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March 10, 2014

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

RE: Docket No. R–1476; RIN 7100–AE08; Extensions of Credit by Federal Reserve Banks

Dear Mr. Frierson:

Americans for Financial Reform ("AFR") appreciates this opportunity to respond to the Board's request for comments on its proposed rule regarding "Extensions of Credit By Federal Reserve Banks" (the "proposal"). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.

During the financial crisis of 2007-2009, the Federal Reserve used its 13(3) emergency lending powers on an unprecedented scale. Beginning in 2007, the Federal Reserve began the creation of a series of over a dozen lending facilities and special purpose entities that supported the financial system in numerous ways. At its peak of use in December 2008, the Federal Reserve had some $1.5 trillion in outstanding loans. Through the entire 2007-2009 period, over $20 trillion in lending flowed through these facilities. While individual loans were generally for a short time period, these facilities were used repeatedly and continuously by a small number of large banks. The average duration of use of the major lending facilities was 22 months, almost two years.[1] Furthermore, typical interest rates were very low – the largest three users of the Primary Dealer Credit Facility, for example, borrowed a total of $6 trillion at an interest rate of approximately 1%.[2] The sustained availability of cheap funding for long periods of time created the perception that these programs were not temporary liquidity support for solvent borrowers, but instead were a subsidy to permit a small number of troubled institutions to remain in operation. In other words, they were seen as a bailout.

The combination of 13(3) assistance with the equity provided by the Troubled Asset Relief Program (TARP) was central to 2008-2009 policies that appeared intended to avoid the

[1] Levy Economics Institute of Bard College, The Lender of Last Resort: A Critical Analysis of The Federal Reserve's Unprecedented Intervention After 2007, Ford Foundation, April, 2013.
[2] This rate was set to exceed the Federal Funds rate for interbank lending during the period, and did exceed the general rate for short-term interbank lending which had been driven to very low levels due to central bank interventions such as the ones described here. However, it was far below market rates such as the prime rate.

restructuring of insolvent systemically significant financial institutions (SSFIs). These policies involved the subordination of other vital public interests—such as the provision of credit to small and medium sized enterprises, and the preservation of home ownership—to the apparent goal of maintaining the existing capital structure of failed SSFIs. These policy choices contributed to millions of foreclosures, to mass unemployment and to anemic growth that continues to the present day. They also damaged the public's confidence in economic policy making and in the Federal Reserve.

It is of course true that these programs were successful in supporting the continued functioning and profitability of systemically significant financial intermediaries. However, only one of the major programs (the Term Asset Lending Facility or TALF) directly supported real economy lending, while other programs provided credit to a limited number of financial intermediaries. While we agree that economic outcomes would have been worse had the Board of Governors taken no action at all, we do not believe our economy or our democracy can afford another success of the kind that resulted from the combination of 13(3) and TARP. Thus it is critical that the rules implementing Section 1101 of the Dodd-Frank Act do not create a backdoor allowing the Board of Governors to thwart the intention of Title II of the Act, which promises that in the future failed SSFIs will be resolved, and not bailed out.

In accord with these intentions, Section 1101 of the Dodd Frank Act places new limitations on the use of 13(3) authority, which are designed to limit emergency lending to broadly available programs providing temporary liquidity support to solvent firms. In creating rules to implement Section 1101, the Federal Reserve has the opportunity to learn from the experience of the financial crisis and frame detailed policies and procedures that will provide effective and temporary liquidity support to troubled markets without creating moral hazard or appearing to place the interests of a limited number of systemically significant institutions above those of the broader public. Such a reappraisal and restructuring of Federal Reserve lender of last resort authority would be very valuable and is long overdue.[3]

Unfortunately, this proposal does not take advantage of the opportunity. It contains no analysis of the financial crisis, nothing other than boilerplate references to Title II of the Act, and no discussion of the broader issues of moral hazard in the financial system. Substantively, the rule mostly reiterates the language of the statute, and the drafters take advantage of every opportunity to interpret the statute in ways that minimize limits on emergency lending authority. While the rule complies with the letter of the law, it does not fulfill the spirit of the Congressional mandate that emergency lending be limited to broad based programs assisting solvent companies with temporary liquidity issues.

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[3] Even before the unprecedented interventions of the financial crisis, there was a long-term expansion of the Federal Reserve lender of last resort authority that raised concerns about excessive financial sector reliance on inappropriate public support. See Goodfriend, Marvin, "Lessons Learned From a Century of Federal Reserve Last Resort Lending", Testimony Before the Subcommittee on Monetary Policy and Trade, House Financial Services Committee, September 11, 2013.

The major specific issues in the rule are as follows:

1) **There is no clear time limit for reliance on Federal Reserve loans:** There are no specified limits on the time period that an institution or market may remain dependent on Federal Reserve assistance. It is true that 201.4(d)(4) of the rule requires periodic review of the justification of the program and its termination when circumstances no longer require it. However, there are no actual limits specified on duration of a loan or the number of times a loan may be turned over.[4] This leaves the door open for multi-year assistance programs of the type seen during the financial crisis.

2) **The definition of "solvency" is far too broad:** Section 1101 limits emergency lending authority to solvent entities. Yet the definition of solvency used here is far too broad. The rule relies on the definition of 'insolvent'' included in the new 13(3)(B)(ii) of the Federal Reserve Act, which states that:

   "A borrower shall be considered insolvent for purposes of this subparagraph, if the borrower is in bankruptcy, resolution under title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, or any other Federal or State insolvency proceeding."

   While the statute states that this is a required element of the definition of 'insolvent', it does not require that the Federal Reserve limit the insolvency definition to this stipulation alone. Yet the proposal does just that. Thus, the proposal would only restrict lending to firms if they were actually in a current insolvency proceeding. An effectively insolvent institution that was on the verge of declaring bankruptcy could be rescued 'on the courthouse steps' by Federal Reserve assistance. The proposal nowhere states that the Federal Reserve will attempt to assess whether institutions receiving assistance meet the ordinary language meaning of insolvency, namely having liabilities which exceed the value of its assets.

3) **There is little specificity in the definition of 'broad based or 'market'**: The proposal repeats the statutory language in requiring that any facility have broad based eligibility, and be designed to assist an identifiable market or sector. This would effectively ban interventions limited to a single institution, such as the Maiden Lane vehicles that assisted AIG and Bear Stearns. However, many of the largest financial crisis facilities were only available to a limited number of primary dealers, and borrowing from those facilities was dominated by an even smaller group of banks. For example, approximately 40 percent of the total lending from the major financial crisis facilities was accounted for

[4] Section 201.4(d)(8) of the rule restates already existing conditions on loans authorized by Section 13(13) of the FRA which are secured by U.S. government obligations. These loans are limited to 90 days. However, this does not appear to apply to the broader 13(3) emergency lending not secured by government collateral. There is also no mention of a limit on how many times such a loan may be turned over.

by just three banks.[5] There is no discussion in the proposal of what 'broad' would mean beyond ruling out an individual institution, and whether it would rule out facilities that were heavily weighted to supporting a narrow group of institutions. This is critical because every significant financial crisis in U.S. history has involved multiple institutions, and there is every reason to believe the next one will as well. A facility which supports a limited number of insolvent SSFI's, while allowing smaller institutions to flounder would be no more acceptable to the public or consistent with the purposes of the Act than a facility that was limited to one SSFI.

4) **There is no discussion of the interest rate at which credit may be extended**: Walter Bagehot famously recommended that lender of last resort liquidity assistance should be given at a 'penalty rate'. This limits the moral hazard that could be created by LOLR assistance and creates an incentive for recipients to terminate reliance on liquidity assistance as soon as possible. As discussed above, the interest rates for assistance provided through financial crisis facilities were well below generally available market rates (although of course they exceeded the extremely low short-term rates for interbank lending that were directly supported by Federal Reserve action). The proposal does not discuss the penalty rate issue, or specify interest rate terms on which aid might be provided. Again, this may set the stage for subsidizing an insolvent capital structure.

Combined, these issues imply that under this proposal it remains possible for 13(3) lending programs to be structured in a way that provides extended, possibly multi-year, assistance to a limited set of effectively insolvent institutions at interest rates well below those available to the broader market. The Federal Reserve likely does not intend to act in this manner and will endeavor to avoid such an outcome. But the most effective way to ensure that this does not occur is to set out specific commitments and procedures regarding emergency lending in advance, before a period of financial stress. During a financial crisis there are strong immediate incentives to prevent financial contagion through extended assistance to effectively insolvent institutions.

In addition, the lack of clear limitations on the duration or term of lending may also create issues for the valuation of collateral. If a 13(3) program is set up to assist a specific market, then presumably some of the collateral accepted for the program will be assets traded in that market. But the possibility of an essentially open-ended assistance program would affect asset valuations in the market, and make it more difficult to determine the long-term value of collateral after assistance ends.

We believe that there are straightforward ways to modify this proposal in ways that would address moral hazard and effectively limit assistance to truly solvent institutions, as Congress intended. Furthermore, we believe this can be done in a way that does not threaten the ability of financial regulators to provide genuine liquidity support for stressed markets on a temporary emergency basis.

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[5] These three banks were Citigroup, Merrill Lynch, and Morgan Stanley. See Levy Institute, op. cit. p. 1.

As an initial matter, we recommend that the Board specify in advance the period of time for which any institution may benefit from emergency lending programs. For example, the rule could specify that all 13(3) loans must be fully paid back within a period of 90 or 120 days from the receipt of the first lending assistance, with no roll over permitted beyond that date.

This change alone would very significantly strengthen this rule. A clearly time-limited program would give genuinely solvent institutions time to address a temporary interruption in liquidity and find private sector counterparties willing to lend against the true value of their assets. A program that provided several months of assistance would also give time to plan a bankruptcy or resolution proceeding for genuinely insolvent institutions, and time for Congress to determine if it wished to pass legislation providing longer-lasting assistance to an affected market. Effectively, 13(3) lending would become a 'bridge loan' to either bankruptcy, Title II resolution, or some other solution including more extended support provided through legislative action conducted with full public debate and discussion.

In assessing the effect of a strict time limitation on 13(3) assistance on the government's ability to provide liquidity assistance, it is crucial to recognize that other parts of the Dodd-Frank Act have provided important additional tools for responding to financial crises. Therefore, a second key change we urge the Board to make is to discuss in detail the manner in which 13(3) assistance is intended to interact with these tools. The two most important additional tools are:

- Title II resolution authority – Title II of the Dodd-Frank Act sets out a procedure by which regulators may access a Treasury line of credit for use in resolution and liquidation of an insolvent systemically significant financial institution.

- Section 1105 Emergency Financial Stabilization Authority – Section 1105 of the Dodd Frank Act grants the FDIC the capacity, subject to Congressional approval, to create a debt guarantee program for solvent depository banks and depository holding companies.

The combination of Title II and Section 1105 greatly expands the ability of financial regulators to respond to a demand for liquidity assistance or a financial contagion threat posed by a failing systemically significant institution. They weaken any case that might once have been made for open-ended 13(3) authority.

Although a strong time limitation on 13(3) authority is our most important recommendation, we also believe this proposal could be strengthened in several other ways.

First, the rule should impose a stronger) more rigorous definition of 'solvency', based on an examination of a recipient institution's assets and liabilities. The Dodd Frank Act significantly expanded the regulatory purview of the Federal Reserve, to include all major bank holding companies and also non-bank systemically significant institutions. Based on regular examinations, the Federal Reserve or another prudential agency should thus have better oversight of and access to major financial institutions in order to make a reasonable judgment as to their solvency. Of course, a truly broad-based program may extend beyond regulated banks or major financial institutions to include smaller market participants who are not supervised by the

Federal Reserve and whose solvency may be more difficult to judge. For such participants, the clear time limit on participation recommended above could still serve as some proof of solvency. While any forecast of solvency will inherently have a subjective component, it is striking that this proposal contains no effort to judge solvency in any manner other than the essentially circular definition of not currently being in bankruptcy.

Second, the Federal Reserve should establish in advance that 13(3) lending will only be provided at a penalty rate that exceeds some broadly available market rate. Penalty rates should not be set solely with reference to another rate set by the Federal Reserve such as the discount window or overnight Federal Funds rate. This will help limit moral hazard and encourage financial institutions to seek out private sector funding.

Finally, we encourage the Board to examine how any future emergency lending programs could more effectively support real economy lending and employment, rather than simply provide support to systemically significant financial intermediaries.

Thank you for the opportunity to comment on this rule. Should you have any questions, please contact Marcus Stanley, AFR's policy director, at 202-466-3672 or marcus@ourfinancialsecurity.org.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action

- Green America
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network

- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK

- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center

- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH

- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
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- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET