

FEDERAL RESERVE SYSTEM

12 CFR Part 201

Regulation A; Docket No. R-1123

Extensions of Credit by Federal Reserve Banks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board of Governors is publishing for comment a proposed amendment to Regulation A that would replace the existing adjustment and extended credit programs with new discount window programs called primary credit and secondary credit, respectively. This proposed restructuring of Federal Reserve credit programs is designed to improve the functioning of the discount window and does not represent a change in the stance of monetary policy. The proposed rule also would reorganize and streamline existing provisions of Regulation A. The Board solicits comment on all aspects of the proposal.

DATES: Comments on the proposed rule must be received not later than [INSERT DATE 90 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Comments should refer to docket number R-1123 and should be sent to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551 or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered between 8:45 a.m. and 5:15 p.m. to the Board's mail facility in the west courtyard of the Eccles Building, located on 21st Street between Constitution Avenue and C Street, N.W. Members of the public may inspect comments in accordance with the Board's Rules Regarding the Availability of Information (12 CFR part 261) in Room MP-500 of the Martin Building on weekdays between 9:00 a.m. and 5:00 p.m.

FOR FURTHER INFORMATION CONTACT: Brian Madigan, Deputy Director (202/452-3828) or William Nelson, Senior Economist (202/452-3579), Division of Monetary Affairs; or Stephanie Martin, Assistant General Counsel (202/452-3198) or Adrienne Threatt, Senior Attorney (202/452-3554), Legal Division; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202/263-4869.

SUPPLEMENTARY INFORMATION:

Background

Current Credit Programs of Reserve Banks and Their Relationship to Monetary Policy and Open Market Operations.

Under existing Regulation A, the Reserve Banks may make credit available to depository institutions at the discount window by making advances secured by acceptable collateral or by discounting paper that meets the requirements of the Federal Reserve Act. Reserve Bank credit usually takes the form of an advance.

Reserve Banks make credit available at the discount window through three credit programs: adjustment credit, seasonal credit, and extended credit. Adjustment credit is available for short periods of time at a basic discount rate that, over the past decade, typically has been 25 to 50 basis points below the market rates that apply to overnight loans, as indexed by the federal funds rate. Reserve Banks also extend seasonal credit for longer periods than permitted under the adjustment credit program to help smaller depository institutions meet funding needs that result from expected patterns in their deposits and loans. Finally, Reserve Banks may provide extended credit to depository institutions where similar assistance is not reasonably available from other sources. The rates applied to seasonal and extended credit are at or above the basic discount rate.

When implementing monetary policy, the Federal Reserve relies primarily on open market operations to supply reserves to the banking system and currency to the public and to make short-run adjustments in reserves. However, lending to depository institutions through the discount window aids the Federal Reserve's open market operations in two important ways. First, discount window lending provides additional reserves to the overall banking system when the supply of reserves provided through open market operations falls short of demand. Second, discount window lending provides a temporary source of reserves and funding to financially sound individual depository institutions that have experienced an unexpected shortfall in reserves or funding. Discount window credit permits such an institution to make payments without incurring an overdraft in its Federal Reserve account or failing to meet its reserve requirements. Historically the Federal Reserve System has relied on the adjustment credit program to accomplish these two objectives.

The discount window also can, at times, serve as a useful tool for promoting financial stability by providing temporary funding to depository institutions that are experiencing significant financial difficulties. The provision of credit to a troubled depository institution can help to prevent the sudden collapse of the institution by easing liquidity strains while the institution is making a transition to more sound footing, or by facilitating an orderly closure of the

institution. An institution obtaining credit in such a situation must be monitored appropriately to ensure that it does not take excessive risks in an attempt to return to profitability and does not use central bank credit in a manner that would increase costs to the deposit insurance fund of resolving the institution if resolution were to become necessary. Historically, the Federal Reserve System has relied on extended credit to aid depository institutions experiencing significant financial difficulties.

The Rationale for Changing the Basic Framework through which Reserve Banks Extend Credit.

A below-market discount rate creates incentives for institutions to obtain adjustment credit to exploit the spread between the discount rate and the market rates for short-term loans. Regulation A therefore provides that a Reserve Bank cannot extend adjustment credit to a depository institution until the institution exhausts other sources of funds. Regulation A also provides that recipients may not use adjustment credit to finance sales of federal funds.

Because of the restrictions necessitated by a below-market discount rate, a substantial degree of Reserve Bank administration is associated with adjustment credit. In particular, the Reserve Bank may need to review each prospective borrower's funding situation to establish that the borrower has exhausted other reasonably available sources of funds and that the reason for borrowing is appropriate. Because that evaluation necessarily is subjective, achieving a reasonable degree of consistency in credit administration across the System is difficult.

The administration of and restrictions on discount window credit create a burden on depository institutions that reduces their willingness to seek credit at the discount window. In addition, the rules governing discount window credit have proved difficult to explain, and depository institutions often have cited uncertainty about their borrowing privileges as a disincentive to seek credit. Depository institutions also have expressed concern about the requirement that borrowers fully utilize other sources of funds before borrowing adjustment credit. Institutions have expressed concern that turning to the window after signaling in the market their need for funds could be interpreted as a sign of weakness, particularly during periods of financial stress. Concerns such as these have limited the willingness of depository institutions to borrow at the discount window, even in circumstances of extremely tight money markets where such borrowing would have been appropriate. The reluctance to borrow in turn has limited the discount window's effectiveness in buffering shocks to money markets.

In light of the drawbacks associated with the current below-market discount window programs, the Board believes that the interests of depository institutions, the Federal Reserve System, and the economy more generally would be served more effectively by an above-market lending program. Under the Board's proposed rule, Reserve Banks would extend credit under the primary credit program to institutions the Reserve Banks determine to be generally sound.

Primary credit usually would be extended at an above-market rate, which should essentially eliminate the incentive for institutions to seek discount window credit simply to exploit the usual spread between the discount rate and short-term market rates. Eliminating this incentive would reduce sharply the need for administration regarding the extension and use of Federal Reserve credit. The streamlined eligibility criteria also should encourage greater uniformity in administration of the discount window across Federal Reserve districts. By minimizing a Reserve Bank's need to question potential borrowers, not requiring that an institution first attempt to borrow elsewhere, making the borrowing program significantly more transparent, and limiting extensions of primary credit to generally sound financial institutions, the proposed above-market lending program should reduce depository institutions' reluctance to borrow when money markets tighten sharply. As a result, the discount window should become a more effective policy instrument.

The Board reiterates that replacing the current below-market adjustment credit program with an above-market program would not signal a shift in the stance of monetary policy. Rather, the proposed changes represent a broad structural change that should enable the discount window to operate more efficiently as a source of funds for individual depository institutions and as a mechanism for implementing the policy objectives of the Federal Reserve System. The proposed structure of providing credit at the margin at above-market interest rates also would be similar to mechanisms adopted by other major central banks.

Section-by-Section Analysis

The Proposed Changes to the Discount Lending Framework -- §§ 201.4 and 201.51.

The Board proposes to replace the adjustment credit with a new lending program called primary credit and the extended credit program with a new program known as secondary credit. Although the proposed regulation retains the seasonal credit program with minor revisions, as discussed in more detail below the Board specifically requests comment on whether a seasonal credit program remains necessary and, if so, whether the interest rate on seasonal credit would more appropriately be set at the primary discount rate. As required by the Federal Reserve Act, all advances made under the proposed discount lending programs would have to be adequately collateralized. The Reserve Banks' collateral policies would be unchanged and they would continue to accept a broad range of financial assets as collateral for discount window loans.

The substantive changes to the lending programs are contained in § 201.4 of the proposed rule, which replaces existing § 201.3. The rates that apply to the proposed lending programs are described in § 201.51, which combines and replaces existing §§ 201.51-201.52. Primary Credit.

Primary credit would replace adjustment credit, would be extended on a very short-term basis (usually overnight) at an above-market rate, and ordinarily would be available to generally sound depository institutions with little or no administrative burden on the borrower or the Reserve Banks. A Reserve Bank also could extend primary credit with maturities up to a few weeks to a depository institution if the Reserve Bank finds that the institution is in generally sound condition and cannot obtain such credit in the market on reasonable terms. The Board expects that institutions receiving longer-term primary credit would be relatively small institutions that lack access to national money markets.

Although the primary credit program is designed to make short-term credit available as a backup source of liquidity to generally sound institutions, a Reserve Bank is not obligated to extend primary credit. A Reserve Bank therefore may choose not to lend to a generally sound depository institution if the Reserve Bank determines that doing so would be inconsistent with the purposes of the primary credit program.

Section 201.4(a) of the proposed rule describes the primary credit program, and § 201.51(a) sets forth the rate that applies to primary credit.

1. Interest Rate Applicable to Primary Credit.

The interest rate on primary credit ordinarily would be above short-term market interest rates, including the target federal funds rate, and would be set by the boards of directors of the Reserve Banks subject to review and determination by the Board of Governors. A substantial spread between the discount and market rates would encourage depository institutions to use primary credit only to meet short-term, unforeseen needs. If the spread were too wide, however, the primary discount rate would not cap the federal funds rate at a reasonable level above the rate targeted by the Federal Open Market Committee (FOMC).

The Board proposes to recommend that the boards of directors of the Reserve Banks, subject to the Board's review and determination, initially establish a primary discount rate that is 100 basis points above the FOMC's then-prevailing target for the federal funds rate. A spread of 100 basis points would be similar to the spreads employed by other central banks and likely would place the primary discount rate somewhat above the alternative cost of overnight funds for eligible depository institutions. The Board believes that public comment could help inform the Federal Reserve System's choice of the initial spread between the federal funds and discount rates and assist the boards of directors of the Reserve Banks when they establish rates subsequently. The Board therefore specifically solicits comment regarding the interest rate spread.

After establishment of the initial primary discount rate, the Federal Reserve System would change that rate through a process identical to the existing discretionary procedure for

changing the basic discount rate. The boards of directors of the Federal Reserve Banks would establish a primary discount rate and other discount rates every two weeks subject to review and determination by the Board of Governors, as required by the Federal Reserve Act. The primary discount rate presumably would move broadly in line with the target federal funds rate, much as the basic discount rate does currently.

2. Eligibility for Primary Credit.

Under the proposed regulation, only depository institutions deemed generally sound in the judgment of the Reserve Bank would be eligible to obtain primary credit. Reserve Banks would classify depository institutions with borrowing agreements already on file as either eligible or ineligible for primary credit before a primary credit program takes effect and would notify each such institution of its status. A new applicant for Federal Reserve credit would be notified of its eligibility after filing borrowing documents with the appropriate Federal Reserve Bank. The Reserve Banks would notify an institution promptly of any change in the institution's eligibility status. An institution's eligibility status, which would be based in part on that institution's confidential supervisory and examination information, would be considered confidential information and the Federal Reserve System would handle it accordingly.

The Board expects that the Reserve Banks would adopt on a System-wide basis uniform guidelines for judging the degree of an institution's financial soundness and thus its eligibility for primary credit. The Board envisions that the guidelines for determining eligibility would be based primarily on supervisory ratings, but supplementary information, such as ratings issued by major rating agencies, spreads on subordinated debt, and information from supervisory exams in progress, also would be considered. The Board further expects that the majority of depository institutions would be eligible for the primary credit program under such guidelines.

The Board anticipates that Reserve Banks initially would adopt guidelines under which domestically chartered depository institutions with composite CAMELS ratings of 1 or 2 and U.S. branches and agencies of foreign banking organizations with Strength of Support Assessment (SOSA) composite rankings of 1 would be eligible for primary credit, unless supplementary information suggested that the financial condition of the depository institution had deteriorated since the most recent exam. Similarly, the Board expects that under the initial guidelines institutions rated CAMELS 3 or SOSA 2 would be eligible for primary credit if supplementary information suggested that they were generally sound. However, the funding situation of such institutions seeking credit would be reviewed and monitored more closely than that of stronger institutions. The Board expects that institutions rated CAMELS 4 or SOSA 3 would be ineligible for primary credit except in rare circumstances, such as an ongoing examination that indicated a substantial improvement in condition. The Board further anticipates

that institutions rated CAMELS 5 would in no case be eligible for primary credit and could obtain only secondary credit.

Because lending to troubled institutions would be subject to careful monitoring, the expected eligibility criteria would be consistent with the intent of the guidelines for discount window lending included in section 10B(b) of the Federal Reserve Act, as added by the Federal Deposit Insurance Corporation Improvement Act. The criteria also would be consistent with the guidelines used by Federal Reserve Banks to determine institutions' access to daylight credit in the Payments System Risk policy. In general, the depository institutions that qualify for access to daylight credit would qualify for primary credit, and those that would not qualify for daylight credit would be restricted to secondary credit.

A depository institution that meets the eligibility criteria adopted by the Reserve Banks would not be required to exhaust other reasonable available sources of funds before obtaining primary credit. The removal of this requirement is consistent with the overall reduction in discount window administration under the proposed new discount window structure. In addition, depository institutions that receive primary credit would be free to sell federal funds to others. This would enhance the ability of the primary credit rate to serve as a cap on the federal funds rate when money markets tighten. The Board would encourage financially sound institutions to use primary credit to fund sales of federal funds if such transactions were in their financial interest.

3. Benefits of a Primary Credit Program.

Because of the reduced administration and corresponding reduction in the reluctance of depository institutions to borrow, the Board expects that primary credit would serve as a more effective safety valve for the banking system and a backup source of liquidity for individual depository institutions that are financially sound.

The proposal to adopt a primary credit program also is an aspect of the Federal Reserve's ongoing planning for contingencies. The Federal Reserve System expects to establish special procedures through which the System could lower discount rates quickly in an emergency. If, as the Board intends, the availability of primary credit significantly reduces the reluctance of depository institutions to use the discount window, the System should be able to cap the federal funds rate near the target during a crisis by reducing the primary discount rate to a level close to the federal funds target rate. During a financial market crisis, the proposed discount window structure therefore would provide a means of preventing an undue tightening of money markets if depository institutions' demands for excess reserves rose sharply, if disruptions inhibited the flow of funds through the banking system, or if the Federal Reserve's ability to carry out open market operations were impaired.

In addition, the Board expects that moving to an above-market primary credit program would be beneficial to the Federal Reserve System as the mechanisms by which the Board implements monetary policy evolve. For example, if Congress authorizes the Federal Reserve Banks to pay interest on reserve balances, an above-market lending program would allow the Reserve Banks to avoid lending to depository institutions at a below-market rate while paying interest to those institutions at a market-related rate. Also, if the level of required operating balances resumes the substantial downward decline experienced for much of the last decade, a lending program with appreciably less administration could enhance the day-to-day implementation of monetary policy. A decline in operating balances could lead to increased volatility in the federal funds rate, and the availability of reserves from an above-market lending facility would serve to limit the increase in volatility.

Secondary Credit.

Secondary credit would replace extended credit and would be available to depository institutions that do not qualify for primary credit. Because some institutions that currently are eligible for adjustment credit would not qualify for primary credit, secondary credit potentially would be used more often than has the extended credit program. The text of the proposed regulation therefore seeks to eliminate the focus on longer-term credit extensions in the existing extended credit program and to recognize the somewhat broader class of borrowing situations that a Reserve Bank may handle under the secondary credit program.

Section 201.4(b) of the proposed rule describes the secondary credit program, and § 201.51(b) describes the interest rate that applies to secondary credit.

Under the proposal, Federal Reserve Banks may extend secondary credit to meet temporary funding needs of an institution if such a credit extension would be consistent with the institution's timely return to a reliance on market funding sources. A Reserve Bank also may extend secondary credit if it determines that such credit would facilitate the orderly resolution of serious financial difficulties of the borrowing institution. When extending secondary credit to an undercapitalized or critically undercapitalized depository institution, a Reserve Bank also must observe the requirements set forth at proposed § 201.5. The interest rate on secondary credit would be set by formula 50 basis points above the primary discount rate. This higher rate reflects the less-sound condition of borrowers of secondary credit.

Seasonal Credit.

Section 201.4 of the proposed rule makes only minor revisions to the existing seasonal credit provisions of Regulation A. The seasonal credit interest rate is based on short-term market rates, and historical interest rate relationships suggest that the rate for seasonal credit usually will be below the primary credit rate. Sections 201.4 and 201.51(c) of the proposed

rule, which discuss the rate applicable to seasonal credit, would not contain existing language requiring the seasonal credit rate to be at least as high as the primary credit rate. In addition, the System for some time has not required that a seasonal credit borrower demonstrate that it could not obtain similar assistance from special industry lenders, and the proposed rule accordingly deletes this requirement.

The seasonal credit program originally was designed to address the difficulties that relatively small banks with substantial intra-yearly swings in funding needs faced because of a lack of access to the national money markets. Reserve Banks traditionally have extended seasonal credit to small institutions that demonstrate significant seasonal swings in their loans and deposits. However, funding opportunities for smaller depository institutions appear to have expanded significantly over the past few decades as a result of deposit deregulation and the general development of financial markets. The Board therefore specifically solicits comment on whether small depository institutions still lack reasonable access to funding markets; on the desirability of eliminating the seasonal lending program; and on the appropriate setting of the seasonal lending rate, particularly in view of the proposed establishment of a primary credit program with an above-market rate. Depending on the comments received, the Board may decide to adjust the rate applicable to seasonal credit or to eliminate the seasonal credit program altogether.

Reorganization of and Proposed Changes to Other Provisions of Regulation A.

In addition to replacing the adjustment and extended credit programs with primary and secondary credit programs, respectively, the Board also proposes to reorganize much of existing Regulation A in order to streamline the text of the rule and make it easier to read and understand. In addition, the Board proposes to delete certain provisions of existing Regulation A that are obsolete or superfluous.

Deletion of Provisions Concerning the Century Date Change Special Liquidity Facility (SLF).

The Board previously amended Regulation A so that depository institutions would have access to an SLF from October 1, 1999, to April 7, 2000, to ease liquidity pressures unique to the century date change period. The SLF for U.S. depository institutions is described at existing § 201.3(e), and the circumstances under which a U.S. branch or agency of a foreign bank could use the facility are described at existing § 201.7(b). Sections 201.2(j)-(k) define two terms – “eligible institution” and “targeted federal funds rate,” respectively – that pertain only to the SLF provisions. Because the SLF is no longer in effect, the Board proposes to delete each of the four provisions discussed above. As discussed in more detail in connection with proposed § 201.3(d), the Board proposes to delete a portion of existing § 201.6(d) that allows a depository institution to use credit obtained from the SLF to fund sales of federal funds.

Section 201.1 Authority, Purpose and Scope.

The Board proposes to amend the existing authority citations at § 201.1(a) to include sections 11(i)-11(j) and 14(d) of the Federal Reserve Act. Sections 11(i)-(j) provide the Board with rulemaking authority and general supervisory authority over the Reserve Banks, respectively, and section 14(d) authorizes the Reserve Banks, subject to the review and determination of the Board, to establish discount rates.

As in the existing regulation, § 201.1(b) of the proposed rule describes the purpose and scope of the Regulation A and states that the regulation governs lending by Reserve Banks to depository institutions and others. To gather all the provisions concerning the scope of Regulation A into one section, the proposed rule incorporates language from existing § 201.7(a) regarding the circumstances under which U.S. branches and agencies of foreign banks are subject to the regulation.

Section 201.2 Definitions.

This section would remain unchanged except for the deletion of five definitions. As discussed above, §§ 201.2(j)-(k) contain definitions that are unnecessary because they relate only to the SLF. The other three terms the Board proposes to delete are liquidation loss, increased loss, and excess loss, found at existing §§ 201.2(d)-(f), respectively.

Liquidation loss and increased loss are used to derive the term excess loss, which is the amount the Board would owe the FDIC under section 10B(b) of the Federal Reserve Act if outstanding Reserve Bank advances to a critically undercapitalized depository institution increased the FDIC's cost of liquidating that institution. Excess loss, the only one of these three terms used elsewhere in the regulation, appears in existing § 201.4(c). That section states that the Board would assess a Reserve Bank for any excess loss attributable to advances made by that Reserve Bank and discusses the procedure by which the Board would calculate the amount to be assessed.

The Board believes the regulation would be less cumbersome but no less accurate if the assessment section incorporated the concept of excess loss by simply cross-referencing section 10B(b) of the Federal Reserve Act. Although the existing definitions explain accurately and in detail how the Board would calculate the excess loss, they produce the same result required by section 10B(b) of the statute.

Section 201.3 General Requirements Governing Extensions of Credit.

This section would prescribe the Board's rules governing a Federal Reserve Bank's extension of credit. This section would permit Federal Reserve Banks to extend credit in the form of an advance or discount and would discuss requirements that both the Reserve Banks and the depository institutions receiving credit must observe. The text of proposed § 201.3 combines in one place all the existing provisions of Regulation A that relate to each of these topics.

Proposed paragraph (a) of § 201.3 would consolidate all the existing provisions of Regulation A concerning a Reserve Bank's authority to extend credit. Proposed § 201.3(a) mostly contains existing text from § 201.5 and provides that a Reserve Bank may extend credit to a depository institution in the form of an advance or a discount of certain types of paper described in the Federal Reserve Act. Like existing § 201.5, the proposed section states that credit to depository institutions generally will take the form of an advance but preserves a Reserve Bank's discretion to lend through discounting eligible paper if the Reserve Bank determines that a discount would be more appropriate for a particular depository institution. The proposed rule would delete existing § 201.8, which provides that a Reserve Bank may discount paper for an institution that is part of the farm credit system, and instead would discuss that authority at proposed § 201.3(a)(3). Rather than providing the lengthy discussion at existing § 201.8, proposed § 201.3(a)(3) simply cross-references section 13A of the Federal Reserve Act, which authorizes Reserve Banks to discount paper for such institutions.

Proposed § 201.3(b) contains the text of existing § 201.9, which states that a Reserve Bank has no obligation to make, increase, renew, or extend any advance or discount to a depository institution.

Proposed § 201.3(c) gathers in one place the existing provisions of Regulation A concerning the requirements a Reserve Bank must observe when it does extend credit. Section 201.3(c)(1) contains text from existing § 201.4(d) providing that a Reserve Bank should ascertain whether an institution is undercapitalized or critically undercapitalized before extending credit to that institution. This section adds text stating that, if the institution is undercapitalized or critically undercapitalized, the Reserve Bank must follow special lending procedures. These procedures are specified in proposed § 201.5, which contains the text of current § 201.4 and is discussed in more detail below.

Proposed §§ 201.3(c)(2)-(3) include text from existing §§ 201.6(b)-(c) regarding a Reserve Bank's duty to require any information it deems appropriate to ensure the acceptability of assets tendered as collateral or for discount, to ensure that credit is used consistent with Regulation A, and to keep itself informed of the general character and amount of loans and investments of a depository institution as required by section 4(8) of the Federal Reserve Act.

Proposed § 201.3(d) consists of existing § 201.6(d), with revisions, regarding how a depository institution may use Federal Reserve credit. In existing Regulation A, only depository institutions that received credit under the century date change SLF were permitted to use Federal Reserve credit to fund sales of federal funds without permission of the Reserve Bank extending the credit. Because the SLF no longer is in effect, the Board would delete the language that pertains to credit obtained through that facility. Instead, as explained more fully above in the section discussing primary credit, proposed § 201.3(d) would permit an institution that receives primary credit to use that credit to fund sales of federal funds without Reserve Bank permission. Recipients of secondary or seasonal credit would continue to need Reserve Bank permission to use Reserve Bank credit to fund sales of federal funds.

The Board proposes to delete existing § 201.6(a), which provides that a depository institution may not use Federal Reserve credit as a substitute for capital. Although the Board continues to believe this to be an appropriate policy, the Board believes that other provisions of the statutes and regulations that it administers address this issue. Thus, the Board sees no need to retain this provision in Regulation A.

Section 201.5 Limitations on Availability and Assessments.

The existing text of § 201.4 would be redesignated as § 201.5, with technical revisions. This section incorporates the limitations on advances to an undercapitalized or critically undercapitalized depository institution set forth in section 10B(b) of the Federal Reserve Act and also applies those limitations to discounts for such institutions. In addition, § 201.5 discusses section 10B(b)'s requirement that the Board pay a specified amount to the FDIC if a Reserve Bank advance to a critically undercapitalized depository institution increases the loss the FDIC incurs when liquidating that institution. The existing regulation explains in detail through the definitions of "liquidation loss," "increased loss," and "excess loss" how the Board would calculate that amount. The proposed rule, by contrast, would delete these three definitions and simply provide that the Board will assess the Federal Reserve Banks for any amount the Board pays to the FDIC in accordance with section 10B(b) of the Federal Reserve Act.

Regulatory Flexibility Act

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a)) the Board must publish an initial regulatory flexibility analysis with this proposed regulation. As discussed above, the proposed above-market discount rate structure is designed to enable the discount window to operate more efficiently as a back-up source of funds for individual depository institutions and as a mechanism for implementing the policy objectives of the Federal Reserve System. By limiting primary credit eligibility to generally sound institutions, minimizing a Reserve Bank's need to question potential borrowers, and making the borrowing programs

more transparent, the proposal seeks to eliminate current disincentives for depository institutions to seek Federal Reserve credit when money markets tighten. The Board knows of no other regulations that overlap or conflict with, or duplicate, the proposed rule.

The proposed rule would apply to all depository institutions that are eligible to borrow at the discount window, including approximately 16,000 small depository institutions, and would not add any recordkeeping, reporting, or compliance requirements associated with discount window borrowing. The requirements of the proposed rule would be the same for all depository institutions regardless of their size. However, if the Board altered the seasonal credit program in response to public comments, small depository institutions, which are the primary users of that program, would be affected more than larger institutions. Because the Board estimates that fewer than 5 percent of eligible small depository institutions typically receive seasonal credit each year, the Board does not expect changes to or elimination of the seasonal credit program to have a large impact in the aggregate.

The Board solicits comment on the likely impact the proposed rule would have on depository institutions, including those that are small business concerns. The Board particularly is interested in the public's view on how the increase in the discount rate relative to money market interest rates and the corresponding reduction in administrative burden would affect depository institutions of different sizes.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the proposed rule under the authority delegated to the Board by the Office of Management and Budget. The proposed rule contains no new collections of information and proposes no substantive changes to existing collections of information pursuant to the Paperwork Reduction Act.

12 CFR Chapter II

AUTHORITY AND ISSUANCE

For the reasons set forth in the preamble, the Board revises part 201 of subchapter A of Chapter II, Title 12 of the Code of Federal Regulations to read as follows:

**PART 201 EXTENSIONS OF CREDIT BY FEDERAL RESERVE BANKS
(REGULATION A)**

Sec.

201.1 Authority, purpose and scope.

201.2 Definitions.

201.3 Extensions of credit generally.

201.4 Availability and terms of credit.

201.5 Limitations on availability and assessments.

201.51 Interest rates applicable to credit extended by a Federal Reserve Bank.

Authority: 12 U.S.C. 248(i)-(j), 347a, 347b, 343 et seq., 347c, 348 et seq., 357, 374, 374a, and 461.

§ 201.1 Authority, purpose and scope.

(a) Authority. This part is issued under the authority of sections 10A, 10B, 11(i), 11(j), 13, 13A, 14(d), and 19 of the Federal Reserve Act (12 U.S.C. 248(i)-(j), 347a, 347b, 343 et seq., 347c, 348 et seq., 357, 374, 374a, and 461).

(b) Purpose and scope. This part establishes rules under which a Federal Reserve Bank may extend credit to depository institutions and others. Except as otherwise provided, this part applies to United States branches and agencies of foreign banks that are subject to reserve requirements under Regulation D (12 CFR part 204) in the same manner and to the same extent as this part applies to depository institutions. The Federal Reserve System extends credit with due regard to the basic objectives of monetary policy and the maintenance of a sound and orderly financial system.

§ 201.2 Definitions. For purposes of this part, the following definitions shall apply:

(a) Appropriate federal banking agency has the same meaning as in section 3 of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1813(q)).

(b) Critically undercapitalized insured depository institution means any insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813(c)(2)) that is deemed to be critically undercapitalized under section 38 of the FDI Act (12 U.S.C. 1831o(b)(1)(E)) and its implementing regulations.

(c)(1) Depository institution means an institution that maintains reservable transaction accounts or nonpersonal time deposits and is:

(i) An insured bank as defined in section 3 of the FDI Act (12 U.S.C. 1813(h)) or a bank that is eligible to make application to become an insured bank under section 5 of such act (12 U.S.C. 1815);

(ii) A mutual savings bank as defined in section 3 of the FDI Act (12 U.S.C. 1813(f)) or a bank that is eligible to make application to become an insured bank under section 5 of such act (12 U.S.C. 1815);

(iii) A savings bank as defined in section 3 of the FDI Act (12 U.S.C. 1813(g)) or a bank that is eligible to make application to become an insured bank under section 5 of such act (12 U.S.C. 1815);

(iv) An insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752(7)) or a credit union that is eligible to make application to become an insured credit union pursuant to section 201 of such act (12 U.S.C. 1781);

(v) A member as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422(4)); or

(vi) A savings association as defined in section 3 of the FDI Act (12 U.S.C. 1813(b)) that is an insured depository institution as defined in section 3 of the act (12 U.S.C. 1813(c)(2)) or is eligible to apply to become an insured depository institution under section 5 of the act (12 U.S.C. 15(a)).

(2) The term “depository institution” does not include a financial institution that is not required to maintain reserves under § 204.1(c)(4) of Regulation D (12 CFR 204.1(c)(4)) because it is organized solely to do business with other financial institutions, is owned primarily by the financial institutions with which it does business, and does not do business with the general public.

(d) Transaction account and nonpersonal time deposit have the meanings specified in Regulation D (12 CFR part 204).

(e) Undercapitalized insured depository institution means any insured depository institution as defined in section 3 of the FDI Act (12 U.S.C. 1813(c)(2)) that:

(1) Is not a critically undercapitalized insured depository institution; and

(2)(i) Is deemed to be undercapitalized under section 38 of the FDI Act (12 U.S.C. 1831o(b)(1)(C)) and its implementing regulations; or

(ii) Has received from its appropriate federal banking agency a composite CAMELS rating of 5 under the Uniform Financial Institutions Rating System (or an equivalent rating by its appropriate federal banking agency under a comparable rating system) as of the most recent examination of such institution.

(f) Viable, with respect to a depository institution, means that the Board of Governors or the appropriate federal banking agency has determined, giving due regard to the economic conditions and circumstances in the market in which the institution operates, that the institution is not critically undercapitalized, is not expected to become critically undercapitalized, and is not expected to be placed in conservatorship or receivership. Although there are a number of criteria that may be used to determine viability, the Board of Governors believes that ordinarily an undercapitalized insured depository institution is viable if the appropriate federal banking agency has accepted a capital restoration plan for the depository institution under 12 U.S.C. 1831o(e)(2) and the depository institution is complying with that plan.

§ 201.3 Extensions of credit generally.

(a) Advances to and discounts for a depository institution.

(1) A Federal Reserve Bank may lend to a depository institution either by making an advance secured by acceptable collateral under § 201.4 of this part or by discounting certain types of paper. A Federal Reserve Bank generally extends credit by making an advance.

(2) An advance to a depository institution must be secured to the satisfaction of the Federal Reserve Bank that makes the advance. Satisfactory collateral generally includes United States government and federal-agency securities, and, if of acceptable quality, mortgage notes covering one- to four-family residences, state and local government securities, and business, consumer, and other customer notes.

(3) If a Federal Reserve Bank concludes that a discount would meet the needs of a depository institution or an institution described in section 13A of the Federal Reserve Act (12 U.S.C. 349) more effectively, the Reserve Bank may discount any paper indorsed by the institution, provided the paper meets the requirements specified in the Federal Reserve Act.

(b) No obligation to make advances or discounts. A Federal Reserve Bank shall have no obligation to make, increase, renew, or extend any advance or discount to any depository institution.

(c) Information requirements.

(1) Before extending credit to a depository institution, a Federal Reserve Bank should determine if the institution is an undercapitalized insured depository institution or a critically undercapitalized insured depository institution and, if so, follow the lending procedures specified in § 201.5.

(2) Each Federal Reserve Bank shall require any information it believes appropriate or desirable to ensure that assets tendered as collateral for advances or for discount are acceptable and that the borrower uses the credit provided in a manner consistent with this part.

(3) Each Federal Reserve Bank shall:

(i) Keep itself informed of the general character and amount of the loans and investments of a depository institution as provided in section 4(8) of the Federal Reserve Act (12 U.S.C. 301); and

(ii) Consider such information in determining whether to extend credit.

(d) Indirect credit for others. Except for depository institutions that receive primary credit as described in § 201.4(a), no depository institution shall act as the medium or agent of another depository institution in receiving Federal Reserve credit except with the permission of the Federal Reserve Bank extending credit.

§ 201.4 Availability and terms of credit.

(a) Primary credit. A Federal Reserve Bank may extend primary credit on a very short-term basis, usually overnight, to a depository institution that is in generally sound condition in the judgment of the Reserve Bank. Such primary credit ordinarily is extended with minimal administrative burden on the borrowing institution. A Federal Reserve Bank also may extend primary credit with maturities up to a few weeks to a depository institution if the Reserve Bank determines that the institution is in generally sound condition and that the institution cannot obtain such credit in the market on reasonable terms. Credit extended under the primary credit program is granted at the primary discount rate.

(b) Secondary credit. A Federal Reserve Bank may extend secondary credit to meet temporary funding needs of a depository institution that is not eligible for primary credit if, in the judgment of the Reserve Bank, such a credit extension would be consistent with the institution's timely return to a reliance on market funding sources. A Reserve Bank also may extend secondary credit if the Reserve Bank determines that such credit would facilitate the orderly resolution of serious financial difficulties of a depository institution. Credit extended under the secondary credit program is granted at a rate above the primary discount rate.

(c) Seasonal credit. A Federal Reserve Bank may extend seasonal credit for periods longer than those permitted under primary credit to assist a smaller depository institution in meeting regular needs for funds arising from expected patterns of movement in its deposits and loans. An interest rate that varies with the level of short-term market interest rates is applied to seasonal credit.

(1) A Federal Reserve Bank may extend seasonal credit only if:

(i) The depository institution's seasonal needs exceed a threshold that the institution is expected to meet from other sources of liquidity (this threshold is calculated as a certain percentage, established by the Board of Governors, of the institution's average total deposits in the preceding calendar year); and

(ii) The Federal Reserve Bank is satisfied that the institution's qualifying need for funds is seasonal and will persist for at least four weeks.

(2) The Board may establish special terms for seasonal credit when depository institutions are experiencing unusual seasonal demands for credit in a period of liquidity strain.

(d) Emergency credit for others. In unusual and exigent circumstances and after consultation with the Board of Governors, a Federal Reserve Bank may extend credit to an individual, partnership, or corporation that is not a depository institution if, in the judgment of the Federal Reserve Bank, credit is not available from other sources and failure to obtain such credit would adversely affect the economy. If the collateral used to secure emergency credit consists of assets other than obligations of, or fully guaranteed as to principal and interest by, the United States or an agency thereof, credit must be in the form of a discount and five or more members of the Board of Governors must affirmatively vote to authorize the discount prior to the extension of credit. Emergency credit will be extended at a rate above the highest rate in effect for advances to depository institutions.

§ 201.5 Limitations on availability and assessments.

(a) Lending to undercapitalized insured depository institutions. A Federal Reserve Bank may make or have outstanding advances to or discounts for a depository institution that it knows to be an undercapitalized insured depository institution, only:

(1) If, in any 120-day period, advances or discounts from any Federal Reserve Bank to that depository institution are not outstanding for more than 60 days during which the institution is an undercapitalized insured depository institution; or

(2) During the 60 calendar days after the receipt of a written certification from the chairman of the Board of Governors or the head of the appropriate federal banking agency that the borrowing depository institution is viable; or

(3) After consultation with the Board of Governors. In unusual circumstances, when prior consultation with the Board is not possible, a Federal Reserve Bank should consult with the Board as soon as possible after extending credit that requires consultation under this paragraph.

(b) Lending to critically undercapitalized insured depository institutions. A Federal Reserve Bank may make or have outstanding advances to or discounts for a depository institution that it knows to be a critically undercapitalized insured depository institution only:

(1) During the 5-day period beginning on the date the institution became a critically undercapitalized insured depository institution; or

(2) After consultation with the Board of Governors. In unusual circumstances, when prior consultation with the Board is not possible, a Federal Reserve Bank should consult with the Board as soon as possible after extending credit that requires consultation under this paragraph.

(c) Assessments. The Board of Governors will assess the Federal Reserve Banks for any amount that the Board pays to the FDIC due to any excess loss in accordance with section 10B(b) of the Federal Reserve Act. Each Federal Reserve Bank shall be assessed that portion of the amount that the Board of Governors pays to the FDIC that is attributable to an extension of credit by that Federal Reserve Bank, up to 1 percent of its capital as reported at the beginning of the calendar year in which the assessment is made. The Board of Governors will assess all of the Federal Reserve Banks for the remainder of the amount it pays to the FDIC in the ratio that the capital of each Federal Reserve Bank bears to the total capital of all Federal Reserve Banks at the beginning of the calendar year in which the assessment is made, provided, however, that if any assessment exceeds 50 percent of the total capital and surplus of all Federal Reserve Banks, whether to distribute the excess over such 50 percent shall be made at the discretion of the Board of Governors.

§ 201.51 Interest rates applicable to credit extended by a Federal Reserve Bank.

(a) Primary credit. The rates for primary credit provided to depository institutions under § 201.4(a) are: [INSERT APPLICABLE RATES HERE].

(b) Secondary credit. An interest rate 50 basis points above the rate for primary credit in § 201.51 will apply to secondary credit extended to depository institutions under § 201.4(c).

(c) Seasonal credit. The rate for seasonal credit extended to depository institutions under § 201.4(b) is a flexible rate that takes into account rates on market sources of funds.

By order of the Board of Governors of the Federal Reserve System, May 16, 2002.

(signed) Jennifer J. Johnson

Jennifer J. Johnson
Secretary of the Board.