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Proposal and Comment Information

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Attached please find a comment letter from the Institute of International Bankers addressing the Board of Governors of the Federal Reserve System's Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit (Federal Reserve Board Docket No. OP-1838).

Best,

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VIA ELECTRONIC SUBMISSION
Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit Federal Reserve Board Docket No. OP-1838

The Institute of International Bankers (the "IIB") appreciates the opportunity to submit this letter in response to the Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit (the "RFI") of the Board of Governors of the Federal Reserve System (the "FRB").

The IIB represents the U.S. operations of internationally headquartered financial institutions from more than 35 countries around the world. The membership consists principally of international banks that operate branches, agencies, bank subsidiaries, and broker-dealer subsidiaries in the United States. The IIB works to ensure a level playing field for these institutions, which are an important source of credit for U.S. borrowers and comprise the majority of U.S. primary dealers. These institutions also enhance the depth and liquidity of U.S. financial markets and contribute significantly to the U.S. economy through direct employment of U.S. citizens, as well as through other operating and capital expenditures.

The IIB welcomes the FRB's ongoing effort to bolster contingency liquidity planning by reducing the operational burdens associated with accessing the discount window and intraday credit. The discount window is an important source of contingency funding for banking institutions, including Foreign Banking Organizations ("FBOs"). It serves an important backstop function, by enabling banking institutions to continue to support the economy through their lending and other banking activities during times of economic stress.

In order to serve as an effective backstop, the discount window needs to be modernized. We support the FRB's goal to have a discount window that can serve as a backstop to as much of a banking institution's lending activity as possible to prevent any sudden removal of credit from the economy during a crisis. To this end, we appreciate the effort to improve the operational shortcomings of the discount window so that banking institutions, including FBOs, are better able to prepare to utilize the window as a part of their contingency planning processes.

The IIB requests that the FRB consider the following operational improvements:

- The FRB should allow FBOs to submit discount window access documents with electronic signatures, similar to domestic institutions, or by electronic portal, so that FBOs are not unnecessarily impeded from maintaining ready legal access to the discount window.

- The FRB should reduce the operational burdens associated with pledging loans.

- The FRB should consider how to simplify the process of pledging loans with foreign obligors or that benefit from foreign guarantors.

- The FRB should implement a more accessible and automated method of determining the potential lendable value of pledged loans and securities.

- The FRB should work to extend the processing deadlines for the pledging of securities collateral.

- The FRB should make intraday credit easier to understand and use.

- The FRB should extend processing deadlines for requesting advances and make opening hours uniform across Reserve Bank districts and time zones to prevent unnecessary frictions.

- If the FRB decides to expand the operating hours of the Fedwire Funds Service ("FFS") and the National Settlement Service ("NSS"), it should make the discount window available during the expanded hours. In the alternative, it should alleviate the penalties for relying on overnight extensions of credit.

- The FRB should continue expanding Discount Window Direct in order to make the discount window process as online, accessible, and efficient as possible.

- The FRB should consider creative mechanisms to incentivize test draws from the discount window.

I. The FRB should allow FBOs to submit discount window access documents with electronic signatures, similar to domestic institutions, or by electronic portal, so that FBOs are not unnecessarily impeded from maintaining ready legal access to the discount window.

The FRB has taken important steps over the past year to encourage banking institutions to establish and maintain legal access to the discount window.[1] The FRB should continue this focus by eliminating unnecessary frictions to establishing and maintaining access. One such friction is the process by which banking institutions must inform the Reserve Banks of the individuals authorized to borrow on behalf of the institutions. Discount window borrowers must submit and keep current an OC-10 Authorization List with each Reserve Bank from which they may seek to borrow, which details the bank personnel that are authorized to request advances or pledge collateral from the Reserve Bank.[2] Each Reserve Bank requires that this authorization list be updated frequently "to reflect any changes to employment, staffing, contact information, or the action(s) that each individual is authorized to perform," but then also requires, with respect to FBOs, that each update be submitted using wet-ink signatures (or as may be otherwise instructed by individual Reserve Banks), and by up to three individuals at the FBO.[3] Although domestic banking institutions may submit these operational access documents with electronic signatures, FBOs are not permitted to do so in all instances.[4]

The IIB suggests several steps to improve readiness. First, allow FBOs to submit such updates using electronic signatures or, better yet, an electronic portal. Electronic signatures are standard and recognized by law in the United States, and the FRB should not have undue concerns about electronic authentication processes with respect to FBOs that are authorized to operate in the United States, and for whom other counterparties in the market readily accept electronic signatures. Second, consider how often FBOs (and other banking institutions) are required to update the list. The IIB has seen instances where even minor changes in title have caused Reserve Banks to require the new submission of such forms and accompanying resolutions, leading to complexity and, perhaps more concerning from a contingency planning perspective, delay. Third, for FBOs with offices or subsidiaries that have access to multiple Reserve Banks, require only one submission, rather than multiple—or, as discussed

[1] *Discount Window Readiness*, Board of Governors of the Federal Reserve System (Apr. 12, 2024), https://www.federalreserve.gov/monetarypolicy/discount-window-readiness.htm.

[2] *OC-10 Agreements*, Federal Reserve: Discount Window (Oct. 24, 2024), https://www.frbdiscountwindow.org/Pages/Agreements/OC10_Agreements.

[3] *Appendix 4 Form OC-10: Official Authorization List*, Federal Reserve: Discount Window, https://www.frbdiscountwindow.org/-/media/Documents/OC10_docs/OC10-Appx4_OAL.pdf?sc_lang=en&hash=C45E6B76E5BF74F07E19A6F2B2901B9C (last visited Dec. 3, 2024).

[4] *Instructions for Completing Required OC-10 Agreements*, Federal Reserve: Discount Window (Oct. 24, 2024) (document available at the following webpage: https://www.frbdiscountwindow.org/Pages/Agreements/OC10_Agreements).

below, enhance Discount Window Direct or another electronic portal to enable updates to be handled instantly and seamlessly.

II. The FRB should reduce the operational burdens associated with pledging loans.

Because of the nature of their businesses—lending to support foreign investment in the U.S.—FBOs tend to have a significant amount of loan collateral, often more than other similarly situated financial institutions. As a result, the manual nature of the discount window's pledging and valuation process for loans can be especially burdensome for FBOs. For branches and agencies with smaller staff, especially, the reporting requirements of the borrower-in-custody ("BIC") program can be a significant disincentive to pledge collateral to the discount window. To address these heightened operational burdens, the FRB should institute the following changes:

a. The FRB should automate and streamline the loan pledging process and reduce duplicative documentation requirements.

Initiating the loan pledging process is resource-intensive, requiring extensive manual processes, many of them specific to particular Reserve Banks. The FRB should consider opportunities to automate and streamline the loan pledging process and remove unnecessary burdens so that FBOs have better incentives to pledge collateral to the discount window. The FRB could consider making available credit for pledged loans automatic, as some former Federal Reserve staff have suggested.[5]

The FRB should also consider if there are ways to streamline ongoing reporting. The current process requires the pledging institution to submit periodic reports, at least monthly. These reports often include repeating and resubmitting information that has been reported previously, either as part of the initial eligibility review or as part of a prior monthly report. Moreover, the reporting format is outmoded and burdensome. All "in-scope" institutions, a category which includes all foreign banking organizations no matter their size, must "send a plain text file of vertical pipe (|) separated fields containing the required loan fields on loans pledged as collateral."[6] Pledging institutions that make even small ministerial errors in implementing this unusual format may have their reports rejected, leading to delays in readiness to pledge collateral.

[5] *See, e.g.*, Susan McLaughlin, *Lessons for the Discount Window from the March 2023 Bank Failures*, Yale School of Management (Sep. 19, 2023), https://som.yale.edu/story/2023/lessons-discount-window-march-2023-bank-failures.

[6] *Pledging Collateral*, Federal Reserve: Discount Window, https://www.frbdiscountwindow.org/pages/collateral/pledging_collateral (last visited Dec. 3, 2024).

The FRB could consider a number of improvements to this process. The FRB should develop an online portal, perhaps as an enhancement to Discount Window Direct, so that institutions can directly enter information about their loans. Direct entry would enable institutions to keep the Reserve Banks more current on the state of their portfolios than does the monthly reporting regime, while eliminating the need to submit redundant reports. This type of change would lead to better risk management for the Reserve Banks, and increased readiness and lower operational risk for pledging institutions.

Short of such a change, the FRB could consider smaller process improvements. The Reserve Banks should move to a more modern file format for required reports. The Reserve Banks could require reporting less frequently, particularly if a loan portfolio is relatively small. Finally, the Reserve Banks could remove the requirement that banks re-submit repetitive data elements that have already been submitted in prior reports.

b. <u>The FRB should modify collateral policies that have unusual "cliff effects," such as the restriction on any affiliate collateral in a loan portfolio.</u>

The FRB should take this opportunity to look at collateral policies that, while they make sense to safeguard the Reserve Banks from risk on some level, prevent the discount window from providing an effective backstop to legitimate financing activity. For example, the FRB does not accept loans that "may…be obligations of the pledging institution or an affiliate of the pledging institution, or otherwise correlated with the financial condition of the pledging institution."[7] This policy makes sense, generally: a Reserve Bank should not want collateral that is likely to have problems when the pledging institution has problems. There are instances, however, when the administration of this sensible policy has the effect of invalidating more collateral than is necessary or optimal from the FRB's perspective. Banks sometimes make loans to individuals that are collateralized by their entire portfolios, which sometimes will include certain securities or loans from an affiliate of that pledging bank. If the affiliate securities are not material to the collateral package, banks should be able to pledge such loans. The FRB could evaluate whether there are mechanisms to address this and other "cliff effects" that its otherwise sensible credit policies create.

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[7] *Collateral Eligibility*, Federal Reserve: Discount Window, https://www.frbdiscountwindow.org/Pages/Collateral/collateral_eligibility (last visited Dec. 3, 2024).

III. The FRB should consider how to simplify the process of pledging loans with foreign obligors or that benefit from foreign guarantors.

FBOs provide crucial funding to foreign companies investing in the U.S. economy, financing businesses and employment in the U.S. For example, FBOs will frequently lend to a U.S. subsidiary of a foreign company that benefits from a guaranty from a foreign parent. However, the Reserve Banks limit how and whether they will accept loans to foreign obligors or with foreign guarantors. The Reserve Banks vary in their practices, but some will not accept loans to foreign obligors or that rely on the strength of foreign guarantors (or foreign obligors or guarantors not headquartered in the same jurisdiction as the FBO) unless the banking institution provides a legal opinion supporting perfection and enforceability of the obligation directly to the Reserve Bank after engagement directly with Reserve Bank counsel—a costly and onerous process.[8] The rejection of loans that rely on the strength of foreign guarantors is particularly burdensome, and can require the operational implementation of new controls designed to meet the FRB's unclear standard for what is and is not restricted.

While the IIB understands that the Reserve Banks that impose this requirement are concerned about risks that they may face in enforcing their security interests against foreign obligors and guarantors, in practice, this requirement means that such collateral is rarely pledged before a stress event. This is the opposite outcome of what the FRB is seeking to achieve in its discount window readiness campaign, and an outcome that disproportionately affects FBOs.

The FRB should consider whether these policies should be liberalized so that FBOs and other borrowers would be incentivized to engage in prudent liquidity planning. FBOs, as supervised banking institutions, engage in extensive underwriting of their loans, which includes identifying the risks associated with them and any potential concerns about enforceability in international jurisdictions. When FBOs lend, to the extent that foreign law is material to the FBOs' assessment of the overall collateral package, they will often receive legal opinions about perfection and enforceability. These legal opinions are taken into account as the FBOs risk-rate their portfolio, just as they would be in the context of a loan to a domestic obligor or with a domestic guarantor. The IIB recommends that the Reserve Banks give credit to these processes.

If an FBO has received a reasoned legal opinion in the relevant foreign jurisdiction regarding perfection and enforceability of an obligation, we recommend a presumption in favor of accepting the collateral. This would reduce the need for the cumbersome, manual process of seeking individualized legal counsel review and approval for these kinds of loans, better allowing access to liquidity for such collateral.

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[8] *Id.*

In the alternative, to promote more efficient judgments about loan eligibility, the FRB could analyze, and consider publishing, the desirable characteristics of foreign legal systems and/or loan types that would promote its ability to enforce against loan collateral. Further, Reserve Banks could consider whether applying appropriate margin adjustments that reflect the Reserve Banks' assessment of the enforcement risk may be appropriate, similar to how the Reserve Banks handle other types of risks.

IV. The FRB should implement a more accessible and automated method of determining the potential lendable value of pledged loans and securities.

Banking institutions that are taking prudent steps to secure financing for their loan and securities portfolios need to be able to gauge how much lendable value they may receive for their collateral. It is hard to do so with the discount window because of the wide ranges in the margin schedules, particularly for loans. Currently, the only feasible way for banking organizations to determine the value of a pledged loan at the discount window may be by either going through the process of pledging the loan or by receiving an ad hoc valuation from a Reserve Bank. The lack of a streamlined valuation method that clearly and quickly tells banks what their loans may be worth results in banking organizations experiencing unnecessary friction in determining the benefits of pledging collateral at the discount window. For smaller FBOs with fewer operational resources, this additional friction and uncertainty disincentives pledging collateral to the discount window, limiting its effectiveness as a source of liquidity during times of stress.

The FRB should provide more and better online tools for evaluating collateral eligibility and valuations. For example, the FRB could consider implementing online tools by which a banking organization could input relevant characteristics of collateral—either a loan or a security—and quickly receive an indication of the potential value for which it may be eligible.

V. The FRB should work to extend the processing deadlines for the pledging of securities collateral.

Financial markets are evolving quickly and, as seen in the regional banking stress of 2023, liquidity pressures can develop far more rapidly than in the past. Accordingly, the IIB suggests that the FRB work with securities depositories to extend the processing hours for pledging collateral. Currently, the deadlines for pledging securities collateral depend on the appropriate depository.[9] While we recognize that these deadlines may be imposed by those entities, the IIB suggests that the FRB (and other central banks) continue to work with securities depositories to extend processing timelines so that backstop liquidity is available as funding markets evolve.

[9] *Pledging Collateral*, Federal Reserve: Discount Window, https://www.frbdiscountwindow.org/pages/collateral/pledging_collateral (last visited Dec. 3, 2024).

VI. The FRB should make intraday credit easier to understand and use.

The FRB recognizes that intraday credit is an important tool to foster the safety and efficiency of payment and settlement systems. In order to make intraday credit more operationally robust, the IIB suggests several improvements. First, similar to our suggestion above with respect to collateral valuation, the FRB should provide an electronic means for banking institutions to see their available net debit cap and max cap in real time. This could be done by enhancing the Discount Window Direct tool. This improvement would remove ambiguity and the unwelcome delay that comes with manually checking available net debit cap and max cap levels with Reserve Bank staff. Increasing transparency and reducing latency are particularly important as funding markets gain speed and complexity. Second, the IIB suggests that the Reserve Banks offer a testing environment for intraday credit usage. Banking institutions may not test intraday credit usage properly without draining reserves from a bank's account, which is difficult and undesirable. Instead, the Reserve Banks could create a testing environment, as they have in other instances, to facilitate testing and operational readiness to use intraday credit.

VII. The FRB should extend processing deadlines for requesting advances and make opening hours uniform across Reserve Bank districts and time zones to prevent unnecessary frictions.

During times of stress in the market, the need to borrow from the discount window may not be known to a banking institution until mid-day or later. This puts pressure on the deadlines for borrowing.

The FRB should consider extending the deadlines for requesting advances at the discount window. The deadline for requesting advances from the discount window is 6:30 P.M. ET (in the relevant Reserve Bank district) and the final deadline for cash settlement of such advances is at 7:00 P.M. ET. The FRB should consider extending the deadlines for requesting an advance—at least until 7:00 P.M. ET, and potentially later if feasible. In addition, the Reserve Banks should establish consistent practices for extending such deadlines during times of special stress in financing or other markets, so that the discount window can play its intended role as a source of backstop financing.

Second, the hours of the discount window's operations should be made uniform across all Federal Reserve Districts and time zones. FBOs, like domestic institutions, sometimes have operations that access the discount window through multiple Reserve Banks. The current variation in the opening hours of each Reserve Bank's discount window operations causes unnecessary operational friction and complexity for such institutions.

VIII. If the FRB decides to expand the operating hours of the Fedwire Funds Service and the National Settlement Service, it should make the discount window available during the expanded hours. In the alternative, it should alleviate the penalties for relying on overnight extensions of credit.

The IIB submitted a letter on September 6, 2024, in response to the FRB's request for comment on a proposed expansion of the operating hours of FFS and NSS. In that letter, the IIB recommended that, if the FRB were to expand the hours of FFS and NSS, the FRB expand the hours of the discount window accordingly, and the IIB repeats that recommendation here. There needs to be a backstop source of liquidity available when large-value payments systems are operating or participating banks are subject to liquidity risk. If the FRB declines to extend the discount window hours, the FRB should alleviate the penalties for overnight extensions of credit on those days when the discount window is not available, for the same reasons.

IX. The FRB should continue expanding Discount Window Direct in order to make the discount window process as online, accessible, and efficient as possible.

Currently, banking institutions are able to request advances via the Federal Reserve's new Discount Window Direct online application. This online tool is precisely the type of operational improvement that facilitates streamlined access to the discount window, providing quick and simple access to liquidity in times of crisis. The FRB should continue expanding the functionality of Discount Window Direct, so that more legal readiness, pledging and valuation activity is able to be conducted in the online portal.

X. The FRB should consider creative mechanisms to incentivize test draws from the discount window.

Banking institutions remain concerned about the "stigma" that sometimes accompanies discount window borrowing, despite official efforts to allay such concerns. This concern about stigma can disincentivize banks from engaging in testing of borrowing from the discount window, since such draws, even if tests, will show up in required public reporting approximately two years afterwards. The FRB could consider creative mechanisms to incentivize test draws in light of these reasonable concerns, such as by establishing a virtual test environment that does not involve an actual draw. The FRB could also consider providing specific instructions on how to engage in a test drawing, with parameters that would clearly signal that a particular transfer is a test (for example, by requiring test draws to be done during the middle of a month or with a set, de minimis "test" draw amount).

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The IIB appreciates the opportunity to submit these comments. We look forward to engaging with the FRB further on operational improvements to the discount window and intraday lending.

Sincerely,

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