BANK POLICY INSTITUTE

The Mysterious Footnote 7: To Whom and on What Terms is the Fed Lending $173 Billion?

Bill Nelson | April 20, 2023

Although the Federal Reserve has at times been accused of excessive secrecy about its lending, up until recently it has actually been exceptionally transparent. In particular, all the terms and conditions of all of its regular and emergency lending programs have been published prior to or coincident with any lending. The only thing the Fed keeps secret is the identity of the borrowers, but that secrecy is critical for being an effective lender of last resort.[1]

For example, the Fed has an entire website, frbdiscountwindow.org, containing information on its regular discount window lending extended under Section 10B of the Federal Reserve Act. The website includes descriptions of the programs, legal and regulatory background, their interest rates, eligible collateral and haircuts, FAQs and other information.

Similarly, the Board publishes term sheets and FAQs for all of its emergency programs created under Section 13(3) of the FRA. Most recently, the Fed opened the Bank Term Funding Program under 13(3) and published its term sheet and FAQs, all contained on the program's own website (here). The website also includes the required reports to Congress on the program and the press release announcing the program.

It is therefore striking that the Fed has opened and is operating a large lending program about which it has provided extraordinarily little information. The cover page of the Fed's weekly H.4.1 on March 16, 2023 stated:

> Factors affecting reserve balances of depository institutions (table 1) "other credit extensions" reports loans that were extended to depository institutions established by the Federal Deposit Insurance Corporation (FDIC). The Federal Reserve Banks' loans to these depository institutions are secured by collateral, and the FDIC provides repayment guarantees.

A footnote to the table, which has also been included in subsequent releases, provides the same information:

> 7. Includes loans that were extended to depository institutions established by the Federal Deposit Insurance Corporation (FDIC). The Federal Reserve Banks' loans to these depository institutions are secured by collateral and the FDIC provides repayment guarantees.

The H.4.1 indicates the loans' maturities are "Within 15 days" and a footnote to that table further provides that "these loans are recognized as performing based upon payment due from the receiverships, collateral securing the loans, and the FDIC repayment guarantees."

As of April 19, those loans equaled $173 billion. By way of comparison, that is more than 3 times the peak amount of regular discount window lending in response to the COVID crisis and half again as much as the peak amount of regular discount window lending during the Global Financial Crisis.

[1] Identities and other loan-level details are provided with a one-year lag for emergency loans extended under section 13(3) of the Federal Reserve Act and with a two-year lag for regular discount window loans extended under section 10B.

The Fed has released no other information about these loans. It has not provided the interest rate, the collateral, any other terms, or the legal basis for the loans.[2]

Nor were the loans mentioned in any of the information released by the FDIC, Federal Reserve or Treasury concerning the failures of SVB and Signature and the FDIC's actions as receiver.

In addition to their secret terms and conditions, there are two other big questions about the loans.

First, under what legal authority were they extended? It wasn't 13(3) because the Fed is obligated to officially notify Congress of such loans (we're unaware of any such notice), and the loans were inconsistent with the limits on such lending established by Dodd-Frank. The Federal Reserve website suggests the loans may have been extended under 10B. If it was 10B, the authority for the Fed's normal discount window lending to depository institutions, then that raises the question of whether the loans are within the guidelines established by statute established by statute in 1991. Were the bridge banks adequately capitalized?[3] Perhaps the loans were extended under 13(13), which allows the Fed to make a loan to anyone with virtually no restrictions as long as the loans are collateralized by Treasury or agency obligations. If so, were they backed by such securities or is the FDIC guarantee standing in for them? Although the Fed authorized lending to Fannie and Freddie under Section 13(13) during the GFC, it did not extend any loans. We have been unable to identify any past instance of the Fed extending a loan under 13(13).

Second, as far as we can tell, the Fed has not previously lent to a bridge bank. Did the Fed make the loans to avoid the potentially alarming outcome where the FDIC runs out of money and is unable to compensate depositors? Without the loan, the FDIC's resources are the DIF and then a line from Treasury. But when the FDIC borrows from Treasury, Treasury, in turn, uses its own cash and then would have had to borrow the funds in the market, which ultimately could implicate the debt limit.

We hope that the upcoming Barr report on the SVB failure will shed light on these critical public policy issues.

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[2] A note on the Federal Reserve website suggests the loans may have been extended through the discount window but the Fed has not provided any clear legal justification for providing the loans. The FDIC also has not provided any account of its role in guaranteeing the loan. See https://www.federalreserve.gov/feeds/h41.html.

[3] The OCC takes the view that the capital requirements for a national bank do not apply to a bridge bank and that in the case of SVB's bridge bank, and for supervisory purposes, the OCC deemed the bridge bank to have capital of 6% of the bank's average total assets. See https://occ.gov/topics/charters-and-licensing/app-to-charter-silicon-valley-bridge-bank-na.pdf.