets overlooked is the leadership that moved quickly to advance proposed solutions. Said Pozsar,

> My biggest lesson was in leadership. Having two leaders, Tim Geithner as president of the New York Fed and Bill Dudley as head of the Markets Group—the two of them were an extremely powerful duo . . .
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> Having the right people in the right seat at the right time is very important . . . Whatever technical ideas and facilities came out of the Fed from staffers like me, they were the ones who championed it at the Board, at the Treasury, in front of Congress.

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