Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Neel Kashkari[1] U.S. Department of Treasury Interim Assistant Secretary of the Treasury for Financial Stability (October 2008 - May 2009)
Interviewer Name	Yasemin Esmen (Contractor) Yale Program on Financial Stability
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<u>Introduction</u>:

The Yale Program on Financial Stability (YPFS) contacted Neel Kashkari by email to request an interview regarding Mr. Kashkari's time as interim Assistant Secretary of the Treasury for Financial Stability from October 2008 to May 2009.[2]

During the Global Financial Crisis, Mr. Kashkari oversaw the architecture and administration of the Troubled Asset Relief Program (TARP.) He recruited professionals for the program and chaired the five-member investment committee within Treasury that decided which banks would receive TARP money. Kashkari remained in the position after the change in administration to ensure smooth transition of the program to the Obama administration.

Mr. Kashkari is currently the president of the Federal Bank of Minneapolis, a role he assumed in 2016.

Before serving as interim Assistant Secretary of the Treasury for Financial Stability, Kashkari was Assistant Secretary for International Economics and Development at the Treasury Department.

Mr. Kashkari is a graduate of University of Illinois, Urbana Champaign and University of Pennsylvania.

[*This transcript of a phone interview has been edited for accuracy and clarity.*]

<u>Transcript</u>

[1] The opinions expressed during this interview are those of Mr. Kashkari, 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. Kashkari is available here in the Yale Program on Financial Stability's *Journal of Financial Crises*.

YPFS: **How was the number $700 billion reached for TARP? I read somewhere that your first proposal was for a much higher $1 trillion, but then you modified it and reached $700 billion by taking 5% of the $14 trillion setting of US mortgages. Is that correct?**

Kashkari: It is. It was ultimately a political calculation that the Treasury Secretary [Hank Paulson] made. The crisis was much worse than we had appreciated and we did not know how many resources we needed to stabilize the situation. So, we wanted as much authority as we could get from Congress and it was a political judgment on how much we thought we could get. If we thought we could have gotten a trillion, then I think we would have asked for a trillion. However, Secretary Paulson did not think that was possible so he decided on $700 billion. One way we tried to justify the $700 billion number was that it was 5% of the $14 trillion mortgage market: 11 trillion in residential and 3 trillion in commercial [mortgage debts.]

YPFS: **Do you think it would have been made your work easier if it was higher, around $1 trillion?**

Kashkari: No, because, at the end, we ended up not needing to spend the full $700 billion. So, we had more resources than we needed. We did not know that when we were at the point of negotiating the TARP with Congress and, in fact, during the worst times of the crisis, we thought we would use all the $700 billion and have to go back for more. At the end, 700 billion proved to be enough but that was not clear when we were negotiating.

YPFS: **My second question is whether there were concerns about administrative architecture of TARP, especially as it related to enforcing annual capital reports and the strength of board members appointed by the Treasury.**

Kashkari: Well, administrative architecture of TARP can mean a lot of different things. A lot of my job was building the team and the operations to actually run the TARP to implement our programs and to make sure that they had the right controls around them and that they could be executed quickly. I do not think there were particular concerns.

Kashkari: One of the big design concerns we had was that if we made it too onerous for banks, then they would not use the assistance. It is like making medicine taste good for children so they'll take it. However, there were many political pressures to make it very onerous. Well, if we created a very onerous program, then the banks would not use the facilities and the financial system would collapse. So, there was a constant struggle about how onerous to make it. Also, how attractive do you make it? At the end of the day, our first priority was stabilizing the financial system and preventing a financial collapse. We erred on the side of designing our programs so that banks would use it and we could stabilize the system. I think that was effective.

YPFS: **What were the challenges in TARP's implementation and how were they overcome?**

Kashkari: [The biggest challenge] was building a huge program in the middle of the financial crisis. So, in six months or so I hired, I do not remember [the exact number], 130 people from across the government, from the private sector, from the nonprofit sector… Just building all of that… Then we also had a presidential transition, so, we knew that we had to hand off this program to the new administration. I ended up staying on for several months until we basically got through the worst of the crisis. So, hiring was a big focus. Hiring people with experience working in government and in the private sector, and we also worked very hard to hire completely nonpartisan [professionals.] I was the only political appointee in the whole TARP [U.S. Department of the Treasury's] Office of Financial Stability. Everybody else was a nonpolitical permanent appointee so that we could hand the new administration of fully functioning people. That was done by design and it worked very well.

YPFS: **I imagine it must've been difficult to find people who had experience in such a crisis.**

Kashkari: A lot of people were volunteering. A lot of people said this was the time of national crisis and that they wanted to come and serve. However, when you actually explained to them what the challenge of working conditions were, the sacrifices they had to make, a lot of people said, "Okay, maybe not." However, we still had really talented people to choose from and we needed a mix of skills: people from within the government who do want to get stuff done in government, but people who also had experience in financial markets. So, we ended up building a very good team that worked well together. However, speed was the key, and every day that went by, the crisis got worse. So, we were hiring and designing our programs and implementing our programs all at the same time.

YPFS: **How was the decision as to which banks would receive TARP made?**

Kashkari: We did a capital program; we put out a set of a term sheets, basically. Any bank in America could apply. They needed a recommendation from their primary federal regulator that they deemed this bank was a viable ongoing institution. We did not want to put money into failing institutions, but if the primary regulator said, "No, this is effectively a healthy bank," then we had an investment committee in the Office of Financial Stability that reviewed their application, reviewed the recommendations from the regulator, and then we made the decision as to whether or not to make the investment. Ultimately, I made the call. However, our investment committee made a recommendation, and based on the investment committee's recommendation, which included the regulators' views as well as the data that the applicants were submitting, we made the decision.

YPFS: **They had to give annual capital reports. Was it difficult to enforce this?**

Kashkari: Not that I am aware of, but I was gone by the time year-end reports would be coming in because I left by May of 2009. So, I do not know if that was a challenge or not. While I was there, we did not put any board members on these banks' boards because they were not at that point missing any dividend payments. So, those might be better asked to somebody else.

YPFS: **I listened to, and also read, the 2016 Brookings Institute speech that you gave. You said that the Dodd Frank did not go far enough. What did it miss? Where did it fall short?**

Kashkari: It did not raise the capital requirements nearly high enough. Lots of economic analyses have been done by the Minneapolis Fed and others that say the biggest banks do not have enough capital of their own to withstand a major downturn and, if there is another major downturn and maybe we are facing it now, that they will have to be bailed out again. So, the banks are stronger than they were, Dodd Frank did do some good, but it did not go far enough. They need to make sure banks could actually cover their own losses and protect the taxpayers.

YPFS: **Also during the same speech, you said that bolder, more transformative measures are needed. One of the measures was breaking up the large banks, the too big to fail. In December 2017 your bank came up with a plan to end too big to fail. Now, it is almost two and a half years later. Is too big to fail still a systemic risk and if yes, what can we do?**

Kashkari: Well, the challenge is political. We know what to do: The answer is to substantially increase the capital requirements so that banks have enough buffer so that, if they have big losses, they can absorb those losses and not risk collapsing and then need a bailout. However, the political challenge is that there are banks that have very powerful lobbyists in Washington and they fund a lot of political campaigns. So, getting elected leaders to say, "Hey, let's really address this issue," has been challenging. It is a political problem more than it is an economic problem or a policy problem. We know what to do. The challenge is finding the political will to do it.

YPFS: **Do you think it can be done?**

Kashkari: Well, not at the moment, but we will see. Sometimes things change, circumstances change and all of a sudden political sentiment shifts. So, we will see.

YPFS: I think you also answered my next question as to what the arguments and concerns regarding such transformational measures are and how they can be overcome…

Kashkari: The banks will argue that if you raised their capital requirements to levels that I am suggesting, they will no longer be competitive and that the U.S. economy will be somehow at a disadvantage if other countries do not do the same thing for their banks. My answer is simply: Well, if other countries want to take huge risks with their financial systems, then let them do that. That does not mean we need to do that. By the way, the biggest banks in America that do have more capital than European banks are outcompeting the European banks. Therefore, capital has not been a competitive disadvantage; it has probably been a competitive advantage. So, their arguments collapse when anybody looks at them carefully.

YPFS: In retrospect, now that we are 10 years along the line, or even more, and we are facing another crisis almost, were the measures taken back then effective? Would you now advise to do something differently or anything differently?

Kashkari: Well, two things... Number one, we were always slow and timid in our response to the crisis and that was because we did not know how bad it was going to get, and we did not want to overreact. When the downside is a devastating recession, as we saw in 2009, what we could be facing now, the right answer is, in fact, overreact. I think we have learned that lesson and, in turn, that is moving much more aggressively today than it did 10 years ago. The second thing is we were very targeted in our responses, especially around housing and helping homeowners avoid foreclosures. Our response was targeted because many Americans were angry--thinking that maybe their neighbor had been irresponsible and were wondering why their neighbor should have their mortgage forgiven. So, we tried to help homeowners who only needed a little bit of help.

Kashkari: By making it targeted, it really narrowed how effective the program was and it slowed it down. That, in hindsight, was a mistake. What I have learned is that, when you need to do these bailouts, it is much better to be generous and not worry about bailing out people who do not deserve it because, overall, the economy will be helped if you are more generous with assistance. We tried to be very targeted and I think that was a mistake. We, Michael Barr, myself, Phillip Swagel, Andreas Lehnert, wrote about this in the Yale paper on housing. We specifically addressed this point that we were much too narrow, in both the Bush and Obama administrations. If we had been much more generous, that would have been the right policy call.

YPFS: Are there any other lessons that we can draw from the last crisis?

Kashkari: I think those are the most important two.

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