



FEDERAL RESERVE BANK *of* NEW YORK

Discount Window

Specialized Course in U.S. Monetary Policy Implementation

September 2015

PRE-QUIZ



True or False?

Discount Window lending rates are at a discount to prevailing market rates.



True or False?

Funds obtained from Discount Window loans may be used to take advantage of arbitrage opportunities.



True or False?

Details of individual Discount Window loans are never publicly disclosed.



Agenda

- Discount Window Basics
 - Governance
 - Facilities
 - Collateral
- Crisis Initiatives
- Dodd-Frank Act
 - Public Disclosure
 - Crisis Authority



Discount Window Basics – Governance

- Board of Governors
 - Determines general policies
 - Approves proposed rate changes
- Individual Reserve Banks
 - 12 regional Banks
 - Boards of Directors propose rate changes
 - Each has autonomy in lending and collateral decisions as they bear their own risk exposure
- Subcommittee on Credit Risk Management (SCRM)
 - Promotes consistency and coordination across Reserve Banks



Discount Window Basics - Facilities

Primary Credit For healthy banks	<ul style="list-style-type: none">• Generally, no questions asked• Penalty rate over fed funds target (currently 75 bps)• Provide temporary liquidity• Arbitrage is ok
Secondary Credit For troubled banks	<ul style="list-style-type: none">• Questions may be asked• Penalty rate over primary credit rate (currently 1.25 percent)• Provide short-term funding when other sources of funds are not available at a reasonable rate
Seasonal Credit For small banks with seasonal funding needs	<ul style="list-style-type: none">• Discount rate (currently 20 bps)• Longer-term funding over periods of seasonal need• Mostly small banks in agricultural regions
Emergency Credit For “unusual and exigent” circumstances	<ul style="list-style-type: none">• Under Section 13(3) of the Federal Reserve Act• Allows for lending to non-banks• Prior to 2008, not used since 1930s• During 2008 to 2010, used for many facilities• New limits under Dodd-Frank Act



Discount Window Basics - Facilities

- Discount Window facilities were restructured in 2003, primarily to address stigma against borrowing

Classic Role Lender of last resort	<ul style="list-style-type: none">• Below market rates• Used infrequently, in extreme circumstances• Highly stigmatized
2003 Updated Role Marginal lender	<ul style="list-style-type: none">• Above market rates• Central bank has a role to play in fostering payment system functioning• More regular small amounts of late-day borrowing

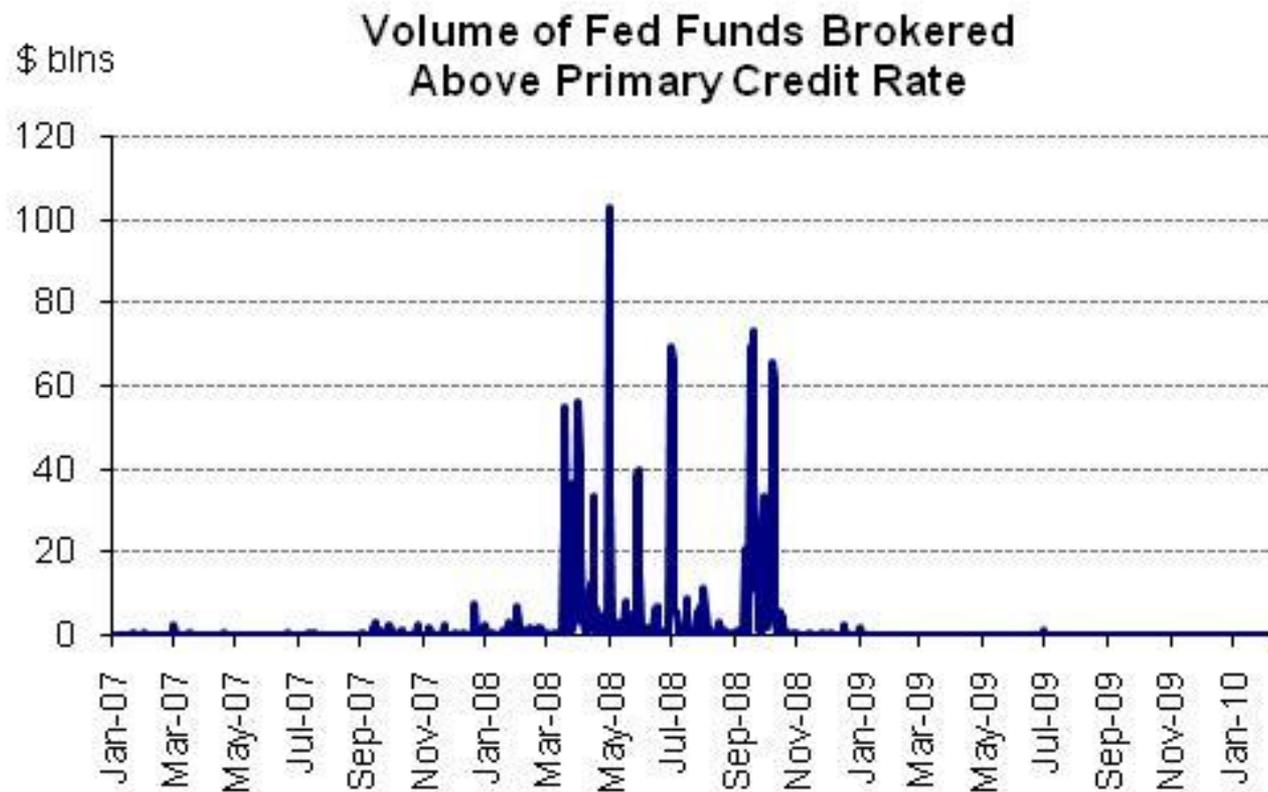


Discount Window Basics

- Typical reasons for borrowing
 - To meet liquidity needs due to unexpected outflows of funds from an institution's Reserve account
 - Operational problems
 - Arbitrage opportunities
 - To satisfy reserve requirements
 - As a test to validate borrowing processes and loan applications
 - Institution cannot access funding markets due to financial condition



Discount Window Basics - Stigma



Source: FRBNY



Discount Window Basics – Acceptable Collateral

Securities (Investment Grade)	Loans
US Treasuries and Agencies	Commercial Loans
Foreign Sovereign Debt*	Commercial Real Estate
Corporate Bonds*	1-4 Family Mortgage Loans
Municipal Securities*	Consumer Loans
Asset-Backed Securities	Agency Guaranteed Loans
Agency Mortgage-Backed Securities	
CDOs, CMBS, Private-Label CMOs (AAA)	

* Foreign currencies: Japanese Yen, Euro, Australian Dollar, Canadian Dollar, British Pound, Danish Krone, Swedish Krona, Swiss Franc



Discount Window Basics – Pledging Methods

- Securities are pledged via various methods
 - DTC (corporate bonds, municipals, ABS, MBS, CDOs, CP)
 - Fedwire (U.S. Treasury and agency securities)
 - Euroclear/Clearstream (foreign-denominated securities)
- Loans are pledged via Borrower-in-Custody (BIC) program
 - Loan collateral remains with the pledging bank
 - Discount window staff conducts regular reviews to ensure compliance with BIC guidelines
- Collateral eligibility questions are reviewed on an ongoing basis



Discount Window Basics – Collateral Margins

- Collateral pledged to the Discount Window is margined based on a published table
- Margins are based on the riskiness of the asset as well as its duration
- Margin table was last updated in August 2015
 - The Federal Reserve conducts periodic reviews of margins and valuation practices
 - Changes are released to depository institutions well in advance of change date
 - Analytical improvements in methodology, technical improvements to models, and better use of data



Some of the Changes Announced in August 2015

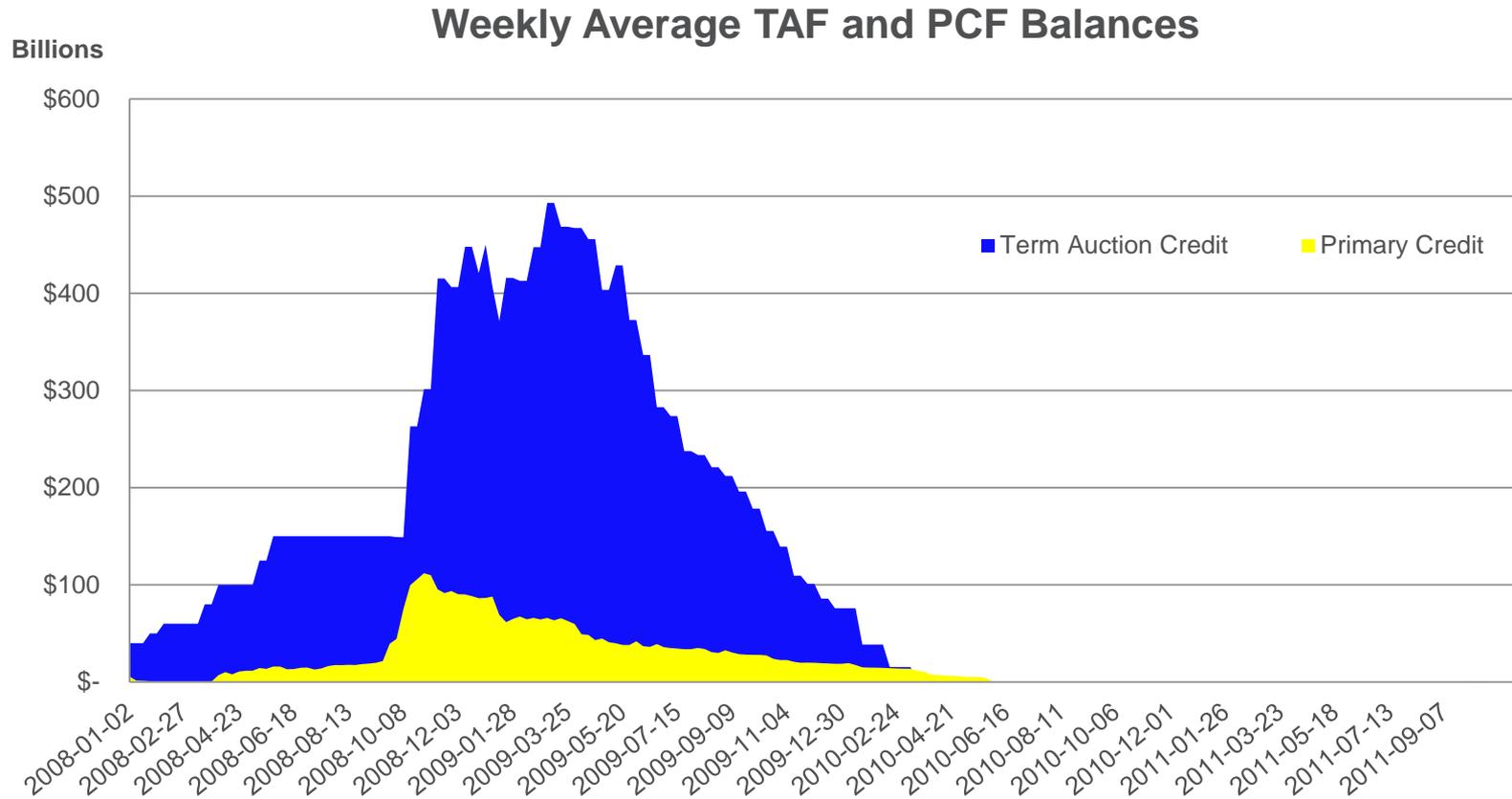
- Additional duration buckets for Certificates of Deposit
- Student Loans can now be pledged individually
- Additional coupon buckets for all individually deposited loans
- The lendable value of collateral pledged to the System increased by approximately 2.6 percent



Crisis Initiatives

- Term Discount Window lending
- Rate cuts
- Term Auction Facility (TAF), creation and expansion
- Other special facilities

Crisis Initiatives – DW & TAF Borrowing



Source: H.4.1. Report, Factors Affecting Reserve Balances



Dodd-Frank Act – Public Disclosure

- Dodd-Frank Act
 - Required borrower, loan, and collateral details for special facilities to be released on 12/1/10 (included TAF, did not include traditional Discount Window facilities)
 - Requires borrower, loan, and collateral details for traditional Discount Window facility loans from 7/22/2010 to be released with about a two-year lag
- Freedom of Information Act lawsuit required disclosure of borrower, loan, and collateral details for traditional Discount Window facility loans from 8/8/07 through 3/1/10 on 3/31/2011
- Stigma impacts



Dodd-Frank Act – Crisis Authority

- Section 13(3) of the Federal Reserve Act allows lending to non-depository institutions “in unusual and exigent circumstances”
- New requirements:
 - Facility with broad-based eligibility
 - Participants unable to secure sufficient private credit
 - Prior approval of the Treasury Secretary
 - Report details to Congress within 7 days
 - Public disclosure within one year after termination



Resources

- System Discount Window Website
<http://www.frbdiscountwindow.org>
- New York Discount Window Website
<http://www.newyorkfed.org/banking/discountwindow.html>
- Discount Window Margins Table
<http://www.frbdiscountwindow.org/discountmargins.xls>
- Collateral Eligibility Guidelines
<http://www.frbdiscountwindow.org/FRcollguidelines.pdf>
- Lending Details (Quarterly, with 2-year Lag)
http://www.federalreserve.gov/newsevents/reform_discount_window.htm

