



## Lessons Learned Oral History Project Interview

<b>Interviewee Name and Crisis Position</b>	Scott G. Alvarez, <sup>1</sup> Esq. Former General Counsel to the Board of Governors of the US Federal Reserve System
<b>Interviewer Name</b>	Steven Kelly Yale Program on Financial Stability
<b>Date of Interview</b>	April 14, 2022
<b>Lessons Learned No.</b>	2022-09

### Introduction:

The Yale Program on Financial Stability (YPFS) interviewed Scott Alvarez, who is a former General Counsel at the Federal Reserve Board of Governors.<sup>2</sup> Alvarez began working at the Federal Reserve Board in 1981 and became the Board's General Counsel in 2004. Throughout his career at the Federal Reserve Board of Governors, Alvarez experienced working on the rescue of Continental Illinois, the savings and loan crisis of the late 1980s, and the 2007-2009 Global Financial Crisis. Alvarez retired from the Federal Reserve Board of Governors in 2017.

In this interview, Alvarez discusses several legal issues related to the Fed's interventions under its emergency liquidity provision authority, Section 13(3) of the Federal Reserve Act. The transcript from an earlier Lessons Learned interview, which occurred in December 2018 and largely focuses on the rescue of American International Group (AIG) and other GFC issues can be [accessed here](#).

*This transcript of a telephone interview has been edited for accuracy and clarity.*

### Transcript:

**YPFS:** I just want to start generally with the invocation of Section 13(3) [of the Federal Reserve Act], the communication of it. When the Fed announces a facility that has invoked Section 13(3), it doesn't typically walk through why. And I know there were some instances in the Global Financial Crisis where the press releases didn't even mention 13(3), but, even in the term sheets, it doesn't say, "we're invoking section 13(3) because, you know, we want to buy corporate bonds or we want to lend to a new type of counterparty . . ."

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<sup>1</sup> The opinions expressed during this interview are those of Mr. Alvarez, and not those of any institutions for which the interview subject is affiliated.

<sup>2</sup> A stylized summary of the key observations and insights gleaned from this interview with Mr. Alvarez is available in the Yale program on Financial Stability's *Journal of Financial Crises*.

**Is there a specific reason for that? Is that for expediency? Is it because there's just not worth it? There's a myriad of reasons?**

Alvarez: Oh, so there is always a resolution that the Board approves that explains, "We're doing this facility, it has these features, and we're invoking 13(3)." So, there is an official document that has all that. After that, it depended very much on who was preparing the documents. If the public affairs people were doing it, they may or may not put it in the press release. When a Reserve Bank was outlining the general terms, they may or may not include it in their outline document. It really didn't matter from that perspective, as long as we had the official Board resolution that made that clear.

**YPFS: So, the Board resolution, that's a confidential document?**

Alvarez: I would think by now they might they should be public. They're resolutions the Board voted on and those have to be made public, so you should be able to get those.

**YPFS: Okay. Because I know Dodd-Frank required that the Board minutes from that period be released. And we have Board votes for 2020, but I don't know, without a law passing . . .**

Alvarez: Oh, no. The Freedom of Information Act required that all matters voted on by the Board be made public. You know, they can take out confidential information, but we usually didn't take out that it was 13(3). That wasn't needed to take out. But the documents that are publicly released are really short. You know, it's like, "Staff explained this facility that would do that," or, "we were exercising our 13(3) authority and the vote was this, that, or the other," whoever voted for it or against it.

**YPFS: I know the minutes from the GFC, they say exactly what you just said, and they don't say they "invoke Section 13(3) specifically to lend to a broader set specifically to buy this asset that they can't normally buy." So, you expect that's always going to be the case that it's not explicitly laid out in those terms?**

Alvarez: Yeah. It's not going to have the deep legal memo that explains all this stuff. We would have one of those, but that was [protected by] attorney-client privilege; that was not made public. Though, as you know, from the memo you surfaced and sent to me, some of those memos were released in litigation.

**YPFS: Yeah. We have one from the FCIC and then two from litigation which were actually also submitted by the Fed to the congressional record alongside a semiannual monetary policy report.**

Alvarez: Right.

**YPFS:** We'll come up on those in a few minutes. So, just related to the Reserve Bank being involved in the facilities, can you talk a little bit about that process, about a Reserve Bank's role in the design of the facility, bringing it to the Board, the Board has to vote, but then sometimes there are changes that come back to the Board. Sometimes there are changes that don't go to the Board.

**Can you talk a little bit about that and when a facility change has to go back to the Board, when the Reserve Bank can do it by itself, et cetera?**

Alvarez: Yeah. So, the facilities were run by the Reserve Banks, but they weren't necessarily originated by the Reserve Banks. What would usually happen was we would be watching the markets. Let's talk about the broad-based facilities, and we can talk about the individual ones separately. But, for the broad-based facilities, we were watching the markets, watching what was going on; economists at the Board and economists at the Reserve Banks were paying attention to that on a moment-by-moment basis.

And so when it looked like there was a market that was becoming illiquid, jamming up, freezing for one reason or another, the interest rates were getting out of whack or the transactions were becoming just too few, generally what would happen was somebody at the Board would raise a concern—[former Vice Chair of the Fed] Don Kohn was in charge of a lot of the coordination. And Don would have these regular meetings with staff. And we would brainstorm about various things. And then a person or a group of people would be sent off to develop a facility. And they would be in touch with the Reserve Bank people, and there'd be reserve people and Board staff on the same group. And we would be talking by phone and emails to try to figure out what would be a sensible approach and what we could actually operationally do.

We couldn't do these things without the Reserve Bank's operational capabilities. But it would not be correct to say that the Reserve Banks came up with facilities and then they sent them to the Board and the Board approved them. They were developed by the staff of the system, Board and Reserve Banks working very closely together.

**YPFS:** At that point, has a specific regional bank been picked already? Is it obvious which bank is going to do the facility?

Alvarez: So, yes and no. [Regarding] the one that was done by Boston: New York was really becoming pretty swamped. And the Boston folks actually volunteered to do any facility they could capably do. And so, with that in mind when we started working on the mutual fund facility, the AMLF, that had a lot of firms in the Boston district. So, it seemed like a natural thing, and Boston was very enthusiastic about helping out. So, that's how they got involved. It wasn't so

much that we sat down and said, "okay, let's go pick another Reserve Bank." It was very organic.

I can't emphasize that enough: everything that was going on was really very organic. It was happening in the moment. Everybody was paying attention to a lot of things. And as we saw stuff that needed attention, groups got hived off to pay attention to that, to work on those things. In fact, there was no playbook. This really was just responding to what was going on in the markets at the time. It was very fluid.

**YPFS:** **Sure. And then just back to the question of when a change was made to a facility, there are certain occasions where there is a Board vote, typically like a rate decrease or increase something major. How is that decided, when it has to go to the Board?**

Alvarez: That would be a combination of things. Staff would get a sense of how important or major the change was. Because a lot of times when we presented these things to the Board, we would present it in a way that was explained broadly what was going on in addition to the details.

And so, we would have a sense of what the Board members thought about the broader idea and what they were concerned about. So, that would be one indicator of when we would bring things to the Board. Also, we would run things by Don Kohn and the chair: How important do they think these things are?

There was a lot of walking around the halls to get a sense of what the governors thought and keeping them up to speed, just briefing them on things. And you'd get a sense of, "Well, do they care enough about this?" If somebody objects, let's get everybody together and talk it through. If everybody says, "this is fine," then you just move forward. Because time was of the essence on a lot of these things. You know, it was very dynamic in that respect.

**YPFS:** **Yeah. That's great. I know you weren't there specifically for any 13(3) facilities that showed up post-Dodd-Frank, but presumably all the situations where you would go to the Board for a vote would now also include the Treasury secretary, correct?**

Alvarez: Yep.

**YPFS:** **And I assume that would sort of be part of the same process where you're in discussion with the Treasury secretary, you have a sense for what they like or don't like, and if there's conflict, would you say your characterization of the Board would apply also to the Treasury or would it be a different process?**

Alvarez: I think nowadays is a little different than when we were doing it in 2007-2009. Back in 2007–2009, the secretary of the Treasury wasn't required to approve things, but we were running things by the Treasury staff. And [Fed Chair] Ben [Bernanke] and [Treasury Secretary] Hank [Paulson] were in daily communication about everything. So, we had a really good sense of where the Treasury was. Sometimes, we got really helpful suggestions from them. And if the Secretary was against something, that got people to think about it, but it never happened that we were in disagreement back in 2007–2009 about what to do.

Sometimes Treasury was more supportive than [other times] because they had their priorities under TARP, and they had to be careful about how they used the TARP money. But we were consulting, and we were in lockstep. In 2020, in the pandemic, I think it was a little bit different. In the pandemic, they had to get the approval of the Secretary. So, that gave the Secretary actual leverage. My reading from the outside is that there were probably some terms that were changed to suit the Secretary, and there may have been a facility or two that was done in a different way because of the Secretary's preferences. That's not a bad thing because the Secretary was providing money, and so he should have a say. But it was a little looser back in 2007–2009.

**YPFS: Sort of zooming out a little bit, you and others have written quite a bit on this sort of definition of “secured to the satisfaction” [of the lending Reserve Bank]. [Former New York Fed President and Treasury Secretary Geithner and Chair Bernanke have also said basically what you guys have said—that the legal standard is: you have to reasonably expect repayment of any discounting done [under the authority]. I was curious if it's fair to say that that's a floor on the legal standard and that “secured to the satisfaction” really is a discretionary issue because it is sort of- it comes up with Lehman a little bit where you have a lot of folks saying, “If the institution's not going to survive, we don't think this is appropriate use of the authority.” That is a little different. Is that a situation where the repayment [legal standard] is sort of a floor and the “satisfaction of the Fed” sort of can be built on top of that floor? Or is that a mischaracterization?**

Alvarez: No. I think I would put it in a slightly different way. I do agree, to start, that “secured to satisfaction” is a kind of floor. And we can talk about what the floor actually is in a second. But I would go back one step more: even if there is a lot of security, the Fed has no obligation to lend under 13(3). It's totally discretionary. And the Fed could decide it's just not going to lend to someone. Indeed, during 2007–2009, we were inundated with requests from people to borrow from the Fed, and they were pledging everything you can imagine. And the Fed said all but a few handfuls of times, “no, we're not gonna do it.” And it was largely because the Fed thought that a lot of the borrowers were not systemically important. They could be allowed to fail. They likely would've

failed. And some of them did. And the Fed was just, “the economy will have to take that.” That is just the way it is. It's only in the unusual and exigent circumstance, and then the belief that there will be some systemic shock that got the Fed to do lending. So, in that sense, security is the second step.

The question always is: how much security do you need to be satisfied? Does it have to be 100% or 110%? Can it be 90% of the value of the loan? That is an area of the discretion. And that's where the judgment, the principle that we applied was, “Do we feel that we have a reasonable belief that we're going to get repaid given the collateral or the endorsement that we have on the loan?”

**YPFS: Endorsement including recourse to a balance sheet or the strength of the borrower.**

Alvarez: Yeah. Or like in the CPFF and in some of the facilities backed by the secretary with TARP funds, do we have enough? We may not have 100% collateral, but we have an extra pool of funds, or we have the promise of the secretary to donate a certain amount of money to take up losses. Those are like endorsements against loss.

**YPFS: Sure. Relatedly, Dodd-Frank added to Section 13(3) that, in addition to the Fed being secured to its satisfaction, the security had to be sufficient to “protect taxpayers from losses.” Do you think this meaningfully changed the standard of security for Fed emergency interventions? In *First Responders*, you wrote with co-authors that the added language codified what was already existing practice for 13(3). So, did it raise the bar on security? Or just write down what was already the Fed’s operating interpretation of the law?**

Alvarez: In my view, this addition would not have meaningfully changed the way the Fed approached using section 13(3) during the 2007–09 financial crisis. At that time, the Fed was very aware that we were trying to mitigate the financial crisis using taxpayer money—any losses the Fed experienced on its emergency lending would have been borne by the taxpayer through reduced Fed earnings needed to cover those losses. And, as I mentioned earlier, we viewed the requirement already in section 13(3) that an emergency discount be endorsed or otherwise secured to the Reserve Bank’s satisfaction as requiring a reasonable expectation that the Fed would be repaid. So, we were already taking the amount of security we thought we needed to ensure that the taxpayer was protected. What I think that change in the Dodd-Frank Act did do, though, is respond to those who criticized the Fed for not lending to Lehman—or to any other IPC [individual, partnership, or corporation] where the Fed very likely would have taken losses. The change made it clear that Congress intended the Fed to approach 13(3) lending with the same approach to security we did in 2007–09.

**YPFS:** Let's keep moving in that direction then and talk about the assets in general. I guess we can sort of back up and talk about this memo ("Bear Stearns Memo").<sup>3</sup> You talk about the term "discount" and the sort of broad interpretation that the Board has given to the term "discount": that it can be a loan or purchase. Can you speak a little more to that and this word "discount" and how it's been used?

Alvarez: Sure. So, the way discount when the Fed first got this authority to do discounts, it actually was in the original Federal Reserve Act in 1913, but it was in a way different form. But the word "discount" was used throughout the original Federal Reserve Act. And then it was used again in 13(3) in 1932.

But what "discount" meant back then was: there would be a note, like I would lend money to you, and you would write me a document that said, "I agree to pay Alvarez back." And then that note could be sold to somebody else, and it was sold at a discount, and that's where we got the term "discount."

But the note was sold. So, my obligation is still to repay the note, but instead of repaying it to you, I repay it to whoever holds the note.

The key was that there had to be some kind of note, some kind of loan documentation. In 1932, that's how the Fed thought about it. And then 13(3) comes along, and the Fed makes a very important decision in 1932. And that's that there really is no difference between me writing a note and selling it to you for a discount and me just giving you a note directly. But the legal term is "discount" for one and "advance" for the other.

So, the two of them, the Fed treated right from the beginning under 13(3) as exactly the same thing. And that was a very helpful thing for us because discounts are done on securities all the time, and repos are a kind of discount, but they're documented as a purchase and sale transaction. Discounts in the old-fashioned sense aren't really done as much now as they were back then.

**YPFS:** I want to follow up on that "discount" versus "advance" and them sort of being interpreted the same way. So, in 1991, we have the Federal Deposit Insurance Corporation Improvement Act (FDICIA), and it contains this small amendment to Section 13(3)—which had previously included a sort of rider on the type of collateral. Like it says now, it said the Fed may discount for basically anyone, [but it stipulated that it had to be] against

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<sup>3</sup> Alvarez, Scott G., Richard M. Ashton, Mark Van Der Weide, and Heatherun S. Allison. "The authority of the Federal Reserve to provide an extension of credit in connection with the acquisition by JPMorgan Chase of Bear Stearns." April 2, 2008. <https://ypfs.som.yale.edu/library/legal-memorandum-board-governors-re-authority-federal-reserve>

**collateral *eligible for discount elsewhere under this Act*. And the FDICIA drops that language.**

**And there's an accompanying note from the Senate Banking Committee that says, effectively, "we dropped this language because we saw 1987 and the volatility there. We want the Fed to be able to lend against stocks and bonds, to securities houses."<sup>4</sup>**

**So, my question is why—and maybe this is just Congress covering themselves—but, if "discount" and "advance" are the same thing, why do you need to drop that language?**

Alvarez: Okay. So, this is like deep, legal kind of stuff. Okay. So, it doesn't surprise me that nobody else even understands any of this. But the original 13(3) was, as you said, notes of the type the Federal Reserve could discount elsewhere. Well, if you go back and you read the rest of Section 13, it's 13, like, [subsections] 7, 8, and 9, and those other numbers you'll find that there's two constraints on the Reserve Bank discounting directly, and with another bank, with a member bank. And it can only discount paper that is involved in a commercial, industrial, or agricultural transaction. And it cannot be to finance the purchase and sale of securities, okay. That's called the real bills doctrine. So, in 1991, in response to the '87 crisis, by taking that phrase out, what that meant was they could discount any kind of note including one directly given by a brokerage firm. Brokerage firms were considered not to be engaged in commerce, industry, or agriculture. They were engaged in speculation as far as Congress was concerned. And, of course, there was the ban in those other provisions that said, "and you can't do it for the purposes of speculation." So, by saying those provisions no longer apply, the Fed was freed to make an advance or a discount to anybody that was an IPC.

**YPFS: Right. So, the question is: because the discount window already exists and the discount window says "make advances" and the "make advances" clause has no collateral constraints specified in Section 10B on the**

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<sup>4</sup> The report reads, in part: "The Federal Reserve Act specifically provides that notes, drafts or bills covering investments in or issued for the purpose of trading in stocks, bonds or other investment securities may not be used for discount advances.

[. . .]

Stocks bonds and investment securities not eligible for discount are the greatest share of the assets of the nation's securities firms. Because these assets are not eligible for discount, the Federal Reserve is limited in its ability to make discount advances to securities firms in emergency situations. . .

Title XI therefore amends the Federal Reserve Act to allow stocks, bonds and other securities to be used for discount advances by borrowers other than member banks. This clarifies that access to liquidity in special circumstances can be made available directly to a securities dealer to help preserve market liquidity and avoid market disruption." U.S. Senate. "Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991- Report of the Committee on Banking, Housing and Urban Affairs" (pp. 202-03). <https://ypfs.som.yale.edu/node/3932>



**discount window—other than that the Reserve Bank must be secured to its satisfaction.**

Alvarez: Right. Remember now you're talking about lending to banks, advances to banks. That's right.

**YPFS: Right. So, my question is: the old language on Section 13(3) that said, "collateral elsewhere specified," given that advances and discount are the same thing, that specific provision [Section 10B] would've only limited the term of the lending.**

Alvarez: Oh yeah. That's right. So, 10B. So, all these other kinds of real bills doctrine provisions—which is much of the rest of Section 13—became useless once 10B was enacted. Because it used to be, before 1932, the Fed could only lend to a member bank against these real bills. Then 10B comes along and says, "okay, no, you can do advances against any kind of collateral if it's to a member bank." So then, everything happened under 10B, not so much under 13(8) or 13(9), or any of those other 13s. But it still was part of 13(3). 13(3) still made that tie. So, it was important to break the tie [via the FDICIA changes] in lending under 13(3), because that wasn't to member banks, that was to IPCs generally.

**YPFS: So, it was just really to clarify—**

Alvarez: Oh, it was a big change. We could not have lent to a securities firm like Bear Stearns if there had not been that change in 1991, because 10B only allows us to lend to member banks. It makes advances to member banks, not to securities firms.

**YPFS: Right. So, I'm just going to drill down on this a little bit further. Okay, the Board has consistently interpreted "make advances" and "discount" as the same.**

Alvarez: Right.

**YPFS: So, you have Section 10B which says you can advance on anything you want—**

Alvarez: To a member bank.

**YPFS: Right, to a member bank. Yep. And you have Section 13(3), which says you can advance to anyone you want against anything eligible for discount elsewhere in the act.**

Alvarez: Anything eligible for discount.

**YPFS: Right.**

Alvarez: So, it's not, you're not referring back to 10B. Those references are now to other parts of 13.

**YPFS: Okay. So, that's my question: so even though we're saying "discount" and "advance" are the same, we're not allowing that in this case?**

Alvarez: Oh, no, no. It's not that we're not allowing it. It's, okay. There's a little confusion here. The "discount" and "advance" as a legal matter are the same, but the reference in 13(3) prior to 1991 was to a specific type of collateral. It wasn't that advance or discount was the same. It says you could, you could do a discount of a note so long as it was secured by the same kind of collateral, the same type of note that a Reserve Bank could discount. It was making a specific reference to the other parts of Section 13. It wasn't, and we couldn't have read that to somehow include 10B and free us up from the collateral requirement.

**YPFS: That's what I wanted to clarify.**

Alvarez: Yeah. No, that's a really interesting question, but legally, we were tied into [Section] 13.

**YPFS: Okay, great. Because yeah, the other thing that comes up—and I guess I don't have a question attached to this—but in the Dodd-Frank amendments, in the new Section 13(3), which is much longer, sometimes it says "loan," sometimes it says "loan or other financial assistance," "collateral against lending"—it's kind of all over the map. I assume that's just the drafting process?**

Alvarez: Yeah. And, as you can imagine, that section wasn't drafted with the help of the Federal Reserve. So, we couldn't make it consistent [laughs].

**YPFS: Okay. Yeah. That's helpful. We'll sort of transition here to the SPV question. You wrote the Bear Stearns memo in 2008, in which you sort of evaluate the first time using an SPV to lend for the Maiden Lane facility; you evaluate the legality on a sort of a look-through basis: as if the Fed was discounting directly.**

**But, for some reason, there's this myth that has come about—and it's been repeated in various congressional reports, books, and articles—that the Fed creates an SPV so it can purchase assets. It lends to an SPV and then purchases the assets.**

**As I said, you evaluated on a look-through basis, and we just talked about discount being the same whether it's a loan or purchase. So, can you talk a little bit about the SPVs? If you have any thoughts on where that sort-of myth cropped up, that would be interesting too. But also, just kind of talk about the use of the SPV, particularly in the broad-based cases. There's less on the record about why SPVs are used in the broad-based facilities.**

Alvarez: So, I think the myth just comes up because it's easier for people to think that way and they don't have to worry much about the fineries of the law.

I also think it doesn't matter anymore because the authority [to design assistance for an individual firm] has been taken away, right. So, there's two ways we evaluated the SPVs, and I think they're both actually explained in the memo that you have. One is thinking about it as just a convenience vehicle where the loan is really—like let's take the Bear Stearns and JPMorgan situation. The loan is really a loan to JPMorgan secured by this pool of assets that they've gotten from Bear Stearns. It's a nonrecourse loan against those assets.

**YPFS: You're talking about the Thursday night loan, right?**

Alvarez: I'm talking about the loan after Thursday night, the Maiden Lane I loan that we made after JP agreed to buy Bear Stearns. The Thursday night loan, that was a pretty straightforward loan against collateral kind of situation.

**YPFS: Right, so I didn't think JPMorgan had any [debt] obligation in that, in Maiden Lane.**

Alvarez: So, let's, let's think about this. There's two ways to think about the Maiden Lane I loan. And it becomes important when we get to AIG. The Maiden Lane I loan originally was going to be a loan directly to JPMorgan secured by assets. And there was going to be assets owned by JPMorgan. All the Bear Stearns loan assets would be owned by JP. So, there was no question that this was a loan to JP to help JP do the transaction. Okay. So, they didn't want the assets on their balance sheet. We wanted to have a little more control and transparency. So, that's why the SPV was set up. But the original thought process was, this is really a loan to JP. The worry we had was setting up the SPV at that point was, "Well, the Fed had the paperwork done on the SPV; the Fed was going to be one of the managing partners. Was that going to open us to the argument that this was a subsidiary of the Federal Reserve Bank of New York? And so [the Federal Reserve Bank of] New York was lending to itself." That's not an argument you want to have to worry about. So, JPMorgan put in what we considered to be the equity of that vehicle—a billion dollars, real serious money. And it was going to take the first set of losses. So, that was a serious injection, very much like a JPMorgan subsidiary. But the accountants, when they looked at that, they said, "Well, you lawyers can think of that as a subsidiary of JPMorgan; we don't know if it's a subsidiary of anybody. We don't know, but we're going to say JPMorgan doesn't have to report those assets, and the Fed does." So, that's fine. We didn't care much about the accounting. We didn't like it much. But we were okay with it. But the idea was still: it is a loan in substance to JPMorgan against these particular assets that are JPMorgan assets.

The second way to look at it, and we note this in the memo too, is that like 99% of the assets going into that Maiden Lane vehicle, were notes of some sort or another—either loans, or mortgage-backed securities or something like that. So, we could look at that as the Fed discounting those notes.

There were small amounts of derivatives, which we had a harder time saying were notes. Though, you could make an argument, but it was really a harder argument. But since it was a small amount, we argued that you could look at that as just under our incidental authorities to take things related to the underlying assets.

But the point is that in either one of those justifications, you're thinking about the SPV as part of the Federal Reserve. The Federal Reserve is either discounting notes, or it is lending to something that is a convenient way to lend to JPMorgan against certain assets. That became really important in AIG because there were two AIG facilities.

Both of those were designed in the same way with the same logic: that AIG has to put in a big slug of money that is equivalent to equity. And it's going to take the first loss on all of that, just like shareholders of a corporation would take the first loss. And so, in that way, we are thinking of that not as the Fed lending to the Fed, but the Fed lending really to AIG through this vehicle.

It's easy to think of the SPV as the recipient of the loan and that the Fed is using 13(3) to lend to the SPV. But if you follow that logic, you get to two bad places. One is the Fed lending to the Fed, which is a bad place to be. And the second is then the SPV can hold anything, including real estate, including equity securities, you know that kind of stuff—stock of different companies.

And the Fed never wanted to be in the position of saying it was buying stock through the SPV. So, I know it's sort of nerdy, but that was the way we were thinking about it at the time. And that's why I've been consistently saying that we didn't use an SPV so we would have somebody to lend to; we were lending to whoever it was on the other side of that SPV.

**YPFS:** **I do want to come back to the eligible assets in a second. But what would you say the benefit is in the broader-based case of (1) still using the SPV, even when you don't have sort of a single [borrowing] entity? [In that case], it is more akin to a discount window that's opened broadly. And (2) making separate SPVs for each facility as opposed to sort of pooling them all into one?**

**Alvarez:** So, in the broad-based facilities, it's a lot easier because the Fed is discounting notes in every one of those broad-based facilities. It wasn't taking stock; it wasn't taking real estate. Everything has been a note of one sort or another. Commercial paper is a note. The mortgage-backed securities that they've been taking, they could do that probably under Section 14 if they needed to.

All the facilities—the credit card receivables, the small business loans, the PPP [Paycheck Protection Program] loans . . . everything there is a note. So, you could say in those situations, if you needed to, the SPV is the Federal Reserve. It's just a separate form of the Federal Reserve. And we are doing what we could do which is discount notes for individuals, partnerships, and corporations in a broad-based facility. That makes it easier. The tricky part was with the JP and AIG facilities.

The idea of doing multiple rather than one is really that it is easier than having just one SPV for all the facilities and having it be monstrous. It is easier to keep track of things, to have separate vehicles for each broad-based facility. You have different staff working on different ones. You have different conditions for the lending, different durations and maturities, different reporting, and you want to cleanly report and audit each one. You don't want to have any kind of confusion about where money belongs. The Treasury offers different amounts of support for different facilities.

Then there's this corporate separation thing that lawyers like to worry about where, suppose one facility loses money and another facility makes money. And you have to go after somebody. If they challenge one facility, that doesn't damage—or it doesn't represent a challenge against any other facility. They're sealed off from each other [in the case of separate SPVs]. Profits of one facility don't go to pay off losses in another facility. The government, in the end, takes all of those together. But as a corporate legal matter, you don't have to worry about fighting off different people who want access to different levels of profit.

So, there are a lot of [reasons]; maybe they're all around the edges and none of them so critical. But all together, they just made life easier and simpler and more convenient for everybody to have different facilities.

**YPFS:** **Sure. Yeah. Actually, as you're describing that—in 2008, the TALF has an injection from the Treasury, the CPFF equity layer is actually [from the] private sector. So, that certainly could have been an issue of who's going after what, in the pooling of losses or gains.**

Alvarez: Right.

**YPFS:** **That's helpful. Alright, so let's talk about “notes, drafts, and bills of exchange” and what that language in 13(3) is inclusive of. And I'll let you speak broadly. And I guess the lens that I'm thinking about in asking is that we've sort of prefaced this all with this idea that “discounting” can be a purchase, or it can be a loan.**

**And we have [seen] these loans that have gone against everything, gone against equity, have gone against derivatives. So, is “notes, drafts, and bills of exchange” inclusive of all financial assets?**

Alvarez: Yeah. So, it doesn't include all financial assets, because that would include, for example, equity securities. And the Fed could not purchase or discount equity securities, I think, using the 13(3) authority. To be a note, it has to be an obligation of somebody to repay a set amount at a timing that the parties agree to: Money is given to them, and they have to repay that money. So, there's a lot of ways to document a note, and bills of exchange and drafts are actually two ways of documenting notes. An advance is another way to document a note. But it's all credit transactions. And there, the Fed has been pretty liberal in the kind of paperwork that it's willing to take, but it has to be some kind of credit transaction. A person gets money, and they're obligated to repay that full amount plus some interest or something related, some maybe even fees, but at least some interest.

**YPFS: So, equity securities could serve as collateral because you have the note that underlies it.**

Alvarez: Correct.

**YPFS: The SPV to go out and buy equities is—**

Alvarez: Couldn't do it.

**YPFS: Couldn't do it?**

Alvarez: Yeah.

**YPFS: All right. That's helpful. You mentioned real estate. So, you're saying real assets or anything like that is all—**

Alvarez: Those can serve as collateral, but they are not a note or a draft or a bill of exchange. Yeah. And see that's why it doesn't turn out I think to be that big of an obstacle because someone who needs money can always provide a note and then provide these real assets or securities or other financial assets as collateral for repayment of the loan.

**YPFS: Yeah. So, and then just thinking about a more broad-based facility, Section 13(3) would be inclusive of something that goes out and buys notes on the open market, like the Fed did with the corporate bond facility in 2020. But going out and buying equities—because there's no maturity, because there's no obligation to repay underlying it—would be out of the “notes, drafts, and bills of exchange” definition.**

Alvarez: Right.

**YPFS: Okay. Great. All right. Well let's—**

Alvarez: So, Steven, I want to say one thing, I'm not saying necessarily that these are good ideas [laughs].

**YPFS: Yeah, no, no of course.**

Alvarez: I just, it's just what the law, what we thought the law meant.

**YPFS: Right. No. Yep. We're not prescribing anything today for sure. I want to go back to your comment about using derivatives as collateral. Can you talk about that a little bit more?**

Alvarez: So, I don't really have a lot to say about that. Derivatives are crazy instruments, right? You got a collateral side to a derivative, which could be really helpful, but collateral changes all the time, depending on where the credit is. So, they are difficult things to value. And difficult to know when you're, over the long term, how it's going to work out, so . . .

**YPFS: Yeah, there's a draft memo<sup>5</sup> that was submitted to the congressional record regarding AIG about taking warrants. And it's mostly about the authority of the Fed to do so. But there is a bit in there where it does say that the warrants may help [the Fed] become secured to [its] satisfaction. So, it seems like there is some ability for it to count as some value.**

Alvarez: Oh yeah, some value. But if it's only warrants, you gotta question how much value would be there. And the issue with warrants by the way was not a 13(3) issue at all.

**YPFS: Right. Yeah. Most of the memo was about just the authority of the Fed to do so. But there was that bit in there about it adding to the security.**

Alvarez: Yeah.

**YPFS: Alright. So, I want to shift gears a little bit, and I want to talk about Regulation A.**

**So, there's a couple mentions in 2008 in some memos that have been released publicly about the Fed's discretion around Regulation A. Regulation A sort of represents one authority. And there's a couple notes in the Board minutes where it says a Reserve Bank has recommended not following Regulation A strictly, they want to use a different interest rate or something like that.**

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<sup>5</sup> Alvarez, Scott, Mark Richard Ashton, and Mark Van Der Weide. Memo to Vice Chairman Kohn. "Draft: Authority of a Reserve Bank to take warrants in connection with an extension of credit under section 13(3)." September 17, 2008. <https://ypfs.som.yale.edu/library/draft-authority-reserve-bank-warrants-connection-extension-credit-under-section-133>

**Can you talk about that discretion a little bit, as well as the process for when an exemption from Regulation A is given, or sort of how Regulation A was considered when designing the facilities?**

Alvarez: Regulation A was an authorization to the Reserve Banks to lend given certain circumstances. And there's conditions there, and some of the conditions were beyond what the law required. But that was the way the Fed was feeling about discount window and other kinds of loans at the time it wrote Reg A. But I never viewed Reg A as the complete explanation and limitation on the Fed statutory authority. When Reg A was written, the Fed wasn't trying to define the outside limits of section 13(3) lending authority. It was simply laying out one way to implement 13(3): A Reserve Bank can lend if authorized by the Federal Reserve Board subject to conditions imposed by the Federal Reserve Board under Reg A. So, Reg A represented one specific authorization. And if it met those requirements, the Reserve Bank was free to provide liquidity.

But what we were confronting during the financial crisis was a need for lending far beyond what Reg A had authorized, what Reg A contemplated. When Reg A was written, they didn't know that they would need broad-based facilities or other kinds of stuff. And so, the question was: Can the Fed do that without amending Reg A?

And it seemed pretty clear and simple to me that it could, as long as the Board did the authorization in accordance with section 13(3). And so, the Reserve Banks were free to ask the Board for authority to lend under different conditions than Reg A had authorized. And the Board obviously did that.

All the broad-based lending facilities are outside of what Reg A authorized, because nobody had thought of that when they wrote Reg A. And it's a little different kind of regulation than some others—like the bank regulatory stuff the Fed imposes on banks, where it says, “you can only do the following.” Reg A did not say, “Reserve Bank, you may only do lending in this way.” It said, “you are authorized to do lending if these requirements are met.” And then we gave them separate authorizations during the crisis.

**YPFS: And Reg A, it authorizes lending if certain conditions are met, which still involves a Board vote.**

Alvarez: Yeah, yeah. But the Reserve Banks knew that under Reg A, if they had good reasonable documentation that met all those conditions, they would likely get an approval from the Board.

**YPFS: Okay. And so as long as the Reg A exception was—I assume it would be highlighted to the Board: “FYI you're voting on something that is outside of Reg A”? Or not necessarily?**



Alvarez: Nope. We didn't bother with that at all. We started right at the beginning, saying Reg A is just one way that lending is authorized. The Board has authority to authorize lending any way it wants under 13(3). And then from then on, we just presented the different options to the Board. We didn't compare it to Reg A or mention that it was separate from Reg A. It just didn't seem necessary.

**YPFS: So, Reg A wasn't like a starting point where you said "here we have a Reg A compliant facility and a Reg A non-compliant facility" or anything like that?**

Alvarez: No. No. We just said you have a 13(3)-compliant facility or loan, so we went right to the statute there.

**YPFS: Sure. And so, because it's not like bank regulation, in the way you described, that's why there's no, like when there's a bank regulation exception, there's a press release: "FYI, banks, for the next year, you don't have to comply exactly with this regulation." There's no press release associated with Reg A.**

Alvarez: Because of the way Reg A was written. If Reg A had been written as "the Reserve Banks may only lend using this authority,"—which is the way most bank regulation is done; you know, "you must abide by the following things"—if it had been written that way, we might have had a different problem, but it wasn't. It was written as, "you are authorized to lend if you meet these following conditions," and then we could authorize them to lend in other conditions.

**YPFS: Sure. And then I guess this is kind of a narrow question but in those minutes from the crisis era, for example, it'll say like, "the Federal Reserve Bank of New York recommended using this interest rate."**

Alvarez: So, interest rates have to be recommended by the Reserve Bank under [Section] 14(d). And then the Board acts on it, and the Board can change the interest rate as it deems fit. But all interest rates always start at the Reserve Bank.

**YPFS: Sure. Okay, great. And then if we could talk about ring-fence agreements, just briefly. So, I know obviously the individual assistance is no longer within the statutory authority of 13(3), but I just want to talk about the use and interpretation of 13(3) in these instances because obviously bits of it are still relevant. So, in the ring-fence agreements, there's tons of collateral. There's several [loss] layers that can be drilled into before the Fed ever has to do anything. And the Fed ended up not extending any credit under these agreements. But, in the event all these layers get drilled through and the Fed has to do an extension of credit, I have two questions on that. One is that the actual extension of credit in theory**

**could've happened after “unusual and exigent circumstances” had expired? Because the terms [of the ring-fence agreements] were for many years.**

Alvarez: But at the time we weren't sure how long things would last. Plus, we were afraid Citi—there was always the potential that Citi could collapse within the few months after the ring-fencing agreement.

**YPFS: So, okay. So, I guess, is the interpretation then that, “okay, if the Fed has to lend under these, we're going to be in unusual and exigent circumstances”?**

Alvarez: Yeah. Things are going to be pretty bad. Yeah. Precisely because of what you just said about how many layers they have to go through. Think about what the world would've been like if they had gone through them.

**YPFS: The other piece I wanted to get your thoughts on is: Say the layers have been drilled through. So, at the moment that the Fed is extending the loan, the collateral, which is non-recourse with the exception of the interest payments has been impaired down to the value or less of the Fed loan.**

Alvarez: But we did have some recourse. Remember, we took a 90-10 share of losses thereafter.

**YPFS: So, between the interest payments and the 10%, the security was satisfactory?**

Alvarez: Yeah.

**YPFS: Okay. That was all the questions I had on that.**

Alvarez: But there were two other things we were thinking about as far as collateral was concerned then. One is that by then the losses, the collateral value would've been so distilled down, it was hard to imagine at that point that the collateral would not be sufficient to get us repaid. And if it did, then the whole world will have collapsed.

There are so many layers of losses on those assets; we expected we would be repaid. Then the second thing was that we also thought that we could, if there was a chance that there was some loss, we could perhaps temper the loss by holding the assets long enough for them to come back in value. And there was at least a reasonable chance of that. So, we had those two advantages. One, the distillation, and the second was holding, as the central bank, holding them for a long period of time and letting them see if they came back.

The other thing that's worth noting is that we were behind the FDIC, and the FDIC's Sheila Bair had an analysis done. And her economist thought there was no chance the FDIC would lose money. So, we are sitting behind the FDIC. So, we figured there was also very, very little chance that our loan would be actually called on—because the FDIC was very confident that it could cover everything and be repaid, which would mean there weren't any losses for us to finance.

**YPFS:** **Sure. All right. Well, Scott, do you have anything else before we wrap, anything else you want to put on the record or any lingering thoughts on any other questions?**

Alvarez: One thing I think is really key, and I'm sure you guys are talking about it, is the law makes a big difference in what the government can do in response, and the constraints we were under really shaped the response that we gave. And the Lehman Brothers situation, for example, there's nobody that wanted it to happen like it did. But, in the end, we just didn't feel we could take the losses that would be associated with that, given the authority that we had. And so, I hope that when folks read through the material, they understand not so much, "oh those lawyers were too stodgy, and they didn't give their decision-makers enough flexibility." I hope they come away with the idea that, look, it does matter what you write down in the statute! Make it a useful statute that's going to allow the government to respond in a way that is helpful. Otherwise, you do have calamities that occur and there is nothing that you can do about them, and, as a decision maker, you're just sort of left to watch, and that's painful. Painful for consumers, painful for the economy, not just painful for the decision-maker, but painful for the people we're trying to protect by having this authority.

**YPFS:** **Very good. I think we can wrap it there.**

Alvarez: Okay. Lot of fun for me. Take care.

Alvarez, Scott, 2022. "Lessons Learned Interview." Interview by Steven Kelly. Yale Program on Financial Stability Lessons Learned Oral History Project. April 14, 2022. Transcript. <https://ypfs.som.yale.edu/library/ypfs-lesson-learned-oral-history-project-interview-scott-alvarez-2>

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