CRS INSIGHT

Federal Reserve Issues Final Rule on Emergency Lending

January 6, 2016 (IN10426)

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On November 30, 2015, the Federal Reserve (Fed) issued final regulations governing emergency lending under Section 13(3) of the Federal Reserve Act and implementing Section 1101 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). In response to comments received during the rulemaking process which criticized the proposed rules as lacking limits and meaningful definitions, the final regulations provide certain limits on the Fed's discretion under Section 13(3) that did not appear in the 2013 proposed regulations. The final rule implements the Dodd-Frank requirement that Section 13(3) lending provide liquidity to the entire financial system, as opposed to assisting individual distressed institutions. Nevertheless, House Financial Services Committee Chairman Jeb Hensarling issued a press release decrying the final rule as "leaving the door wide open to future taxpayer-funded bailouts." H.R. 3189, as passed by the House on November 11, 2015, H.R. 2625, and S. 1320 would further curtail the Fed's flexibility under Section 13(3).

Section 13(3) was enacted during the Great Depression in 1932. The Fed used this authority during the recent financial crisis to prevent the failure of specific large financial firms, such as Bear Stearns and AIG, and for more broadly available liquidity programs for various markets (e.g., primary dealers in the U.S. government securities market and participants in the commercial paper market). CRS Report R44185, *Federal Reserve: Emergency Lending* includes an appendix detailing the Fed's actions under Section 13(3).

Dodd-Frank retains certain basic elements of Section 13(3): the authority may be invoked only in "unusual and exigent circumstances," pursuant to an affirmative vote of five Fed Board members, upon showing that the borrower cannot "secure adequate credit accommodations," and upon presentation of satisfactory collateral. Dodd-Frank adds various substantive requirements, as well as provisions requiring the Fed to report any actions to Senate and House Committees. Specifically, the Dodd-Frank Act

- replaced "individual, partnership, or corporation" with "participant in any program or facility with broad-based eligibility";
- required that assistance be "for the purpose of providing liquidity to the financial system, and not to aid a failing financial company." It ruled out lending to an insolvent firm, defined as a firm in any bankruptcy, resolution, or insolvency proceeding;

- required that loans be secured "sufficient(ly) to protect taxpayers from losses," and that collateral be assigned a "lendable value" that is "consistent with sound risk management practices";
- forbade "a program or facility that is structured to remove assets from the balance sheet of a single and specific company";
- required any program "to be terminated in a timely and orderly fashion"; and
- required the "prior approval of the Secretary of the Treasury."

Table 1 outlines how the final rule implements the statutory requirements.

Table 1. Major Provisions of the Fed's Final Rule

Section 13(3)	Final Rule
Limits assistance to any "participant in any program or facility with broad-based eligibility."	Minimum of five eligible participants for a program to meet the "broad-based eligibility" requirement.
Specifies that assistance be "for the purpose of providing liquidity to the financial system, and not to aid a failing financial company." Requires that regulations preclude assistance to insolvent borrowers, i.e., borrowers "in bankruptcy, resolution ... or any other Federal or State insolvency proceeding." Forbids "a program or facility that is structured to remove assets from the balance sheet of a single and specific company."	Specifies that liquidity may be provided only to an identifiable market or sector of the financial system. Provides that a program may not be used for a firm to avoid bankruptcy or resolution. Specifies that a program designed to aid one or more failing companies or to assist one or more companies to avoid bankruptcy, resolution, or insolvency will not be considered to have the required "broad-based eligibility." Requires borrowers be current on their debt for 90 days before borrowing. Permits the Fed to determine whether the applicant is insolvent. Excludes a firm from borrowing from the Fed if the purpose is to help a third party firm that is insolvent. Includes immediate repayment and enforcement actions for firms that "make a willful misrepresentation regarding its solvency." Specifies that the Fed is under no obligation to extend credit to a borrower.
Requires that loans be secured "sufficient[ly] to protect taxpayers from losses," and collateral be assigned a "lendable value" that is "consistent with sound risk management practices."	Requires that the Fed assign a lendable value to collateral at the time credit is extended.
Requires "prior approval of the Secretary of the Treasury."	Specifies that no program may be established without the approval of the Secretary of the Treasury.
Specifies that the authority may be invoked only in "unusual and exigent circumstances" and that any program be "terminated in a timely and orderly fashion."	Requires that the Fed provide "a description of the unusual and exigent circumstances that exist" no later than 7 days after establishing a program. Requires that initial credit terminate within one year, with extension possible only upon a vote of five governors and approval by the Secretary of the Treasury. Requires a review of programs every six months to assure timely termination.
Specifies that rates be consistent with the	Requires the rate charged must be a "penalty

statutory requirements governing the discount rate.*	rate," defined as a rate that is a premium to the market rate in normal circumstances. It must also be a rate that "affords liquidity in unusual and exigent circumstances; and ... encourages repayment of the credit and discourages use of the program" when "economic conditions normalize." Permits the charging of "any fees, penalties, ...or other consideration...to protect and appropriately compensate the taxpayer.... "
Specifies that the borrower must be "unable to secure adequate credit accommodations from other banking institutions."*	Requires evidence of inability of participants in a program to obtain credit. The evidence may be based on economic conditions in a particular market or markets; on the borrower's certification of its inability "to secure adequate credit accommodations from other banking institutions," or on "other evidence from participants or other sources."

Source: CRS, based on final rule.

Notes: *=requirement is largely unchanged by Dodd-Frank.