

# The New York Times

## Six Years Later, We're Still Litigating the Bailouts. Here's What We Know.



*The electronic ticker at the Bank of America Branch in New York carried grim tidings about A.I.G. and Lehman Brothers on September 15, 2008*

Neil Irwin: OCT. 3, 2014

When Wall Street imploded in the fall of 2008, a few things were apparent at the time: that the economic consequences would be dire; that the financial industry was in need of major reform; that the impact of the crisis would be wide-ranging.

But here's what was not at all apparent, or at least not to me as a reporter covering it all: that six years later, we would still be litigating, metaphorically and literally, who was at fault and what ought to be done to create a stronger financial system.

Were the policy makers who led the fight against the crisis — principally the Federal Reserve chairman Ben Bernanke, Treasury Secretary Hank Paulson and the New York Fed chief, Timothy Geithner — heroes who rescued the global economy through creativity and bravado? Were they stooges of Wall Street who funneled hundreds of billions of taxpayer dollars to the financial

industry? Did they wield power with a vindictive, arbitrary approach that left them picking winners and losers? Should the policy makers have been stingier? More generous? More consistent?

With the economy still not fully recovered from the recession brought on by that crisis, those arguments can seem as raw and relevant today as they were in 2008.

This week, A.I.G. shareholders went to court to argue that the Federal Reserve's bailout of the company was an illegal taking of private property; the three chief engineers of the bailout are to testify next week.

Meanwhile, my colleagues James B. Stewart and Peter Eavis reported that, contrary to the longstanding contention of the officials involved, the Lehman Brothers bankruptcy, which set off the most intense phase of the crisis, might not have been inevitable. Some analysts at the New York Fed, they wrote, concluded that fateful weekend in September 2008 that Lehman might have been solvent and a plausible candidate for a bailout.

And in a less prominent story, a court tossed out claims by shareholders of Fannie Mae and Freddie Mac, the two housing finance firms taken over by the government a week before the Lehman bankruptcy. Investors in the companies said the government shouldn't be able to hoard their now-huge profits.

The events of the fall of 2008 and the factors that led to them have been rehashed in numerous books and scrutinized by the Financial Crisis Inquiry Commission. But after all these years, America remains deeply conflicted about what our government did on our behalf.

How should the new legal proceedings and press reports shape our perception of this crucial time? Here are some key questions, and my best guesses at the answers based on my years of reporting and my reading of a range of journalistic accounts, memoirs of those involved, and internal documents released through litigation.

**Could the government have saved Lehman Brothers?** Mr. Geithner and the others involved have long claimed they had no legal tools to rescue Lehman Brothers and prevent its bankruptcy filing because the company was insolvent (with financial obligations greater than its assets).

The provision of the Federal Reserve Act that the Fed used to bail out Bear Stearns and A.I.G. allowed it to make loans against good collateral, not to give money to a financial institution willy-nilly. And indeed some later analysis, including one by William R. Cline and Joseph E. Gagnon, has tended to confirm that Lehman was insolvent, not just temporarily short of cash.

Does the latest reporting by my colleagues change that view? It does. Inside the New York Fed there were teams who concluded that Lehman was narrowly solvent, and thus potentially eligible for a bailout. (Interestingly, Mr. Geithner pretty much acknowledged the accuracy of the recent Times report in his memoir, writing, "Even some of my former colleagues at the Fed and Treasury still think we could have rescued Lehman.")

Here's an attempt to reconcile these seemingly contradictory versions:

By the weekend of Sept. 13, 2008, there was bailout fatigue. Fannie Mae and Freddie Mac had been taken over by the government a week earlier; Bear Stearns was rescued a few months before that. There was a "*no more bailouts*" consensus in the Bush administration and in both parties in

Congress. Going into the weekend when Lehman Brothers failed, Mr. Paulson pre-emptively leaked to the press that there would be no bailout (this was first reported in Andrew Ross Sorkin's book "**Too Big to Fail**" and confirmed in Mr. Paulson's memoir).

The mind-set was "*we have to draw the line somewhere, and that somewhere is here.*" Against that backdrop, one can imagine that Mr. Geithner, once it became clear there was no private sector rescue of Lehman in the offing, turned his attention to containing the damage of a bankruptcy.

It remains true that the key policy makers never had a clear-cut plan for how to rescue Lehman. But they didn't have one because they didn't seek one.

**If they had rescued Lehman, would it have mattered?** Would the entire course of world economic history have been changed? This is of course unknowable, but there's plenty of reason to think that even if Lehman Brothers had been rescued, sooner or later the crisis was going to spread to a firm too big or too broke to do anything about, particularly in the absence of the bank bailout legislation that didn't pass until early October — and only after the Lehman failure prompted big enough drops in the stock market to get Congress's attention.

In other words, even had Lehman been saved, the crisis would have come to a head with A.I.G. a few days later, or Morgan Stanley a few days after that, or Wachovia or Citigroup. Would one of those results have been better or worse than what actually happened? That's the part that is anybody's guess.

**Why did the government bailout A.I.G.?** The most controversial action that the Paulson-Geithner-Bernanke triumvirate took that fall was to bail out the insurer A.I.G. The three will be asked to explain their actions on the stand in the A.I.G. shareholders' lawsuit.

It must be a strange feeling for the three, after taking years of abuse from Congress and the public for throwing taxpayer money at the insurance company, to now testify in a trial over whether they should have offered even more generous terms. The officials involved have been open about their anger at the decisions that got A.I.G. in trouble in the first place.

A.I.G., besides being a giant company that insured everything from homeowners' policies to jumbo jets, owed billions to major global banks from its ill-conceived business guaranteeing the value of highly rated securities backed by mortgages.

The Fed bailout of A.I.G. was in no small part about ensuring that those banks would get the money they were owed: \$12 billion each for Deutsche Bank and Société Générale, for example. The obvious question, asked many times now, is why the Fed did not insist that those banks take "haircuts" on what they were owed given A.I.G.'s near-bankruptcy and government bailout. That would certainly seem like the fair course.

But the policy makers' answer is also becoming clear: To demand haircuts from the banks would have defeated the point. The entire goal of the bailout was to avoid a default and the unpredictable ripple effects it would create. Yet to get the banks to agree to haircuts, they would need to threaten the very thing they were looking to avoid — to send one of the world's largest insurance companies into the same kind of disorderly bankruptcy that had already enveloped Lehman Brothers.

**Were policy makers arbitrary and random in their decisions?** "South Park" once gave a memorable answer, involving the wanderings of a headless chicken. For the public, the decisions on whom to bail out, nationalize or allow to fail surely seemed random. Bear Stearns?

Government-assisted bailout. Fannie Mae and Freddie Mac? Government takeover. Lehman Brothers? Bankruptcy. A.I.G.? Bailout.

To the policy makers involved, the decisions seemed methodical and grounded in the unique circumstances of each firm involved and their legal authorities. Is it a bank? Is it solvent? Is it systemically important?

But the policy makers were reluctant to lay out in advance some framework of what institutions would be rescued and which weren't, viewing strategic ambiguity as their friend. They didn't want to pre-commit. That added to the uncertainty of a difficult time, and with hindsight some clearer sense of the rules of the game when the financial system is under stress might make the consequences less severe.

The Great Depression was 80 years ago, and people are still debating the causes and response. Perhaps the 2008 crisis is destined to be the same. To the question we began with — were the financial leaders heroes, benefactors of Wall Street or vindictive decision-makers, the answer that is coming into focus is this: all three.

\*\*\*\*\*