



Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Lewis “Lee” Sachs ¹ Counselor to Secretary of Treasury and Head of Obama Administration's Financial Crisis Response Team (2009-2010), U.S. Department of Treasury
Interviewer Name	Yasemin Esmen (Contractor) Yale Program on Financial Stability
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Introduction:

The Yale Program on Financial Stability (YPFS) contacted Mr. Lewis “Lee” Sachs by email to request an interview regarding Mr. Sachs’s time as Counselor to the Secretary of Treasury and Head of Obama Administration’s Financial Crisis Response Team.²

During the Global Financial Crisis, Mr. Sachs lead the development and coordination of the Obama administration’s Financial Stability Plan in an effort to stabilize the financial system. He was tasked with continued coordination with the outgoing Bush administration as well as putting together a team to develop plans further and their execution.

Mr. Sachs is Co-Founder and Managing Partner of private investment firm Gallatin Point Capital. Prior to founding GPC, Mr. Sachs was co-founder and chairman of Alliance Partners, an asset management and advisory firm, where he served as CEO until 2015 and Chairman of the Board until 2017.

Before serving at the Treasury, Mr. Sachs was a Partner and Chairman of the investment committee at Mariner Investment Group. He also served as the CEO of Cornerstone Asset Management and as Vice Chairman of Perseus LLC, a merchant bank and private equity fund management firm.

During the Clinton Administration, Mr. Sachs was Assistant Secretary of the Treasury for Financial Markets. Until 1998, Mr. Sachs was a Senior Managing Director, Head of Global Capital Markets and a member of the Board of Directors of the Bear, Stearns Companies Inc. Mr. Sachs is Chairman of the Board of Trustees and a graduate of Denison University.

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

Transcript

¹ The opinions expressed during this interview are those of Mr. Sachs, 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. Sachs is available in the Yale Program on Financial Stability’s *Journal of Financial Crises*.

YPFS: My first question is very general. For the record, could you please elaborate on your role in fighting the global financial crisis?

Sachs: Sure. I was counselor to Treasury Secretary [Timothy] Geithner and head of the Financial Crisis Response Team for the Obama administration. I started right after the election in November of 2008 and we began by doing three things. One, developing the architecture for the Obama administration's Financial Stability Plan. Two, we began coordinating with the Fed and other regulators and with the Bush administration and their team. Thirdly, we started putting a team together to develop the plans further and executing those plans. Because, as you know, on January 20th, the administration changes over and you have to, pretty much, start from scratch with a new team.

Treasury is not set up like the Defense Department where you have standing armies who are prepared to fight wars and defend the country when necessary. The Treasury Department is not set up to do that. We did not have standing armies of people with expertise in fighting financial crises. So, it was those three things: Put the team together, begin to develop the plans for how we were going to respond, and coordinate with the outgoing administration as well as the other agencies. Treasury played the coordinating role with the Fed [Federal Reserve], the FDIC, the comptroller et cetera. So, it was a busy time.

YPFS: You were one of the major players in the team during that transition from the Bush administration to the Obama administration. This was not at a usual time but was at the peak of a very major financial crisis. How was the transition? What were the concerns and the challenges that you had? And how did you overcome them?

Sachs: The concerns, first and foremost, were that the economy was falling off a cliff, that we were losing eight or nine hundred thousand jobs a month, that the markets were tumbling, that people were losing their homes, that businesses were being forced to shut down. Every month that went by millions and millions more people were being affected. So, everything we did, every plan we put together, every step we took, was designed to break that negative feedback loop, with all those things negatively impacting the others. We had to develop detailed plans and start to rebuild confidence in the markets, the financial system, et cetera, very quickly.

Doing all of that and coordinating with the outgoing administration was vital. It was challenging just because events were moving so quickly. I would say that the outgoing team, [74th Secretary of the Treasury] Hank Paulson and his team in particular, were incredibly easy to work with. Hank started reaching

out even before the election to try and make sure that there was going to be as much coordination as was possible. Continuity was important, we did not want to make too many abrupt U-turns.

We thought that a lot of what they were doing was absolutely necessary and it helped that Tim was part of the team as head of the NY Fed. He was part of the team that was involved in the initial steps to stem the crisis. So, we coordinated as closely as we could with the Bush Treasury. They were very open; they kept us informed of everything that they were doing. You never want to have a financial crisis; you certainly do not want to have one during transition between administrations. However, if you are going to have to have one, and you are going to have to have one during a transition, it is much better to have it when the outgoing administration is as skilled, open, easy to work with [as the Paulson Treasury], and I think they deserve a lot of credit for that.

Also, coordinating with the other agencies, the Fed, FDIC, comptrollers' office, was also complicated. Of course, they were all going to be staying on and had been involved up to the time we got there, and then they were going to continue. That was largely a pretty smooth process. Each organization, of course, had their own issues that they had to think about, but also, more importantly, recognized that the only way we were going to be able to break the fever of the crisis was for each of the organizations to work together.

YPFS: About the GSEs, Fannie Mae and Freddie Mac... Their conservatorship was designed as a temporary measure, however, a decade later, they are still there. In hindsight, would you have designed the conservatorship differently to avoid having them still there, and, if yes, how would you have designed it?

Sachs: The initial conservatorship was put in place prior to our arrival and so I am not sure I have much to add to that question. It is, obviously, unfortunate that they are still [in conservatorship,] that the GSEs are still wards of the state. I do not think anyone who was involved at that stage thought that 10 years later we would be in this situation. This is not directly in response to your question about what could have been done differently, but it seems like the politics have lined up and conspired against fixing the GSEs in that there is no real political constituency to fix them. While they are in their current state (mortgage credit is flowing, it is cheap, it is working for markets, it is working for housing, it is working for homeowners, et cetera,) there is no real impetus to fix them, which is too bad because, at the end of the day, they have to be fixed.

YPFS: Do you think they will run into trouble in the future?

Sachs: Hard to say. Certainly, it is possible.

YPFS: You already kind of touched upon it, but how important was attaining market confidence to solving the crisis and how did you attain it?

Sachs: We used to say that confidence is the cheapest form of stimulus. And it is true. Confidence was central to everything that we were doing because, without confidence, credit does not flow, markets do not function, businesses are weak. So, everything we were doing was designed to rebuild confidence in the system, institutions, markets, and the economy as a whole. Nothing succeeds without confidence.

In terms of how we attained it... It was a combination of programs. Everything that the administration did in terms of economic policy in those first 18 months contributed to reestablishing confidence. It meant you had to reestablish confidence in the institutions themselves, in markets, in housing. So, if you look at the programs we put in place, each one was designed to work in conjunction with the others to rebuild confidence.

For example, the world lost confidence in financial institutions, and so people (investors, counterparties, creditors) were pulling their money out and this was contributing to the downward spiral in the markets and credit. The other reason there was no confidence in them, was because they were opaque. Investors, depositors, savers, counterparties, shareholders, bond holders, governments, who were involved with them, did not know what the underlying assets looked like. While markets were deteriorating, counterparties, who did not know what was behind the curtain at Bank X, started running from Bank X. Then Bank X had to start selling assets that were on their balance sheet, which put further downward pressure on the value of those assets, which, in turn, caused Bank Y to potentially look weaker. As this happened at institution after institution, the downward pressure on assets caused the cost of borrowing to increase or, in many cases, become unavailable.

What we did was put together several programs, the most prominent of which were the stress tests that were designed to show the world what was in these banks and what they would look like in the most severe economic scenarios. We simultaneously said to the banks, in this case, that they would have to raise enough capital so that, even in those most severe economic scenarios, they would have enough capital to be able to not only survive, but to go on lending.

While we put in place the stress test, we simultaneously put in place a capital backstop. This meant that we told the banks we were going to put them through these stress tests and at the end the test results will show how much capital, if any, they needed to raise. Then they would have a period of time where they could go out and try to raise it privately. We felt quite strongly that the system as a whole is better off when banks are held in private hands

as opposed to government hands. However, we set a backstop because we did not know how much capital would be necessary and we did not know if the markets would be prepared to provide that capital. We said that if, at the end of, I think it was six months, the banks were unsuccessful in raising that capital privately, the government would stand in and buy what was necessary. We set that at a fixed price on the date of the announcement to prevent a further downward spiral.

YPFS: **The stress test was, as you said, one of the earliest programs that you started. Were you ever concerned that the results might be so bad, that these banks are so under-capitalized, that it might result in a run from those banks?**

Sachs: That the stress test would cause a run?

YPFS: **Yes.**

Sachs: Yes, and that is why we put in place the capital backstop. We said basically, we would not let them fail, that we would buy the equity if necessary.

YPFS: **In the case that the private sector would not be willing to provide the capital, the government would be giving the capital to the banks. Were you ever concerned that there could be a moral hazard problem there?**

Sachs: Yes, we were. You always have to worry about moral hazard. I will say that when you are losing eight or nine hundred thousand jobs a month and the economy is collapsing, you do everything you can to put out the fire. You also do everything you can to minimize the moral hazard, but it is a second order issue. Having said that, the equity holders of the institutions that got into the most trouble, lost a tremendous amount through the process. If you look at the largest financial institutions going into the crisis, a big portion of those do not exist in the same form that they existed going into the crisis.

If you were a shareholder of say, (American International Group) AIG, Fannie and Freddie, Lehman Brothers, Bear Stearns, etc., these lost almost all of the value of their investment. In terms of moral hazard, if the main concern of moral hazard is that institutions and investors will be less careful in the future because they think the government will be there to save them, I am not sure you would feel that way if you were a shareholder of those institutions. I think where we may have exacerbated a moral hazard issue is for senior creditors of these institutions. However, for equity holders and others further down the capital structure, I am not sure it (moral hazard) got much worse because of what we did.

YPFS: **In a 2012 interview with Frontline you said that "it would be best to act sooner and with great force in the face of a crisis, but it is difficult to do so". Could you please elaborate on that?**

Sachs: I really do believe that that is the case. Many of the steps you have to take to address a financial crisis are deeply unpopular. No one likes to see the government taking steps to "bail out a bank" (we do not think we bailed them out but that is what the world believed.) Yet, those steps often have to be taken in order to put out the fire. The longer you wait, the deeper the crisis gets, the more expensive it becomes, the more people lose their jobs, the more homeowners lose their homes, the more businesses have to lay off workers and close their doors, so the harder it becomes to turn that around.

The problem is, because the steps you have to take are so unpopular, it is harder to take them until the pain has gotten so bad that the world says, "You have to do something to stop this. It is just too painful." The longer these crises go on, the louder that gets, and then, frankly, the easier it is to do the things that are necessary.

We have a real-life example. The TARP legislation was absolutely necessary to give government the tools it needed to deal with the crisis. It failed the first time it went up for a vote because it was so unpopular. Well, then the markets cratered even further, and the panic got so great that Congress came back and passed the legislation. That is probably the clearest example of what I am referring to there. It would have been better to have acted earlier, but really hard to do so.

YPFS: There has been some criticism on this: Were your efforts aimed at saving the economy as a whole, Main Street along with it, or just saving Wall Street?

Sachs: It is a question we get asked all the time. If we could have figured out, if anyone could have figured out, how to stop the economy from imploding, how to stop losing eight or nine hundred thousand jobs a month, how to stop people from losing their homes, how to prevent the markets and credit from drying up, and how to stop businesses from shutting their doors, laying off their workers because they cannot get credit... If we could have figured out ways to do that without saving the financial system and the institutions that make up that system, we would have done it.

Everything we did was viewed through the lens of how to stop losing eight hundred thousand jobs a month, how to stop the economy from declining at an eight, or nine, or 10 percent annual rate. This was the most effective, cheapest way to do it. To this day I have not seen any ideas or proposals, even with the benefit of time and 20-20 hindsight, that would have allowed us to achieve those goals, without reestablishing confidence in the system and the institutions that make it up at the time. If we could have, we would have.

YPFS: You were responding to a crisis that was burning down the house, and it was happening quite fast. I assume that some of the measures were just aimed at “stopping the bleeding” at that moment, and some of them were aimed at “curing the patient” at a later date. Was there a balance between the two of them? How did they work together? Looking back at it in hindsight, would you say that some of the measures taken worked better than others on the long run? If so, would you have done anything differently?

Sachs: There are two separate questions there. One, about what were we doing to save the patient and what were we doing to try and ensure the patient did better going forward. All the steps around the financial stability plan itself were first and foremost designed to save the patient. However, by making sure the institutions were well-capitalized with plenty of liquidity, the intent there did serve two masters: It saved the patient, and then it also went a long way to making sure that those institutions would be in a good position to lend going forward. In fact, if you look at what did happen subsequently and compare it to the experience in other countries, which were not necessarily as aggressive, our institutions and the flow of credit, and our recovery, happened much more quickly than elsewhere. So, the steps we took were, in the first instance, designed to save the patient and were also to make sure that the patient did well later.

The other part of that is what was done on the regulatory front with respect to things like Dodd-Frank... Those were not designed to have an effect in the moment but were designed to have a more robust regulatory framework going forward.

YPFS: It is difficult to assess where the next crisis will come from, we keep hearing that, but you sort of did, actually... You have been calling for clearing houses for derivatives since 1999 and in an April 2000 speech at the House Committee on Banking and Financial Services, you said that, with an updated regulatory and legal framework, we can reduce systemic risk, enhance competitiveness, and increase retail customer protection in the OTC derivatives market. How did you see the shortcomings? What were the signs?

Sachs: What I was referring to there, with respect to clearing of derivatives, I felt quite strongly about at the time. I still do. If you look at where the problems did and did not develop in our financial system, one of the things that we did not worry too much about were the clearing systems, the clearing houses. There was a momentary scare around one of them, but those largely operated as you would hope in a crisis. If one of the things that the world was afraid of was opacity, or lack of transparency, not knowing where exposures lay, clearing systems actually did quite well.

You wanted to know what, say, Citi Group's exposure was to listed and cleared instruments, you knew where to call, you knew what to look for. For derivatives that were not cleared, and other instruments that were not cleared, no one knew. It added to the problem. Therefore, clearing houses, while not perfect by any stretch, increase transparency, they reduce the gross exposures, and you know who the counterparties are. So, clearing houses can be extremely powerful in terms of helping financial institutions, investors, government officials, executives, et cetera, know where the exposures lie.

YPFS: **You mentioned that the world is afraid of opacity because we do not know where the weaknesses are when something is opaque. So, when we are looking for weaknesses [in the system,] should we look for where the opacity is?**

Sachs: Yes, you should. It is not the only thing of course, because even with more instruments cleared, there is still going to be opacity. However, I think wherever there is opacity, opacity creates uncertainty. Uncertainty reduces confidence and with less confidence you have weaker markets, less credit, less business activity, so again it comes back to confidence.

YPFS: **You also said that opacity was not the only thing we should be looking at. What else should we be watching out for?**

Sachs: Although I do not think it is a problem today, you always need to keep an eye on things like capital and liquidity at the large institutions. Those are always first and foremost. What else would I be worried about today? Anything can lead to volatility in markets and the economy. Today everyone is focused on a virus (Coronavirus – COVID19) that started in China. Whether it is that or a terrorist event, a cyber-attack, or a natural catastrophe, anything can start a panic. I think what we have been talking about the last few minutes is what are the things that can accelerate a panic? Further, where do investors, counterparties, et cetera, run from when there is a panic and what do they run to when there is a panic?

They tend to run from things they do not understand. They tend to run from things that are, like I said, opaque. They tend to run towards things that are safe and liquid. Financial institutions, going into 2008, were under-capitalized with insufficient liquidity and were almost completely opaque. We have made them more transparent; we have made sure they have more capital and more liquidity. So, I do not know what is going to kick off the next crisis, but hopefully the financial system will be in better shape going into it than it was going into 2007, 2008.

One of the things that really concerns me is in the cyber realm. If you think about what we have been talking about the last few minutes, the things that

accelerate a crisis are fear, uncertainty, opacity. In a cyber-attack, you may not know what has happened to your counterparty, you may not know what has happened to Citi, or Bank of America, or pick your institution. They may not know themselves. So, while we have more capital and more liquidity today, the wrong kind of attack could either be impetus for a panic or could also be an accelerant.

YPFS: Are we better off at preventing or fighting a crisis if it happens?

Sachs: I think we are better off in some ways and worse off in others. Again, the financial system is much better capitalized today and has much more liquidity today than it did before. So, in that sense we are substantially better off. However, some of the tools that we had to fight the last crisis are diminished or were taken away. We will have another crisis, there is very little we can be certain about, but that is something we can be certain about. What tools do you have available to fight that crisis? Unfortunately, some of those tools were taken away by congress. So, the system is better in some ways and yet the fire department is weaker in other ways.

YPFS: What should we do to make it stronger?

Sachs: If you were king or queen, I could make some suggestions... But in today's political environment I think it would be deeply challenging to provide more of those tools to the Fed and others to address the next crisis but those were taken away.

YPFS: Do you think that in a time of crisis, just as before, they will be able to be used again?

Sachs: Some, but others will not. The Fed's authorities were curtailed in ways that I think could make life harder the next time there is a crisis. I think, again, you would have to have some legislation passed in the moment to give them back some of those authorities. Also, you would have to make funds available to the Treasury as was done the last time.

YPFS: Is the Dodd-Frank Act effective?

Sachs: Is it effective? The broad answer is that I think the vast majority of it is effective, and then there are some provisions which made some of the tools that were used in the last crisis less effective. Therefore, it helped in many regards, I think it is overall positive. However, in some ways it made some of the tools that we need less effective.

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