

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

RECD IN RECORDS SECTION

MAR 2 1970

Date February 10, 1970

Office Correspondence

To Board of Governors

Subject: Guidelines for lending to

From Division of Federal Reserve
Bank Operations (Messrs. Ring
and Massey)

nonmember banks.

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SUMMARY

The question presented here is whether the Board will now approve the attached set of guidelines, as proposed by the Presidents of the Reserve Banks and revised by this Division, for the handling of the few likely requests for advances to nonmember banks. These guidelines are intended to make certain, as specified in the Board's letter of August 21, 1969 (copy attached), that such requests will be handled uniformly throughout the System.

Attached also is a draft of a letter that may be used to advise the Chairman of the Presidents' Conference of the Board's action in this matter.

RECOMMENDATION

These guidelines have been carefully studied by interested members of the Board's staff, including representatives of the Supervision and Regulation and Research Divisions, and by the Board's consultant in the Discount function (Mr. Bilby). With the revisions now agreed upon by the staff, these guidelines are believed to afford a practicable means of handling applications of nonmember banks for Federal Reserve credit uniformly throughout the System.

This Division recommends, therefore--

1. That the attached set of guidelines be approved as revised by the staff; and, if so approved,
2. That the Conference of Presidents be advised of such approval and, if there are no questions regarding these revisions, that the complete set of guidelines be issued in an S-letter to supersede the Board's letter of August 21, 1968 (S-2100).

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BACKGROUND

As indicated in the attached copy of the Board's letter of August 21, 1969, this matter arose when one of the Reserve Banks (Philadelphia) requested the Board's comments on a proposed policy statement regarding loans to nonmember banks under the authority of paragraph 13 of Section 13 of the Federal Reserve Act. In replying to that letter, the Board pointed out that the Bank's proposed policy statement seemed to raise the possibility of differing evaluations among the Reserve Banks of situations that would adversely affect the economy. The Board concluded, therefore, that each application from a nonmember bank for an initial advance should be submitted to the Board for consideration and approval. The text of the Board's letter to the Philadelphia Reserve Bank was sent to all the other Reserve Banks for their guidance.

Subsequently, the Conference of Presidents expressed a desire, with the Board's concurrence, to draft a set of guidelines that would help to assure uniformity among the Reserve Banks and thus eliminate the need to submit the cases to the Board for approval. It was understood that the guidelines would deal with emergency situations that could arise at any time from particularized difficulties, and that the more generalized emergency borrowing needs of nonmember institutions from liquidity pressures of a national or regional nature would be dealt with by the implementation of procedures of the kind that the Board adopted on December 24.

The guidelines proposed by the Presidents of the Reserve Banks were adopted at their Conference in December 1969 following the recommendation of the Subcommittee on Discounts and Credits in its report dated November 24. In summary, these guidelines would--

1. Base the decision to extend credit to a nonmember bank on the probable impact of the bank's failure on the community or the economy.
2. Require the nonmember bank to exhaust alternative sources of credit and to make other reasonable adjustments before receiving the Reserve Bank's assistance.
3. Require consultation by the Reserve Bank with the Federal and State supervisory agencies, prior to the granting of the loan.

4. Emphasize an early repayment of the loan, with allowance for longer assistance when carrying out an approved program of the supervisory agency.
5. Require the Reserve Banks to follow closely the progress of the nonmember bank.
6. State a need for the Reserve Bank to be advised in advance of possible emergency situations.
7. Provide for direct extension of credit to the extent of available U. S. Government obligations and additional credit as needed through a member bank.

With respect to proposed guidelines 1 and 3, which afford the only criteria for determining whether a loan should be made in a particular case, this Division felt that they did not clearly state the following relevant principles adopted in the July 1968 Report of a System Committee on the Reappraisal of the Federal Reserve Discount Mechanism.

- a. It would be most unusual for the failure of a single institution or small group of institutions to have such significant repercussions as to justify Federal Reserve action.
- b. Supervised nonmember financial institutions would be required to obtain the support and assent of the relevant supervisory agency to receive Federal Reserve emergency credit.

These shortcomings in the guidelines as originally proposed were corrected in the revisions of the first and third paragraphs, as agreed upon at a recent meeting of interested members of the staff and Mr. Bilby. In addition, the sixth paragraph of the proposed guidelines was revised to make it clearer that the Board should be advised of any developing situations that may result in a request for Federal Reserve credit, whether or not such a situation is one that needs to be discussed with other supervisory authorities in Washington.

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Guidelines for emergency lending to nonmember banks

(As proposed by the Conference of Presidents, and
AS REVISED BY THE BOARD'S STAFF)

1. A decision to extend credit to nonmember banks should be based upon the probable consequences of the failure to obtain Reserve Bank credit and the impact of any resulting bank failure on the community or the economy. Credit should not be granted merely to protect the stockholders of a nonmember bank.

IT WOULD BE MOST UNUSUAL FOR THE FAILURE OF A SINGLE INSTITUTION OR SMALL GROUP OF INSTITUTIONS TO HAVE SUCH SIGNIFICANT REPERCUSSIONS AS TO JUSTIFY FEDERAL RESERVE ACTION. HOWEVER, IN EXCEPTIONAL AND UNUSUAL CASES, CREDIT MAY BE EXTENDED TO A NONMEMBER COMMERCIAL BANK UNABLE TO OBTAIN ASSISTANCE ELSEWHERE IN ORDER TO PREVENT THE FAILURE OF THE BANK, PROVIDED THAT THE FAILURE, IN THE RESERVE BANK'S JUDGMENT, WOULD IMPOSE A SERIOUS HARDSHIP ON THE LOCAL COMMUNITY OR ECONOMY, OR WOULD SERIOUSLY AFFECT THE CONDITION OF OTHER BANKS.

2. Credit should be extended to nonmember banks only if all reasonable alternative sources of credit have been exhausted, and only if the bank has made all reasonable and appropriate offsetting adjustments in its investment portfolio and lending practices.

3. Emergency credit should not be made available to a nonmember bank until ONLY after consultation with the responsible Federal and/or State bank supervisory agencies. A Federal Reserve Bank should

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not MAKE A LOAN TO A NONMEMBER BANK AGAINST THE WISHES OF THE

APPROPRIATE SUPERVISORY AGENCY WITHOUT PRIOR CONSULTATION ON THE

MATTER WITH THE BOARD OF GOVERNORS, NOR SHOULD IT be obligated

~~in-any-way~~ to lend to nonmember banks on an emergency basis merely

because of a request by such ~~agencies~~ AGENCY.

4. A nonmember bank granted emergency credit will be expected to arrange promptly for all reasonable and orderly adjustments of its position in order to achieve repayment of its loan. In some cases, the Reserve Banks may provide emergency credit to a nonmember bank for an extended period in order to provide assistance to the responsible bank supervisory agencies in carrying out a well-defined and approved program of reorganization designed to place the bank in a sound financial condition.

5. In all cases, the Federal Reserve Bank will oversee closely the progress of the adjustment program of the borrowing nonmember bank, and will reserve the right to take appropriate steps to protect its interest and to otherwise accomplish the purpose of the loan.

6. Inasmuch as the emergency situations referred to above do not usually arise without some advance warning, the Reserve Banks should be furnished, as early as possible, with information on developing situations that may result in a request for Federal Reserve credit.

The Board of Governors should also be informed of such situations by the Reserve Banks as promptly as possible, as PARTICULARLY SINCE it may be necessary to consult with other supervisory authorities in Washington.

7. Emergency credit to nonmember banks should be extended initially under the last paragraph of Section 13, and until such time as the supply of collateral eligible under that paragraph is exhausted. With the permission of the Board of Governors, additional credit may be extended indirectly through a member bank under Section 10(b), secured by assets acquired by the member bank from the nonmember bank for the purpose of obtaining credit for the latter, if the assets are acceptable to the Reserve Bank. While of limited potential application, direct discounting of eligible paper for a nonmember bank, upon authorization by an affirmative vote of no less than five members of the Board of Governors, is provided for by the third paragraph of Section 13.

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ERM
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Mr. Charles J. Scanlon, Chairman,
Conference of Presidents of the
Federal Reserve Banks,
Federal Reserve Bank of Chicago,
Chicago, Illinois. 60690

Dear Mr. Scanlon:

This refers to the matter of establishing guidelines for the uniform handling throughout the System of applications from nonmember banks for loans under paragraph 13 of Section 13 of the Federal Reserve Act. You will recall that a set of such guidelines, as recommended by the Subcommittee on Discounts and Credits, was proposed by the Conference of Presidents at its meeting on December 15, 1969.

The Board has considered the proposed guidelines, along with some minor changes for clarification in paragraphs 1, 3, and 6, as enumerated in the enclosure with this letter. If the Conference has no further suggestions with respect to these guidelines, the Board is prepared to accept and issue them as an S-letter to supersede the Board's letter of August 21, 1969 (S-2100).

Very truly yours,

Robert C. Holland,
Secretary.

Enclosure