Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Robert Hoyt[1] U.S. Department of the Treasury General Counsel (2006-2009)
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Date of Interview	November 25, 2019
Lessons Learned No.	2019-39

Introduction:

The Yale Program on Financial Stability (YPFS) contacted Robert Hoyt by email to request an interview regarding Hoyt's time as General Counsel at the U.S. Department of the Treasury during the Global Financial Crisis, between 2006 and 2009.[2]

At the Treasury Department, Mr. Hoyt was the Chief Legal Officer of the Department and a senior policy advisor to Secretary Henry Paulson. He oversaw legal aspects of policies implemented to manage the crisis, including the rescues of Bear Stearns, AIG, and the U.S. Auto industry, the conservatorship of Fannie Mae and Freddie Mac, and the failure of Lehman Brothers, as well as the creation and implementation of the Troubled Asset Relief Program (TARP.)

Before the U.S. Department of Treasury, Mr. Hoyt served at the White House where he was Special Assistant and Associate Counsel to President George W. Bush.

Mr. Hoyt currently is Group General Counsel at the British multinational investment bank and financial services company Barclays, where he is responsible for all legal and regulatory matters.

[*The following is a summary of the interview conducted over the telephone.*]

YPFS: **For the record, could you please elaborate on your role at the Treasury [Department] during the financial crisis?**

Hoyt: I was general counsel at the Treasury Department from December 2006 until February 2009. I was in charge of the legal division of the Treasury and was

[1]The opinions expressed during this interview are those of Mr. Hoyt, and not those any of the institutions for which the interview subject is affiliated.
[2]A stylized summary of the key observations and insights gleamed from this interview with Mr. Hoyt is available here in the Yale Program on Financial Stability's *Journal of Financial Crises*.

the principal legal advisor to the Secretary of the Treasury, Henry Paulson. Paulson worked closely on these matters with [President and Chief Executive Officer of the Federal Reserve Bank of New York] Tim Geithner, and [Chairman of the Board of Governors of the Federal Reserve System] Ben Bernanke. I was responsible for legal analysis, legal advice, and legal strategies for the Treasury Department.

YPFS: **In March 2008, JP Morgan Chase bought Bear Stearns and the Federal Reserve extended a credit line to JP Morgan Chase for this acquisition. Why was JP Morgan chosen for this?**

Hoyt: Bear Stearns had run into severe trouble and was on the verge of going into bankruptcy. J.P. Morgan agreed to purchase Bear Stearns but there was a challenge: Bear Stearns had assets, but it was very hard to value these assets. To meet this challenge, the Federal Reserve loaned money to a legal entity that held these assets. The loan was secured by the value of the assets and enabled J.P. Morgan to finalize the acquisition of Bear Stearns. By loaning money to the legal entity to facilitate J.P. Morgan's acquisition of Bear Stearns, we were able to prevent it from going into bankruptcy.

Our view was that Bear Stearns going under would be very bad for the U.S. economy and global markets. It would have been best to avoid it. J.P. Morgan had the willingness to buy the firm, but there needed to be financial support.

J.P. Morgan was chosen because they were ready to buy Bear Stearns. No one else was. If any other institution had been willing, it would have been fine as well.

YPFS: **It is said that Bernanke, Paulson, and Geithner wanted Lehman Brothers to survive but that "rescuing it would have been illegal, and they were unwilling to break the law" and that they did not have the authority for Lehman's rescue. What were the legal considerations there?**

Hoyt: We were prepared to do the same for Lehman Brothers what we had done for Bear Stearns. In fact, Lehman Brothers were stressed and my current institution, Barclays, was ready to buy it. However, Barclays was prevented from doing so because of legal considerations. If Barclays had bought Lehman Brothers, the same financial support would have been available for that acquisition as well.

The problem with Lehman Brothers was that there were no other buyers once Barclays pulled out. Bank of America was considering a bid, but it backed out and decided to buy Merrill Lynch instead — a transaction it was prepared to do without support from the government.

In the case of Lehman Brothers, we had the ability to support a private market transaction, but the transaction had to be there. It was not within our gift to create the transaction or simply write a check. Unfortunately, the circumstances that would have worked did not come to pass with Lehman Brothers.

YPFS: **In March 2008, regarding the Bear Stearns bailout, Treasury Secretary Paulson said: "When you go through a period like this, policymakers need to balance various consequences." What were the legal consequences you were balancing in the case of Bear Stearns?**

Hoyt: The considerations I will be mentioning here applied to everything we did to fight the crisis. In the government, the executive branch has limits on what it can do. Most important of these limits is in spending the government's money. If the executive branch spends money without Congress's approval, it will be committing a crime. We were at the same time trying to be creative to fight the crisis — trying to avoid a disastrous situation but still respect the law. There were some ideas that, from the legal perspective, we had to say "no."

The biggest consideration was that we had to respect the letter and spirit of the law and, at the same time, avoid a severe situation with massive consequences. The challenge was how to advise policymakers so they could use to maximum extent the powers they had to fight the crisis without going out of bounds.

YPFS: **What were the legal considerations in regard to the conservatorship of Fannie Mae and Freddie Mac? How were they different?**

Hoyt: There was a more direct involvement of the government in the conservatorship of Fannie Mae and Freddie Mac. In the summer of 2008, the Congress amended the legal regime for Fannie Mae and Freddie Mac. It amended what both Fannie Mae and Freddie Mac could and could not do, as well as what the government could do with them. There was nothing like this in the cases of Bear Stearns, Lehman Brothers, or American International Group (AIG.)

What was different was that the government had specific authority to intervene with Fannie Mae and Freddie Mac. The Congress had in mind that things could go badly so they amended the legal regime governing the government-sponsored enterprises (GSEs) such that the government could, if it needed to, get involved.

The Bush administration, for many years, had been urging Congress to amend the regulatory regime that governed Fannie Mae and Freddie Mac, but was

not successful. Finally, in the summer of 2008, the Congress gave the authority for the government to get involved.

YPFS: **The Treasury and the Federal Reserve collaborated closely for the conservatorship of the GSEs. How was this collaboration?**

Hoyt: In my view, the Treasury, the Federal Reserve Board in Washington D.C. and the Federal Reserve Bank of New York, which was headed then by Tim Geithner, worked very well together. There was an extremely close collaboration between the entities and their leaders. The partnership demonstrated by Bernanke, Paulson, and Geithner throughout the crisis was extraordinary. While working together we generated ideas, tested each other; there was extraordinary collaboration. The OCC, FDIC, SEC, CFTC and the National Economic Council at the White House added to this collaboration.

I personally collaborated with Scott Alvarez at the Federal Reserve Board in D.C. and Tom Baxter, who was the general counsel of the Federal Reserve Bank of New York. We worked closely together; we were all trying to get the best results.

YPFS: **What were the legal considerations for the reforms of Fannie Mae and Freddie Mac?**

Hoyt: The new law that was enacted concerning Fannie Mae and Freddie Mac gave the authority to the government for conservatorship or receivership of these institutions. Our considerations were which one to choose and then, how to structure the intervention. If the government took a certain percentage of ownership in Fannie and Freddie, how much could it take? If it took too much, would they be considered government agencies? We also had to consider the impact on private shareholders. Lastly, what would happen if Fannie and Freddie did not agree to the terms of our support? In the end they agreed, but we had to also consider what would happen if they did not.

We had to consider how it would work to take a controlling interest in two privately owned entities that had a part private, part public role. It later became the subject of a legal challenge in a lawsuit on behalf of the shareholders. This was because one consequence of the conservatorship of the GSEs was that the stockholders' investment became virtually worthless.

YPFS: **In a 2018 book, *The Fed and the Lehman Brothers: Setting the Record Straight on a Financial Disaster*, Professor Laurence Ball argues that Lehman had ample collateral to justify a U.S. government loan that would have staved off bankruptcy, which comes as contrary to statements that such a bailout would be illegal. How would you answer to this viewpoint?**

Hoyt: This was more of a financial issue than a legal one. There is this term "run on the bank," where investors or people that fund the banks lose confidence and the failure of a bank becomes a self-fulfilling prophecy. In the cases of Bear Stearns and Lehman Brothers, people did not lend money to them even overnight, and customers did not do business with them because they were afraid these banks would go bankrupt. A simple government loan would not have cured their issues; they just did not have enough capital. In the case of Bear Stearns, J.P. Morgan bought them and backed them, absorbing the losses. We provided a loan for this transaction. Just a loan to Lehman Brothers would not have worked.

YPFS: What were the legal considerations for the AIG bailout?

Hoyt: It was similar to the case of Fannie Mae and Freddie Mac because of the ownership position that the government took. AIG did not have a capital problem but a liquidity one. Its problem was timing as opposed to capital. Once we decided to support it, the question became how to support it fairly and how to protect the taxpayers. Going over the threshold of government ownership would have meant that different laws would apply.

Once it was decided, it was done by the same way as a corporate transaction would be done, the terms of the transaction were negotiated as if it was a big corporate buyout. It is unusual for the federal government to play that role. No one had ever done this before. So, we used and collaborated with lawyers from Wall Street firms (Wachtell Lipton), advisors at investment banks, and lawyers from Fannie and Freddie, all of whom were knowledgeable about commercial deals. The government cannot accept gifts of service so we paid them a fraction of what they would have otherwise be charging. It was very impressive to have professionals of this caliber stepping in to help out.

YPFS: Why was article 13(3) of the Federal Reserve Act invoked for AIG?

Hoyt: Article 13(3) of the Federal Reserve Act was invoked for Bear Stearns, AIG, and a number of the rescues. This article gave the Federal Reserve the authority to make extraordinary loans. Until the (Troubled Asset Relief Program) TARP was approved, section 13(3) was the main vehicle used. We figured out a way to use 13(3) effectively to fight the crisis.

We then questioned if using section 13(3) was sustainable and decided that we could not continue using it. Another factor was the amount of public money used for what were seen as bailouts. We questioned how long we could go on without an act of Congress. We decided we needed the Congress's blessing to authorize our use of this money. This was a significant factor to go to the Congress to pass the TARP.

The TARP was in the amount of $700 billion. The idea of the executive branch of the government committing this much money without approval from the

Congress did not seem in the spirit of the Constitution. Furthermore, this was all happening in the midst of a presidential campaign and the idea of bailouts was controversial. It was not ideal from a political perspective to continue with section 13(3) without approval from Congress.

The first time the TARP came to congressional vote, it was rejected, and the stock market plummeted. This came as a wakeup call for the Congress. The day that the vote failed to pass was probably the most stressful day of the whole crisis for me.

YPFS: **Were you worried about a moral hazard problem occurring in any of the bailouts or the TARP?**

Hoyt: We, of course, wanted to avoid the moral hazard problem. When you look at Bear Stearns, Lehman Brothers, AIG, and Fannie and Freddie, their stockholder value was wiped out, their executive teams were replaced, and their CEOs were fired. Part of the reason why we did it was because we did not want banks to think bailout was desirable. By replacing the executive team and with the stockholder value going to zero, we made sure that banks did not want a bailout unless they truly needed it. We thought about this issue quite a bit and did our best to avoid it.

YPFS: **What were the legal considerations in the auto industry bailout process? How was Ford's case different?**

Hoyt: The auto industry was a very different animal. General Motors and Chrysler were going to bankruptcy, Ford was not. The source of their problems was not the financial crisis. However, the auto industry was so concentrated that if one, let alone two, of the biggest players would go bankrupt, then their suppliers would also go bankrupt. Then Ford, which was not in financial trouble, would also go bankrupt because it would not be able to find suppliers.

Auto companies were bailed out before the Global Financial Crisis, so there was precedent for it. Could we use TARP for that? Legally, yes, we could, because TARP was so broadly drafted that it gave authority to the government to bailout the auto industry. Then the question was: Should we?

We asked the Congress for authority specifically for the auto industry bailout. Auto workers are unionized and their unions historically favor Democrats, so this had the potential to become a partisan issue, which we did not want. Although a majority of Congress appeared to favour the bailout, the legislation failed to clear procedural hurdles.

At that point, President Obama had won the election, and we felt that the right thing to do, with the blessing of the Bush administrations, was to ask the new administration what they wanted to do. We could not get a definitive

answer from the Obama transition team. Because a bankruptcy cannot be reversed, we decided to provide temporary relief to last until the new administration got into office. Then they would have the option to bailout the auto industry or not. Otherwise, their hands would have been tied. I think this is an example of how well our democracy works.

YPFS: In retrospect, knowing what you know today, would any of your legal advice be any different?

Hoyt: No, but this is not to say that we did things perfectly. I am proud of the fact that, and I am sure Tom Baxter and Scott Alvarez would share this view, of all the actions we took, they were either not challenged or the challenges were unsuccessful. We were able to find ways for the government to do what it needed to do to fight the crisis within the boundaries of law.

As an example, during the considerations for the Bear Stearns bailout, my team got together over the weekend and thought about ways we could meet one of the demands that had been made. We could not find any. I called Secretary Paulson on Sunday and told him we cannot find a legal way to meet this particular demand. He replied, "This is terrible news because I was just on the phone with the President and told him it was done." Nevertheless, he respected the advice, and we went back to the drawing board with the other parties and found another way to proceed. This is a concrete example of how the actions we took were taken with complete respect for the law. So, I think the legal advice has withstood the test of time.

YPFS: Can the government put up laws that will prevent such a crisis or laws that will make controlling or fighting such a crisis easier?

Hoyt: In terms of preventing, I would say no, the government cannot put up laws to prevent crises. However, in terms of fighting them, yes, the government can do that. However, in the aftermath of the crisis, the Congress did the opposite. Rather than make new laws to make fighting or containing a crisis easier, they took away the tools that had worked in this last crisis.

They amended Section 13(3) of the Federal Reserve Act in a way that it will make it harder to use in the way we did. The law creating the Exchange Stabilization Fund was amended in a way that the government can no longer use it as it did during the crisis. The Systemic Risk Exception — an important provision of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which we used as a tool — was also amended.

And so, the Congress, in the aftermath of the crisis, took away the tools that had worked and did not replace them with new tools. They did approve reforms intended to make another crisis less likely. But if there is another financial crisis, whoever is in my seat will have a much more difficult time because there will be fewer tools available.

Suggested Citation Form: Hoyt, Robert, 2019. "Lessons Learned Interview." Interview by Yasemin Esmen. Yale Program on Financial Stability Lessons Learned Oral History Project. November 25, 2019. Transcript. https://ypfs.som.yale.edu/library/ypfs-lesson-learned-oral-history-project-interview-robert-hoyt

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