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INSIGHT

Bank Term Funding Program (BTFP) and Other Federal Reserve Support to Banking System in Turmoil

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On March 10 and 12, respectively, the Silicon Valley Bank (SVB) and Signature Bank were taken into receivership by the Federal Deposit Insurance Corporation (FDIC) after large and sudden withdrawals by their depositors. The government then responded swiftly to concerns that arose about the systemic risk these failures posed with several actions designed to stabilize the banking system. This insight discusses the Federal Reserve's (Fed's) actions, including the creation of the Bank Term Funding Program (BTFP).

Overview of the BTFP

The new BTFP provide banks and other insured depository institutions with loans of up to one-year maturity. According to the Fed, "this action will bolster the capacity of the banking system to safeguard deposits and ensure the ongoing provision of money and credit to the economy." The program provides an alternative to selling off securities or private lending to access liquidity in times of stress.

The loans are backed by high-quality collateral, such as U.S. Treasuries and mortgage-backed securities. Banks are allowed to pledge those securities at par (face) value instead of market value. This benefits banks because many securities they bought when interest rates were lower have fallen in market value. To create this program, the Fed used emergency authority found in Section 13(3) of the Federal Reserve Act (12 U.S.C. §343.) As required by statute, the Fed Board of Governors unanimously found "unusual and exigent circumstances" to justify its creation and the program was approved by the Treasury Secretary. Treasury pledged $25 billion in assets from the Exchange Stabilization Fund (ESF) to backstop potential future losses that the program might incur. The Fed reported to Congress that it does not expect losses on the program, because the loans are backed by collateral and the loans are made with recourse (i.e., borrowers must repay beyond the collateral value).

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Comparison to Other Programs

The Fed was created in 1913, in part, to act as "a lender of last resort" to the banking system. The Fed has long used a facility called the "discount window" to fill this role by providing short-term collateralized loans to banks. Discount window usage is typically high during crises and negligible during normal market conditions. In some ways, the emergency BTFP functions similarly to the traditional discount window—both are places banks can pledge collateral in return for cash, thereby increasing its liquidity. Banks that are undercapitalized cannot borrow from the discount window's primary credit program or the BTFP. However, there are a few key differences (see **Table 1**.)

Table 1. Comparison of BTFP and Discount Window

Category	BTFP	Discount Window
Eligible collateral	only collateral that is eligible for purchase by the Fed in open market operations	wider range of securities and loans
Collateral valuation	par value	market value
Margin	100%	100% on collateral eligible for BTFP but margins on other types of eligible collateral remain[a]
Term	up to one year	up to 90 days
Rate[b]	one-year overnight index swap rate plus 10 basis points fixed at time of advance	rate set by Fed, typically at top of federal funds rate target range for primary credit

Source: Federal Reserve.

a. See https://www.frbdiscountwindow.org/Pages/Collateral/collateral_valuation.

b. See https://www.frbdiscountwindow.org/.

When the BTFP was created, the Fed adjusted margin requirements for the discount window so that banks can borrow up to 100% of the collateral value for these securities from each. However, valuing collateral at par through the BTFP currently increases borrowing potential for many securities compared to the discount window. This is one way the BTFP has more favorable terms than the discount window. In addition, banks can borrow for longer from the BTFP and the BTFP's interest rate is currently lower than the discount window's. Nonetheless, in the first few days of the program's existence, lending through the discount window far surpassed lending through the BTFP. Whether this trend continues remains to be seen.

This is not the first time the Fed has created an emergency lending facility for banks. The Fed created the Term Auction Facility (TAF) in December 2007 in response to the financial crisis to auction reserves to banks. The Fed did not use Section 13(3) to create TAF but rather used the lending authority used for the discount window (12 U.S.C. §347b.) All loans made under TAF were repaid.

Usage of Fed Programs

According to the Fed's balance sheet, as of March 29, advances from the BTFP totaled $64.4 billion. The discount window showed significantly more activity, peaking at $152.9 billion on March 15, and most recently at $88.2 billion as of March 29. As shown in **Table 2**, below, lending through the discount window surpassed lending during the 2008 financial crisis and the pandemic.

According to its balance sheet, the Fed has also lent about $180 billion to the "bridge banks" established by the FDIC to resolve SVB and Signature Bank as of March 29, 2023. According to the Fed, these loans are fully collateralized and guaranteed by the FDIC, so they pose no risk to the Fed.

Compared to the financial crisis (see **Table 2**), current Fed lending to banks has been lower, but it is still significantly higher than during normal conditions and about 6.5 times higher than it was during the COVID-19 pandemic. Thus far discount window lending has been higher than in these episodes, but use of the temporary crisis program has been smaller. Discount window lending has been higher than normal since February 2022.

Table 2. Fed Lending to Banks

2007-2023, $ billions

	Discount Window	Crisis Programs	FDIC Bridge Banks	Total
Financial Crisis Peak (3/4/09)	66.7	493.1 (TAF)	0	559.9
Weekly 12/1/10-3/11/20	<1	n/a	0	<1
COVID-19 Peak	50.8	n/a	0	50.8
2023 Peak (3/22/2023)	110.3	53.7 (BTFP)	179.8	343.7

Source: CRS calculations based on Federal Reserve data

Policy Issues

The creation of the BTFP raises several issues for Congress:

- **Moral Hazard.** The favorable BTFP terms, notably collateral valuation at par, reduces the incentive for banks to manage interest rate risk if they believe the Fed will lend them money regardless of the market value of the securities pledged.
- **ESF Backing.** The BTFP is being backed by ESF funds. This could be controversial given that it is not the originally intended use of the ESF and similar actions were prohibited in the past.
- **Inflation.** The BTFP increases the size of the Fed's balance sheet, and could, therefore, increase inflationary pressures at a time when the Fed has been raising interest rates to reduce inflation.
- **Risk.** The BTFP requires high quality collateral and is backed by ESF funds, minimizing the risk of losses to the Fed.
- **Transparency.** The Fed is required to disclose participation with a one-year lag. The lagged release is meant to balance desires for transparency with the stigma that could be associated with an immediate release.

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