Conference Call of the Federal Open Market Committee on March 10, 2008

A conference call of the Federal Open Market Committee was held on Monday, March 10, 2008, at 7:15 p.m. Those present were the following:

Mr. Bernanke, Chairman
Mr. Geithner, Vice Chairman
Mr. Fisher
Mr. Kohn
Mr. Kroszner
Ms. Pianalto
Mr. Plosser
Mr. Warsh

Ms. Cumming, Messrs. Evans, Lacker, and Lockhart, and Ms. Yellen, Alternate Members of the Federal Open Market Committee

Messrs. Hoenig and Rosengren, Presidents of the Federal Reserve Banks of Kansas City and Boston, respectively

Mr. Sapenaro, First Vice President, Federal Reserve Bank of St. Louis

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Stockton, Economist

Mr. Kamin, Ms. Mester, Messrs. Rosenblum and Sniderman, Associate Economists

Mr. Dudley, Manager, System Open Market Account

Mr. Clouse, Deputy Director, Division of Monetary Affairs, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of Staff Director for Management, Board of Governors

Mr. Leahy, Associate Director, Division of International Finance, Board of Governors

Ms. Liang, Associate Director, Division of Research and Statistics, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Mr. Luecke, Section Chief, Division of Monetary Affairs, Board of Governors

Messrs. Fuhrer and Judd, Executive Vice Presidents, Federal Reserve Banks of Boston and San Francisco, respectively

Mr. Altig, Ms. Perelmuter, Messrs. Rasche, Sellon, Sullivan, and Weinberg, Senior Vice Presidents, Federal Reserve Banks of Atlanta, New York, St. Louis, Kansas City, Chicago, and Richmond, respectively

Ms. Logan, Assistant Vice President, Federal Reserve Bank of New York

Transcript of the Federal Open Market Committee Conference Call on March 10, 2008

CHAIRMAN BERNANKE. Good evening, everybody. I am sorry, once again, to have to call you together on short notice. We live in a very special time. We have seen, as you know, significant deterioration in term funding markets and more broadly in the financial markets in the last few days. Some of this is credit deterioration, certainly, given increased expectations of recession; but there also seem to be some self-feeding liquidity dynamics at work as well. So the question before us is whether there are actions we can take, other than monetary policy, to break or mitigate this adverse dynamic.

There are two actions on the table, which I think we should just try to consider together, if possible. The first is the proposed term securities lending facility—I know you received the documentation on this without much notice, but we will get some explanation in the meeting. The second item—we have received formal requests from the European Central Bank (ECB) and from the Swiss National Bank (SNB) to expand and extend the currency swap lines that we have with them. As you recall, in December we had a coordinated action, which involved the ECB and the SNB doing dollar funding auctions that piggybacked on our term auction facility. They stopped doing that after the turn of the year, but they would like to return to doing that now for some time. They think that dollar funding conditions warrant it. They are requesting that we raise their swap lines. The ECB's line is currently $20 billion. It would like to raise its line to $30 billion, so it can do two $15 billion auctions a month. The Swiss National Bank would like to have its $4 billion line raised to $6 billion, so it can do one $6 billion auction each month. That would be a coordinated effort. We would have a joint statement, along with the United Kingdom and Canada, and also supporting statements from Sweden and Japan. So it would be a type of coordination similar to the one we saw in December. Again, the request is to increase the swap lines and to extend them, and we propose to extend them through September 30. That requires a vote of the FOMC, and so, again, we have two items for your discussion.

I would like to proceed as follows. I am going to turn first to Bill Dudley and his colleagues in New York to give us a brief update on market conditions and then to outline for us the proposed term securities lending facility and how it would work and what we hope it would do in the markets. I don't think extensive exposition of the swaps is necessary, but any questions are welcome. After New York's presentation, we have Bill, Brian Madigan, Scott Alvarez, and other staff here, if you have any questions. Following that, we would have a go-round and get comments and positions, and then we proceed to votes. So without further ado, let me turn to Bill in New York to start with a market update and then to talk a bit about the proposed facility. Bill.

> MR. DUDLEY. Thank you, Mr. Chairman. Financial conditions have worsened considerably in recent days. Credit spreads have widened, equity prices have declined, and market functioning has deteriorated sharply. Although there are many factors that can be cited to explain what we are seeing—including the acute weakness in the U.S. housing sector, a deteriorating macroeconomic outlook, and the loss of faith in credit ratings and structured-finance products—we may have entered a new, dangerous phase of the crisis. Major financial intermediaries are pulling back more sharply and along more margins than previously—shrinking their collateral lending books and raising the haircuts they assess against repo collateral. For a time, this adjustment was occurring in a relatively orderly way, but we appear to have passed that point about ten days ago. The failure of Peloton—a major hedge fund—and the well-publicized problems of Thornburg Mortgage and Carlyle Capital Corporation in meeting margin calls have triggered a dangerous dynamic.
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> That dynamic goes something like this: Asset price declines—say, triggered by deterioration in the outlook—lead to margin calls. Some highly leveraged firms are unable to meet these calls. Dealers respond by liquidating collateral. This puts downward pressure on asset prices and increases price volatility. Dealers raise haircuts further to compensate for the heightened volatility and the reduced liquidity in the market. This, in turn, puts more pressure on other leveraged investors. A vicious circle ensues of higher haircuts, fire sales, lower prices, higher volatility, and

still lower prices, and financial intermediaries start to break as a liquidity crisis potentially leads to insolvency when assets are sold at fire sale prices.

This dynamic poses significant risks. First, it impairs the monetary policy transmission mechanism. We have seen that in recent weeks in the sharp widening between mortgage rates on an option-adjusted basis and Treasury bond rates. Second, as hinted at above, there is a systemic issue. If the vicious circle were to continue unabated, the liquidity issues could become solvency issues, and major financial intermediaries could conceivably fail. I don't want to be alarmist, but even today we saw double-digit stock price declines for Fannie Mae and Freddie Mac. There were rumors today that Bear Stearns was having funding difficulties: At one point today, its stock was down 14 percent before recovering a bit. Third, the problems in one financial market disturb others. We have seen the problems move from subprime to alt-A mortgages to jumbo prime mortgages and now even agency mortgage-backed securities. Commercial-mortgage-backed security spreads and corporate credit spreads have also widened, and we have seen considerable distortions in the municipal market.

The deterioration in market function can be seen in a number of ways. First, term funding spreads have widened back out. For example, the one-month LIBOR–OIS spread today is 56 basis points, up from its low point in 2008 of 16 basis points, which was reached in January. Second, haircuts for residential MBS have increased sharply, and if anything, the rate of deterioration in terms of haircuts has accelerated markedly in the last week. Third, bid-asked spreads for transactions on many types of financial instruments have widened, indicating a growing liquidity problem in the market.

To address these issues, the Federal Reserve has responded by increasing the size of the TAF program and by implementing a large, term, single-tranche RP program. Together, these two programs will likely cumulate to total outstandings of about $200 billion. In addition, as the Chairman mentioned, the ECB and the SNB today have submitted requests to increase their foreign exchange swap draws and restart their term funding auctions. But there are limits to what these programs can do. The TAF provides liquidity only to depository institutions—this liquidity is not necessarily passed on readily to primary dealers and to other financial institutions. Although term RPs do provide some assistance to primary dealers, these operations are limited to the highest quality collateral—Treasuries, agencies, and agency mortgage-backed securities. Moreover, as both programs are scaled up, there is a large impact on reserves that must be offset by Treasury redemptions, sales, or reverse repurchase operations. Frankly, there are limits to our ability to adjust our portfolio quickly without our actions becoming a source of disruption to financial markets.

For this reason, the staff has proposed a new facility, the term securities lending facility, or TSLF. A memo from the New York Fed staff and a term sheet were circulated to the FOMC earlier today, and these documents discuss in some detail this proposal. Let me give a summary of what I see as the most important points. In brief, this facility would expand the Federal Reserve's securities lending program for primary dealers by lending securities secured for a term of 28 days, rather than overnight, by a pledge of other securities—Treasuries, agencies, agency mortgage-backed securities, or AAA-rated private-label mortgage-backed securities. The last category is not currently eligible for open market operations (OMO). Currently, our securities lending program is overnight and exchanges only Treasuries for Treasuries. The purpose of this facility is to help alleviate the rapidly escalating pressures evident in term collateral funding markets.

So how would this facility help to accomplish this? By providing the ability to swap illiquid mortgage-backed collateral for Treasury securities, the program would reduce the uncertainty among dealers about their ability to finance such collateral. The expanded supply of Treasuries obtained in the collateral swaps would improve the ability of primary dealers to finance the positions on their balance sheets. This should, in turn, increase the willingness of dealers to make markets across a range of securities. Better market-making, in turn, should lead to greater liquidity for these securities. This, then, should reduce price volatility and obviate the need for dealers to assess higher haircuts against such securities. The liquidity option provided by the TSLF should reduce liquidity risk more generally. The program should help slow, or even reverse, the dynamic process of reduced liquidity, greater price volatility, higher haircuts, margin calls, and forced liquidation.

Why does the staff recommend that the scope of collateral be broader than OMO-eligible collateral? The staff believes that a program based only on OMO collateral could help improve liquidity in those markets. An improvement in liquidity in these core markets could help other related markets. Despite this, the staff recommends that the TSLF go one step further and also accept AAA-rated private-label residential-mortgage-backed securities in this program. The staff believes that it is important to take this additional step because the level of dysfunction in the non-agency mortgage-backed securities market is pronounced, this market is large, and steps to improve market function in this asset class are likely to have positive consequences for the availability and the cost of mortgage finance. In other words, improvement in this area would make monetary policy more effective and would likely generate significant macroeconomic benefits.

To limit the credit risk exposure of the Federal Reserve, the facility for non-OMO-eligible collateral would be limited to AAA-rated residential-mortgage-backed securities assets not on review for downgrade. In addition, the securities would be repriced daily, and appropriate haircuts would be applied against such securities. Why not go further? Although the SOMA lending facility could be extended to include other asset classes such as commercial-mortgage-backed securities, corporates, and municipals, the staff recommends against such a broader extension for two reasons. First, these markets are not under the same degree of duress as the residential-mortgage-backed securities market. Second, adding additional asset classes would increase the operational complexity and risk of the program—for example, by requiring additional auction cycles.

What are the risks of such a program? We think there are several risks that are particularly noteworthy. First, we cannot be sure that the program will have its intended impact. Experience with the TAF suggests that it will, but there is no guarantee of this. Second, the TSLF could increase moral hazard. If the program is successful in preventing losses that would have arisen from an inability to obtain funding, the TSLF would be a form of insurance that could conceivably induce broker–dealers to run smaller liquidity cushions during normal times. Third, Federal Reserve credit risk would increase as the SOMA portfolio accepted lower-quality collateral from primary dealers.

On the first point—Will it work?—the TSLF would be quite large, perhaps cumulating to $200 billion, the same size as the TAF and the term RP program combined. We can make it even bigger if we desire. So we think we have the muscle here to have an impact on term funding markets. On the second point—the moral hazard issue—the staff believes that the TSLF will increase moral hazard somewhat. Ideally, this type of program would also be accompanied by prudential regulation to ensure that primary dealers hold adequate liquidity buffers across the typical business cycle. On the third point—the issue of credit risk to the Federal Reserve—we conclude that there will inevitably be some increase in credit risk. But this risk should be controllable. We know our counterparties, we are not accepting securities that are on watch for downgrades, and the non-agency MBS securities will be AAA-rated. Moreover, we plan to limit the exposure to the more robust AAA-rated MBS by not accepting private-label MBS with CDO-type structures and characteristics. And if securities are put on watch, we can demand substitution.

Fully cognizant of these risks and others—which are outlined in more detail in the memorandum circulated to the FOMC earlier today—we conclude that the benefits are likely to significantly exceed the costs of the program. The staff believes it is important to take those steps necessary to restore the monetary policy transmission mechanism to working order and to short-circuit the vicious dynamic now evident in financial markets. Debby Perelmuter will now describe the TSLF program in more detail, focusing on how it will operate in practice, now that I've outlined the theory. Debby.

MS. PERELMUTER. Thanks, Bill. Should the Committee approve the proposal for the TSLF, we intend to announce tomorrow to the public the total program size envisioned as of today—as Bill mentioned, up to $200 billion. It will consist of $100 billion against pledges of OMO-eligible collateral and $100 billion against pledges of TSLF-eligible collateral beyond the OMO-eligible. Together the two tranches will be comparable in size to the TAF program plus the recently announced 28-day single tranche RPs.

For an immediate impact, we are thinking about auctioning $50 billion in each of the tranches at the outset, with the first auction occurring during the week of March 24. Specifically, the plan is to hold separate 28-day auctions for each main category of collateral in successive weeks with our primary dealer counterparties. We will auction the first tranche against pledges of OMO-eligible collateral on Thursday, March 27, to settle the following day (T+1) and to mature 28 days hence, and we will auction the second tranche against pledges of the non-OMO-eligible collateral on the following Thursday, April 3, also for T+1 and for a period of 28 days. The auctions will be held at 2:00 p.m. and will close at 2:30 p.m. with results posted shortly thereafter. We plan to auction in this pattern, each Thursday, alternating between the two collateral tranches for the duration of the facility.

The auctions will be based on a fee rate, in a bonds-versus-bonds construct. It is similar to our daily securities lending operations, and it is very familiar to our primary dealers. The fee rate bid will represent the spread, in basis points, between the cost of 28-day financing of general collateral Treasury securities and the cost of 28-day financing of the respective basket of collateral in the respective tranche. As with the TAF auctions and our daily securities lending operations, a minimum fee will be set by the Federal Reserve Bank of New York for each of the collateral tranches ahead of each auction. The fee will be set by a competitive single-priced auction process in which the accepted dealer bids will be awarded at the same fee rate, which shall be the lowest fee rate at which bids were accepted. Similar to our temporary open market operations, haircuts for the OMO-eligible collateral pledged will be the same, given that the facility is open to the same set of counterparties—the primary dealers—and the collateral in this tranche is identical. In addition, the Federal Reserve Bank of New York will use the services of the major clearing banks, BONY and JPMorgan Chase, and all transfers of collateral will be made through the borrower’s clearing bank account. This is how we do things for our open market operations.

Overall, the terms and conditions are similar to those of the TAF auctions in the following ways. There will be a 28-day fixed fee determined via a single-price centralized auction. The TSLF will have a minimum fee rate, and settlement will be forward settling. The term of operation will be 28 days except for holiday conflicts. The TSLF will have a minimum bid amount ($10 million as opposed to $5 million in the TAF). The maximum number of bids per participant will be two. The total propositions for each bid submitted and the total award may not exceed a specified percentage of the announced offering amount. We are contemplating a 20 percent limit per dealer. If a participant ceases to qualify for the TSLF (if it is no longer a primary dealer, for instance), the Federal Reserve Bank of New York may accelerate the unwinding of the loan, making the return of any pledged collateral immediately due.

The main differences between the TAF and the TSLF are as follows. They involve different sets of counterparties. The TAF provides direct funds, and the TSLF will provide securities. A different range of collateral is accepted: The TSLF is limited to OMO-eligible collateral and AAA non-agency residential-mortgage-backed securities. We expect to assess higher haircuts on non-OMO-eligible collateral as loans will be to the primary dealers and not to depository institutions. Overall we expect haircuts to be higher than those in normal times but lower than those *in extremis*. The haircuts on non-OMO-eligible collateral are expected to be higher than those on OMO-eligible collateral.

We expect to develop the terms and conditions of the TSLF more precisely after consultation with the primary dealers and the clearing banks. Should the Committee approve the proposal this evening, we expect these conversations to begin shortly following the announcement. Thank you.

CHAIRMAN BERNANKE. Thank you very much. We have all the staff here. Are there any questions about any aspect of the presentation or about the swaps? President Hoenig.

MR. HOENIG. If I understand this, the ability to go outside our normal collateral and into, say, these jumbos and so forth is based upon section 13 (3) in the Federal Reserve Act. Am I right on that? As you talked about moral hazard, did you have any concerns that, should the market not accept this and things deteriorate further, we would find ourselves going down the road to greater acceptance of greater varieties of collateral that we need to think about in the future?

CHAIRMAN BERNANKE. Scott, do you want to answer the first part about section 13(3)?

MR. ALVAREZ. Yes. President Hoenig, you are correct. We are relying in part on section 14, the open market operations piece, even for accepting collateral that is not section 14 collateral because it does have an effect in improving the market for U.S. government securities, but there is a very strong component of this that is providing liquidity to the primary dealers, and to satisfy that we are relying on section 13(3) authority.

MR. HOENIG. I assume that to try to handle the issues around moral hazard, the fact that we are confining it to the primary dealers is an important consideration?

MR. ALVAREZ. That is right. We are relying on market conditions, on limiting it to primary dealers, and on limiting the types of assets that we will accept as collateral.

MR. DUDLEY. You asked a question about broadening it potentially to other asset classes. I don’t think there is any presumption. That is certainly not our intention, but obviously we have to be responsive to the way things evolve. We are certainly not intending to do that, but I can’t say categorically that we would want to rule it out.

MR. HOENIG. I don’t oppose this. I just want to make sure that I understand some of the implications because I assume that part of this, given the circumstances in the markets, is to create a floor under this that is, in effect, trying to stanch the momentum and keep the losses down. So that logic will apply more broadly should the markets deteriorate, and that is kind of the path we are on. This is a crisis, I admit, and I just want to make sure that we are clear on what it is we are initiating here.

CHAIRMAN BERNANKE. We would not be setting a price floor for the asset, but we would be trying to reduce the liquidity premium. If there were further deterioration in price associated with the credit risk, that would still show through.

MR. HOENIG. Okay.

CHAIRMAN BERNANKE. President Fisher has a question.

MR. FISHER. Mr. Chairman, you wanted to have a go-round, but I do have some questions.

CHAIRMAN BERNANKE. This is the question phase now. We will have a chance for everyone who would like to speak to do so.

MR. FISHER. Well, Bill, you used the term “presumably prudential regulation,” I think it was. We are talking about broker–dealers. This gets to a broader concern that I have, which is the stick part of this. I can understand the carrot side of this thing, and we are doing it for the reasons that you stated, and I am very sympathetic to the argument. The question is, What do we get in return, and how do we make sure that, since we are not the regulator of these dealers, there is indeed discipline? I would like to know what your answer is. Do we have an arrangement with the SEC, or how do we work with the other regulators to make sure that discipline is applied here? In essence, as I understand this in my simple fashion, obviously we are taking lesser-quality paper in return for high-quality paper over the defined time frame that you stated and under the conditions that you stated. But I am just a little worried about being taken advantage of here. So the question is specifically about the "prudential regulation" of those people that we're dealing with. Then, I have other questions to follow.

MR. DUDLEY. Well, the first thing I would say, President Fisher, is that we are doing this collateral swap for a fee and for one that is higher than the normal fee in normal markets. So in no way is it free. In terms of the prudential regulation, I think there will be a lot of lessons learned from this crisis that will be addressed in the fullness of time, and this is one lesson that we are going to have to remember when we look at what we have learned from this experience.

CHAIRMAN BERNANKE. I would like to note that I did talk to Chairman Cox today about this and got his strong support.

MR. FISHER. Again, I think it would be helpful, Mr. Chairman—you and I talked about this a little last night—to have a full understanding of that strong support because it is critical input. Just to move on, on the question of the haircut, as I understand it from the paper, on the non-OMO eligible collateral, we are talking about an 8 percent haircut—is that correct?

MR. DUDLEY. That is the working assumption for the time being. We are going to have conversations with our primary dealers, and that is where we are going to really fine-tune what the appropriate haircut is. But I think the general operating principle here is to have haircuts that are considerably higher than the market during normal times but lower than the market during times of crisis, which we would argue that we are in or are close to being in right now.

MR. FISHER. The only thing I would caution about is the sentence in the paper that said "conservative relative to pre-crisis levels." Those were fantastically low spreads that were out of touch with reality, which we now know. Obviously, you are going to be prudent about this, but it seems to me that 8 percent is not much more than what we have on the TAF now. Is it 7 percent that we apply as a discount?

MR. DUDLEY. For AAA collateral, I think it is actually lower than that. I think it is 3 percent, so we would expect that the haircut should be higher because we are dealing with primary dealers rather than depository institutions as our counterparties. So we certainly accept the fact that there should be higher haircuts.

CHAIRMAN BERNANKE. Other questions?

MR. FISHER. Well, I had some other questions, Mr. Chairman, but I don't want to bore the group. I would like to listen to the conversation. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. President Lockhart.

MR. LOCKHART. Thank you, Mr. Chairman. The question relates to what President Fisher was pursuing, which, if I understand correctly, is our chance of actually incurring a loss in holding the less creditworthy paper. That would relate to a default on the part of a broker–dealer in unwinding the swap and then an ultimate loss in how we dispose of the paper over time if we were to hold it. So the question is, Are we aware of any primary dealers who are really in serious condition at this stage and constitute a "first way out" risk?

MR. DUDLEY. We have the right to limit our exposure to primary dealers that we have less confidence in. In fact, that is what we would actually do in the implementation of this kind of program.

CHAIRMAN BERNANKE. Any other questions? President Plosser.

MR. PLOSSER. Thank you, Mr. Chairman. If I could, I have basically three clarifying questions, a couple of them related to other comments. The first is on this issue of haircuts and discounts on the collateral. If I understand from looking at what we do for the TAF and for the discount window, the haircut that is given depends on the duration of the security, and it ranges from 8 percent to 3 percent. As I think Bill Dudley suggests, it is lowest for very short term duration buckets. But those haircuts apply, at least in my understanding, only to assets for which there are in fact market prices being quoted somewhere. For assets that are committed, even AAA assets, for those types of collateralized mortgages where there are no market prices, the haircut is 20 percent. So are we then accepting only collateral for which market prices in fact exist, or would we be following what we do at the discount window and take a substantially higher haircut for securities that we don't observe market prices for? That is my first question.

MR. DUDLEY. My understanding is that we are going to take only securities for which market prices exist.

MR. PLOSSER. Okay. The second concern—I want to go back to President Fisher's and President Hoenig's comments—I am a bit nervous about the slippery slope here. Once we start taking assets of a particular class that is in distress, are we setting ourselves up for potential risks down the road, when all of a sudden some other asset class that is commonly used in both trading and securities, whether by mutual funds or banks, comes under greater duress and for which spreads widen significantly? Are we going down a path here in which we are going to implicitly provide support for a whole range of potential asset classes? I worry a bit about where this might lead us over a longer period of time. That is related to my question. Maybe I missed it reading the document or in the discussion. This facility is different from the traditional lending facilities that we have in place primarily because of the term, even for the non-schedule 1 assets. Are we going to bill this as something different, and if so, does that mean we can remove it at some point? How long do you anticipate this facility being in place, and how do you think about the magnitude of the operations that we want to open the door for?

CHAIRMAN BERNANKE. President Plosser, I would make just a couple of comments, and Bill can follow. On the slippery slope, it requires an FOMC vote to add assets. So if we come to that point, you will have your opportunity to vote "no" or to object. Again, we don't propose to do that—but, you know, time consistency. I'm sorry, what was the other thing? Oh, you asked about the duration. The section 13(3) legal basis for this operation requires an affirmation that market conditions are significantly impaired. If we couldn't honestly make that affirmation, our legal basis would disappear. So I think we would have to remove it once conditions had normalized. Bill, do you have anything to add to that?

MR. DUDLEY. I think you answered the question very well.

CHAIRMAN BERNANKE. Gee, thanks. [Laughter] Charlie, did you have other questions? No? President Rosengren.

MR. ROSENGREN. I just want to follow up on one of Bill Dudley's comments. I noticed in the terms and conditions that it included that the New York Fed reserves the right to reject or declare ineligible any bid entirely at its own discretion. Under the TAF, we require that people be qualified under the primary credit program. Are we planning on using a credit standard equivalent to what is done for the TAF for the broker–dealer community? Do we currently have the capacity to make that determination?

MR. DUDLEY. I think the answer to that question is that we are going to make a determination but we don't have the same level of knowledge about the institution because we are not the primary consolidated supervisor.

CHAIRMAN BERNANKE. President Pianalto, do you have a question?

MS. PIANALTO. Yes. I just wanted to clarify that we are being asked to authorize the acceptance of different collateral. Who determines the size of the lending program on an ongoing basis? Is that determined by the Desk?

MR. DUDLEY. We are proposing the rough size of the facility today. As we gain experience with the facility and examine market conditions, we will be keeping the FOMC apprised of the programs and certainly seeking the input of the Committee on how to take this going forward. I hope that we will get a lot of feedback as we go through this auction process. If the bidding is very strong and if the markets are under tremendous distress, then we would probably want to increase the size of the program. Conversely, if the bidding is weak and if the markets settle down, then we would want to wrap up this program pretty quickly.

MR. ALVAREZ. The resolution that the FOMC will be asked to vote on today will have an outside limit of $200 billion as the total size of the term securities lending facility. If it were to go above that, it would have to come back to the FOMC.

CHAIRMAN BERNANKE. President Evans.

MR. EVANS. President Pianalto asked my question.

CHAIRMAN BERNANKE. Okay. President Fisher, do you have another question?

MR. FISHER. Yes, sir. I want to come back to President Rosengren's question, just so I understand this. Bill, let's take an example. What I think Eric is referring to is footnote 6 on page 9 of 10: "The Federal Reserve Bank of New York reserves the right to restrict individual primary dealer use of the program, even at the outset." Do we have the capacity, for example, going back to your introductory comments on what happened in the markets, to evaluate Bear Stearns as a participant in this program and to say, "No, you can't participate"? If we did that, what would that do to Bear Stearns?

MR. DUDLEY. Well, the first thing is that almost all of these primary dealers have the SEC as their primary consolidated supervisor. So it is important to understand that it is not as though there isn't an entity looking at the financial strength and stability of these institutions. We have the right not to accept collateral from any of the primary dealers, should we decide to do that. It is not going to be public. We are not going to be making a statement. This is just going to be a bilateral arrangement between us and the given primary dealer.

MR. FISHER. I guess my concern is that the safety-and-soundness disciplines that we apply don't appear to be applied to these broker–dealers. I guess the real question is that we can fly blind for a little time and we can try something—and I am for trying something—but if this doesn't lead to some broader regulatory authority or some change in the nature of the regulatory authorities, if we are indeed going to have counterparties in this sense that are outside our realm of regulation, I just wonder what the end game here is. Mr. Chairman, I am saying that I think we need to really think that through. We can react to what we are seeing going on in the marketplace, but I would feel much more comfortable as we go through time if we could understand what the end game is and what we want to get in return long term for providing this hopefully short-term solution to the liquidity crisis—that is the point I am trying to make.

VICE CHAIRMAN GEITHNER. Mr. Chairman, maybe I could say something in response to this. I agree with the concerns expressed about giving access to liquidity when we haven't done it before without a full capacity to affect the supervisory constraints these guys operate under. We are not doing this for them, though. We are doing it because we think it is necessary to help improve market functioning more generally. We do not have the capacity in these circumstances to redesign the regulatory framework to give us, as a condition of access to something that we are doing for market functioning, the ability to affect and constrain the risk-taking behavior of those institutions. All primary dealers, except for one, I believe, are subject to consolidated supervision in some form. Those primary supervisors, with which we have a very close-running relationship, often subject those institutions to a set of constraints, including in the investment banks a consolidated capital regime and a set of other constraints on liquidity.

We will, of course, be in very close contact, as we have been with those primary supervisors, about the evolving financial conditions of those institutions. If we have evidence, directly or through the supervisors, of some material erosion in the financial business of those institutions from a solvency perspective, that will cause us to reflect on what we do with those institutions going forward. I wish it were the case that we could condition this step on a change in the regulatory regime that would give us that capacity. But we just don't have that ability now. Are we protecting ourselves carefully against that risk? We are protecting ourselves carefully, but not perfectly, against that risk.

One last comment. The Desk has a lot of experience in affecting the incentive that primary dealers have—how much they can actually bid for, particularly in circumstances where the condition of the primary dealer is eroding quickly. That is not perfect, but it gives us some experience and some chance to make sure that we don't put ourselves in a position where we allow an institution that is deteriorating rapidly to take a progressively larger amount of a particular auction in that context. So although I agree with the concerns and I really am sympathetic to the objective, the reality today is that we can't remake this messy system we have in this context to give us that additional comfort.

MR. FISHER. Just a comment, Tim, if I may. You are right, and we can't stuff this ugly genie back in the bottle. But I think we should be thinking longer term as much as we can as to how we can reshape things, taking advantage of our franchise. I am not arguing against the program. But we are taking a risk here, and we want to mitigate the risk as much as possible. I am just saying that (a) we need to use this as leverage somehow over the longer term, as we become more comfortable with this, to exert our authority, and (b) in the way you just explained this, we need to have a good way of explaining it to the public because we are going to get severe criticism. I can see the criticism of almost lending blind, taking substandard collateral. That kind of cogent explanation is going to be very, very important, Mr. Chairman. We need to be prepared to explain this to our critics because we are going to have a lot of criticism on this front. So I thank you, Tim, for your response.

CHAIRMAN BERNANKE. I agree, President Fisher. We have deficiencies in our regulatory system. Even this change would take us short of what the ECB routinely already has because they don't have this division of commercial and investment banks, and they have essentially a much broader ability to take collateral. There is a problem, and it is a long-term issue. But the Treasury, for example, is looking at some of these regulatory structure issues going forward. Are there other questions? President Evans.

MR. EVANS. This discussion stimulated a question that I didn't anticipate. If we decide that there is a broker–dealer that we can't allow to enter into this program and then it ends up not doing very well and going under, is there some type of risk that we are taking on by hastening that in making that determination? Do we have the right information to take that action?

VICE CHAIRMAN GEITHNER. I agree that we face that risk. As many of us have learned over the past six to nine months, even the primary supervisors of these institutions have limits around their capacity to understand in real time what is actually happening. So we face that vulnerability—I agree with you—and that will limit, realistically, how much protection we are going to be able to take for ourselves in this context. I think that is a necessary and uncomfortable risk in taking this next step. I am not sure it is dramatically different from the risk we face with the discount window generally and with the TAF. It is different, of course, because of our limited supervisory reach over at least five of the institutions. But I think that you stated the risk well and that it is important to recognize that risk.

MR. EVANS. The interesting difference is that with the window and the TAF it is voluntary that you could come in. I suppose this is voluntary, but if we pick out somebody and say, "You can't participate," and if it's wildly successful—

VICE CHAIRMAN GEITHNER. But this is voluntary like the TAF. In that sense, it is equivalent. But you are right; it would be a consequential act for us to say to a primary dealer, "We are going to restrict you to X" or "We are not going to consider you eligible any more to bid." It would not be, we would hope, a visible act. But, of course, in taking the action we would be responsible, in some sense, for contributing to the failure of that institution.

CHAIRMAN BERNANKE. But not in a legal sense.

MR. DUDLEY. However, if we did improve market function, we would be helping that dealer.

CHAIRMAN BERNANKE. I think President Evans is asking if we would have liability in some legal sense, and I don’t think we would. We have the right to decline any counterparty.

MR. EVANS. Okay. Thank you.

CHAIRMAN BERNANKE. President Hoenig.

MR. HOENIG. Just a comment. When I read this paper, I sensed that you have to get comfortable with the fact that we are extending the safety net to a group with the goal of settling the markets, which reflects, in fact, the reality that we now have with this very integrated, much more complicated marketplace. As we do this, I think moving back from it will be much more difficult than we are anticipating. That is why going into this we make a pretty clear decision that we have opened the safety net to a broader group for the purposes of managing this crisis and that we will probably revisit this again, depending on whether we stanch this now or whether it continues forward—the question that we have been asking ourselves for several months. I think this is the way that we will find ourselves continuing down, depending on how long this lasts—that we are going to extend the safety net.

CHAIRMAN BERNANKE. I think we have moved into the commentary period. [Laughter] President Yellen, did you have a question?

MS. YELLEN. No, I don’t have a question.

CHAIRMAN BERNANKE. All right. Let’s start with President Lacker, then. President Lacker.

MR. LACKER. Thank you, Mr. Chairman. As all of you know, throughout this episode I have opposed measures using our balance sheet to attempt to arrest credit market developments, and so it will come as no surprise that I oppose, respectfully, this measure as well—and for similar reasons. These measures are all aimed, one way or another, at altering the relative prices of some financial claims. I think the burden of proof ought to be on those who are advocating such measures to provide evidence of some sort of market failure. I have yet to see a plausible case for market failure that would warrant such intervention by a central bank here. In this case, I don't think the concerns raised by the New York staff memo really come close, and it strikes me that they could equally well rationalize buying tech stocks in late 2000. More broadly, our efforts to ameliorate credit market conditions appear to be motivated by the notion that exogenous malfunctions internal to credit markets endanger the real economy. But it seems much more plausible to me now that the credit market phenomena we have been seeing over the past year are driven entirely by the evolution of expectations regarding the fundamental real return on mortgages and other primitives.

I have a deep concern that is particular to this proposal. This proposal crosses a bright line that we drew for ourselves in the 1970s in order to limit our involvement in housing finance. Legislators at that time were proposing various schemes that would involve using our balance sheet to fund various housing initiatives of one sort or another. In the current climate, legislators seem to be casting about for funds to bail out mortgage borrowers. Given the extent to which we have been singled out far more than any other federal regulators as scapegoats for this episode, it would be natural for them to contemplate raiding our portfolio—not to mention, in fact, that our portfolio is larger than other regulators' portfolios.

Whatever one feels about the advisability of fiscal policy of that sort, I think the legal memo did a creative job of interpreting the Federal Reserve Act as allowing direct ownership of this form. But I think we should view opening up this sort of expansive interpretation of the act as a relatively irreversible step because it will be next to impossible to put this interpretation back in the bottle and argue that the act prevents us from holding particular mortgage-backed securities outright. Setting this precedent is going to measurably weaken our ability to resist congressional proposals to use us and our balance sheet for off-budget fiscal policy. So, again, Mr. Chairman, I respectfully oppose this term securities lending facility.

CHAIRMAN BERNANKE. Thank you. Governor Kohn.

MR. KOHN. Thank you, Mr. Chairman. I thought I would begin, if it is okay with you, Mr. Chairman, with talking a bit about what I heard in Basel this weekend. I just got back this afternoon from Basel. I think it is fair to say that Bill's description of what is going on in U.S. financial markets is going on much more broadly. Liquidity has dried up in London and other European markets in particular, but elsewhere as well. There is really no price discovery. There is aggressive deleveraging and a flight to safety and soundness.

Spreads have widened everywhere. It is true that the EURIBOR–OIS spreads haven't widened very much in the one-month and three-month areas, unless something happened today. But the people from the ECB in Europe reported that they had widened beyond three months, suggesting that people expect this crisis to go on for quite a while. Even in European government bond markets, spreads have widened among different governments that are part of the ECB for the first time since the ECB was founded, reflecting probably liquidity rather than differences in perceived credit risk. Prices were perceived in European markets as well as in U.S. markets to be well out of alignment with any plausible path for economies. That is, the risk spreads were way out of whack with anything that might possibly happen to the economy. There was no price discovery. The prices that were out there were just being driven by fear.

Liquidity and solvency were becoming intertwined. The dysfunction in the securities markets and the banking sector were intertwined, and there was just a very vicious spiral going on in many financial markets. "Dysfunctional" was the word that a lot of people used to describe their home markets. Even in the emerging market economies, which so far had been relatively "decoupled"—in the current vogue phrase— from the industrial economies, there at least the financial markets were becoming coupled to our markets. One emerging market economist—this is in my CGFS, my global financial system group—reported that locally owned banks in his market were refusing to advance funds through their New York affiliates and their London affiliates to U.S. and European banks. I think I will pause there for the irony to sink in for a second. Those economies that had multinational banks operating in them said that the multinational banks with headquarters in Europe or the United States were definitely selling assets in emerging market economies, not only their portfolios in order to raise funds and hoard liquidity but also subsidiaries were being shopped around in order to conserve their capital.

It was broadly viewed that way by everybody, and my global financial system group probably has 35 countries—I don't know the exact number, but every industrialized country and a half a dozen emerging-market economies are represented. When I summarized the meeting just as I did for you and I asked if anyone disagreed with that summary, no hands went up. In that context, the G-10 governors were very concerned about what was going on and about the turn that financial markets had taken over the last couple of months, but especially over the past week. Any number of them said that they had been getting calls on Thursday and Friday from lots of market participants reporting the same type of dynamic that I was just describing to you and being very, very worried. In that context, they suggested—it didn't require any urging by me, I can assure you—that a coordinated announcement such as was undertaken in December would be an appropriate step to take. In addition to the swap actions, the United Kingdom and Canada are planning special auctions in their term funding markets much as they did in December, a similar combination. That will be announced tomorrow in conjunction with our stuff.

Let me go on to the TSLF and the swap lines. I support these steps, but I agree with the thrust of the questions. This is not an easy decision. It hasn't been easy for me in any regard. I think in many respects this is a logical next step. We are broadening the collateral. We're expanding securities lending. We're lengthening terms. We're being more aggressive in the term funding markets. We're holding auctions. This is an extension of what we've been doing all along in response to this crisis, and this is just the next step. Other central banks have been doing exactly the same thing, reaching out to counterparties, taking more collateral, and doing more at longer maturities. As you pointed out, Mr. Chairman, one very critical difference between us and the other central banks is that they are dealing with universal banks, so they don't have this division between investment banks and commercial banks in the United Kingdom and Switzerland and in Europe. When they do an open market operation, it's with the investment banks as well as the commercial banks because they are one and the same thing.

I think this facility is aimed at the critical piece of the market, the mortgage markets. This is where the problems are most acute and from where they are radiating out into the rest of the market, where the liquidity, price, and solvency interactions are most intense in this downward spiral that Bill described. As Bill and Debby noted, this swap, which can be expanded rapidly, is a very efficient way to try to address this problem, and we don't present the Desk with the issues of absorbing the reserves.

But I also acknowledge, as many of you pointed out, that we are crossing a line because of the combination of the collateral and counterparty. It is not so much the asset class—that's not the line we're crossing because we already crossed that line at the discount window. We've taken many classes of assets at the discount window for a long time. The line we're crossing is the combination of the collateral and the counterparty. That's why this has to be a combination of sections 14 and 13 of the act. We are setting a precedent of a sort. I mean, I think we can step back when markets improve, but it is a precedent. There are moral hazards. There are risks. There are reputational risks. I agree with all of those things, and as Chairman Bernanke can tell you, I was resistant to this idea when it was raised a little while ago.

But I have changed my mind, and I have changed my mind for a variety of reasons. The first and most important of them is the downward spiral that we're in. I had changed my mind before I went to Europe, but certainly hearing the people in Europe describe the same thing happening on a global basis just reinforced it. That is the most important thing that has happened. We are in dysfunctional markets, and we have to try what we can to help them along.

I think there are sensible steps here to limit the costs. The degree that the safety net is being extended is small, but the perception that it is being extended is there. I think we've limited it as best we can. If I thought that price discovery was occurring in these markets, I would be hesitant to do anything that might interfere with it. But there isn't any real price discovery happening. So I don't think this is a case that, if we could only get out of the way, the markets would find their prices, and then the prices would be low enough, and people would step in, and price and liquidity would be restored. That's not what's happening. The markets just aren't operating.

There are no guarantees that this will work. We're not addressing the solvency issues that are to a certain extent at the heart of this. But I do think liquidity and solvency are interacting in a particularly difficult and vicious way right now. To the extent that we have even a chance of breaking that spiral by intervening on the liquidity side—which is what the central banks are here for—and can help at least stabilize the situation, it may encourage the dealers to make markets if they know that we're behind there in terms of the AAA mortgage-backed securities tranche as well as the agencies and the agency mortgage-backed securities. I think it is well worth taking the chance in the current situation. One of the members of the CGFS said toward the end of our meeting on Saturday that “sometimes it’s time to think the unthinkable,” and I think that time is here for us right now, Mr. Chairman. Thank you.

CHAIRMAN BERNANKE. Thank you. President Yellen.

MS. YELLEN. Thank you, Mr. Chairman. I strongly support the proposed term securities lending facility. I certainly agree that we face a situation in which systemic risk is large, and it’s escalating very quickly. A dangerous dynamic has set in. Bill, Don, and all the memos did a great job in describing it. I think financial stability is truly at stake here, and although there are financial and reputational risks in pursuing this approach, it is a creative and well-targeted approach, and it is worth taking these risks to try to arrest the downward spiral in market conditions. Our monetary policy efforts have been seriously thwarted by the spread-widening that’s taking place, and the rapid escalation we’re seeing in these spreads—large increases in a matter of just the past couple of days in the absence of significant news that relates to the real creditworthiness of borrowers—suggests to me that the spread increases are, indeed, related to deteriorating liquidity conditions and not primarily to higher underlying credit risk. I think it is absolutely right to worry that liquidity problems are escalating into solvency problems. So as with the TAF, I am not 100 percent convinced that this is going to work, but I definitely think it is a good idea to move ahead and to do so quickly.

CHAIRMAN BERNANKE. Thank you. President Rosengren.

MR. ROSENGREN. Market conditions have deteriorated and are likely getting worse. I strongly support both the swap and the TSLF to help mitigate those problems. In the longer run, I think we do need to consider how to better assess counterparty risk to primary dealers. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Other comments? President Plosser.

MR. PLOSSER. Thank you, Mr. Chairman. I have just a couple of observations and a question. I am not terribly confident that this will have the effect we desire. I thought I heard Governor Kohn saying that the ECB actually does take this sort of risk and collateral and it's not working particularly well. So I'm not sure we ought to hold out a whole lot of hope that it will have the desired effect here. That doesn't mean we shouldn't try it, but I'm a little dubious. I am concerned with the comments that President Lacker and Governor Kohn made about crossing a line. However, having said that, I can go along with this proposal; but to be honest, I am concerned about the exit strategy here. Mr. Chairman, you said that we would stop when the markets were no longer impaired. I'm not exactly sure how we would define that at some point. I wonder whether it might be worthwhile thinking about putting this facility in place and doing it for a fixed period of time—I don't know, three months or whatever—and then having it automatically expire or to be renewed by a conscious act of this Committee rather than having an ongoing process where there was some vague notion of how we would define when we would remove it. I just offer that as an idea for doing this. I guess that's all I have to say. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. President Fisher.

MR. FISHER. Well, Mr. Chairman, extraordinary circumstances require extraordinary responses. I am very worried about this vicious cycle or, as Governor Kohn put it, vicious spiral of liquidity constriction. I have a lot of questions about the program, and I have, like President Plosser, a sort of end game concern, but I would vote in favor of this program. I think it is something we have to take a risk with. I would like very much for us to think through collectively or under your leadership, again, how we can use this to strengthen our franchise and at least influence this odd regulatory structure we have, which I think is insufficient. I have the same concerns that President

Rosengren has, which I expressed about having counterparties over which we don't have great influence, even though we have communication with other regulators. I also think it would be worthwhile, once we have set up this thing and are moving forward, to have some kind of decision tree on all the risk parameters that were outlined in the memo. If we inappropriately affect the pricing of financing credit or if the scale is too small or all the other risks that we're concerned about occur, what do we do under those circumstances? Where do we go next? What are the cutoff points?

This is a fine piece of work that took an awful lot to put together, but it would be helpful at least to me and I think it would be helpful to the Committee if we knew where these different branches would go under different circumstances and what our responses are likely to be so that we can be prepared to go forward. Having said that, I support the program with the different concerns that I have, and I would vote for it. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. On exit strategies, we do get a lot of feedback from the auction itself, of course, in terms of demand and price, and we can monitor the market conditions. Obviously, we'll keep you well apprised of developments in the markets and in the auction. I'm a little worried about having a firm cutoff date ex ante. If we want the dealers to make markets, we need them to feel that there will not be an arbitrary cutoff when the situation is still in a turbulent state. But that's just a thought. President Evans.

MR. EVANS. Thank you, Mr. Chairman. I support the extension of the swap and the term securities lending facility of up to the $200 billion amount that you're talking about. This can improve market functioning, as I understand the discussion; and it targets action to markets with major liquidity shortfalls, so I think that it is effectively targeting policy to the right place. It has some risks definitely, but it is important to do something innovative like this. I hope that, after these actions, market conditions might improve somewhat so that ultimately fewer adjustments in the funds rate might be called for. If so, then it's possible that the inflation risks that come with those adjustments might be more limited. That's not obviously true because the stance of policy depends on overall accommodation, including in financial markets, but that could be the case. If this works, as you were alluding to, we will get a lot of information from the auctions and the market conditions themselves. Removing this might be a lot easier than actually removing the funds rate accommodation that we talked about as being so important. So targeting this could have another beneficial effect on policy. I would guess that we would review or at least have some assessment of how the policy is working at each of the upcoming FOMC meetings, and that would be a natural time for the Committee to talk about that further. Thank you.

CHAIRMAN BERNANKE. Thank you. President Lockhart.

MR. LOCKHART. Thank you, Mr. Chairman. Just a couple of comments. I, too, am supportive. I think the escalating and lengthening crisis really justifies this, and I see the TSLF action really as a measured and incremental response. In that respect, I am somewhat concerned that it may be too small and that the market may react that it's too little and not preemptive enough. Having said that, I do think it's an appropriate step, and it has a chance of reversing the dangerous dynamic that Bill Dudley referred to because it helps housing finance and may have some positive effect on housing prices ultimately, and that's critical to stabilization. So I support both the TSLF and the swap. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Other comments? If you're prepared to take a vote—oh, I'm sorry. You know, it's very late here in the East Coast. Governor Warsh.

MR. WARSH. Thank you, Mr. Chairman. My comments will be short. I share the assessment that Bill Dudley and others made in terms of the market functioning, and I think the rolling capital call that we discussed at videoconferences appears to be accelerating, particularly in recent days. The most recent catalyst, as was pointed out, was counterparty weakness driven by large balance sheet exposures and a lack of term funding. Highly leveraged institutions are uncertain about a lot of things, but let me highlight two of them: first, the value of their collateral and, second, their ability to secure financing. I think today's action is an attempt to hit the second and not hit the first, and in so doing hopes to respect a pretty important line.

As I heard the discussion today and the discussion of the markets, it's as though three horses are competing in a race. The deleveraging horse seems to have raced ahead. The policy reaction function horse is the one we're working on now. The most important horse is the horse that represents fresh capital, and again, I think the goal of our policy is to get that third horse to go. I am trying to figure out what our objective function is here, and I think it is principally to help provide liquidity for high-quality assets held by a class of highly leveraged financial institutions so that we can do three things: buy time to facilitate price discovery, improve market functioning, and improve the efficacy of open market operations. We are not trying to establish asset values. We're not trying to buy assets. Those aren't our goals, and it strikes me that they shouldn't be. The hard question that came up at the outset is whether these actions can stabilize some part of the capital structure of financial institutions to help us achieve those objectives. For me, as Governor Kohn said, this is a very difficult call, but in the end I do support the judgment. I think we're going to have to continue to watch the extent to which the healing that might happen in the agency market and in the AAA MBS market moves down the quality spectrum, and we have to be alert to ensure that they don't come to us seeking solutions there but that we get that third horse back into the race. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. Governor Kroszner.

MR. KROSZNER. Thanks. I, too, support this facility, but I share with Governor Kohn some of the struggles over it. Are we crossing certain lines? Are we going a bit further than we might feel comfortable doing? Those questions are very serious ones, and the questions that have been raised about the program are quite valid. But given the conditions in the market and, at least as far as I'm concerned, the clear connection between solvency issues and liquidity issues and the fact that the only way we have to get indirectly at the solvency issues is through these liquidity provision mechanisms, I think that we should go forward with something like this.

It is crossing a line in terms of counterparty risk understanding and control. That's something that I'm certainly concerned about. We have pretty good relations with the SEC, but it's always different to be having good relations with the supervisor as opposed to actually being the supervisor or having the experience of supervising those institutions. So I think that is an important issue. There are concerns about the interpretation of what we are doing that could lead to moral hazard concerns. There are also concerns that this may be just another step along a path that we haven't really defined well. That is very important, and I very much agree—actually, I have forgotten who made these comments earlier—that we really need to think about the full path of where we're going because we did the TAF and that seemed to have a good effect initially but it doesn't seem to be having quite the same effect as we had hoped.

I don't really understand why some of the risk spreads have blown out again in the last week or two. That doesn't mean that we need to study it to death and that we can act only after we understand the origins of it. But I think we need to have a bigger-picture view to see what is going to go next and how to respond going forward to people who say, "Well, you've tried five different little things, and none has really worked, or they work as temporary palliatives." So I think we really need to understand the origins of this better to better understand how we can respond. We may have to respond very boldly in ways that we haven't done before, but trying to get that big picture of that direction could be helpful to the markets. We may not actually have to take some of those steps if they see that we could go there, but we would understand better what we will be needing to do down the line.

I'm hopeful that this could stop some of the problems, but I fear that it may be like the TAF initially. We'll do something that gets us in a good place for a short time, but then some of the bad dynamic between liquidity and solvency can come back, and we'll be back at a similar place in the not-too-distant future. I am supportive of this, but I do think we have to think about the bigger picture. Thank you.

CHAIRMAN BERNANKE. Any other comments? Vice Chairman Geithner.

VICE CHAIRMAN GEITHNER. Thank you, Mr. Chairman. Just a few final things. I support both of these steps, of course. I think monetary policy can't bear the full burden of dealing with these kinds of pressures, dangerous dynamics, in markets that Bill and Don described so well. This proposal is the best of a bunch of bad options. It is very hard to know how much effect it is going to have. It is very possible it will get overwhelmed by the sheer magnitude of the selling pressure, risk reduction, and forced deleveraging still under way. It is very hard for us to know now how much of that is necessarily ahead of us, even in a world where there is less uncertainty about the macro outlook. I think all of you who said this are right. There's some risk in doing this that we'll just face much more pressure to do more. But I think that pressure will be with us anyway, and it would intensify even without action in this context. The important thing is that the Congress gave us the authority, although they may not fully have envisioned the world we live in today, to do a range of things to address these kinds of pressures. Not to use that authority in carefully designed, responsible ways because of the fear that we could not resist pressure to expand is not, in my view, a good argument not to do things that we think would be sensible in mitigating these pressures. I think we are a stronger institution than we were. Jeff, you invoked the 1970s. We're a substantially stronger institution than then, and we have the ability to decide what we think is enough and what line we're not prepared to cross, and we should be confident that we're willing to draw that line and that we can sustain it.

Where do we go from here? If only we knew. I would like nothing more than to be able to sit here today and say, "If X, then it's obvious we would do Y, and if we do Y, then we could be confident we could contain it." But I don't think anybody can sit here and say that today. I think none of the options out there beyond this look good. The other options are much worse than this, and if we do not escalate now in this context, I think then we face much more risk that will get to much more uncomfortable options with much worse moral hazard concerns for us and the system as a whole.

So let me just say that I completely agree with the concerns expressed about this. They were eloquently stated by all of you, but I think it's very important that we continue to demonstrate through what we say and what we do that we are willing to do practical things that we think have some prospect of alleviating these pressures on market liquidity. So just to repeat, I support both the swap expansion and reauthorization and this new securities lending facility. Thank you, Mr. Chairman.

CHAIRMAN BERNANKE. Thank you. So, there are different ways to look at this. We're crossing certain lines. We're doing things we haven't done before. On the other hand, this financial crisis is now in its eighth month, and the economic outlook has worsened quite significantly. We are coming to the limits of our monetary policy capability. The Congress has passed a fiscal program. I do not know how much political capacity there is to do additional things, although I assure you that we will be thinking hard about it and I hope you will be, too.

So I view this really as incremental, and I think we need to be flexible and creative in the face of what are really extraordinary challenges. This is a combination of circumstances—a deep and abiding financial crisis, a serious slowdown, and inflation pressures. This combination is really a very challenging and an almost unprecedented combination. I think we need to be flexible, creative, and thoughtful in going forward. I think this is a very creative idea. It's well put together. We will have to do our very best to report regularly to the FOMC for your governance and your oversight of this process. It's not without risks, but I do feel that this is the next step. Whether we will have to take additional steps, we'll come back to you if we think we do or if you think we do. But right now I agree with Vice Chairman Geithner that this is probably the best option that we have, and it comes at a critical time in terms of where the markets are. If there are no other comments, I'd like to ask Scott to tell us what is required of us to move forward.

MR. ALVAREZ. You'll be asked to vote on three resolutions today—one that deals with the term securities lending facility and two that deal with the swaps. The Board is also voting separately to authorize part of the term securities lending facility. One matter I would note, because the rate on the TSLF must be set in the same way that other discount rates are set, we do need a recommendation on how to set the rates. However, because this facility involves just securities lending from the SOMA portfolio, it will be sufficient to receive a rate recommendation from just the New York Reserve Bank, and so the resolutions would not be needed from the boards of directors of the other Reserve Banks at this point. With that, I'll read the resolution for the term securities lending facility, and I will ask for a vote on that.

"In addition to the current authorization granted to the Federal Reserve Bank of New York to engage in overnight securities lending transactions, and in order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend up to $200 billion of U.S. government securities held in the System Open Market Account to primary dealers for a term that does not exceed thirty-five days at rates that shall be determined by competitive bidding.

These lending transactions may be against pledges of U.S. government securities, other assets that the Reserve Bank is specifically authorized to buy and sell under section 14 of the Federal Reserve Act (including federal agency residential-mortgage-backed securities), and non-agency AAA-rated residential-mortgage-backed securities.

The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow.

The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

This authority shall expire at such time as determined by the Federal Open Market Committee or the Board of Governors."

CHAIRMAN BERNANKE. President Lacker.

MR. LACKER. Scott, I'd like you to elaborate a bit on this last part. This was a little confusing. This lending apparently is by the New York Bank. How does it relate to the System Open Market Account? Is it by the New York Bank out of the System Open Market Account?

MR. ALVAREZ. That's correct. This is securities lending by the New York Reserve Bank out of the SOMA.

MR. LACKER. So while these securities we take in are on our books, they're on the System Open Market Account's books.

MR. ALVAREZ. Correct.

MR. LACKER. Okay. Thanks.

CHAIRMAN BERNANKE. Any other questions? Debbie, could you call the roll?

MS. DANKER.

Chairman Bernanke	Yes
Vice Chairman Geithner	Yes
President Fisher	Yes
Governor Kohn	Yes
Governor Kroszner	Yes
President Pianalto	Yes
President Plosser	Yes
Governor Warsh	Yes
President Yellen	Yes

Thank you.

CHAIRMAN BERNANKE. Thank you. We turn now to the swap authorization.

MR. ALVAREZ. There are two swap resolutions. The first: "The Federal Open Market Committee directs the Federal Reserve Bank of New York to increase the amount available from the System Open Market Account under the existing reciprocal currency arrangement with the European Central Bank to an amount not to exceed $30 billion. Within that aggregate limit, draws of up to $15 billion are hereby authorized. The current swap arrangement shall be extended until September 30, 2008, unless further extended by the Federal Open Market Committee."

MS. DANKER.

Chairman Bernanke	Yes
Vice Chairman Geithner	Yes
President Fisher	Yes
Governor Kohn	Yes
Governor Kroszner	Yes
President Pianalto	Yes

President Plosser	Yes
Governor Warsh	Yes
President Yellen	Yes

Thank you.

CHAIRMAN BERNANKE. Finally, the Swiss.

MR. ALVAREZ. "The Federal Open Market Committee directs the Federal Reserve Bank of New York to increase the amount available from the System Open Market Account under the existing reciprocal currency arrangement with the Swiss National Bank to an amount not to exceed $6 billion. Draws are authorized up to the full amount of the swap. The current swap arrangement shall be extended until September 30, 2008, unless further extended by the Federal Open Market Committee."

MS. DANKER.

Chairman Bernanke	Yes
Vice Chairman Geithner	Yes
President Fisher	Yes
Governor Kohn	Yes
Governor Kroszner	Yes
President Pianalto	Yes
President Plosser	Yes
Governor Warsh	Yes
President Yellen	Yes

Thank you.

CHAIRMAN BERNANKE. Thank you. There will be an announcement at 8:30 a.m. Eastern time tomorrow simultaneously with four other central banks and supporting statements from Japan and Sweden, just like in December. Brian, why don't you quickly read the announcement?

MR. MADIGAN. Okay. "Since the coordinated actions taken in December 2007, the G-10 central banks have continued to work together closely and to consult regularly on liquidity pressures in funding markets. Pressures in some of these markets have recently increased again. We all continue to work together and will take appropriate steps to address those liquidity pressures.

To that end, today the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, and the Swiss National Bank are announcing specific measures."

There is a section called "Federal Reserve Actions."

"The Federal Reserve announced today an expansion of its securities lending program. Under this new term securities lending facility (TSLF), the Federal Reserve will lend up to $200 billion of Treasury securities to primary dealers secured for a term of 28 days (rather than overnight, as in the existing program) by a pledge of other securities, including federal agency debt, federal agency residential-mortgage-backed securities (MBS), and non-agency AAA-rated private-label residential MBS.

The TSLF is intended to promote liquidity in the financing markets for Treasury and other collateral and thus to foster the functioning of financial markets more generally. As is the case with the current securities lending program, securities will be made available through an auction process. Auctions will be held on a weekly basis, beginning on March 27, 2008. The Federal Reserve will consult with primary dealers on technical design features of the TSLF.

In addition, the Federal Open Market Committee has authorized increases in its existing temporary reciprocal currency arrangements (swap lines) with the European Central Bank and the Swiss National Bank. These arrangements will now provide dollars in amounts of up to $30 billion and $6 billion to the ECB and the SNB, respectively, representing increases of $10 billion and $2 billion. The FOMC extended the term of these swap lines through September 30, 2008.

The actions announced today supplement the measures announced by the Federal Reserve on Friday to boost the size of the term auction facility to $100 billion and to undertake a series of term repurchase transactions that will cumulate to $100 billion."

Finally, there's a section on related actions being taken by other central banks with links to the other central banks' websites.

CHAIRMAN BERNANKE. Okay. Thank you all. Again, thank you for the short-notice meeting. I apologize for that. We'll see you next week in Washington. The meeting is adjourned.

END OF MEETING