CITADEL; THE FEDERAL RESERVE AS LENDER OF LAST RESORT

FROM THE GREAT FINANCIAL CRISIS TO THE GLOBAL PANDEMIC

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ABSTRACT

This article considers the role of the Federal Reserve as lender of last resort. It draws a comparative synopsis and analysis of the actions taken by the Federal Reserve during the financial crisis of 2008-09 and the macroeconomic crisis caused by the Covid-19 pandemic. It criticizes the Dodd Frank Act's legal regime as applied to the Federal Reserve's emergency lending powers, which came to be tested for the first time during the Covid-19 pandemic, and suggests interpretative and reformative approaches to improve such legal regime. It also analyzes the effect of the more recent Coronavirus Aid, Relief, and Economic Security Act of 2020 and the Consolidated Appropriations Act of 2021 on the Federal Reserve's emergency lending powers. Contrary to the latest legislative trend towards more curtailment of the Federal Reserve's emergency lending authority, it argues that such authority should be expanded. It also addresses the very debated issue of the moral hazard implications of the Federal Reserve's lending of last resort and calls for future legislative reform that explicitly grants the Federal Reserve a financial stability mandate to safeguard the financial system and the broader economy against systemic risks.

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INTRODUCTION

The financial crisis of 2008-09 (the "Financial Crisis") put into stark relief, perhaps too abruptly, the other and more controversial nature of central banking, which is, in addition to monetary policy, the ultimate provision of liquidity to the financial system and the insurance that an economy would always have a "lender of last resort" to which it can turn.

Never before had the Federal Reserve System (the "Federal Reserve" or the "Fed"), or indeed any foreign central bank, done so much to stem a financial panic as during the Financial Crisis. Had the Fed not reacted so decisively to prevent the financial system from imploding and prop up an economy in free fall, the United States would have conceivably known a crisis as grave as that of 1929. The Fed obviously had learned from its irresoluteness during the Great Depression.[1]

But the Fed's unapologetic display of force during the events of 2008-09 evoked a strong reaction from both sides of the political aisle. The general public was stunningly reminded about how much financial power the Fed actually wields and the extent to which it could exert influence on the economy, and indirectly, the social distribution of wealth. Critics spoke out in a chorus of reprobation against the use of taxpayers' money to bail out reckless financial institutions. Some condemned the Fed's efforts as encouraging irresponsible risk-taking.[2] The Fed had overstepped the law, other reprehensive views averred.[3] This article examines and challenges these legitimate critiques.

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[1] The Fed's timorous use of its lending of last resort authority during the Great Depression is commonly accused of having aggravated the crisis. *See* MILTON FRIEDMAN AND ANNA JACOBSON SCHWARTZ, A MOMETARY HISTORY OF THE UNITED STATES, 1867-1960, 357-362 (1963, 9th ed. 1971); *see also* JOHN KENNETH GALBRAITH, THE GREAT CRASH OF 1929 51-68 (1954); *see also* Ben S. Bernanke, Remarks by Governor Ben S. Bernanke at the Conference to Honor Milton Friedman, Nov. 8, 2002, https://www.federalreserve.gov/boarddocs/speeches/2002/20021108/default.htm.

[2] *See* June Kronholz, Sarah Lueck & Greg Hitt, *'No' Votes Came From All Directions*, WALL ST. J. (Sept. 30, 2008), https://www.wsj.com/articles/SB122273311165788291; *see also* David M. Herszenhorn, *A Curious Coalition Opposed Bailout Bill*, N.Y. TIMES (Oct. 2, 2008), https://www.nytimes.com/2008/10/03/business/03naysayers.html; *see also* Adam Nagourney, *Bracing for a Backlash Over Wall Street Bailouts*, N.Y. TIMES (Mar. 15, 2009), https://www.nytimes.com/2009/03/16/us/politics/16assess.html; *see also* Craig Torres, *Fed Rescues Student Debt; Critics Fear Rise in Pleas*, The Philadelphia Inquirer (May 6, 2008), https://www.inquirer.com/philly/business/20080506_Fed_rescues_student_debt__critics_fear_rise_in_pleas.html.

[3] *See e.g.*, Chad Emerson, *The Illegal Actions of the Federal Reserve: An Analysis of How the Nation's Central Bank Has Acted Outside the Law in Responding to the Current Financial Crisis*, 1 WILLIAM MARY BUSINESS LAW REV. 110 (2010); *see also* Lawrence H. White, Testimony before the Subcomm. on Monetary Policy and Trade House Committee

In the aftermath of Lehman Brothers' spectacular demise, there arose a strong sense of collective introspection and substantive legislative work began; aimed at fixing the abuses of contemporary finance. What ensued in 2010 is the most comprehensive piece of financial legislation so far, the Dodd–Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"),[4] which overhauled the United States' financial regulatory regime, including with respect to the Fed's lending of last resort.

In 2020, little more than a decade after the Financial Crisis, the Fed once again received a clarion call to shore up an agonizing economy and avert a searing social crisis in the United States, as the world was struck with the COVID-19 global pandemic (the "Global Pandemic"). The swiftness and magnitude of the Fed's engagement this time exceeded that of its already immense liquidity response to the Financial Crisis.[5]

During both these crises, the Fed acted as an international lender of last resort for U.S. Dollar-funding markets through liquidity swap lines with foreign central banks pursuant to international bilateral agreements.[6] This article focuses solely on the domestic aspect of the Fed's role as lender of last resort. The argument will be made that such role should be strengthened and expanded considering the Fed's decisive action during the Financial Crisis and the Global Pandemic; firstly, by granting the Fed an official financial stability mandate, and secondly, by reversing some of the Dodd-Frank Act's curtailments of the Fed's emergency lending authority and broadening its purview.[7]

Part I of the article emphasizes the need for a lender of last resort generally and recapitulates the legal framework under which the Fed acts as such, both in ordinary and extraordinary times. It then describes the Fed's interventions during the Financial Crisis and the Global Pandemic. Part II

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on Financial Services, Sept. 11, 2013, HHRG-113-BA20-Wstate-WhiteL-20130911.pdf (house.gov).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[5] The Fed's balance sheet's assets increased from $870 billion in August 2007 to $2.3 trillion in July 2010. It increased from $4.2 trillion in March 2020 to $7.2 trillion in November 2020. *See Credit and Liquidity Programs and the Balance Sheet, Recent Balance Sheet Trends*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm (last update Nov. 5, 2021).

[6] *See* 12 U.S.C § 355. *See* Policy Tools, *Central Bank Liquidity Swaps*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/central-bank-liquidity-swaps.htm (last update June 16, 2021).

[7] In this article, in most instances, the phrase "emergency lending" refers to the Fed's lending under Section 13(3) of the Federal Reserve Act. As the context admits, it may also refer to Fed's lending under Title VIII of the Dodd-Frank Act.

calls for a statutory financial stability mandate for the Fed. Part III addresses the hotly debated issue of moral hazard. Part IV assesses the Dodd-Frank Act's amendments to the Fed's emergency lending legal regime in light of the Financial Crisis and, more recently, the Global Pandemic. Part V examines the impact of the newly passed Consolidated Appropriations Act, 2021 (the "Consolidated Appropriations Act")[8] on the Fed's emergency lending powers. Part VI proposes a legislative reform to expressly permit the Fed to act as purchaser of last resort, in addition to it being the lender of last resort.

I. THE FEDERAL RESERVE AS LENDER OF LAST RESORT

A. The Federal Reserve and the Need for a Lender of Last Resort

Banks present an intrinsic weakness due to their maturity and asset transformation of generally short-term liabilities, the most representative of which being sight deposits, into typically long-term assets, illustrated by various forms of private credit.[9] The maturity mismatch between assets and liabilities results in a fractional reserves system where banks hold a small portion of liquid assets in proportion to their instantly due liabilities and avail themselves of the flimsy probability that not all depositors would withdraw their money at the same time.[10]

The inherent liquidity flaw of banks made them particularly vulnerable to panics before the advent of a central banking system in the United States.[11] A run on one bank could also easily cause mimetic behaviors by depositors of other banks, even ones that were not originally at risk.[12] This was compounded by the then-inelasticity of the currency, which made it impossible to offset a profound depletion of a few banks' reserves by an aggregate increase in national reserves.[13] With the enactment of the Federal Reserve Act (the "Federal Reserve Act") and the creation of the Fed in 1913,

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[8] Consolidated Appropriations Act, Pub. L. No. 116-260, H.R.133 (2021).
[9] *See What is Fractional Banking?*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/finance/fractional-banking/ (last visited Oct. 20, 2021).
[10] *Id.*
[11] *See Banking Panics of the Gilded Age*, FED. RSRV., https://www.federalreservehistory.org/essays/banking-panics-of-the-gilded-age (last visited Oct. 9, 2021); *see also Banking Panics of 1930-31*, FED. RSRV., https://www.federalreservehistory.org/essays/banking-panics-1930-31 (last visited Oct. 9, 2021).
[12] *See* Charles W. Calomiris, *Bank Failures in Theory and History: The Great Depression and Other "Contagious" Events* 4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 13597, 2007).
[13] *See id.*

modern monetary policy made sure that the generally growing demand for currency in the long run is always met and that temporary and impulsive drops or surges of currency in circulation could be easily forestalled.[14] With the grant to the Fed of its emergency lending powers in 1932, the idea of a lender of last resort, an impregnable bank citadel whose walls never waver against liquidity shocks, came to fruition.[15] It ensured that the provision of liquidity to a small number of troubled banks would shield the entire banking system from panic and that the potential harm caused by the banking business model's fragility would be held back or at least softened. Because of their successive studies on the money market in 19th century Great Britain and their conceptualization of the role of the Bank of England as lender of last resort, Henry Thornton[16] and Walter Bagehot are considered in monetary history as the fathers of the classical doctrine of lender of last resort. In his book Lombard Street (1873), Bagehot prescribed a code of conduct to end a panic by lending widely, at a penalty rate, and with good collateral.[17] It came to be known as the Bagehot dictum and the ultimate reference on the matter.

The characteristic vulnerabilities of commercial banking are today also inherently ingrained in financial intermediation activities performed outside of the realm of classical banking regulation, such as investment banking, *i.e.*, the brokerage and dealing of securities, and "shadow banking," which involves, among other wholesale funding, securitization, money markets, repurchase agreements (affectionately, "repos"), and commercial paper.[18] As with commercial banking, investment and shadow banking support funding endeavors with short-term commitments and face equal liquidity perils. Over time, these non-traditional banking activities grew in breadth and complexity. Shadow banking alone had largely eclipsed the U.S. commercial banking sector in the prelude to the Financial Crisis.[19] In terms of assets,

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[14] Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 251 (1913); *see also* Henry Parker Willis, *The Federal Reserve Act*, IV AM. ECON. REV. 13 (1914).
[15] *See* Emergency Relief and Construction Act. Pub. L. No. 72-302 (1932).
[16] *See* HENRY THORNTON, AN ENQUIRY INTO THE NATURE AND EFFECTS OF THE PAPER CREDIT OF GREAT BRITAIN (1802).
[17] *See* WALTER BAGEHOT, LOMBARD STREET: A DESCRIPTION OF THE MONEY Market (1873); *see also* Paul Tucker, Remarks at the Bank of Japan 2009 International Conference, May 27-28, 2009, https://www.bis.org/review/r090608c.pdf.
[18] For a definition of shadow banking, *see* Zoltan Pozsar, et. al., *Shadow Banking,* FED. RSRV. BANK OF N.Y. 1 (Feb. 2012), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr458.pdf; s*ee also* Daniel K. Tarullo, Remarks at the Americas for Financial Reform and Economic Policy Institute Conference, Nov. 22, 2013, https://www.federalreserve.gov/newsevents/speech/tarullo20131122a.htm.
[19] *See* FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 32 (2011).

commercial banking represented 20% of the entire financial intermediation industry in the United States in 2020.[20]

Progressive deregulation in the United States before the Financial Crisis, culminating with the repeal of the Glass-Steagall Act at the turn of the former century, reshuffled the cards of the more protective New Deal regulatory framework and blurred its financial chastity lines.[21] Such deregulation left large commercial banks quasi-unrestricted in their carrying out of affiliate activities that were traditionally at the core of investment banking, including the underwriting and trading of securities, and permitted non-commercial banks to engage in like-type deposit-taking.[22] Interconnectedness and certain fundraising activities shared by both commercial and investment banks, such as securitization and the mutualization of funds for investment purposes, made financial risks more easily transferrable from either side of the frontier between commercial and investment banking. Assets and financial institutions became more interwoven because of the increasing use of derivatives, securitization, and other structured finance tools.[23] Transaction execution improved at stellar pace thanks to technology and economies of scale. The old financial landscape, where transactions used to revolve around the neighborhood commercial bank and, later, on a few investment banks, moved to a system dominated by financial markets. The exceeding interdependence and interpenetration of financial markets, in the United States and internationally, magnified the inborn fragility of financial intermediation and globalized its potential spillover effect. Worldwide queuing bankruptcies were revealed not to be so phantasmagoric after all.

Financial instruments such as credit default swaps ("CDS"), which were initially conceived for risk hedging and to provide additional protection against credit default, became a problem in their own right.[24] They contributed to weaving an inextricable financial web and expanded the risk of domino defaults as soon as enough CDS counterparties would pull the strings at once.[25] Before the Financial Crisis, it was assumed that a financial market as large as the United States' would absorb the shock waves of a massive bankruptcy according to an "*arithmetic of dispersion.*"[26] The Financial Crisis attested that no algorithm could stand against an extreme

[20] *See generally* BD. OF GOVERNORS OF THE FED. RSRV. SYS., Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States Q2-2020.
[21] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 36.
[22] *Id.* at 55.
[23] *Id.* at 52.
[24] *Id.* at xxiv-xxv.
[25] *Id.*
[26] ROBERT E. LITAN AND JONATHAN RAUCH, AMERICAN FINANCE FOR THE 21ST CENTURY 98 - 112 (1997).

shock to the financial market itself. The appearance of a diverse financial industry thus calls for a caveat. A variety of markets, intermediaries, products and payment systems should not obscure the intimate interconnections among them and may actually characterize a climax of perils.[27]

More pernicious than the interconnectedness factor during a financial crisis is the sentiment of fear. Whatever the reason behind a panic, it spreads precipitously and strikes indiscriminately; impacting insolvent and solvent financial institutions alike.[28] During the Financial Crisis and the Global Pandemic, the stampede to money market funds' assets by investors, the refusal of many securities dealers to renew their loans in connection with the repo market, or the non-rolling over by lenders of their commercial paper, unfolded exactly as early 20th century bank runs.[29] Regardless of the sophistication of financial markets nowadays, primary psychological investor behaviors remained the same.

Despite their fragility, financial institutions are strategic drivers of an economy's growth and allow the financing of diversified and long-term investments that are, whether on the level of individual residential mortgages or at the scale of large infrastructure projects, socially relevant and more profitable than highly liquid investments.[30] The very fact that a credible lender of last resort exists, and has the legal powers and political will to intervene and reinstate confidence when needed, makes financial crises less probable. If contagion has already started, the profusion of liquidity by the lender of last resort contributes decisively in hampering its spreading effects and containing its consequences on the broader economy.[31] The Fed was predisposed by law to undertake such role on the basis of its ability to create high-powered money that bears the full faith and credit of the government and its aptitude to intervene more broadly than any private lender during a crisis.[32] In times of panic, it warrants more legitimacy when imposing restrictive covenants on a struggling borrower than market competitors and

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[27] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at xxi.
[28] *See* Xavier Freixas, et al., *Lender of Last Resort: A Review of the Literature*, FIN. STABILITY REV., 151, 158 (1999); *see also* George Kaufman, *Bank contagion: Theory and Evidence*, 1–2 (FED. RSRV. BANK OF CHI., Working Paper No. 92-13, 1992).
[29] *See* Ellis W. Tallman and Elmus R. Wicker, *Banking and Financial Crises in United States History: What Guidance Can History Offer Policymakers?*, 19-26 (FED. RSRV. BANK OF CLE, Working Paper No. 10-09, 2010); s*ee also* Rajdeep Sengupta and Fei Xue, *The Global Pandemic and Run on Shadow Banks*, K.C. FED. ECON. BULLETIN 1 (May 11, 2020).
[30] Ben S. Bernanke, Chairman of the Federal Reserve, *Liquidity Provision by the Federal Reserve*, Speech at the Federal Reserve Bank of Atlanta Financial Markets Conference, May 13, 2008, https://www.federalreserve.gov/newsevents/speech/bernanke20080513.htm.
[31] *Id.*
[32] *Id.*

is certainly less susceptible to private market conflicts of interests. As lender of last resort, the Fed also enhances market liquidity by facilitating transactions and giving the financial industry better foresight on prevailing market conditions.[33]

Adepts of market self-regulation and proponents of free banking, who consider financial institutions are better off if left with no or little regulation and consider that "*instincts for self-preservation […] would shield them from fatal risk-taking,*" would argue against the need for systemic regulation, let alone a lender of last resort.[34] They look at last resort lending as placing the fate of financial institutions in the hands of the government, not the "invisible hand" of the market, and thereby distorting fair competition. A system in which a government rescue of a few "too big to fail" institutions is predictable affords these institutions a market advantage over their peers; with more chances to be funded, or to be funded at a reduced cost.[35] Certain commentators and lawmakers decry last resort lending, and deplore government bailouts as "socialism" or as nationalization of private companies.[36] Last resort lending differs from government bailouts in that it does not imply tax-funded capital injections. The inferred undertaking of last resort lending is the granting of loans with central bank money, not the spending or the investment of taxpayers' money towards the acquisition of ownership interests. However, if free market rules could lead to a market halt, it should then be non-problematic that the government intercedes to make the market function again. Capitalism should not become an ideology. The primary purpose of government is not to ensure free market orthodoxy and *laissez-faire* during financial turmoil but to make sure the turmoil does not wreak havoc on the economy and negatively impinge on the livelihoods of citizens.

Another reason for having a lender of last resort is the protection of the payment system and the clearing and settlement process of central clearing parties against liquidity shocks due to the default of one or more clearinghouses on their contractual obligations. A lender of last resort would ensure the performance of certain financial contracts and delivery against payment until the system of mutual risk-sharing by clearinghouses functions seamlessly again and no financial institution is hoarding liquidity because of

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[33] *Id.*
[34] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at xviii.
[35] John C. Coffee, Jr., *Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795, 799 (2011).
[36] James Politi & Daniel Dombey, *Republican anger at 'financial socialism'*, FIN. TIMES (Sept. 24, 2008), https://www.ft.com/content/cdfbdcb6-89a3-11dd-8371-0000779fd18c; *see also* WSJ Staff, *Barney Frank Celebrates Free Market Day*, WALL ST. J. (Sept. 17, 2008), https://www.wsj.com/articles/BL-REB-1978.

unmatched trades. A *force majeure* example of a break in the financial markets' "plumbing" is the disruption of the clearing, settlement and payments' telecommunications infrastructure on September 11, 2001. On that day, a number of financial institutions were not able to use Fedwire to process their payments.[37] Operating centers of clearinghouses in downtown Manhattan ceased to operate and many online broker-dealer platforms were disturbed. It was not before the injection of sizeable central bank liquidity that the clearing and settlement of financial transactions and the delivery of payment instructions resumed.[38]

Apropos of force majeure, from March 2020 to the end of 2021, scores of countries ordered repetitive sanitary lockdowns and confinement measures to curb the spread of the COVID-19 virus. Domestic economies were literally shut down for weeks or months. Different from the Financial Crisis, which found its roots in financial institutions' balance sheets, the economic downturn caused by the Global Pandemic had its origins in the dramatic decreases in businesses' revenues. The genesis of the grief was not the burst of an asset bubble linked to a tulip bulbs mania, a dot-com euphoria or real estate property speculation. It stemmed from an exogenous shock that upset the nucleus of incalculable contractual relationships. Neither side of a contractual bargain could deliver on their obligations for lack of revenue. The utility of the Fed, as lender of last resort in this situation, was not to stop a financial crisis *per se* or prevent its metamorphosis into an economic recession, but rather to provide unswerving liquidity to a trembling economy, such that sufficient corporate cash flows are reestablished and the economic wheel turns again.[39]

B. From Monetary Policy to Lender of Last Resort

1. A Monetary Policy Toolkit …

The Fed's main responsibility is the conduct of monetary policy. It has been statutorily mandated in this respect to achieve maximum employment

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[37] Fedwire refers to Fedwire Funds Service, a transactions gross settlement service operated electronically and in real-time by the Fed. *See Fedwire Funds Service*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/paymentsystems/fedfunds_about.htm (last update May 7, 2021).

[38] *See* Jeffrey M. Lacker, *Payment System Disruptions and the Federal Reserve Following September 11, 2001*, 2 (FED. RSRV. BANK OF RICH., Working Paper No. 03-16, 2003).

[39] *See The Federal Reserve's Response to the Coronavirus Pandemic: Hearing on "Lessons Learned: The Federal Reserve's Response to the Coronavirus Pandemic" before the Select Subcomm. on the Coronavirus Crisis of the H. Comm. On Oversight and Reform*, 117th Cong. 6 (2021) (Statement of Jerome H. Powell, Chairman, Board of Governors of the Fed. Reserve Sys.).

and price stability.[40] To this end, the Fed relies fundamentally on two monetary policy instruments, each of which using commercial banks' reserve balances, *i.e.,* cash at hand or in accounts with the Fed, to manage the money supply and the cost and availability of credit.

First and foremost, the Fed intervenes on the open market through outright purchases and sales of U.S. government and other securities, carried out as an auction process with a limited number of trading counterparties known as "primary dealers."[41] By engaging in open market operations, the Fed credits or debits banks' reserve accounts held with it, depending on whether the corresponding transactions are purchases or sales of securities.[42] It thus increases or decreases the overall volume of reserve balances and alters the rate at which banks lend to each other.[43] The alignment of such rate, the effective federal funds rate, on the target rate intermittently set by the Fed significantly affects the money supply and eventually influences the credit market conditions that underpin the economy.[44]

Second, all depositary institutions that are subject to reserve requirements[45] have the possibility under Section 10B of the Federal Reserve Act ("Section 10B") and Regulation A under the same act to approach the Fed's discount window for loans credited to their reserve accounts.[46] Discount window lending increases the aggregate reserve balances and helps to maintain the effective federal funds rate as much as possible at par with the Fed's target rate; especially if made in conjunction with open market operations. Indirectly, it serves as a pressure relief mechanism for the banking system. Because interest rates charged on discount window loans are typically higher than the Fed's target rate, banks naturally turn to the discount window only if borrowing on the interbank lending market has become too expensive. Functioning in the manner of a "safety valve," when

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[40] *See* Federal Reserve Act § 2A; 12 U.S.C. § 225a.
[41] *See* Federal Reserve Act § 14; 12 U.S.C. § 348a, §§ 353-359; Federal Reserve Act §12A; 12 U.S.C. § 263; *see also* David H. Small and James A. Clouse, *The Scope of Monetary Policy Actions Authorized under the Federal Reserve Act*, 3 (Fin. And Econ. Discussion Series, Working Paper No. 2004-40, 2004).
[42] *See* FED. RSRV., THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS 23-38 (10th ed. 2016).
[43] *Id.*
[44] *Id*.
[45] *See* 12 C.F.R. § 201.2 (2021). This section defines a depository institution in a very broad way. Practically all banks and credit unions insured by the Federal Deposit Insurance Corporation (FDIC), mutual savings banks, savings banks, savings associations and branches of foreign banks are considered depository institutions.
[46] *See* 12 U.S.C. § 347b; Regulation A; 12 C.F.R. § 201 (2021). Discount window lending is also governed by the following sections of the Federal Reserve Act: 10A, 11(j), 13, 13A, 14(d), and 19, as codified under 12 U.S.C. §§ 248(i)-(j), 343 *et seq*., 347(a), 347(c), 348 *et seq*., 357, 374, 374(a), and 461.

insufficient reserves drive the effective federal funds rate way above the target rate, discount window borrowing appeases the interbank lending market and moves the effective federal funds rate down again.[47]

2. … Used for Lender of Last Resort Objectives

The foregoing two monetary policy tools also dress the Fed with clothing for another role; that of lender of last resort.

The Fed matches the increasing demand for currency in the long run through "permanent" open market operations, which consist essentially in purchasing securities that are held to maturity and renewed when due.[48] By contrast, the Fed fine-tunes the money supply to transitory and short-term liquidity demands through "temporary" open market operations.[49] In legal terms, temporary open market operations qualify as repurchase or reverse repurchase agreements.[50] With repos, the Fed buys securities from primary dealers and re-sells them the same securities at a later date (usually the next trading day) and at a higher price than that of the initial purchase transaction.[51] From an economic perspective, repo transactions are akin to secured loans made by the Fed; the underlying securities are used as collateral and the premium received over the original offered amount reflects the interest payment.[52] The corollary is true for reverse repos; the Fed sells to primary dealers securities that it buys back in the future (usually the next trading day) at a higher price.[53] This virtually gives reverse repo transactions the effect of collateralized loans to the Fed.[54] With their credit economic feature and daily injection of liquidity in the market, repo transactions are a form of last resort lending that is used for a more immediate objective than long-term monetary policy, namely that of regulating momentary declines in reserve balances and providing a short-term liquidity to the financial system and the economy. Programing outright purchases during bear economic

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[47] *See* Brian F. Madigan & William R. Nelson, *Proposed Revision to the Federal Reserve's Discount Window Lending Programs*, FED. RESERVE BULLETIN. 313, 315 (2002); *see also* James A. Clouse, *Recent Developments in Discount Window Policy*, FED. RESERVE BULLETIN 965, 969 (1994).
[48] *See Credit and Liquidity Programs and the Balance Sheet, Open Market Operations*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/bst_openmarketops.htm (last update May 10, 2021).
[49] *Id.*
[50] *Id.*
[51] *See Repo and Reverse Repo Agreements*, FED. RSRV. BANK OF N.Y., https://www.newyorkfed.org/markets/domestic-market-operations/monetary-policy-implementation/repo-reverse-repo-agreements (last visited Oct. 17, 2021).
[52] *See Credit and Liquidity Programs and the Balance Sheet, Open Market Operations*, *supra* note 48.
[53] *Id.*
[54] *Id.*

conditions such that their finality becomes the infusion of liquidity as much as the conduct of conventional monetary policy has become a recurrent practice. The Fed undertook massive quantitative easing programs during the Financial Crisis and the Global Pandemic.[55]

The discount window gives more emphasis to the Fed's lender of last resort role than open market operations as it typically provides depository institutions direct and bilateral advances.[56] The Fed's existing three discount window credits are structured depending on a borrower profile. The primary and secondary credit are available on a very short-term basis (usually overnight), but sometimes for longer terms, with the latter imposing a higher discount rate as it is available to weaker depository institutions or in connection with their orderly resolution of serious financial difficulties.[57] The seasonal credit addresses the cyclical liquidity needs of small depository institutions.[58] The primary credit is undoubtedly the most used discount window program.[59] During financial crises, the Fed typically reduces its discount rates to lessen the cost of accessing the discount window.[60] The lower the discount rates become, the more the discount window transmutes from a monetary policy tool to a lending of last resort instrument.

C. Lender of Last Resort in Unusual and Exigent Circumstances

Pursuant to Section 13(3) of the Federal Reserve Act ("Section 13(3)"), the Fed may, in unusual and exigent circumstances and upon the affirmative vote of five members of its Board of Governors, extend credit to both depository and non-depository institutions by discounting for them notes, drafts, and bills of exchange.[61]

The expression "*unusual and exigent circumstances*" was not given any legal meaning in the Federal Reserve Act.[62] The Fed also does not need to officially claim the existence of such circumstances to use Section 13(3) but must periodically review, every six months at least, the continuance of these

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[55] *Id*.
[56] 12 C.F.R. § 201.3 (2021).
[57] 12 C.F.R. § 201.4(a)-(b) (2021).
[58] 12 C.F.R. § 201.4(c) (2021).
[59] *See* FED. RSRV., THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS, *supra* note 42, at 42, 46.
[60] For historical data about discount rates, *see* Policy Tools, *The Discount Window and Discount Rate*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., https://www.federalreserve.gov/monetarypolicy/discountrate.htm (last update July 13, 2021); *see also see Historical Discount Rates*, FED. RSRV., https://www.frbdiscountwindow.org/pages/discount-rates/historical-discount-rates (follow "Primary and Secondary" hyperlink).
[61] 12 U.S.C. § 343(A).
[62] *See id.*

circumstances if it has extended credit under Section 13(3).[63] One may nonetheless deduct from the Fed's limited historical use of Section 13(3) that the appreciation of the situation under which to invoke unusual and exigent circumstances involves the existence of extreme hardship factors, and that only events of exceptional nature justify a recourse to Section 13(3).[64] It took the Fed the traumatizing events of the Financial Crisis to solicit its emergency lending powers for the first time since the Great Depression.[65] A virtual freeze of the world economy during the Global Pandemic induced the Fed into taking a suite of Section 13(3) measures again.[66] Title XI of the Dodd-Frank Act brought substantive amendments to Section 13(3). These are examined in Part IV below.

In unusual or exigent circumstances, Title VIII of the Dodd-Frank Act permitted the Fed, upon a majority vote of its Board of Governors, to provide liquidity to a designated financial market utility (FMU),[67] defined in the statute as any manager or operator of a multilateral system for the transfer, clearing, or settlement of payments, securities, or other financial transactions.[68] Title VIII notably used the conjunction "*or*" between the adjectives "*unusual*" and "*exigent.*"[69] It implies that the circumstances for emergency lending to an FMU warrant less demanding adverse economic thresholds than Section 13(3) envisages.[70] The implication is reinforced by the fact that the Fed's provision of liquidity to an FMU is also authorized under Section 10B, the statutory authority for discount window type-liquidity.[71]

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[63] 12 C.F.R. § 201.4(d)(9)(iv) (2021).
[64] *See Turmoil in U.S. Credit Markets: Examining the Recent Actions of Federal Financial Regulators: Hearing before the Comm. on Banking, Hous., and Urb. Aff.*, 110th Cong. 2 (2008) (Statement of Ben S. Bernanke, Chairman, Board of Governors of the Fed. Reserve Sys.); *see also* MARC LABONTE, CONG. RSCH. SERV., R44185, FEDERAL RESERVE: EMERGENCY LENDING 19 (2020); *see also* David Fettig, *Lender of More than Last Resort*, FED. RSRV. BANK OF MIN. (Dec. 1, 2002), https://www.minneapolisfed.org/article/2002/lender-of-more-than-last-resort; *see also* David Fettig, *The History of a Powerful Paragraph*, FED. RSRV. BANK OF MIN. (June 1, 2008), https://www.minneapolisfed.org/article/2008/the-history-of-a-powerful-paragraph; Alexander Mehra, *Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis*, 13 U. PA. J. BUS. L. 221, 227–29 (2010).
[65] *See* David Fettig, *The History of a Powerful Paragraph*, *supra* note 64.
[66] *See* LABONTE, CONG. RSCH. SERV., *supra* note 64, at 6.
[67] Dodd-Frank Act §806(b); 12 U.S.C. § 5465.
[68] Dodd-Frank Act §803(6)(A); 12 U.S.C. § 5462.
[69] *See* Colleen Baker, *The Federal Reserve as Last Resort*, 46 U. MICH. J.L. REFORM 69, 110 (2012).
[70] *Id.* at 110-11.
[71] Dodd-Frank Act §806(b); 12 U.S.C. § 5465. As discount window advances are available only to member banks of the Federal Reserve System, section 806(b) of the Dodd-Frank Act

D. The Fed's Lending of Last Resort During the Financial Crisis of 2008-09

The housing bubble of the early 2000's, driven by low interest rates and imprudent real estate lending practices, eventually burst when an increasing number of subprime and other residential mortgages defaulted. The securitized products backed by such mortgages became non-marketable. Trillions of dollars' worth of toxic mortgage-backed securities ("MBS") burdened the balance sheets of financial institutions and caused severe liquidity tension in the summer of 2007.

The Financial Crisis that followed was most virulent in its shock, fast in its unfolding and global in its outreach. It brought the United States' financial system to the brink of collapse in the days following the bankruptcy of Lehman Brothers in September 2008. It was then feared that the failure of large financial institutions and companies, starting with the insurer American International Group ("AIG"), would cause devastating losses and the disintegration of vast swathes of the economy.

The Fed initially fought the Financial Crisis with its monetary policy toolkit. From September 2007 to December 2008, it gradually brought the target rate to its zero percent bound.[72] At this juncture, any further open market operations would have been tantamount to unconventional monetary policy, which the Fed pursued through a stimulating quantitative easing program that considerably swelled its balance sheet.[73] When the Financial Crisis began to wind down in March 2010, open market purchases had reached $1.7 trillion.[74]

In parallel with its target rate cuts, the Fed progressively reduced its discount rates, starting in August 2007.[75] The primary credit rate was set at 50 basis points over the target rate in December 2008,[76] the spread lowered to only 25 basis points in March 2008.[77] In December 2007, the Fed established under Section 10B a temporary auction-driven liquidity facility,

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states that the designated FMU need not be or become a member bank of the Federal Reserve System or a bank holding company to have access to the discount and the borrowing privileges of Section 10B.

[72] For all changes in the Fed's target rate, *see* Policy Tools, *Open Market Operations*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/openmarket.htm (last update July 28, 2021).

[73] Stephen Williamson, *Quantitative Easing: How Well Does This Tool Work?*, REGIONAL ECONOMIST 1, 1–3 (2017).

[74] FED. RSRV. BANK OF N.Y., 2009 ANNUAL REPORT 4 (2010).

[75] For all changes in the Fed's discount rates,.

[76] *Id*.

[77] *Id.*

the Term Auction Facility (TAF), to ease the liquidity strains of depository institutions.[78]

The Fed then resorted to exploiting its Section 13(3) arsenal. In March 2008, it alleviated the pressure on the repo and other short-term funding markets in which primary dealers are predominantly active by creating the Primary Dealer Credit Facility ("PDCF")[79] and the Term Securities Lending Facility ("TSLF").[80] The PDCF made cash advances to primary dealers.[81] The TSLF allowed primary dealers to exchange their toxic assets against government securities using a broader range of collateral than typically accepted in open market operations.[82] After Lehman Brothers' failure in September 2008, the Fed established the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility ("AMLF") and the Commercial Paper Funding Facility ("CPFF") to avoid dislocations in the commercial paper market.[83] Under the AMLF, the Fed provided non-recourse loans to financial intermediaries so they could purchase asset-backed commercial paper from money market funds facing unrelenting redemption demands from investors.[84] The CPFF purchased maturing commercial paper with no roll-over prospects through a special purpose vehicle ("SPV") funded by fully-secured Fed loans.[85] In March 2009, the Fed initiated the Term Asset-

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[78] Press Release, *Federal Reserve Actions* (Dec. 12, 2007), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/20071212a.htm. *See also* REGULATORY REFORM, *Term Auction Facility (TAF)*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/regreform/reform-taf.htm (last update Feb. 12, 2016).

[79] REGULATORY REFORM, *Primary Dealer Credit Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/regreform/reform-pdcf.htm (last update Mar. 18, 2020).

[80] Press Release, *FOMC statement: Federal Reserve and Other Central Banks Announce Specific Measures Designed to Address Liquidity Pressures in Funding Markets* (Mar 11, 2008), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20080311a.htm. *See also* Policy Tools, *Term Securities Lending Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/tslf.htm (last update Feb. 5, 2010).

[81] FED. RSRV. BANK OF N.Y., 2009 ANNUAL REPORT, *supra* note 74 at 60.

[82] *See* Press Release, *FOMC statement: Federal Reserve and Other Central Banks Announce Specific Measures Designed to Address Liquidity Pressures in Funding Markets*, *supra* note 80.

[83] FED. RSRV. BANK OF N.Y., 2009 ANNUAL REPORT, *supra* note 74 at 33-34.

[84] Financial intermediaries included depository institutions and bank holding companies as well as broker-dealer subsidiaries of bank holding companies. *See Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility*, Fed. Rsrv., https://www.frbdiscountwindow.org/Archive/Asset-Backed-Commercial-Paper-ABCP-Money-Market-Mutual-Fund-MMMF-Liquidity-Facility-Terms-and-Conditions (last update Feb. 5, 2010).

[85] Loans made by the Fed to the CPFF SPV were 3-months loans secured by all the assets of the SPV. *See* Press Release, *Board announces creation of the Commercial Paper Funding Facility (CPFF) to help provide liquidity to term funding markets* (Oct. 7, 2008), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20081007c.htm.

Backed Securities Loan Facility ("TALF") to foster the liquidity of triple-A rated asset-backed securities originating out of small business, student and consumer loans.[86] All of the Section 13(3) programs in connection with the Financial Crisis ended in the first semester of 2010.[87]

The Fed also intervened timeously and pursuant to its Section 13(3) authority to save two financial institutions; Bear Stearns and AIG. After months of mounting financial troubles, Bear Stearns experienced a liquidity run in March 2008 by derivative counterparties and repo and other lenders.[88] The Fed dreaded that a failure of Bear Stearns would trigger cascading defaults of other financial institutions.[89] The Fed formed a special purpose limited liability company, Maiden Lane LLC, to which it lent funds for the purchase of a $30 billion worth portfolio of Bear Stearns' toxic assets, hence clearing the way for a JPMorgan acquisition of Bear Stearns without such assets.[90] Pursuant to the transaction terms agreed between the Fed, Bear Stearns and JPMorgan, Maiden Lane LLC bought the Bear Stearns portfolio by using a subordinated loan of $1.15 billion from JPMorgan and a senior loan by the Fed covering the rest of the purchase price.[91] The Fed had sole discretion in the management of the portfolio and would retain any residual gain if the portfolio sold for more than its acquisition price, which it did. The Fed realized a net profit of $2.5 billion on the transaction.[92]

Following Lehman Brothers' failure in September 2008, AIG faced precipitating calls on its CDS, a run by its securities lending counterparties, and a steep decline in the value of its portfolio of MBS.[93] The fall of an insurance giant of such wide retail penetration could have drastically impacted small businesses and households. The Fed made available to AIG up to $85 billion by way of a revolving credit facility; secured by a

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[86] REGULATORY REFORM, *Term Asset-Backed Securities Loan Facility (TALF)*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/regreform/reform-talf.htm (last update Feb. 12, 2016).
[87] The PDCF, the TSLF, the CPFF, and the AMLF expired on February 1, 2010. The TALF expired on June 30, 2010. For a detailed description of each of these emergency lending programs, *see* U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *FEDERAL RESERVE SYSTEM, OPPORTUNITIES EXIST TO STRENGTHEN POLICIES AND PROCESSES FOR MANAGING EMERGENCY ASSISTANCE*, GAO 11-696, (2011); *see also* MARGARET E. TAHYAR ET AL., *FINANCIAL CRISIS MANUAL, A GUIDE TO THE LAWS, REGULATIONS AND CONTRACTS OF THE FINANCIAL CRISIS* (2009).
[88] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 289-291.
[89] *Id.* at 290.
[90] *Id.*
[91] U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87 at 183; *see also Maiden Lane Transactions*, FED. RSRV. BANK OF N.Y., https://www.newyorkfed.org/markets/maidenlane (last visited Oct. 17, 2021).
[92] *See Maiden Lane Transactions*, *supra* note 91.
[93] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 347-352, and 376-377.

significant bundle of the assets of AIG and its domestic and foreign subsidiaries.[94] A condition precedent to the credit facility agreement commanded the establishment, by the Fed, of a trust for the benefit of the Treasury to receive preferred stock convertible into almost 80% of AIG's share capital.[95] The preferred stock were ultimately converted into common stock and sold with profit.[96] The Fed also made two loans to two special purpose limited liability companies, Maiden Lane II LLC and Maiden Lane III LLC, in the amounts of $19.5 billion and $24.3 billion, respectively.[97] The first entity took out of AIG's books illiquid MBS.[98] The second entity unloaded collateralized debt obligations ("CDOs") from AIG's counterparties so that they could terminate the CDS guaranteeing such CDOs.[99] As an additional protection to the Fed, AIG acquired a $1 billion subordinated interest in the credit facility to Maiden Lane II LLC and made a $5 billion equity contribution to Maiden Lane III LLC.[100] The Fed amassed a cumulative net profit of $17.7 billion on all AIG-related loans.[101]

It is widely believed today that the Fed's actions during the Financial Crisis, save for the Lehman Brothers epilogue, were instrumental in quelling the panic. The $660 billion poured into the economy between 2008 and 2010 via more than a hundred contracts under Section 13(3) ultimately yielded positive results to the government, and indirectly to taxpayers.[102] Dissected individually, the Fed's emergency lending programs and standalone rescues were each profitable.[103]

E. The Fed's Lending of Last Resort During the Global Pandemic

The Fed was quicker in using its lending of last resort battery during the Global Pandemic than during the Financial Crisis. It was indeed easier to acknowledge the impact of a fast-spreading coronavirus on the global economy than that of early defaults of borrowers on their subprime

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[94] U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87, at 32.
[95] *Id.* at 166.
[96] Press Release, *Treasury Sells Final Shares of AIG Common Stock, Positive Return on Overall AIG Commitment Reaches $22.7 Billion* (Dec. 11, 2012), U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/press-center/press-releases/Pages/tg1796.aspx.
[97] U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87, at 171-77.
[98] *Id.* at 171.
[99] *Id.* at 174.
[100] *Id.* at 171-77.
[101] Press Release, *New York Fed Sells Remainder of Maiden Lane III LLC Securities; Marks End of AIG-Related Assistance; Approximately $6.6 Billion Net Gain Generated for U.S. Public from the Portfolio* (Aug. 23, 2012), FED. RSRV. BANK OF N.Y., https://www.newyorkfed.org/newsevents/news/markets/2012/an120823.html.
[102] U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87, at "What GAO Found."
[103] *Id.* at 99.

mortgages. Many of the Section 13(3) programs designed for the Financial Crisis only waited to be revived during the Global Pandemic.

In March 2020, the Fed lowered its target rate to its zero percent floor,[104] its primary credit rate to 0.25 percent,[105] and its reserve ratio to zero percent.[106] Such infrequent elimination of reserve requirements freed up reserves of depository institutions to create liquidity.[107] On the open-market front, the Fed pledged more than $700 billion in purchases of government securities.[108]

Moreover, the Fed took a series of measures pursuant to its emergency lending powers.[109] In support of these measures, Congress authorized through the Coronavirus Aid, Relief, and Economic Security Act of 2020[110] ("CARES Act") up to $454 billion for loans, guarantees and other investments in connection with Section 13(3) programs or facilities,[111] to be directed by the Treasury through the Exchange Stabilization Fund ("ESF").[112]

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104 *See* Policy Tools, *Open Market Operations*, *supra* note 72. *See also* Press Release, *Federal Reserve issues FOMC statement* (Mar. 15, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315a.htm.

105 Press Release, *Federal Reserve Actions to Support the Flow of Credit to Households and Businesses* (Mar. 15, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm.

106 *Id.*

107 *See id.*

108 *See* Press Release, *Federal Reserve issues FOMC statement*, *supra* note 104.

109 *See* Press Release, *Federal Reserve announces extensive new measures to support the economy* (Mar. 23, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.

110 Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020).

111 CARES Act § 4003(b)(4); 15 U.S.C. § 9042(b)(4). Businesses eligible for CARES Act funds are those created or organized in the United States or under the laws thereof, which have significant operations in, and a majority of their employees are based in, the United States, and which agree to maintain their employment levels at certain thresholds. *See* CARES Act § 4003(c)(2)(G).

112 *Id. See also* MARC LABONTE ET AL., CONG. RSCH. SERV., IF11474, TREASURY'S EXCHANGE STABILIZATION FUND AND COVID-19 (2020).

The Fed revived the PDCF ("PDCF 2020"),[113] the TALF ("TALF 2020"),[114] and the CPFF ("CPFF 2020") under terms close to their 2008 equivalents, with the last two being structured through SPVs to which the Treasury contributed $10 billion of equity.[115] The Fed created the Money Market Mutual Fund Liquidity Facility ("MMLF") with an additional $10 billion credit protection from the Treasury to support prime money market mutual funds in their barrage against investor runs.[116] Two other Section 13(3) facilities were initiated to unclog liquidity pressure in the corporate bond market; the Primary Market Corporate Credit Facility ("PMCCF") and the Secondary Market Corporate Credit Facility ("SMCCF").[117] Through a combined $750 billion SPV that was partly capitalized with $75 billion of CARES Act funds, the PMCCF subscribed directly to corporate bonds and the SMCCF purchased in the secondary market corporate bonds issued by investment grade companies and U.S.-listed ETFs with exposure to the investment grade and high yield bonds markets.[118]

The Fed authorized the Paycheck Protection Program Liquidity Facility ("PPPLF") under Section 13(3) to support lending to small businesses via

[113] Press Release, *Federal Reserve Board announces establishment of a Primary Dealer Credit Facility (PDCF) to support the credit needs of households and businesses* (Mar. 17, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317b.htm#:~:text=To%20support%20the%20credit%20needs%20of%20American%20households%20and%20businesses,Dealer%20Credit%20Facility%2C%20or%20PDCF.&text=The%20PDCF%20will%20offer%20overnight,available%20on%20March%2020%2C%202020.
[114] Policy Tools, *Term Asset-Backed Securities Loan Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/talf.htm (last update Sept. 13, 2021).
[115] Press Release, *Federal Reserve Board announces establishment of a Commercial Paper Funding Facility (CPFF) to support the flow of credit to households and businesses* (Mar. 17, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm.
[116] Press Release, *Federal Reserve Board broadens program of support for the flow of credit to households and businesses by establishing a Money Market Mutual Fund Liquidity (MMLF)* (Mar. 18, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200318a.htm; *see also Money Market Mutual Fund Liquidity Facility FAQs*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf (last update May 26, 2020).
[117] Policy Tools, *Primary Market Corporate Credit Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/pmccf.htm (last update Sept. 13, 2021); *see also* Policy Tools, *Secondary Market Corporate Credit Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/smccf.htm (last update Sept. 13, 2021).
[118] The allocation was as follows: $50 billion towards the PMCCF and $25 billion towards the SMCCF. *See* Press Release, *Primary Market Corporate Credit Facility* (June 18, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf.

back-to-back loans made by depository institutions ("PPP Loans") under the Paycheck Protection Program of the CARES Act.[119]

A Main Street Lending Program was also established using Section 13(3) to help credit flow to small and medium-sized businesses through three facilities: the Main Street New Loan Facility ("MSNLF"), the Main Street Expanded Loan Facility ("MSELF"), and the Main Street Priority Loan Facility ("MSPLF") (together, the "Main Street Facilities").[120] Pursuant to the Main Street Lending Program, the Fed would lend up to $600 billion on a recourse basis to a common SPV (the "Main Street SPV"), to which the Treasury would also contribute $75 billion in equity.[121] Under the MSPLF, the Main Street SPV would purchase 85% participations in loans made to eligible borrowers by qualified lenders.[122] Qualified lenders would retain 15% of each eligible loan.[123] Under the MSNLF and the MSELF, the Main Street SPV's stake would be 95% and qualified lenders' retention percentage would be 5%.[124] The Main Street Facilities required the same borrower eligibility criteria and had somewhat, except for a few differences, the same term sheet.[125] The Main Street Lending Program operated two additional facilities to ease lending to non-profit organizations.[126]

One last Section 13(3) lending program, the Municipal Liquidity Facility ("MLF"), made the Fed purchase eligible notes from governmental entities

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[119] Press Release, *Federal Reserve announces its Paycheck Protection Program Liquidity Facility is fully operational and available to provide liquidity to eligible financial institutions* (Apr. 16, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200416a.htm.
[120] Press Release, *Federal Reserve takes additional actions to provide up to $2.3 trillion in loans to support the economy* (Apr. 9, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf; *see also* Policy Tools, *Main Street Lending Program*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm (last update Nov. 12, 2021).
[121] *See Main Street Lending Program For-Profit FAQs* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm.
[122] Qualified lenders are depository institutions (whether U.S.-based or branches of foreign banks), bank holding companies, U.S. intermediate holding companies, or any U.S. subsidiaries of the foregoing. *See* Press Release, *Main Street Priority Loan Facility* (Apr. 30, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200430a2.pdf.
[123] *Id.*
[124] *See Main Street Lending Program For-Profit FAQs*, *supra* note 121.
[125] *Id.*
[126] *Id.*

(states, cities and counties) via an SPV capitalized with $35 billion of CARES Act funds.[127]

The PMCFF, the SMCCF, the TALF 2020, and the MLF ended on December 31, 2020.[128] The Main Street Lending Program was terminated on January 8, 2021.[129] The PDCF, the CPFF, the MMLF and the PPPLF ended on March 31, 2021.[130] As of April 2021, the Fed did not expect losses on either of these programs.[131]

The Consolidated Appropriations Act, one of the most generous economic relief bills ever passed to date, repurposed uninvested CARES Act funds in the Fed's emergency lending programs to stimulate spending measures outside of the Fed's authority.[132]

II. A FINANCIAL STABILITY MANDATE FOR THE FED

The considerable emergency lending during the Financial Crisis recast an old debate about whether the Fed should have a financial stability mandate,[133] or such obligation to prevent or repair the disrupted allocation of resources and credit through financial intermediation.[134]

A functional separation of monetary policy and financial stability finds its justification in that the Fed, in addition to its independence from political interference and private influence which gives it the required legitimacy to act according to its mandate, should be clear of internal contradictions in the framing of its monetary policy.[135] It is first a question of focus. A long-term macro-economic policy for price stability and full employment is better not

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[127] Policy Tools, *Municipal Liquidity Facility*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/muni.htm (last update Nov. 12, 2021).
[128] *Periodic Report: Update on Outstanding Lending Facilities Authorized by the Board under Section 13(3) of the Federal Reserve Act* (Apr. 9, 2021), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/publications/files/pdcf-mmlf-cpff-pmccf-smccf-talf-mlf-ppplf-msnlf-mself-msplf-nonlf-noelf-04-12-21.pdf.
[129] *Id.*
[130] *Id.*
[131] *Id.*
[132] Consolidated Appropriations Act, 2021, H.R.133, 116th Cong. Sec. 311(a) (2020).
[133] In his memoirs on the Financial Crisis for example, Ben S. Bernanke recounts that senators "*Chris Dodd and Richard Shelby - far from giving the Fed more authority - were determined to strip [the Fed] of [its] supervisory duties, leaving [to it] monetary policy alone.*" BEN S. BERNANKE, THE COURAGE TO ACT, A MEMOIR OF A CRISIS AND ITS AFTERMATH 443 (2015).
[134] For a definition of "financial stability," *see* FED. RSRV., THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS, *supra* note 42, at 15-17; *see also* Adina Apatachioae, *Central Banks and Financial Stability, Literature Review,* I SEA - PRACTICAL APPLICATION OF SCI. 245, 246 (2013).
[135] *See* Joseph G. Haubrich, *Combining Bank Supervision and Monetary Policy*, ECONOMIC COMMENTARY, FED. RSRV. BANK OF CLE. (1996).

perturbed by immediate considerations over the safety of financial institutions. It raises second a more serious concern about a potential conflict of interests between monetary policy and financial stability. The focus issue may be easily dismissed by giving the Fed sufficient pragmatic means and supervisory powers to address financial stability. The concern regarding a conflict of interests, if any, between monetary policy and financial stability may be relegated to secondary importance by the fact that, most often in practice, both functions steer in the same direction.[136] If well-performed, they are complementary and mutually reinforcing, rather than conflicting.[137] Momentary frictional incompatibilities between policies for price stability and financial soundness ultimately give way to synergies among them.[138] Prudential requirements may initially limit the effect of lower Fed target rates but surely dampen unwarranted inclination to leverage that such rates could incentivize in the long run. High interest rates planned to stabilize prices may at first upend the credit activity of financial institutions, but, if successful, they reduce volatility, permit a better valuation of assets, and strengthen financial stability in due course.

While it is true that the Federal Reserve Act has not afforded the Fed an express financial stability mandate, one may interpret from the spirit of the law an implicit financial stability mandate.[139] Had not the preamble of the Federal Reserve Act intended for the Fed to "*furnish an elastic currency*" and to "*establish a more effective supervision of banking in the United States?*"[140] A sound and proficient financial system is by many aspects an extension of monetary policy and ensures the smooth transmission of its effects into the economy.[141] Central bank money creation alone would not be sufficient in funding the economy without the liquidity transformation feature of financial institutions and its corresponding money multiplier. It thus seems important that financial stability measures complement monetary policy and that the Fed has a say in financial stability.

The Dodd-Frank Act cleverly charged the Fed with a heightened supervisory role.[142] In addition to its traditional supervision of state-member banks and bank holding companies, it saw its supervisory authority

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[136] *See* Tommaso Padoa-Schioppa, *Central Banks and Financial Stability: Exploring a Land In Between*, EUROPEAN CENTRAL BANK 27-28 (2002).
[137] *Id.*
[138] *Id.*
[139] *See* Thomas C. Baxter Jr., Executive Vice President and General Counsel of the Fed. Rsrv. Bank of N.Y., Remarks at the Future of Banking Regulation and Supervision in the EU Conference, Nov. 15, 2013, https://www.bis.org/review/r131125e.pdf.
[140] *See* Federal Reserve Act, *supra* note 14.
[141] FED. RSRV., THE FED EXPLAINED: WHAT THE CENTRAL BANK DOES 1 (2021).
[142] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, *supra* note 4.

broadened to encompass non-bank financial companies,[143] FMUs, and payment, clearing, or settlement activities ("PCS activities") that the Financial Stability Oversight Council ("FSOC")[144] designates as systemically important.[145] The Fed applies enhanced prudential standards to systemically important non-bank financial companies and the largest bank holding companies.[146] It may limit the ability of the foregoing entities to merge, or restrict or break-up their business activities if deemed dangerous to financial stability.[147] The Fed further prescribes, jointly with the Commodities Futures Trading Commission and the Securities and Exchange Commission whenever these commissions are deemed to be the competent authority, risk management standards for designated FMUs or PCS activities.[148] The Fed is further called to consider financial stability and the United States economy when approving proposed mergers and acquisitions of banks and bank holding companies.[149]

The Dodd-Frank Act clearly broadened the supervisory powers of the Fed. It fell short though of putting a name on what is already tacitly the case, a financial stability objective for the Fed. Future legislation should expressly give the Fed a financial stability mandate. What would that entail? First, a unification under the clout of the Fed of all commercial banking regulation and supervision. The parallel functions and powers of the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration, and the Office of the Comptroller of the Currency ("OCC") with respect to commercial banks engenders a bewilderment of accountabilities and supervisory gaps for the authorities, as well as a risk of opportunistic regulatory arbitrage by commercial banks.[150] The business of accepting deposits fills up the Fed's reserves and plays a preponderant role in the transmission of monetary policy and the financing of the economy.[151] It should be solely regulated and supervised by the Fed. Moreover, this would

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[143] A non-bank financial company is defined as a domestic or foreign company that is "*predominantly engaged in financial activities,*" other than bank holding companies and certain other types of firms. *See* 12 U.S.C § 5311(a)(4).
[144] 12 U.S.C. § 5321-5322.
[145] 12 U.S.C. § 5323; 12 U.S.C. § 5463. *see Non-Bank Designations - FAQs*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/fsoc/designations/nonbank-designations-faqs (last visited Oct. 16, 2021).
[146] 12 U.S.C. § 5365.
[147] 12 U.S.C. § 5331.
[148] 12 U.S.C. §§ 5464(a)-(b); 77 Fed. Reg. 45,919 (Aug. 2, 2012); 12 U.S.C. 5461 *et seq.*; 12 C.F.R § 234.1.
[149] 12 U.S.C. § 1842.
[150] *See* James L. Robertson, *Federal Regulation of Banking: A Plea For Unification*, 31 Law & Contemp. Probs. 673 (1966).
[151] Joe Peek and Eric S. Rosengren, *The Role of Banks in the Transmission of Monetary Policy* 4, Fed. Rsrv. Bank of Boston Public Pol'y Discussion Paper, Paper No. 13-5, 2013.

be a natural progression since the commercial banking sector is largely consolidated among a few bank holding companies already supervised by the Fed.[152] The FDIC and the CFPB would examine depository institutions only to the extent the regulatory objectives of deposit insurance and consumer financial protection are concerned.

Second, the Fed should assume a commanding role in systemic risk protection. Together with other federal agencies, and largely owing to the supervisory impetus given by the Dodd-Frank Act, the Fed has incrementally implemented the Basel III Accords into the United States up until the beginning of 2020, which improved financial institutions' capital buffers and capacity to self-absorb losses, and internalized, in no small measure, solvency and liquidity risks within the financial system.[153] A revamped and more resilient financial system defied the Global Pandemic with a thicker equity cushion and a larger emancipation from undue short-term borrowing. But the vetoing power conferred to the Treasury in the designation of systemically important non-bank financial companies and the recent rescissions of the designations of AIG, Prudential and GE Capital, insinuate that systemic risk assessment may be enmeshed in politics.[154] The latest amendments to the FSOC's interpretive guidance on designating systemically important non-bank financial companies also made the designation process more onerous.[155] Outside of commercial banking, the Fed should not become an overarching supervisory authority for the entire

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[152] Assets of bank holding companies represented almost all the assets of the commercial banking sector as of June 30, 2020. *See* FED. RSRV. BANK OF CHI., REPORT OF U.S. TOP TIER BANK HOLDING COMPANIES (JUNE 30, 2020).

[153] *See* MICHAEL S. BARR, HOWELL E. JACKSON, MARGARET E. TAHYAR, *FINANCIAL REGULATION: LAW AND POLICY* 25 (2nd ed. 2018). *See also* Davis Polk, *Implementation of Basel III for U.S. GSIBs* (Apr. 17, 2015), https://wiki.harvard.edu/confluence/download/attachments/204380235/Implementation%20of%20Basel%20III%20for%20U%20S%20%20GSIBs.pdf.

[154] The FSOC rescinded the designations of General Electric Capital Corporation, Inc., AIG and Prudential Financial, Inc. as systemically important financial institutions on June 28, 2016, September 29, 2017, and October 17, 2018, respectively. *See* FIN. STABILITY OVERSIGHT COUNCIL, BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING GE CAPITAL GLOBAL HOLDINGS, LLC (2016); *see also* FIN. STABILITY OVERSIGHT COUNCIL, NOTICE AND EXPLANATION OF THE BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING AMERICAN INTERNATIONAL GROUP, INC. (2017); *see also* FIN. STABILITY OVERSIGHT COUNCIL, NOTICE AND EXPLANATION OF THE BASIS FOR THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S RESCISSION OF ITS DETERMINATION REGARDING PRUDENTIAL FINANCIAL, INC. (PRUDENTIAL) (2018).

[155] 12 C.F.R. § 1310 (2021). The new Final Guidance, effective as of January 29, 2020, makes it more difficult for the FSOC to designate a new systemically important non-bank financial company. *See* 84 Fed. Reg. 71,740 (Dec. 30, 2019); *see also* Press Release, *Financial Stability Oversight Council Issues Final Guidance on Nonbank Designation* (Dec. 4, 2019), U.S. DEP'T OF TREASURY, https://home.treasury.gov/news/press-releases/sm844.

financial system. But as the lender of last resort to such system, it should have a clear objective of guarding against systemic risk, irrespective of the financial sector or activity involved.[156] This guardianship should begin with the sole discretion over the designation and supervision of systemically important non-bank financial companies, FMUs and PCS activities. The unhandy conglomerate configuration of the FSOC would be better used in the context of agency coordination only.

Third, the workload of the Fed should be alleviated by stripping from it the responsibilities that do not traditionally fall on a central bank, such as consumer protection.[157]

Finally, the Fed should be granted stronger emergency lending powers. What the Dodd-Frank Act gave the Fed with one hand, it took with the other. The empowerment of the Fed with new *ex ante* regulatory and supervisory powers to prevent financial unrest and the widening of its *ex post* lending of last resort authority with respect to FMUs and PCS activities were regrettably accompanied by a curtailment of its Section 13(3) margin for maneuver, which we address in Part IV.

III. THE FED AND THE QUESTION OF MORAL HAZARD

A. The Case for a Fed Intervention

The Fed's lender of last resort actions during the Financial Crisis earned it a scathing critique for amplifying moral hazard in financial markets, or the tendency of large financial institutions to take excessive risks because of an anticipated governmental rescue, and the resulting potential taxpayer's loss.[158]

This would have perhaps been the case had the Fed been able to use its Section 13(3) authority routinely, as it does with the discount window. Even discount window lending prior to the Financial Crisis drew little appetite among depository institutions.[159] It is hard to believe that the excessive risk-

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[156] *See* Squam Lake Working Group on Financial Regulation, *A Systemic Regulator for Financial Markets* 2-5 (Council on Foreign Relations, Ctr. for Geoeconomic Stud., Working Paper, 2009); *see also* Frederic S. Mishkin, *The Financial Crisis and the Federal Reserve*, Address at the Nat'l Bureau of Econ. Rsch. Macro Annual (Apr. 10, 2008) (transcript available on the Columbia Business School website); *see also* Viral Acharya, *Financial Stability in the Broader Mandate for Central Banks: A Political Economy Perspective* 4 (Hutchins Ctr. on Fiscal & Monetary Pol'y at Brookings, Working Paper No. 11, 2015).

[157] *See* Alan S. Blinder, *How Central Should the Central Bank Be?,* 48 J. ECON. LIT. 123, 131-32 (2010).

[158] For a definition of "moral hazard," *see* Richard Scott Carnell, *A Partial Antidote to Perverse Incentives: The FDIC Improvement Act of 1991*, 12 ANN. REV. BANKING L., 317, 319 (1993).

[159] *See infra* Part IV(E).

taking, perturbing leverages and household debt at the root of the Financial Crisis were encouraged by a Section 13(3) safety net. Such safety net was used only once in the preceding seventy-five years up to the Financial Crisis, was barely known to most finance practitioners in 2008, requires the existence of unusual and exigent circumstances to be assessed by the Fed in its absolute discretion, and is to be deployed solely at the Fed's initiative. It seems unlikely therefore that such safety net was to blame.

It is also far-fetched to see any significant moral hazard consequences in the Fed's emergency lending during the Global Pandemic,[160] despite the still fresh memory of the Fed's colossal intervention during the Financial Crisis.[161] Neither financial institutions nor commercial and industrial businesses were pardoned bad behaviors in 2020-21. They were saved from a rare and irresistible "black swan" event.[162]

Moral hazard is a precarious notion anyway. A general damages insurance does not necessarily push its beneficiary to act recklessly. Similarly, shareholder or creditor moral hazard are not unequivocal concepts either. Considerable shareholding wealth or debt portfolios may be wiped out during a crisis as share prices tumble or yields spike, notwithstanding government intervention.

Over time however, repetition may become custom. The anticipation of governmental rescues of financial institutions, whether through Fed actions or otherwise, may raise to a certain extent the propensity of financial institutions to act carelessly and indulge in risky behaviors. Moral hazard should nonetheless not become the tree that hides the forest. Systemic instability still lies first in the riskiness of maturity and asset transformation. Other culprits include poor corporate governance and risk management,

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[160] *See* Jonathan Tepper, *Federal Reserve has encouraged moral hazard on a grand scale*, FIN. TIMES (Apr. 13, 2020), https://www.ft.com/content/52a46bcf-f238-43cd-82dd-c48c3c1883e3; *see also* Kathryn Judge, *The Truth About The COVID-19 Bailouts*, FORBES (Apr. 15, 2020), https://www.forbes.com/sites/kathrynjudge/2020/04/15/the-covid-19-bailouts/?sh=40164b303b77.

[161] *See* Hal Scott, *The Fed Needs to Move Faster*, WALL ST. J. (Apr. 10, 2020), https://www.wsj.com/articles/the-fed-needs-to-move-faster-11586557721; *see also* Ann Saphir & Lindsay Dunsmuir, *Seen everywhere in the last U.S. crisis, moral hazard is nowhere in this one*, REUTERS (Apr. 12, 2020), https://www.reuters.com/article/us-health-coronavirus-fed-moralhazard-an/seen-everywhere-in-last-u-s-crisis-moral-hazard-is-nowhere-in-this-one-idUSKCN21U0GV; *see also* Christian Gollier & Stephane Straub, *Some micro/macro insights on the economics of coronavirus. Part 1: Impact assessment and economic measures*, VOX CEPR POLICY PORT. (Apr. 2, 2020), https://voxeu.org/article/some-micromacro-insights-economics-coronavirus-part-1.

[162] A black swan event is an unpredictable even characterized by their extreme rarity and severe impact. Investopedia Team, *Black Swan*, INVESTOPEDIA, https://www.investopedia.com/terms/b/blackswan.asp (last update Mar. 22, 2021).

independently of any bailout pretext.[163] A more distant reason may be found at the heart of the free-enterprise mind and its excesses; a blind search for profit, risk-taking whatever the stakes may be, and erratic speculation. Lending of last resort is in fact far more the consequence than the cause of risk-taking. U.S. commercial banks have encountered liquidity problems since the 18th century and have historically done better since the introduction of the Fed's emergency lending powers in 1932. Certain emerging countries have witnessed risk-taking of the vilest kind by their banking systems despite a weak lender of last resort.[164] Others have relied on the International Monetary Fund's aid to end their financial troubles precisely because they did not have a strong lender of last resort.[165]

A few authors take the position that while financial stability should not be disregarded, it should be addressed only through monetary policy.[166] Lender of last resort activities should therefore cover the market as a whole, in preference to institutions individually, and be carried out via open market operations only. Market participants would in return be less inclined to engage in negligent behavior and moral hazard would decrease. However, open market operations are too wide to be instantaneous during collective financial misfortunes. Flushing the market with liquidity through quantitative easing was not enough when specific financial aid to certain sectors of the economy appeared indispensable to rehabilitate flows of money, goods, and services during the Global Pandemic. A number of the Financial Crisis' events unfolded so quickly that immediate action, sometimes within days or hours, was crucial to save troubled financial institutions. Such pressing problems could simply not afford to wait for open market operations' diffuse liquidity to make its effect. On the contrary, focused bilateral lending in one or several directions can recreate value bases

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[163] Stephen G. Cecchetti & Piti Disyatat, *Central Bank Tools and Liquidity Shortages*, ECON. POL'Y REV. 29, 31-37 (2009).

[164] One common example is that of the Lebanese banking system betting for decades nearly all depositors' money on a State that was widely known for its endemic corruption. This triggered a major financial and liquidity crisis as of October 2019. *See* Sarah El Deeb, *Lebanon's currency on downward spiral amid financial turmoil*, ABC NEWS (Apr. 23, 2020), https://abcnews.go.com/International/wireStory/lebanons-currency-crashes-amid-financial-turmoil-virus-70306182.

[165] Recent examples of International Monetary Fund-type lender of last resort interventions include Mexico, Argentina, Ireland, Greece, Portugal and Iceland. For a discussion on the international lender of last resort role of the International Monetary Fund, *see* Frederic S. Mishkin, *The International Lender of Last Resort: What are the Issues?*, Remarks at the Kiel Week Conference, "The World's New Financial Landscape: Challenges for Economic Policy," Kiel Institute of World Economics, Kiel, June 19-20, 2000, https://www0.gsb.columbia.edu/faculty/fmishkin/PDFpapers/00KIEL.pdf.

[166] Renee Haltom and Jeffrey M. Lacker, *Should the Fed Have a Financial Stability Mandate? Lessons From the Fed's First Hundred Years*, 101 ECON. Q. 49, 52 (2013).

faster and it was partly on this basis that the economy was able to build again during the Financial Crisis and the Global Pandemic.

The problem of moral hazard is better addressed at its roots, with *ex ante* financial regulation and supervision that add solidity to the financial system's edifice. In addition to prudential regulation and risk management standards briefly addressed above, other rules recommended by the Dodd-Frank Act strengthened financial stability.[167] The credit retention rules for securitizations adopted by the Fed and other federal agencies, effective as of 2016 for all kinds of securitizations, obliged the sponsor of a securitization transaction to retain not less than 5 percent of the credit risk of assets collateralized and transferred to third parties through asset-backed securities issuances.[168] Amendments to the SEC's rules on money market funds in 2016 now require a more prudent calculation of such funds' net asset value and counter investor runs by allowing withdrawal gates and redemption fees under special circumstances.[169] The Volcker Rule reform,[170] despite amendments to it in 2020, still erects a wall for the commercial banking industry by generally banning proprietary trading and restricting hedge fund and private equity investments for banking entities.[171]

But financial regulation and supervision also have their limitations. If poorly designed, they create a costly burden, or even bring about moral hazard. If well-carved, nothing is less sure that they would stand the test of time, or curb the cyclical nature of economic recessions, or prevent financial panics.[172] Financial institutions may astutely turn to unregulated activities, find regulatory loopholes for their businesses, or simply resume their risky practices after some time due to regulatory relaxation[173] and the public oblivion of the last financial meltdown.[174] Owing to maturity and asset transformation, financial intermediation businesses are risky by themselves. No *ex ante* financial regulation and supervision may entirely shield them from recurrent yet unpredictable financial crises, just as no fire prevention measures could totally eliminate the risk of fire.[175] A *post factum* fire

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[167] *See* discussion *supra* Part II.
[168] Dodd Frank Act § 941; 12 U.S.C. § 78o-11.
[169] *See* 12 C.F.R. §§ 230, 239, 270 (2021).
[170] 12 U.S.C. 1851.
[171] *See* 5 Fed. Reg. 46,422 (July 31, 2020); 12 C.F.R. §§ 44, 248, 351 (2021).
[172] GARY B. GORTON, MISUNDERSTANDING FINANCIAL CRISES; WHY WE DON'T SEE THEM COMING 134-50 (2012).
[173] *See* Coffee, *supra* note 35.
[174] *See* GALBRAITH, *supra* note 1, at 89.
[175] Iman Anabtawi and Steven L. Schwarcz, *Regulating Systemic Risk: Towards an Analytical Framework*, 86 NOTRE DAME L. REV. 1349, 1351 (2011); *see also* Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. REV. 183, 231–32 (2009).

intervention would always be necessary and that is the purpose of the Fed's emergency lending.[176] A lender of last resort contains the unintended consequences of maturity and asset transformation.[177] It does not end its inherent delicacy.[178]

Stripping the Fed of its emergency lending powers does not solve the problem of moral hazard. The market, and indeed the general public, would always expect the Fed (or other governmental authorities) to intervene in a financial crisis, whether it has the right tools for the task or not. It should therefore be afforded the opportunity to more effectively intervene. Otherwise, the market would improvise itself into one or several quasi-authorities and find ways to address the situation on its own. It seems unrealistic nowadays that any authority legally competent to deal with a financial crisis would stand idly by while observing the financial system or the economy unravel and getting the blame for it. Moral hazard could even be exacerbated this way.[179] The absence of powerful and system-wide governmental safeguards could incite authorities to fall back on less efficient methods for intervention[180] or prompt them to take action more often for fear of greater consequences, hence increasing the costs of moral hazard.

Predictability in the Fed's use of its emergency lending tends to comfort the market.[181] Any wavering in market expectations in the name of the fight against moral hazard would have disastrous effects.[182] The so-called "constructive ambiguity" of a lender of last resort is anything but constructive.[183] In Bagehot's words, "*[e]ither shut the Bank [of England] at once, and say it will not lend more than it commonly lends, or lend freely, boldly, and so that the public may feel you mean to go on lending. To lend a great deal, and yet not give the public confidence that you will lend sufficiently and effectually, is the worst of all policies.*"[184] The ambivalence in the government's response during the Financial Crisis by supporting the

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[176] *See* Mark Carlson, Burcu Duygan-Bump & William Nelson, *Why Do We Need Both Liquidity Regulations and a Lender of Last Resort? A Perspective from Federal Reserve Lending During the 2007-09 U.S. Financial Crisis* 3 (Fin. & Econ. Discussion Series, Working Paper No. 2015-011, 2015).
[177] *See id.* at 4, 8.
[178] *See id.*
[179] *See* John Crawford, *The Moral Hazard Paradox of Financial Safety Nets*, 25 Cornell J. Law & Pub. Pol'y 95, 119, 125 (2015).
[180] *Id.*
[181] Ben Bernanke, *Fed Emergency Lending*, BROOKINGS INST. (Dec. 3, 2015), https://www.brookings.edu/blog/ben-bernanke/2015/12/03/fed-emergency-lending/.
[182] *See* Dietrich Domanski, Richhild Moessner & William Nelson, *Central Banks as Lenders of Last Resort: Experiences During the 2007-10 Crisis and Lessons for the Future* 2, 22 (Fin. & Econ. Discussion Series, Working Paper No. 2014-110, 2014).
[183] *See id.* at 2.
[184] BAGEHOT, *supra* note 17, at 64.

takeover of Bear Stearns and placing Fannie Mae and Freddie Mac into conservatorship but then letting Lehman Brothers go under had shattering consequences.[185] As a general matter, a framework advising under what circumstances the Fed would intervene, and those under which it would not, brings clarity as much as dependability to the Fed's decisions, and may function well in an ordinary market.[186] That being said, it should not pigeonhole the Fed or pointlessly tie its hands in stress periods. Public confidence in the Fed's resolve requires an advanced, firm, and consistent commitment on its behalf to contain financial crises.[187]

Bearing in mind the availability of a potentially endless liquidity source and considering that a central banking system would be determined to act as the ultimate re-insurer for the economy, market participants would indeed be less desperate for deposit withdrawals, investor redemptions or asset fire sales, or simply less prone to succumb to panic. The guarantee of deposits by the FDIC reduced the tendency of savings accounts holders to stage runs on their banks at the first hint of weakness.[188] The social welfare contribution of deposit insurance largely exceeds today the moral hazard implications it may have had.[189] At the height of the global pandemic, uninsured time depositors fled to insured depository institutions that saw their accounts soar by almost $1 trillion.[190] Deposit insurance provided a safe haven.[191] If moral hazard and other costs of the Fed's emergency lending are outweighed by the social and economic costs of numerous bankruptcies, then there must be no doubt that the Fed should engage in emergency lending. Government bailouts should also be rationally pondered against the social and economic ruins of government passivity and retrenchment.[192] Thus regarded, a pro-Fed intervention policy should, however, not be used as economic blackmail,

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[185] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at xxi, 343.
[186] *See* John B. Taylor, *The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong* 25-27 (Nat'l Bureau of Econ. Rsch., Working Paper No. 14631, 2009).
[187] *See* Paul Tucker, *The Lender of Last Resort and Modern Central Banking: Principles and Reconstruction* 11 (Bank for Int'l Settlements, Working Paper No. 79, 2014).
[188] *See generally* 12 U.S.C. § 1821; *see also* 12 C.F.R. § 330 (2021).
[189] PATRICIA A. MCCOY, THE MORAL HAZARD IMPLICATIONS OF DEPOSIT INSURANCE: THEORY AND EVIDENCE 4, 6, 8 (2007).
[190] Sengupta & Xue, *supra* note 29, at 1.
[191] *Id.*
[192] *See* Randall D. Guynn, *Are Bailouts Inevitable?*, 29 Yale J. Regul. 121 (2012) (providing an economic model that could aid in deciding when bailouts are practicable); *see also* Alan S. Blinder & Mark Zandi, *The Financial Crisis: Lessons for the Next One*, CENTER ON BUDGET AND POLICY PRIORITIES (Oct. 15, 2015), https://www.cbpp.org/sites/default/files/atoms/files/10-15-15pf.pdf (establishing that the GDP would have shrunk by 14% had the government not intervened during the Financial Crisis, and that the GDP only shrank by 4% thanks to the government's intervention); *see also* Adam J. Levitin, *In Defense of Bailouts*, 99 Geo. L.J. 435 (2010).

threatening the market with a choice between a Fed intervention or chaos. It is therefore pivotal that shrewd regulation diminishes the prospects of systemic risks materializing to the minimum.

Emergency lending is also not only about "bailing out Wall Street." Small businesses and non-profit organizations borrowed from the Main Street Lending Program.[193] State and local governments received funds under the MLF.[194] When liquidity problems become visible in the shadow banking, emergency lending may allay these problems before they cross the increasingly permeable province of retail banking and affect small depositors.[195] Furthermore, it ultimately guarantees the placements of retail investors.[196] Non-professional investors have become a fixture of the mutual funds industry, which provides an essential source of financing to pensions and the economy.[197] These investors typically passively rely on the diversification and expert money management that mutual funds provide. Instead of active investment monitoring, they are advised to develop an "*ascetic detachment*" to market volatility, which increases moral hazard.[198] But so does the behavior of bank depositors. Unsophisticated shareholders of mutual funds are not indirectly protected by discount window lending or directly insured by the government, as the FDIC does for bank deposits.[199] They should therefore logically, and in all fairness, benefit from the lender of last resort's safety net in unusual and exigent circumstances.

B. The Insufficiency of the Orderly Liquidation Authority and Other Legal Mechanisms for Crisis Management

The FDIC's statutory authority gives it wide discretion for resolving depository institutions in the least costly fashion to the insurance fund and with minimum negative macroeconomic externalities.[200] The resolution of a depository institution entails the purchase of its assets and the assumption of

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193 Policy Tools, *Main Street Lending Program*, *supra* note 120.
194 Policy Tools, *Municipal Liquidity Facility*, *supra* note 127.
195 SOFIA PRIAZHKINA, LIQUIDITY CHANNELS AND STABILITY OF SHADOW BANKING, 11, 32 (2017).
196 *See generally id.*
197 As of October 6, 2021, total money market fund assets were estimated at $4.53 trillion. *See Money Market Fund Assets*, INV. CO. INST. (Oct. 7, 2021), https://www.ici.org/research/stats/mmf.
198 *See* BENJAMIN GRAHAM, THE INTELLIGENT INVESTOR 101 (4th rev. ed. 1934).
199 *Insured or Not Insured?*, FED. DEPOSIT INS. CORP. (May 8, 2020), https://www.fdic.gov/consumers/consumer/information/fdiciorn.html; *see also* REGULATORY REFORM, *Glossary* (Dec. 13, 2012), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/reform_glossary.htm.
200 12 U.S.C. § 1823(c)(4); 12 U.S.C. § 1821(d)(10)(C); *see also Resolutions Handbook*, FED. DEPOSIT INS. CORP. (Jan. 15, 2019), https://www.fdic.gov/bank/historical/reshandbook/resolutions-handbook.pdf#page=7.

its liabilities, or the paying off of insured depositors within statutory limits.[201] The FDIC may use one or several bridge banks as a value preservation and transitional measure in connection with the resolution process and may count on special receivership powers to unwind contractual arrangements held by the failing entity with limited market disorder.[202] Among such powers are the latitudes to repudiate contracts or enforce them despite provisions triggering termination, stay litigation proceedings, or assign assets and liabilities without third-party consents.[203]

The Orderly Liquidation Authority (OLA) under Title II of the Dodd-Frank Act filled in the gap for an effective resolution mechanism outside the Bankruptcy Code for large non-depository institutions.[204] Any such "*financial companies*"[205] whose failure and resolution under conventional insolvency laws "*would have serious adverse effects on financial stability or economic conditions in the United States*"[206] would be placed under FDIC receivership following a recommendation from each of the Fed and the FDIC[207] to the Secretary of the Treasury and the ultimate decision of the latter in consultation with the President. A "single point of entry" strategy would see the FDIC appointed as receiver at the holding level of the failing group.[208] A bridge financial company would then be formed and managed as a going concern. All of the receivership estate's assets in the form of loans and other investments in the subsidiaries of the holding company would be transferred to the bridge financial company. Operating subsidiaries would be maintained such that it would be impossible for their financial counterparties to net out with their contracts. Payment and clearing systems and other functional services ensuring vital privity with the financial markets would be upheld. Equity and subordinated and senior unsecured debt of the holding company would be left to the receivership estate, with losses and bad assets being allocated among claimholders by order of statutory priority. In satisfaction of their claims in the receivership, claimholders would be issued

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201 12 U.S.C. §§ 1821(a)(1)(E), (n)(1)(B).
202 12 U.S.C. §§ 1821(e), (n).
203 12 U.S.C. §§ 1821(d)(12), (e)(13), (n)(3)(A)(iv).
204 *See generally id.* 12 U.S.C. §§ 5381–5394.
205 The Dodd-Frank Act defines "financial company" as one of the following U.S.-incorporated companies: (a) a bank holding company as defined by the Bank Holding Company Act of 1956 (12 U.S.C. § 1841(a)), (b) a Fed-supervised non-bank financial company (12 U.S.C. § 5323), (c) any company predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto, or (d) any subsidiary of any of the abovementioned entities that is engaged in activities that the Fed has determined are financial in nature or incidental thereto (except for insurance companies or depository institutions).
206 12 U.S.C. § 5611.
207 *See generally* 12 U.S.C. § 5383.
208 78 Fed. Reg. 76,614 (Dec. 18, 2013).

debt and equity securities in a new adequately capitalized holding company. Value would be created and no liquidation of assets would wreak havoc in the economy. The FDIC may draw upon the Treasury-funded Orderly Liquidation Fund ("OLF") to provide a liquidity backstop to the bridge financial company on a secured basis against the receivership estate's assets, at no cost to the taxpayers.

Both OLA and the FDIC's general banking resolution authority are designed to circumscribe the systemic effects of a major bankruptcy by rendering it as orderly, transparent, and cost-effective as possible. Other legal contrivances, such as the living wills and the so-called "Resolution Stay Rules," strive toward the same outcome. Systemically important non-bank financial companies and large bank holding companies must report annually to the Fed and the FDIC living wills that consist of inventories of assets and orderly resolution plans under the Bankruptcy Code in preparation for the worst.[209] The Resolution Stay Rules were adopted under the umbrella of the Dodd-Frank Act by the Fed, the FDIC, and the OCC, and became effective as of January 2019.[210] They require Global Systemically Important Banks ("G-SIBs") and their subsidiaries worldwide, as well as U.S. subsidiaries of foreign G-SIBs, to obtain certain acknowledgments from their counterparties to specific "*qualified financial contracts*," including credit and repurchase agreements, derivatives, and other financial contracts that feature default rights or transfer restrictions.[211] In the event the relevant G-SIB, or a subsidiary thereof, becomes subject to an orderly resolution regime, such acknowledgments would confirm that its counterparties would not exercise their default rights or enforce any transfer restrictions against it to any greater extent than that required by such orderly resolution regime.[212] Financial knots would untangle harmlessly, interconnectedness would be reduced, and no financial institution would be "too big to fail." Moral hazard would be reduced accordingly.

However, insofar as these mechanisms prevent value-destroying resolutions, they cannot stop chain reaction failures when panic strikes in the magnitude of the Financial Crisis or when an unpredictable major crisis, such as the Global Pandemic, hammers the economic outlook. As one article puts it, the "*Dodd-Frank [Act] provides a valuable mechanism to 'resolve' a*

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[209] Dodd Frank Act § 165(d); 12 U.S.C. § 5365(d); 12 C.F.R §§ 243, 381 (2021); 84 Fed. Reg. 1,438 (Feb. 4, 2019).
[210] 12 C.F.R. §§ 217, 249, 252 (2021).
[211] To qualify as a G-SIB, a financial institution must have over $700 billion in total consolidated assets or $10 trillion in assets under custody. *See* 12 C.F.R. §§ 217.11, 217.403 (2021). *See generally* 12 U.S.C. § 5390(c)(8).
[212] *See* 12 C.F.R. § 47.4(b)(2) (2021).

failing financial firm. It does not provide a satisfactory mechanism to 'resolve' a financial crisis."[213] Had OLA been applied to Lehman Brothers, repo and commercial paper lenders, derivatives counterparties, or other investors tied to the once revered firm would have perhaps better muddled through the bankruptcy or succumbed less to the impact of that event. But the Lehman Brothers bankruptcy did not generate a market cataclysm because it was messy. Filing had barely been made.[214] Lehman Brothers' Chapter 11 proceeding even beat expectations in terms of efficiency.[215] The market cataclysm was the bankruptcy event itself, announced amid alarming news that AIG would be next and immediately after the takeover of Merrill Lynch by Bank of America.[216] The violent shock of the billions-worth of severed relations between Lehman Brothers and the many money market funds holding its commercial paper and other short-term securities, and the brusque termination of several hundred thousands of derivatives contracts by counterparties of Lehman Brothers, could have been contained.[217] However, this was aggravated by the panic that provoked investors with limited exposure to the failing investment bank to pull out completely from short-term funding markets and cause the collapse of these markets and the credit business generally.[218] Interconnectedness is a systemic risk factor. But the eye of a financial storm is invariably the panic effect.

Living wills would make systemic failures less harmful if materialized, but no plan could prepare for all contingencies or anticipate countless counterparty reactions during a crisis or an extreme *force majeure* event. OLA secures the perimeter of large bankruptcies, but it does not halt the abyssal drop in market confidence that follows each of them during a panic. As with any other resolution procedure, it could even accelerate a run on an institution beforehand if various stakeholders feel that their rights would not be sufficiently protected by the procedure. It is also not enough to proclaim, whether by law as in the Dodd-Frank Act or otherwise, that taxpayers shall bear no losses and that moral hazard would be reduced by OLA proceedings

[213] Jeffrey N. Gordon & Christopher Muller, *Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Insurance Fund*, 28.1 YALE J. ON REGUL. 151, 154 (2011).
[214] Lehman Brothers Holdings Inc. filed for bankruptcy early in the morning on Monday, September 15, 2008. History.com Editors, *Lehman Brothers Declares Bankruptcy*, HISTORY (Sept. 14, 2020), https://www.history.com/this-day-in-history/lehman-brothers-collapses.
[215] *See* Kenneth M. Ayotte & David A. Skeel, *Bankruptcy or Bailouts?*, 35 J. CORP. L. 469, 481 (2010).
[216] *See* Carrick Mollenkamp et al., *Crisis on Wall Street as Lehman Totters, Merrill Is Sold, AIG Seeks to Raise Cash*, WALL ST. J. (Sept. 15, 2008), https://www.wsj.com/articles/SB122139688846233147.
[217] *See* OONAGH MCDONALD, LEHMAN BROTHERS: A CRISIS OF VALUE 113-14 (2016).
[218] *See* Carrick Mollenkamp et al., *The Two Faces of Lehman's Fall*, WALL ST. J. (Oct. 6, 2008), https://www.wsj.com/articles/SB122324937648006103.

for this to be entirely the case.[219] The securities-for-claims exchange in an OLA proceeding mostly converts debt claims into new equity.[220] Moral hazard is decreased by making shareholders and the subordinated and unsecured creditors of a failed institution accountable for the losses.[221] Taxpayers are legally more protected as OLF-secured lenders than as *de facto* shareholders when the government takes an equity position in a failing financial institution.[222] Taxpayers may nonetheless suffer indirect losses if the OLA proceeding fails to sufficiently ward off a panic or turns out to be less profitable than a government rescue, whether in the form of a bailout or last resort lending. Moreover, moral hazard would similarly not be extinguished under OLA if derivatives counterparties and other secured claimholders are not made responsible for any remaining losses.

The cardinal point here is not to call into question the merits of living wills or OLA, which can be beneficial in ordinary times, but to criticize the tradeoff by which they were meant to replace or limit the use of Section 13(3) that proved so determinant during the Financial Crisis, and later on during the Global Pandemic.[223] When living wills and OLA came to be tested for the first time during the Global Pandemic, they were of little use. Voices were even raised to request the suspension of living wills.[224] Emergency lending may also well complement OLA by providing an OLA resolution proceeding enough liquidity to reach its end.

The real issue to any government during a financial crisis is its grip on the situation, not whether its actions create moral hazard. Treasury and Fed interventions during the Financial Crisis halted the panic.[225] In the midst of the Global Pandemic, it was wiser to help private enterprises of all sorts weather the storm through the passage of the CARES Act and the Consolidated Appropriations Act, as well as through the Fed's emergency

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[219] Dodd-Frank Act § 214(c); 12 U.S.C. § 5394(c). *See also* STEPHANIE MASSMAN, THE ORDERLY LIQUIDATION AUTHORITY: FANATICAL OR FAMILIAR? IDEALISTIC OR UNREALISTIC? 1 (2014).

[220] *See Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*, 78 Fed. Reg. 76,614 (Dec. 18, 2013).

[221] *See* U.S. DEP'T OF THE TREASURY, ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM 24, 31 (2018).

[222] *See id.* at 12.

[223] The tradeoff is clearly highlighted in Ben S. Bernanke's memoirs. *See* BERNANKE, *supra* note 133, at 464.

[224] Hal S. Scott, *Do More to Avert a Liquidity Crisis*, WALL ST. J. (Mar. 21, 2020), https://www.wsj.com/articles/do-more-to-avert-a-liquidity-crisis-11584822068.

[225] *See generally* Yale Sch. Of Mgmt., *US Government Crisis Response*, YALE PROGRAM ON FIN. STABILITY, https://ypfs.som.yale.edu/us-government-crisis-response (last visited Oct. 14, 2021).

lending, than to witness a series of liquidations under OLA and other bankruptcy proceedings that would have had a devastating effect.

To mitigate taxpayer losses and hold moral hazard beneficiaries accountable, emergency lending or government bailouts may be conditioned on bail-in procedures converting debt claims into preferred or ordinary stock, or equity dilution by way of new share issuances. Other sanctioning methods in parallel to governmental assistance could also decrease moral hazard. AIG's shareholders were almost 80% diluted by the Fed's rescue of their company in September 2008.[226] The dilution could have been more punishing but for the rule, under generally accepted accounting principles, requiring consolidation of AIG's debt with that of the acquirer if it came to own more than 79.9% of the stock.[227] Outrageous bonuses and golden parachutes, as those rewarding AIG executives in 2008, may also be dealt with by legally allowing the Fed or the Treasury to limit employee compensation in connection with their rescue efforts. CARES Act funds channeled through the Main Street Facilities were made available to borrowers subject to limitations on employee compensation, share buybacks and capital distributions.[228]

IV. THE DODD-FRANK ACT AND THE FED'S LENDER OF LAST RESORT ROLE

Title XI of the Dodd-Frank Act amended substantively the Fed's authority under Section 13(3).[229] On November 30, 2015, the Fed approved the final rule implementing Title XI and setting forth the procedures for its emergency lending ("Final Rule").[230] The Final Rule generally has not imposed restrictions farther than those of Title XI.[231] With the benefit of hindsight and in light of the Financial Crisis, and more recently the Global Pandemic, we assess below the impact of the amendments brought by Title XI of the Dodd-Frank Act and the Final Rule to the Fed's emergency lending powers.

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[226] Matthew Karnitschnig et al., *U.S. to Take Over AIG in $85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up*, WALL ST. J. (Sept. 16, 2008), https://www.wsj.com/articles/SB122156561931242905.

[227] *See* Alec Buchholtz & Aidan Lawson, *The Rescue of American International Group Module A: The Revolving Credit Facility*, 3 J. FIN. CRISES 20, 40 (2021).

[228] CARES Act §§ 4003(c)(3)(A)(ii), 4004(a)(1).

[229] *See* Dodd-Frank Act §§ 1101, 1103; 12 U.S.C. § 343.

[230] *See* Extensions of Credit by Federal Reserve Banks, 80 Fed. Reg. 78,959 (Dec. 18, 2015).

[231] *See id.*; *see also* Dodd-Frank Act tit. 11.

A. Broad-Based Eligibility

Prior to the Dodd-Frank Act, the Fed could make a Section 13(3) loan to "*any individual, partnership, or corporation*," provided that other conditions of the loan were met.[232] The Dodd-Frank Act suppressed such ability for the Fed to lend to one individual or private entity.[233] Section 13(3) currently allows only programs or facilities "*with broad-based eligibility*."[234] The Final Rule specified the conditions satisfying the broad-based eligibility requirement: a program or facility must "*provide liquidity to an identifiable market or sector of the financial system*,"[235] must comprise a minimum of five eligible participants,[236] and must not be designed for the purpose of "*assisting one or more specific companies avoid bankruptcy, resolution under Title II of the [Dodd-Frank] Act, or any other Federal or State insolvency proceeding, including by removing assets from the balance sheet of one or more such [companies]*" or "*aiding one or more failing financial companies*."[237]

A Section 13(3) loan must now be designated to a financial market or sector for impartial reasons, not a particular institution based on discretionary motives.[238] "*Regulation by deal*" is no longer a policy.[239] A borrower's selection would emanate from more transparent criteria, as part of a comprehensive rescue effort. The prohibition to remove balance sheet assets adds to the letter of the law the already implicit limitation on the Fed to purchase assets outside of open market operations, an issue we discuss in Part VI.[240] The last two conditions of the broad-based eligibility requirement intend to eliminate abuses in emergency lending altogether.[241] They rule out the potential trickery of cherry picking specific failing institutions and assembling them in a group of five participants or designing a falsely-inclusive program that would in fact covertly channel the majority of the proceeds to one particular entity.[242] As part of its one-time audit mission of the Fed's emergency lending during the Financial Crisis,[243] the Government Accountability Office ("GAO") had to assess whether Section 13(3)

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[232] 12 U.S.C. § 343. See *supra* Part I(C) for more information.
[233] *Id.*
[234] 12 U.S.C. § 343(3)(A).
[235] 12 C.F.R. § 201.4(d)(4)(ii) (2021).
[236] 12 C.F.R. § 201.4(d)(4)(iii)(C) (2021).
[237] 12 C.F.R. § 201.4(d)(4)(iii)(A)–(B) (2021).
[238] *See* Dodd-Frank Act § 1101.
[239] *See* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009).
[240] *See* Dodd-Frank Act § 1101.
[241] *Id.*
[242] *Id. See also* 80 Fed. Reg. 78,959 (Dec. 18, 2015), *supra* note 230. 12 C.F.R. § 201 (2021).
[243] Dodd-Frank Act § 1109(a)(1).

programs inappropriately favored certain credit recipients over others.[244] The CARES Act provided a mechanism that prevented conflicts of interest or other forms of favoritism from prejudicing emergency lending programs during the Global Pandemic.[245]

Broad-based eligibility was a direct response to the popular sentiment against the 2008 "Wall Street bailouts" and the Fed's then unhampered power in deciding the fate of financial institutions individually, as it chose which ones it would save, like Bear Stearns and AIG, and which it would let die, like Lehman Brothers.[246] Targeting emergency lending exclusively at identifiable markets or sectors of the financial system nevertheless significantly narrows the span of who has access to the lender of last resort and paradoxically limits it strictly to "Wall Street."

During the Global Pandemic, legal abstraction was conflated with reality. The Fed had to overstretch its role in view of Section 13(3) so as to lend to non-financial firms, local governments, or non-profit organizations.[247] The Fed considered the municipal securities market as "*an important part of the financial system*" to provide liquidity to states, cities, counties, and instrumentalities thereof.[248] Lending to consumers and businesses through the TALF 2020 was justified by the support to the securitization market.[249] Paper issued by industrial and commercial companies was bought by the CPFF 2020 to relieve pressure in the commercial paper market.[250] Providing assistance to small and medium businesses and workers through the PPPLF and the Main Street Lending Program was, however, more problematic. The two programs satisfied the broad-based eligibility requirement. Conversely, considering the phrasing of the revised Section 13(3), such programs did not address a specific market or sector of the financial system but the bulk of the economy. The PPPLF "*provide[d] relief to American workers and businesses*"[251] and the Main

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[244] Dodd-Frank Act § 1109(a)(2)(C).
[245] CARES Act § 4019.
[246] *See* LABONTE, CONG. RSCH. SERV., *supra* note 64, at 15.
[247] *Id.* at 23-24.
[248] *FAQs: Municipal Liquidity Facility*, FED. RSRV. BANK OF N.Y. (Oct. 5, 2020), https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq.
[249] *See FAQs: Term Asset-Backed Securities Loan Facility*, FED. RSRV. BANK OF N.Y. (Nov. 2, 2020), https://www.newyorkfed.org/markets/term-asset-backed-securities-loan-facility/term-asset-backed-securities-loan-facility-faq.
[250] *See* Press Release, *Federal Reserve Board Announces Establishment of a Commercial Paper Funding Facility (CPFF) to Support the Flow of Credit to Households and Businesses*, *supra* note 115.
[251] *See Paycheck Protection Program Liquidity Facility (PPPLF) Historical List of Frequently Asked Questions*, FED. RSRV. BANK OF N.Y. BD. (July 30, 2021), https://www.frbdiscountwindow.org/~/media/documents/ppplf_historical_faqs.pdf.

Street Lending Program targeted "*harmed communities and substantially disrupted economic activity in many sectors of the economy*," and nonprofit organizations.[252] It follows that the former availability of Section 13(3) to any individual, partnership, or corporation suits better economic interests when the tide of a crisis submerges more than the financial domain. It also avoids having to resurrect the Industrial Advances Act of 1934, often cited during the Global Pandemic,[253] the past contribution of which to the Federal Reserve Act envisioned that the Fed, even under normal circumstances, would "*make advances of working capital to established businesses if these enterprises were unable to find such capital from usual sources*."[254]

One might wonder why the lender of last resort should look after the liquidity of non-financial firms. These do not have the structural cracks of asset and maturity transformation. However great their financial problems may be, their relatively limited intertwining in the financial system and their non-performance of key financial utilities make them less contagious or porous to systemic risks.[255] When Section 13(3) was enacted in 1932, it instigated a right of entry to Federal Reserve vaults to anyone cast out from private capital and barred from using the discount window, including individuals.[256] Given the ravaged economy back then, non-member banks of the Federal Reserve System were not the only concern of Congress, whose intent behind Section 13(3) was to make emergency lending available to the broader economy, beyond the world of finance.[257] Bagehot's dictum requires to lend "*most freely for the liability of others […], to merchants, to minor bankers, to 'this man and that man'*."[258] Direct emergency lending to the economy shores up capital expenditure and, from a Keynesian standpoint, spending in general; provided it does not supplant private investment or postpone its resumption when the crisis subsides.

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[252] *See Main Street Lending Program For-Profit Businesses FAQs* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.bostonfed.org/mslp-faqs. *See also Main Street for Nonprofit Organizations FAQs* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.bostonfed.org/-/media/Documents/special-lending-facilities/mslp/legal/frequently-asked-questions-faqs-nonprofit.pdf.
[253] *See generally* George Selgin, *When the Fed Tried to Save Main Street*, CATO INST: CATO AT LIBERTY, (Mar. 30, 2020, 1:07 PM), https://www.cato.org/blog/when-fed-tried-save-main-street.
[254] *See* David Fettig, *Lender of More Than Last Resort*, *supra* note 64.
[255] *See* LABONTE, CONG. RSCH. SERV., *supra* note 64, at 23-24.
[256] *Id.* at 16-17.
[257] FRIEDMAN & SCHWARTZ, *supra* note 1, at 192. *See also* Parinitha Sastry, *The Political Origins of Section 13(3) of the Federal Reserve Act*, 24 FED. RSRV. BANK N.Y. ECON. POL'Y REV. 1, 20 (2018).
[258] BAGEHOT, *supra* note 17, at 51.

It is undeniable that broad-based eligibility reduces moral hazard. It makes a borrower benefit from a Section 13(3) loan because its difficulties are tied to a deleterious financial market or sector, less to its particular state of affairs. This was somehow already covered though by the requirement, pre-dating the Dodd-Frank Act, that there must be unusual and exigent circumstances for Section 13(3) to be invoked by the Fed. A non-depository institution may also be under liquidity duress for no reckless behavior on its part and independently of any financial crisis. Moral hazard would not be a concern here. One striking example, among others, is that of a cyber-security attack.[259] While unusual and exigent circumstances generally refer to an exceptionally bad economic environment, the Fed may well interpret such circumstances as relating to the difficulties of one particularly important non-depository institution before they spill over (depository institutions have the backing of the discount window). The subtlety of this interpretation is that it allows the rescue of any non-depository institution if its failure poses a systemic risk. This could be demonstrated, for example, by a power outage at NASDAQ or the hacking of a cloud account or security credentials of a large mutual fund. Under the current Dodd-Frank Act's legal regime, the Fed would have no choice but to stand idle in these situations because of the broad-based eligibility criteria.[260]

Eliminating emergency lending on an individual basis bears other costs. The Fed would lose its ability to act swiftly when the spark of contagion could still be contained within the financial perimeter of one institution.[261] Bagehot outlines very clearly in Lombard Street the necessity for a central bank to intervene at the early stage of a crisis: "*In wild periods of alarm, one failure makes many, and the best way to prevent the derivative failures is to arrest the primary failure which causes them.*"[262] Financial woes having already attained five or more firms by the time the Fed intervenes reduces the impact of such action (it would have been better to act before) or increases the risk of making such action redundant.[263] A timely response by the Fed is crucial in light of the growing sophistication, speed and interconnectedness of financial markets. Sequential failures of several institutions in one financial sector, but at distant points in time, could further prevent an emergency lending facility from ever being established. Such institutions could collapse one after the other before they could be grouped

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[259] John L. Walker, *Emergency Tools to Contain a Financial Crisis*, 35 REV. BANKING & FIN. L. 672, 735 (2015).
[260] *See generally* 12 U.S.C. § 343.
[261] HAL S. SCOTT, CONNECTEDNESS AND CONTAGION: PROTECTING THE FINANCIAL SYSTEM FROM PANICS 205 (2016).
[262] BAGEHOT, *supra* note 17, at 51.
[263] *See generally* SCOTT, *supra* note 261, at 94.

into five as envisaged. By the same token, it would be unfortunate to see the hands of the Fed tied when serious financial difficulties of merely four entities hinder the proper functioning of a market.

During a financial crisis, a large number of financial institutions would most likely be under liquidity stress. The Fed may implement Section 13(3) programs to cover a panel of wide and different financial sectors or markets or draw relaxed eligibility requirements to include as many entities as possible in any Section 13(3) program.[264] This fairly tempers the restriction that the broad-based eligibility requirement imposes on emergency lending. Title VIII of the Dodd-Frank Act may also become handy to provide liquidity to single non-depository institutions.[265] The large definition of an FMU in Title VIII makes any FSOC-designated manager or operator of a central clearing system or of a "payment versus delivery" mechanism for post-trade matches eligible to receive liquidity from the Fed in unusual or exigent circumstances, even outside of a Section 13(3) program.[266] As such, any FSOC-designated broker-dealer may be granted liquidity under Title VIII if it incorporates an in-house central clearing department for its own financial transactions or if it owns a subsidiary that operates a clearing and settlement platform as an independent business. [267]

B. Borrower Solvency

In *Lombard Street*, Bagehot alludes to a borrower's solvency via the quality of its collateral. For Bagehot, the refusal to lend to a borrower with good collateral fuels a crisis.[268] Therefore, "*advances should be made on all good banking securities, and as largely as the public ask for them.*"[269] Bagehot adds that because "*bad business […] is an infinitesimally small fraction of the whole business*" and "*unsound people*" are "*a feeble minority;*" denying them lender of last resort recourse "*will not make the panic really worse.*"[270] Contrary to widespread academic belief, Bagehot did not recommend to lend only to solvent borrowers, but rather to as many solvent borrowers as possible. In other words, while lending to an insolvent entity would not be necessarily an error, although Bagehot contends that "*no advances [should] indeed be made by which the Bank [of England] will*

264 *Id.* at 93.
265 *See* Dodd-Frank Act tit. 8.
266 12 U.S.C. § 5462.
267 *See* Dodd-Frank Act tit. 8.
268 BAGEHOT, *supra* note 17, at 197, 198.
269 *Id.*
270 *Id.*

ultimately lose," refusing to lend to a solvent entity would clearly be a mistake.[271]

There is no express mention of a discount window borrower's "solvency" in either the Federal Reserve Act or Regulation A.[272] But the Fed traditionally lends under its discount window programs pursuant to strict eligibility criteria, CAMELS ratings and other capital adequacy requirements, all of which hinging on the financial soundness–and hence the implicit solvency–of the borrower.[273]

Before the Dodd-Frank Act, there was no prescription that a Section 13(3) borrower be solvent. The Dodd-Frank Act added such prerequisite. An entity is deemed insolvent for purposes of the new Section 13(3) if it is in bankruptcy, resolution under OLA or any other federal or state insolvency proceeding, or if it is generally unable to pay its undisputed debts as they become due during a period of 90 days before the borrowing date under the relevant Section 13(3) program.[274] The Final Rule added to the foregoing statutory insolvency cases a final qualifying criterion that caters for unanticipated situations:[275] an entity may also be deemed insolvent at the sole determination of the Fed.[276]

The Fed considers the borrower's solvency requirement fulfilled by relying on a written certification from an authorized officer,[277] "*recent audited financial statements*,"[278] or other relevant information of the borrower.[279] In the case of a written certification, the compliance weight and probative value put on the officer certificate as updated from time to time,[280] the compulsory acceleration of the borrower's outstanding Section 13(3) loans,[281] and the threat of civil and criminal action against the borrower as well as the certifying officer if there is a "*knowing material misrepresentation*" in the certified document[282] impose additional but

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[271] *Id.*
[272] Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251; Regulation A; 12 C.F.R. § 201.4(a) (2021); *see also The Discount Window*, FED. RSRV., https://www.frbdiscountwindow.org/pages/general-information/the%20discount%20window (last update Nov. 19, 2020).
[273] 12 C.F.R. § 201.4(a) (2021); *see also The Discount Window*, FED. RSRV., *supra* note 272.
[274] Dodd-Frank Act § 1101(a)(6)(B)(ii)-(iii); 12 C.F.R. § 201.4(d)(5)(iii)(A)-(B) (2021).
[275] *See* Extensions of Credit by Federal Reserve Banks, 80 Fed. Reg. 78,961 (Dec. 18, 2015).
[276] 12 C.F.R. § 201.4(d)(5)(iii)(C) (2021).
[277] 12 C.F.R. § 201.4(d)(5)(iv)(A) (2021).
[278] 12 C.F.R. § 201.4(d)(5)(iv)(B) (2021).
[279] 12 C.F.R. § 201.4(d)(5)(iv)(C) (2021).
[280] 12 C.F.R. § 201.4(d)(5)(v) (2021).
[281] 12 C.F.R. § 201.4(d)(5)(vii) (2021).
[282] *Id.*

legitimate pressure on the borrower's management when applying for a Section 13(3) loan. Self-certification saves the Fed time and spares it the administrative hassle of due diligence on each potential Section 13(3) borrower. Without it, the Fed could not have deployed funds as quickly to small borrowers under the PPPLF or the Main Street Lending Program nor to larger borrowers under other Section 13(3) programs during the Global Pandemic.

This situation is much clearer when an entity enters into bankruptcy, orderly liquidation or other insolvency proceedings. There is also relative visibility in the event an entity generally has not paid its undisputed debts as they become due 90 days before borrowing under a Section 13(3) program.[283] The adverb "generally" most likely means that there ought to be some leeway when determining that the entity has failed to pay its undisputed and due debts.[284] Non-substantial amounts of unpaid debt would probably be disregarded.[285] However, this penalizes entities that are solvent, with long-term assets exceeding long-term liabilities, but which are not able to honor their current debts during the 90-day period because of strains on liquidity.

The Final Rule's aforementioned addition to the definition of an "insolvent entity" gives the Fed a wide discretion in determining other cases of insolvency, including on the basis of an applicant's balance sheet.[286] A potential borrower may be under no bankruptcy proceedings or may have no current late payments, but may show a "deep hole" in its financials.[287] Like AIG before its rescue, a beleaguered entity could still be contesting payment claims despite a somber outlook.[288] Such discretion makes the definition of an "insolvent entity" very broad and could be interpreted as weakening the Fed's resolve as lender of last resort for fear of committing outright illegality if a Section 13(3) borrower turns out to be balance sheet insolvent after the fact. Another reading suggests that, as long as the Fed retains some range in the analysis of a potential Section 13(3) borrower's financial statements and in the valuation of its assets, it should not be dissuaded from intervening.[289]

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[283] *See* 12 C.F.R. § 201.4 (d)(5)(iii)(B) (2021).
[284] *Id.*
[285] *See* Ernie Patrikis, *Federal Reserve Board Limits Emergency Lending*, WHITE AND CASE LLP (Dec. 2, 2015), https://www.jdsupra.com/legalnews/federal-reserve-board-limits-emergency-16584/.
[286] *See* 80 Fed. Reg. 78,961 (Dec. 18, 2015), see *supra* note 275.
[287] James B. Stewart & Peter Eavis, *Revisiting the Lehman Brothers Bailout that Never Was*, N. Y. TIMES (Sept. 29, 2014), https://www.nytimes.com/2014/09/30/business/revisiting-the-lehman-brothers-bailout-that-never-was.html.
[288] *See* Peter Eavis, *New Fed Rule Limits Emergency Lending Power*, N. Y. TIMES (Nov. 30, 2015), https://www.nytimes.com/2015/12/01/business/dealbook/new-fed-rule-limits-emergency-lending-power.html.
[289] *See* SCOTT, *supra* note 261, at 94.

Quite the reverse: it would have ample opportunity to clarify its position on contentious Section 13(3) loans afterwards or explain why certain Section 13(3) loan applications passed muster and other did not.

Dire liquidity circumstances could make it very difficult to conclude whether a potential Section 13(3) borrower is balance sheet solvent or not. Up until the very last hours of Lehman Brothers, there were still disagreements on the firm's valuation.[290] An ancillary query is whether to assess the creditworthiness of a borrower in real time or, should the crisis ebb, giving the borrower's assets a chance to regain in value if possible.[291] A solvency determination during a crisis is an approximation exercise at best, yielding more estimates than proper counting.[292] But valuing financial institutions under crisis circumstances based solely on the probability of distress and fire sale assumptions would most probably leave the Fed with very few "solvent" financial institutions to save. Bagehot refers in *Lombard Street* to a borrower's collateralized assets as valued "in ordinary times," that is, outside of crisis conditions.[293] A reasonable solvency determination by the Fed should value a potential Section 13(3) borrower's assets fairly indifferently from their crisis environment and discount any future cash flow at historic reference rates.[294] The Fed had specifically taken this approach in its Main Street Lending Program by considering the financial soundness of borrowers "*prior to the onset of the Global [P]andemic*" and with a view to allowing these borrowers to "*maintain their operations and payroll until conditions normalize*."[295] Eligible borrowers, under each of the Main Street Facilities, must have had an internal risk rating for any of their outstanding loans with eligible lenders that was equivalent to a "pass" in the Federal Financial Institutions Examination Council's supervisory rating system as of December 31, 2019, a date realistically close enough to the start of the

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290 ANDREW ROSS SORKIN, TOO BIG TO FAIL 323 (2009). *See* Michael Grunwald, *The Real Truth About the Wall Street Bailouts*, TIME (Sept. 30, 2014), https://time.com/3450110/aig-lehman. *See also* James B. Stewart, *Solvency, Lost in the Fog at the Fed*, N. Y. TIMES (Nov. 7, 2014), https://www.nytimes.com/11/08/business/the-feds-ambiguous-definition-of-solvency.html.

291 *See* Cardiff Garcia, *What Bagehot Said…*, FIN. TIMES (May 23, 2012), https://www.ft.com/content/0c8aad5a-6dd2-35e2-99eb-275288dd8aef.

292 *See* SCOTT, *supra* note 261, at 103.

293 BAGEHOT, *supra* note 17, at 198. *See also* J. Bradford DeLong, *This Time, It Is Not Different: The Persistent Concerns of Financial Macroeconomics*, WASH. CTR. FOR EQUITABLE GROWTH (Apr. 2012), https://equitablegrowth.org/j-bradford-delong-2012-this-time-it-is-not-different-the-persistent-concerns-of-financial-macroeconomics/.

294 *See* William R. Cline & Joseph E. Gagnon, *Lehman Died, Bagehot Lives: Why Did the Fed and Treasury Let a Major Wall Street Bank Fail?*, PETERSON INST. FOR INT'L ECON., https://www.piie.com/sites/default/files/publications/pb/pb13-21.pdf (last visited Oct. 17, 2021).

295 *See Main Street Lending Program For-Profit Businesses FAQs, supra* note 252.

economic meltdown due to the Global Pandemic.[296] The MMLF permitted amortized cost as an acceptable collateral valuation method, along with fair value.[297] This gave MMLF valuations some detachment from the crisis context during which they were made.

Nothing prevents the Fed from imposing stricter requirements regarding the solvency of a borrower other than those already applied. In each of the Main Street Facilities, a borrower had to certify that it had a reasonable basis to believe in its ability to meet its financial obligations and did not expect to file for bankruptcy for at least 90 days following the origination of its loan under the relevant facility.[298] In the MMLF, a borrower had to certify that both it and the money market mutual fund from which the collateral was purchased were not insolvent.[299]

The Dodd-Frank Act attempted a definition of solvency. It judiciously did not do the same with liquidity. Liquidity is commonly thought of as the ability of a borrower to pay for its current liabilities with its current assets. Under general accounting principles, the epithet "current" means that the relevant balance sheet item is owed by or to the borrower within less than a year.[300] A loan should henceforth have a short-term maturity or else it would lose its liquidity funding trait. Applying a strict accounting approach to the concept of liquidity would, however, not be practical in connection with the Fed's emergency lending whose main termini are not necessarily short-term funding markets. Certain financial markets have liquidity needs beyond a fiscal year. During the Financial Crisis, the TALF made five-year loans for the purchase of MBS and three-year loans in respect of other asset-backed securities.[301] During the Global Pandemic, the TALF 2020 had a three-year

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[296] *Id.*

[297] *See Money Market Mutual Fund Liquidity Facility* (Mar. 18, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200318a1.pdf.

[298] *MSNLF Term Sheet* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20201229a1.pdf; *MSPLF Term Sheet* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20201229a2.pdf; *MSELF Term Sheet* (Dec. 29, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20201229a3.pdf.

[299] *See Money Market Mutual Fund Liquidity Facility FAQs*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/files/mmlf-faqs.pdf (last update May 26, 2020).

[300] *See* HAROLD A. BIERMAN JR., AN INTRODUCTION TO ACCOUNTING AND MANAGERIAL FINANCE: A MERGER OF EQUALS, 16, 18 (2009).

[301] *Term Asset-Backed Securities Loan Facility: Terms and Conditions*, FED. RSRV. BANK OF N.Y. (Nov. 13, 2009), https://www.newyorkfed.org/markets/TALF_Terms_print.html.

calendar for its facilities.[302] To be eligible for purchase under the MLF, a note had to mature within two years.[303] Corporate bonds qualifying for the PMCCF and the SMCCF had maturities of less than four and five years, respectively.[304] The Main Street Facilities had five year-terms.[305]

The Fed is also free to quantify the principal of its Section 13(3) loans as it sees appropriate. During the Global Pandemic, loans under the Main Street Facilities, for example, ranged from $100 thousand to $300 million.[306] In the CPFF 2020, the applicable maximum purchase limit depended on the credit rating of the issuer at a given time and was either the greatest amount of commercial paper outstanding any day during the preceding one year period[307] or the amount of commercial paper outstanding the day before a downgrade.[308] The MLF had a limit for purchased notes per State, city and county, up to an aggregate amount of 20 percent of the general revenue from own sources and utility revenue of the relevant State, city or county in 2017.[309]

The Dodd-Frank Act's legal regime has not imprisoned emergency lending in any timeframe. Nor has it framed the amount of liquidity to be given thereunder. It did however hint at the extent of such liquidity in its broad-based eligibility requirement: a Section 13(3) liquidity provision should not aid failing financial companies or save them from bankruptcy.[310] This tends to negate the idea of a lender of last resort whose role is nothing less but to aid failing financial companies or to save them from imminent bankruptcy. The contrasting ability of the Fed to extend longer-term

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302 *Term Asset-Backed Securities Loan Facility*, FED. RSRV. (July 28, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a6.pdf.
303 *Municipal Liquidity Facility Term Sheet*, FED. RSRV. (Aug. 11, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
304 *Primary Market Corporate Credit Facility Term Sheet*, FED. RSRV. (July 28, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a9.pdf; *Secondary Market Corporate Credit Facility Term Sheet*, FED. RSRV. (July 28, 2020), https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200728a1.pdf.
305 *See* Policy Tools, *Main Street Lending Program*, *supra* note 120.
306 *See Main Street Lending Program For-Profit Businesses FAQs*, *supra* note 252.
307 *See FAQs: Commercial Paper Funding Facility*, FED. RSRV. BANK OF N.Y. (Nov. 30, 2020), https://www.newyorkfed.org/markets/commercial-paper-funding-facility/commercial-paper-funding-facility-faq. For issuers rated A1/P1/F1, the maximum purchase limit was the greatest amount of U.S. dollar commercial paper outstanding any day between March 16, 2019 and March 16, 2020.
308 *Id.* For issuers rated A2/P2/F2 or A1/P1/F1 on March 17, 2020, the maximum purchase limit was the amount of U.S. dollar commercial paper outstanding the day before downgrade.
309 *See Municipal Liquidity Facility Term Sheet* (Aug. 11, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf.
310 12 U.S.C. § 343(B)(i)-(iii).

secondary credit under its discount window to depository institutions, if such credit would facilitate the "*orderly resolution of serious financial difficulties*," also suggests that depository institutions may have a more favorable treatment than non-depository institutions in this regard.[311] Another interpretation may, however, regard the wording of the broad-based eligibility requirement as equipping the Fed with enough flexibility to determine the depth and size of the liquidity it provides. There is no neat legal delimitation to where liquidity ends. Nor is there, outside of bankruptcy and a cessation of payments within 90 days of borrowing, a clear delineation as to where solvency starts.[312] The distinction between the point where a liquidity provision ends and the point where a solvency lifeline begins may thus move over a distending interval. A Section 13(3) liquidity provision can be stretched, in time and in amount, as long as it does not aid a failing financial company or make it evade bankruptcy. This serves two purposes. A liquidity provision is elastic and abundant enough to be efficient. At the same time, it should not, in all good faith, go beyond what is reasonable, let alone resurrect the dead by turning net worth from negative to positive. Last resort lending would be seen less as an implicit governmental insurance against bankruptcy and cease to be vilified as challenging free market principles. Moral hazard would attenuate.

C. Exhaustion of Private Remedies

A prospective Section 13(3) borrower was required prior to the Dodd-Frank Act to bring evidence that it was "*unable to secure adequate credit accommodations from other banking institutions*."[313] The Dodd-Frank Act kept the wording as is and reproduced it for liquidity extensions to FMUs under Title VIII.[314] The phrase most underlines the lender of last resort character of Section 13(3) as it commands the exhaustion by the potential borrower of all private remedies prior to turning to the Fed.

Such a "nail in the coffin" requirement poses an unnecessary difficulty though. Market liquidity would likely have dried up in any event by the time the Fed finds unusual and exigent circumstances. It is unwieldy to ask an ailing entity, in borrowing need at that time, to substantiate that all private doors were pessimistically closed to it before it could apply for a Section 13(3) loan.

The Final Rule brought an ingenious attenuation to this condition by permitting evidence of its fulfillment based on the very socioeconomic

[311] 12 C.F.R. § 201.4(b) (2021).
[312] *See* 12 C.F.R. § 201.4(d)(5)(iii)(A)-(B) (2021).
[313] 12 U.S.C. § 343(3)(A).
[314] Dodd-Frank Act § 806(b).

adversity that the emergency lending intends to address.[315] In 2020, putting law into action, the Fed relied on economic and market conditions, "*including conditions related to the availability and price of credit available to small businesses in light of the Global Pandemic*," to justify lending to small borrowers under Section 13(3).[316] The Fed also indicated, as part of several Section 13(3) programs during the Global Pandemic that the lack of adequate credit "*does not mean that no credit from other sources is available to the borrower*" but "*that the amount, price, or terms of credit available from other sources are inadequate for the borrower's needs during the current unusual and exigent circumstances*"[317] or are "*inconsistent with a normal, well-functioning market*,"[318] or that borrowing under a Section 13(3) program is more adequate because of, for example, a more beneficial capital treatment for the underlying loan. In connection with the Main Street Facilities, a borrower was not "*required to demonstrate that applications for credit had been denied by other lenders or otherwise document that the amount, price, or terms available elsewhere [were] inadequate*."[319] The Final Rule actually equated the condition of exhausting private remedies with that of unusual and exigent circumstances.[320]

Given this pragmatic approach, it seems likely that the Fed would take a similar stance when the opportunity arises with respect to the evidence requirement under Title VIII that adequate credit accommodation be unavailable.[321]

D. Independence

The Fed's impressive deployment of Section 13(3) programs during the Financial Crisis worked to its detriment, despite the success of such programs, and ultimately led to its emergency lending powers being placed under the sway of the Treasury.[322] The Dodd-Frank Act required that the establishment of Section 13(3) programs and their renewals obtain the prior approval of the Treasury,[323] a decision-making process bearing resemblance

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[315] 12 C.F.R. § 201.4(d)(8)(ii) (2021).
[316] *See Paycheck Protection Program Liquidity Facility (PPPLF) Historical List of Frequently Asked Questions*, *supra* note 251.
[317] *See Main Street Lending Program For-Profit Businesses FAQs*, *supra* note 252.
[318] *FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility*, FED. RSRV. BANK OF N.Y. (Dec. 4, 2020), https://www.newyorkfed.org/markets/primary-and-secondary-market-faq/archive/corporate-credit-facility-faq-201204. *See also FAQs: Commercial Paper Funding Facility*, *supra* note 307. *See also FAQs: Municipal Liquidity Facility*, *supra* note 248.
[319] *See Main Street Lending Program For-Profit Businesses FAQs*, *supra* note 252.
[320] *See* Dodd-Frank Act tit. 8.
[321] *Id.*
[322] 12 U.S.C. § 343(3)(B)(iv).
[323] 12 C.F.R. §§ 201.4(d)(2), 201.4(d)(9) (2021).

to that followed by the Bank of England, which has primary responsibility over the management of financial crises but should defer to the Chancellor and HM Treasury for any decision in this respect involving public wherewithal.[324]

In the waning months of the Financial Crisis, both then president of the Federal Reserve Bank of New York Timothy Geithner and Fed Chair Ben Bernanke were rewarded for their actions to stave off the collapse of the financial system: the first took office as Secretary of the Treasury in the Obama administration,[325] and the second was reappointed for a second term at the head of the Fed.[326] It is yet unfathomable why the reward of the Fed, as the institutional lender of last resort, came in the form of a demotion. A Section 13(3) program that must be approved by the Treasury means that the Fed has partially lost its lender of last resort status to the Treasury.[327]

The legitimacy of non-elected technocrats and the extent of powers entrusted to purportedly independent governmental agencies have long raised doubts and skeptical reservations in liberal democracies. The puzzling question of the scope of central banking authority is no exception. In a democratic system resting on power checks and balances, accountability serves agency independence better because the public and their representatives would view an accountable agency as both valuable and legitimate and would be less disposed to resist it or seek to reduce its powers. A central bank's independence does not go unchecked. The Fed's monetary policy statutory mandate subjects it to Congress oversight. Its government delegate status and administration of key federal banking and consumer protection laws make it accountable to the executive branch on certain supervisory accounts. More generally, it is not immune to judicial review.

Nonetheless, the Fed still enjoys the highest degree of agency independence. Its unique self-funding ability guarantees a complete financial autonomy from the federal government, unlike any other executive

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[324] *See Memorandum of Understanding on Resolution Planning and Financial Crisis Management*, HM TREASURY, https://www.bankofengland.co.uk/-/media/boe/files/memoranda-of-understanding/resolution-planning-and-financial-crisis-management.pdf (last visited Oct. 17, 2021).
[325] Jackie Calmes, *Senate Confirms Geithner For Treasury*, N.Y. TIMES (Jan. 26, 2009) https://www.nytimes.com/2009/01/27/us/politics/27geithner.html.
[326] See Michael Grunwald, *Why Obama reappointed Bernanke to the Fed*, TIME (Aug. 25 2009), http://content.time.com/time/politics/article/0,8599,1918422,00.html; *see also* Andrew Clark, *Ben Bernanke Given Second Term At Federal Reserve*, THE GUARDIAN (Jan. 28, 2010), https://www.theguardian.com/business/2010/jan/28/ben-bernanke-wins-reelection.
[327] *See* 12 U.S.C. § 343(3)(B)(iv).

agency.[328] Its monetary policy independence is entrenched in both black letter and soft law. The assigned geographical and career background diversity of the Fed's Governors,[329] their appointment on a staggered basis and for long tenures,[330] the statutory preclusion to remove any of them for no cause, and the "conventional" presidential self-restraint against removing the chairman of the Fed[331] are all assurances of the Board of Governors' imperviousness to political interference and the Governors' exercise of their "duty of ungratefulness"[332] towards their nominating and confirming authorities.

Monetary policy independence ensures that the long-term future goals of the Fed are not contingent upon the realization of present - and often differing - political gains. Direct last resort lending to depositary institutions in normal times is ensured through the discount window and falls within the realm of monetary policy. Emergency lending is the Fed's hat for last resort lending to financial markets or sectors in extraordinary times. Fundamentally different from monetary policy, in that its aim is not to control the money supply, such role nonetheless draws on the Fed's monetary operations to be available and should therefore incidentally benefit from the independence granted for the carrying out of monetary policy.

Emergency lending is not unconditional. It is strictly regulated and further bound by the implicit adherence of the Fed to "soft norms" such as the Bagehot dictum.[333] Other factors among which the Fed's search for consistency in its decisions, the Fed Chair's reputational concern,[334] and the statutory collegiality of the Fed's decisions through its Board of Governors[335] are additional deterrents against arbitrary actions.

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[328] *Where does the Federal Reserve get the money to fund its operations?*, FED. RSRV. BANK OF S.F., https://www.frbsf.org/education/publications/doctor-econ/2006/may/federal-reserve-funding/ (last visited Oct. 17, 2021).
[329] 12 U.S.C. § 241.
[330] 12 U.S.C. §§ 241- 242.
[331] *See* Peter Conti-Brown, *The Institutions of Federal Reserve Independence*, 32 YALE J. REGUL. 257 (2015); *see also* Adrian Vermeule, *Conventions of Agency Independence*, 113 Colum. L. Rev. 1168 (2013).
[332] The expression in French, "*le devoir d'ingratitude,*" belongs to former French Minister of Justice, Robert Badinter. *See* M. Robert Etien, *Faut-il Réformer le Contrôle de la Constitutionnalité de la Loi en France?*, SENAT, https://www.senat.fr/colloques/office_du_juge/office_du_juge38.html (last visited Nov. 2, 2021).
[333] *See* Kathryn Judge, *The Federal Reserve: A Study in Soft Constraints,* 78 LAW & CONTEMP. PROBS. 65, 66 (2015).
[334] *Id.* at 67.
[335] On the governance of the Fed, *see* Peter Conti-Brown & Simon Johnson, *Governing the Federal Reserve System after the Dodd-Frank Act*, PETERSON INST. INT'L ECON., PB 13-25, 2013.

The Fed may temporarily operate with negative capital. But such capacity to carry forward losses by recording them as deferred assets is not open ended. Just as the United States' debt cannot increase infinitely. Ultimately, the Fed's losses are citizens' losses. If worse comes to worst, it would be up to the Treasury to re-capitalize the Fed. Further than numbers, a profitable Fed is therefore also a matter of institutional independence.

A constant concern for its independence made the Fed seek the political support of the Treasury for its emergency lending during the Financial Crisis and the Global Pandemic. It worked hand in hand with the Treasury throughout 2008-09 and made it a point to receive its blessing on most critical accounts, including the rescue of Bear Stearns and AIG.[336] Apprehensive that the then enormous size of its emergency lending could put its autonomy at risk, the Fed not only took shelter under the legitimacy umbrella of the Treasury, but demanded Congress action and played an active role in crafting the indispensable fiscal responses and building Congressional support around the Troubled Asset Relief Program ("TARP") in October 2008.[337] Pursuant to TARP, an equity purchase program allowed for financial institutions to be recapitalized with Treasury funding. During the Global Pandemic, the violins of the Fed and the Treasury similarly worked in equal temperament concerning the implementation of Section 13(3) programs. The Treasury's input was an integral part of each of these programs, except for the PDCF 2020.[338] Equity participations by the Treasury in Fed-created SPVs meant that the Treasury would mitigate the Fed's credit risk by taking the first losses, if any, on the relevant programs. They mutually benefited the Fed and the Treasury. The former would lend more boldly while risking less jeopardizing its independence. The latter would rely on the Fed's already-tested crisis toolkit and swift-moving capabilities and would fund the economy with the multiplication advantage of leverage.[339] For example, the PMCCF and the SMCFF leveraged each U.S. dollar of Treasury's equity by 7 or 10, depending on the corporate bond or asset purchased.[340]

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[336] *See* DAVID WESSEL, IN FED WE TRUST, BEN BERNANKE'S WAR ON THE GREAT PANIC (2009).
[337] Emergency Economic Stabilization Act, Pub. L. 110-343, 122 Stat. 3765 (2008).
[338] *See* Press Release, *Federal Reserve Board announces establishment of a Primary Dealer Credit Facility (PDCF) to support the credit needs of households and businesses*, *supra* note 113.
[339] Jeanna Smialek, *How the Fed's Magic Money Machine Will Turn $454 Billion Into $4 Trillion*, N. Y. TIMES (Mar. 26, 2020) https://www.nytimes.com/2020/03/26/business/economy/fed-coronavirus-stimulus.html.
[340] *See Primary Market Corporate Credit Facility Term Sheet*, *supra* note 304; *see also Secondary Market Corporate Credit Facility Term Sheet*, *supra* note 304.

One thing is nevertheless having the Treasury back the Fed and that both agencies work in collaboration but within the boundaries of their respective authorities, another thing is the deference, as in the Dodd-Frank Act, of the Fed's emergency lending to the consent of the Secretary of the Treasury, a member of the President's Cabinet. In the long and winding path towards the Fed's independence[341] and seventy-five years after ending the Secretary of the Treasury's chairmanship of the Fed,[342] such a severe check by the executive is a setback.

While the Dodd-Frank Act relinquished consent to the Treasury with respect to emergency lending, it kept the initiative of launching and structuring Section 13(3) programs and facilities with the Fed. The CARES Act allowed the Treasury to make a more profound dilution of the Fed's lending of last resort competences. Congress gives no appropriations to the Fed.[343] The CARES Act made funds available to the Treasury for investments in connection with Section 13(3) programs or facilities. It neither obliged the Treasury to pursue, nor the Fed to accept, these investments.[344] Such Congressional appropriation of funds is unprecedented. It is however most perplexing that the CARES Act gave the Treasury, a minority stakeholder in Section 13(3) programs and facilities during the Global Pandemic, the authority to determine the form, terms and conditions, including interest rates, of such programs and facilities.[345] Other conditions as to share redemptions, dividend payments and management bonuses in the Main Street Lending Program could be waived in the sole discretion of the Treasury.[346] The same terms could have been reached through the cooperation of the Fed and the Treasury without expressly giving the Treasury structuring powers in Section 13(3) programs or facilities. There is a fine line between sovereignly warranting the emergency lending of the Fed and treating the Fed as the financing arm of the fiscal authority. A hands-on micromanagement by the Treasury of Section 13(3) programs and facilities may sound punitive. It is also not a matter of optics only. It could nurture the

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[341] 1 ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE, 1913-1951 (2003), and 2 ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE, 1951-1969 (2010).
[342] The Banking Act of 1935 terminated the Secretary of the Treasury's chairmanship of the Board of Governors of the Fed and the Comptroller of the Currency's membership with the Board of Governors of the Fed, effective as of February 1, 1936. *See Banking Act of 1935*, FED. RSRV. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/banking-act-of-1935.
[343] *See* CARES Act § 4003.
[344] *See* Peter Conti-Brown, *Explaining The New Fed-Treasury Emergency Fund*, Online Report, Series on Financial Markets and Regulation, Brookings Center on Regulation and Markets, Apr. 3, 2020, https://www.brookings.edu/research/explaining-the-new-fed-treasury-emergency-fund/.
[345] CARES Act § 4003(c)(1)(A).
[346] CARES Act § 4003(c)(3)(A)(iii).

Fed in organizational complacency about its profitability. Any losses would be imputed in the end to the institution holding the reins. It could cause the Fed to take less ownership of its decisions and incidentally make it less protective of its budget autonomy.

The Government's dithering about its objectives regarding Lehman Brothers, during the final stretch of a presidential electoral year and before the investment bank's fateful weekend in September 2008, stands as a reminder that financial decisions of that importance cannot be totally insulated from their political environment. It was long claimed that the Fed lacked the legal authority to save Lehman Brothers,[347] although the Fed did not show such legality scruples when it rescued Bear Stearns or AIG, the solvency of which was as questionable as Lehman Brothers'.[348] In fact, the Fed yielded to the Treasury's pressure not to save single entities after the Bear Stearns rescue,[349] before reversing its decision in the wake of the Lehman Brothers debacle. Some scholars advocate a deeper involvement of the fiscal authority in emergency lending.[350] One fair opinion is that "*[i]f the issue becomes politicized, as is highly likely, the Treasury, not the central bank, should be available to take most of the political heat - even if the central bank provides most of the money*."[351] In the Lehman Brothers' case however, the exact opposite happened, despite the absence then of any decisional hierarchy between the Treasury and the Fed. The Treasury passed the heat onto the Fed and shared with it its political vicissitudes. Cutting decisional ties between the Fed and the Treasury in connection with emergency lending would better dilute any public and political pressure on

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[347] *See e.g.*, Ben S. Bernanke, Chairman of the Federal Reserve, *Federal Reserve Policies in the Financial Crisis*, Speech at the Greater Austin Chamber of Commerce, Austin Texas, Dec. 1, 2008, https://www.federalreserve.gov/newsevents/speech/bernanke20081201a.htm ("*The Federal Reserve is authorized to lend to nondepositories under unusual and exigent circumstances, but such loans must be backed by collateral sufficient to provide reasonable assurance that they will be repaid; if such collateral is not available, the Fed cannot lend*."). *See also* BERNANKE, *supra* note 133, at 181 and 252. *See also* HENRY M. PAULSON, JR., ON THE BRINK, INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 208 (2010).

[348] *See* WILLIAM R. CLINE & JOSEPH E GAGNON, *Lehman Died, Bagehot Lives: Why Did the Fed and Treasury Let a Major Wall Street Bank Fail?*, PETERSON INST. INT'L ECON., PB13-21, 2013. In this article, the authors arrived at the conclusion that Bear Stearns was "*solvent at the time of its emergency loan, but that its capital had been eroded by more than 90 percent.*"

[349] LAURENCE M. BALL, THE FED AND LEHMAN BROTHERS: SETTING THE RECORD STRAIGHT ON A FINANCIAL DISASTER 195-96 (2018).

[350] Saule T. Omarova, *The People's Ledger: How to Democratize Money and Finance the Economy*, 74 VANDERBILT LAW REVIEW 1231, 1268-82 (2021).

[351] Charles I. Plosser, former President of the Fed. Reserve Bank of Philadelphia, *The Federal Reserve System: Balancing Independence and Accountability*, Speech at the World Affairs Council of Philadelphia, Feb. 17, 2010, https://www.philadelphiafed.org/-/media/frbp/assets/institutional/speeches/plosser/2010/02-17-10_world-affairs-council.pdf.

both the Fed and the Treasury. With no procedural circuit, there is no need to give the Treasury the semblance of a fuse.

During the period of transition to the Biden administration in November 2020, the Treasury stunned the Fed with a unilateral demand for a return by the end of 2020 of unused CARES Act funds allocated to Section 13(3) programs.[352] The relevant programs were in any event initially set to expire on December 31, 2020. What was disturbing though in the Treasury's decision is less the claw back of Congressional funds than the reminder of the extent to which the Treasury in fact controls the calendar of the Fed's emergency lending programs and its predisposition to tie it bluntly to the political agenda. Less than half of the $454 billion appropriated by the CARES Act to Section 13(3) programs had been approved for investment by the time the Treasury clawed back these funds.[353] The Global Pandemic had not even abated yet. In the Secretary of the Treasury's own words, "*portions of the economy [were] still severely impacted*."[354] It was widely expected that the Treasury would prolong the Fed's use of CARES Act funds in Section 13(3) programs and that all such programs would be renewed. The Treasury's decision sounded like an ultimatum to which the Fed had no choice but to surrender. In an unprecedented statement nonetheless, the Fed voiced its disapproval with the Treasury's decision.[355] As with monetary policy, freeing the Fed's emergency lending from the tutelage of the Treasury would make central banking management of financial crises less politicized. A solution would be to follow what Title VIII of the Dodd-Frank Act requires the Fed to do before extending liquidity to an FMU in unusual or exigent circumstances; a consultation of the Treasury only, no formal approval would be sought.[356]

Time gave the Fed a sweet perceptional revenge. Ten years after the passage of the Dodd-Frank Act, it was pressed from all sides during the

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[352] U.S. DEP'T OF THE TREASURY, Secretary of the Treasury, Steven T. Mnuchin, *Letter to Fed Chair Jerome Powell*, Nov. 19, 2020, https://home.treasury.gov/system/files/136/letter11192020.pdf.
[353] *See* JAY B. SYKES, CONG. RSCH. SERV., SECTION 4029 OF THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT AND THE EXTENSION OF THE FEDERAL RESERVE'S EMERGENCY-LENDING PROGRAMS (2020).
[354] U.S. DEP'T OF THE TREASURY, *supra* note 352.
[355] BD. OF GOVERNORS OF THE FED. RSRV. SYS., FOIA, *Letter from Chair Powell to Secretary Mnuchin regarding emergency lending facilities*, Nov. 20, 2020, https://www.federalreserve.gov/foia/letter-from-chair-powell-to-secretary-mnuchin-20201120.htm. *See also* Jeanna Smialek and Alan Rappeport, *Mnuchin to End Key Fed Emergency Programs, Limiting Biden*, N.Y. TIMES (Nov. 19, 2020), https://www.nytimes.com/2020/11/19/business/economy/mnuchin-fed-emergency-programs.html.
[356] 12 U.S.C. § 5465(b).

Global Pandemic to pursue the same wide intervention that cost it its independent decision-making power in relation to emergency lending. Some of the Section 13(3) programs that were previously described as stretching the limits of the Fed's authority, such as the CPPP and the PDCF, oddly were better accepted - and even called for - during the Global Pandemic.[357] However, perceptional revenge is not enough. Congress should give back the Fed its full independence.

E. Accountability and Disclosure

At the core of democratic accountability resides transparency, which yields additional benefits. It brings competency and credibility to a governmental agency, denounces misconduct, gives the public occasions to engage, improves the sincerity and efficiency of the decision-making process, and bolsters productivity. Transparency should not be an end by itself though. Instead, it should be balanced with the efficiency and ultimate goal of government.

The Fed already is subject to heightened scrutiny.[358] Its comprehensive balance sheet is disclosed every week. Its annual financial statements are reviewed by independent internal and external auditors before their release. Minutes of the Federal Open Market Committee meetings are published with a three-week lag. The GAO investigates in detail the Fed's operations outside of monetary policy and makes its findings available online, including with respect to last resort lending. The Fed Chair testifies twice a year before Congress on all Fed matters. Other Fed Governors also give congressional testimony now and then. Votes on actions taken, rules and regulations proposed, and matters examined and decided by the Board of Governors of the Fed are made public.[359] Meetings of the Board of Governors of the Fed are held in accordance with the Government in the Sunshine Act of 1976, and, subject to a few exceptions, are open to the public.[360]

However, the Fed's refusal to share emergency lending records with Bloomberg and other news networks during the Financial Crisis pursuant to

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[357] Eric A. Posner, *What Legal Authority Does the Fed Need During a Financial Crisis?*, 101 Minn. Law Rev. 1529, 1548 (2017).
[358] *FAQs, Is the Federal Reserve accountable to anyone?*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/faqs/about_12798.htm (last update Sept., 4, 2019).
[359] Board Votes, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/aboutthefed/boardvotes.htm.
[360] Pub. L. No. 94–409, 90 Stat. 1241; 5 U.S.C. § 552b. *See also* Fed. Rsrv., Government in the Sunshine Meeting Memorandum, https://www.federalreserve.gov/aboutthefed/board-meeting-sunshine.htm (last update June 27, 2013).

requests under the Freedom of Information Act of 1996[361] ("FOIA") made it seem secretive and gave rise to suspicions about its actions in the public eye. Its compelling to do so in March 2010 by the Court of Appeals for the Second District was a rebuke to its argument that a release of emergency lending data, including the identities of borrowers, would undermine the effectiveness of Section 13(3) programs.[362] The Court of Appeals, quoting a Supreme Court jurisprudence on the subject, reminded "*Congress' repeated rejection of any interpretation of the FOIA which would allow an agency to withhold information on the basis of some vague* "*public interest*" *standard,*"[363] and then stated that "*[i]f the [Fed's] Board believes such an exemption would better serve the national interest, it should ask Congress to amend the statute.*"[364] This is what Congress did, but without the Fed asking, and in a manner that married well the accountability and transparency imperatives of the Fed with the efficiency of emergency lending.

The Dodd-Frank Act's legal regime indeed required the Fed to describe to the public and two Congressional committees, within seven days of commencing a Section 13(3) program (or facility), the unusual and exigent circumstances justifying the program, the market or sector concerned by the program, and the material terms, intended effect, expected taxpayers' costs, and eligibility conditions of the program.[365] More specific information related to the identity of the participants in the program, the amounts borrowed and explicit details concerning the assets used or the collateral held in connection with the program, may be given the seal of confidentiality if so requested by the Fed, in which case such information would be made available only to the chairpersons or ranking members of the above-mentioned Congressional committees.[366] But the Fed must disclose to the public under the Dodd-Frank Act, one year after the effective termination of the program, all detailed information of the program, including borrowers'

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[361] Pub. L. No. 104-231, 110 STAT. 3048; *see* Annie Youderian, *Bloomberg Wins Access to Fed Reserve Loan* Records, COURTHOUSE NEWS SERVICE (Aug. 25, 2009), https://www.courthousenews.com/bloomberg-wins-access-to-fed-reserve-loan-records/.

[362] *See* Bloomberg, Lp v. Board of Governors of the Fed. Res., 601 F.3d 143, 147 (2d Cir. 2010); and Fox News Network, LLC v. Board of Governors of the Fed. Res., 601 F.3d 158, 159 (2d Cir. 2010). The Supreme Court rejected the Fed's petition for a further review of the Court of Appeals for the Second District's decisions on March 21, 2011. On March 31, 2011, the Fed released information related to the borrowers under its discount window and emergency lending facilities for the period from August 8, 2007 to March 1, 2010.

[363] Fed. Open Market Comm. of Fed. Rsrv Sys. v. Merrill, 443 U.S. 340, 354, 99 S. Ct. 2800, 61 L. Ed. 2d 587 (1979).

[364] Bloomberg, Lp v. Board of Governors of the Fed. Rsrv., 601 F.3d 143, 150 (2d Cir. 2010).

[365] Dodd-Frank Act § 1101(a)(6); 12 U.S.C. § 343(C); 12 C.F.R. § 201.4(d)(3) (2021); 12 C.F.R. § 201.4(d)(9)(iii) (2021).

[366] Dodd-Frank Act § 1101(a)(6); 12 U.S.C. § 343(D).

identities.[367] The immediate submission of emergency lending information to Congressional committees, subject to confidentiality treatment if need be, succeeded by a one year delay in the disclosure to the public of borrowers' particulars and other sensitive information, was thought of as a fair balance between accountability and transparency on the one hand and efficiency on the other hand. Congress' oversight in this case does not entail any sort of ratification or active control on its behalf. It is mere examination for future legislative improvements. Practical wisdom seemed to have inhibited any counterproductive intrusion by the legislature in the Fed's work while it is actually being performed.

Before the Dodd-Frank Act, discount window borrowing used to be disclosed in weekly statistical releases[368] on a no-name basis. Financial analysts could however guess discount window borrowers' identities by cross-checking with other financial and market data. In Federal Reserve districts outside of New York, fluctuations in discount window borrowing, synchronized with interbank lending activity, could pinpoint specific borrowers. As a result, commercial banks have historically shied away from the discount window as borrowing thereunder would give the market a perception of weakness; a phenomenon known as "stigma."[369] The discount window's stigma problem carries with it economic costs. Commercial banks short on liquidity could turn to more expensive funding venues. This may worsen their financial state, as well as general market conditions. It may also result in erroneous information being collated on the actual borrowing needs of the economy and prevent the discount window from working properly as a monetary policy "safety valve." During the Financial Crisis, the discount window's stigma did not lessen despite liquidity problems becoming so pervasive that nearly all commercial banks were impacted.[370] Counterintuitively, the market continued to single out frail entities. Stigma

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[367] Dodd-Frank Act § 1103. For disclosed information on Section 13(3) programs established during the Financial Crisis, *see* REGULATORY REFORM, *Usage of Federal Reserve Credit and Liquidity Facilities*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/reform_transaction.htm (last update Dec. 9, 2013).

[368] *See* FED. RSRV. STAT. RELEASE, *Factors Affecting Reserve Balances - H.4.1* (Mar. 19, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/releases/h41/20200319/.

[369] *See* Renee Courtois Haltom, *Stigma and the Discount Window*, FED. RSRV. BANK OF RICH., 15 Econ Focus 6, 6 (2011). *See also* Olivier Armantier et al., *Discount Window Stigma during the 2007-2008 Financial Crisis*, FED. RSRV. BANK OF N.Y., Staff Report No. 483, 1-4, 9-15 (2015). *See also* Joao Santos & Stavros Peristiani, *Why Do Central Banks Have Discount Windows?*, FED. RSRV. BANK OF N.Y., Liberty Streets Econ. No. 20110330, Mar. 30, 2011. *See also* Stephen G. Cecchetti, *Crisis and Responses: The Federal Reserve in the Early Stages of the Financial Crisis*, 23 J. Econ. Perspect. 51, 55-57 (2009).

[370] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 274-276.

has indeed a snowball effect; the more financial troubles intensify, the more eager healthier commercial banks become to throw the anathema against competitors suspected to have borrowed from the discount window.[371]

To counter the discount window's stigma problem, the Dodd-Frank Act changed the publication pattern of discount window borrowing from a weekly release of statistically aggregative and supposedly anonymous information to a quarterly disclosure of more specific data, including borrowers' identities, but with a two-year lag.[372] During the Global Pandemic, the Fed further modified its statistical release practice such that published data no longer disclosed the proportion of discount window loans made by regional Reserve Banks to the Fed's total amount of such loans.[373] The changes in the Fed's discount window release policy stopped any borrower identity-guessing by the time discount window loans were made. It is yet to be seen whether these changes would end the sticky problem of discount window's stigma if maintained in the future. In March 2020, the Fed encouraged depository institutions to tap the discount window more.[374] Discount window loans peaked at around $50 billion in weekly average daily balance in early April 2020,[375] when a few States began lifting their first sanitary lockdowns.[376] Such figures should however be analyzed with caution. Historically, the discount window has not shown signs of stigma when dire borrowing conditions were due to exogenous shocks. Discount window loans soared in the aftermath of September 11, 2001, and the Northeast blackout of 2003.[377]

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[371] *See* Mark Carlson and Jonathan D. Rose, *Stigma and the Discount Window*, FEDS Notes (Dec. 19, 2017), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/econres/notes/feds-notes/stigma-and-the-discount-window-20171219.htm.

[372] Dodd-Frank Act § 1103(b); 12 U.S.C § 248(s).

[373] *See* FED. RSRV. STAT. RELEASE, *Factors Affecting Reserve Balances - H.4.1, supra* note 368; *see also* David Henry, *U.S. banks borrow at discount window after Fed offers stigma relief*, REUTERS (Mar. 26, 2020), https://www.reuters.com/article/us-health-coronavirus-fed-banks/u-s-banks-borrow-at-discount-window-after-fed-offers-stigma-relief-idUSKBN21D3JA.

[374] Press Release, *Federal Reserve Actions to Support the Flow of Credit to Households and Businesses*, *supra* note 105.

[375] FED. RSRV. STAT. RELEASE, *Factors Affecting Reserve Balances - H.4.1*. (May 7, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/releases/h41/20200507/.

[376] BD. OF GOVERNORS OF THE FED. RSRV. SYS., SUPERVISION AND REGULATION REPORT 9 (2020), https://www.federalreserve.gov/publications/files/202005-supervision-and-regulation-report.pdf.

[377] FED. RSRV. STAT. RELEASE, *Factors Affecting Reserve Balances - H.4.1*. (September 20, 2001 through October 31, 2001 and August 7, 2003 through September 25, 2003), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/releases/h41/.

Emergency lending programs may also be subject to stigma. Such was the case for the PDCF during the Financial Crisis.[378] However, the success of the Supervisory Capital Assessment Program (SCAP) conducted by the Fed, the FDIC and the OCC in the spring of 2009, and the extensive disclosure of information about Section 13(3) programs during the Global Pandemic shed the light on a novel approach to tackle the emergency lending's stigma problem.[379]

The SCAP was considered as the turning point in the Financial Crisis' resolution. It dissipated the fog of uncertainty by publicly gauging the extent of capitalization of the largest bank holding companies. The different optimistic and pessimistic scenarios and the numerous assumptions for key economic metrics envisaged in the commonly known "Geithner stress tests" were reflected into hypothetical profit and loss statements and other pro forma tables. They contributed in halting the panic by giving the market a clear understanding of the financial system's situation.[380] Transparency was conducive to rebuilding confidence and durable recovery. Today, the Fed publishes annually its Comprehensive Capital Analysis and Review ("CCAR") of the capital adequacy of the largest bank holding companies and U.S. intermediate holding companies of foreign banking organizations, which incorporates the supervisory and company-run stress tests performed as a part of the Fed's other Dodd-Frank Act stress tests ("DFAST").[381]

During the Global Pandemic, the Fed took upon itself the responsibility of divulging extensive and timely information on its emergency lending, more than what the Dodd-Frank Act actually prescribes. In particular, the Fed informed the public on a monthly basis of its emergency lending, including the names and details of participants in each program, the amounts borrowed, and interest rates and costs charged.[382] The substantial amount of

[378] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 295.
[379] *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., *The Supervisory Capital Assessment Program: Design and Implementation* (Apr. 24, 2009), https://www.federalreserve.gov/bankinforeg/bcreg20090424a1.pdf.
[380] *See* Donald P. Morgan et al., *The Information Value of the Stress Test and Bank Opacity*, FED. RSRV. BANK OF N.Y., Staff Report No. 460 (2010), https://www.newyorkfed https://www.federalreserve.gov/bankinforeg/bcreg20090424a1.pdf.org/medialibrary/media/research/staff_reports/sr460.pdf.
[381] BD. OF GOVERNORS OF THE FED. RSRV. SYS., *Stress Tests and Capital Planning* (Aug 5, 2021), https://www.federalreserve.gov/supervisionreg/stress-tests-capital-planning.htm.
[382] Press Release, *Federal Reserve Board outlines the extensive and timely public information it will make available regarding its programs to support the flow of credit to households and businesses and thereby foster economic recovery* (Apr. 23, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/monetary20200423a.htm.

non-redacted information reported every 30 days or otherwise by the Fed has not adversely impacted the efficiency of its emergency lending.

When divulging information on certain Section 13(3) programs during the Global Pandemic, the Fed also has not departed from usual disclosure market practice and legal requirements. For SPV purchases of eligible notes under the MMLF through a competitive sale process, the issuer was required to provide the same level of disclosure typically found in a public offering of notes.[383] If no competitive sale was involved, the Fed would review the issuer's information on its website or on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system.[384] Each issuer under the MMLF was required to provide continuing disclosure pursuant to federal securities regulations regardless of the method of sale.[385]

The Fed's contrasting moves towards outright transparency in emergency lending and increased opaqueness for its discount window lending during the Global Pandemic conveys that the Fed's strategy towards the stigma problem generally associated with its bilateral liquidity assistance remains unsettled. The problem could well be solved through more prompt transparency rather than with the temporary hiding of borrowers' identities for fear of investor runs on the weakest discovered institutions. The certainty that some financial institutions are weak but backed by the Fed proved to be more reassuring than the uncertainty of guessing financial institutions' soundness by crossing information or obtaining data by artifice.

Quality reporting is one of the main pillars of financial stability and market discipline.[386] Stigma is less relevant when borrowing entities are non-financial companies. In the financial world, addressing the stigma problem is all about managing market expectations. A monthly or quarterly disclosure of Federal Reserve lending usually do not destabilize a borrower if other disclosed figures bode well for the future of the borrower or, at least, confirm what analysts had anticipated.

The Fed should therefore focus its informational and pedagogical effort on desacralizing discount window lending in the market's perception. Borrowers from the discount window's predominant primary credit line are indeed typically in strong financial condition.[387] A depository institution may

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[383] *See FAQs: Municipal Liquidity Facility*, *supra* note 248.
[384] *Id.*
[385] *Id.*
[386] Viral Acharya & Stephen G. Ryan, *Banks' Financial Reporting and Financial System Stability*, 54 J. ACCT. RSCH. 277, 277, 280 (2016).
[387] *See* Felix P. Ackon & Huberto M. Ennis, *The Fed's Discount Window: An Overview of Recent Data*, FED. RSRV. BANK OF RICH., 103 Econ. Q. 37, 37 (2017).

also borrow from the discount window for reasons unrelated to its financial condition.[388] Entities that regularly borrow from the discount window in their ordinary course of business should not be sanctioned by the market if they stick to such practice during economic downturns.

Empirical evidence shows that financial institutions would not hesitate to draw on any liquidity source that does not adversely expose them to the market. During the Financial Crisis, commercial banks relied heavily on an unexpected liquidity provider, the Federal Home Loan Banks system, as an alternative to the then ill-performing discount window.[389] They also sustained a frequent utilization of the TAF which operated as a single-price auction in which competing bids would corrode any perception of stigma.[390] The majority of commercial banks having made borrowing requests under the TAF even did so by bidding rates that were more onerous than discount window rates, especially during the "brink" period of September 2008.[391] Likewise, the auction feature of the TSLF[392] rendered it far more effective during the Financial Crisis than its PDCF counterpart, which worked as a standing facility with Fed pre-determined rates.[393] Encouraging Federal Reserve lending through an auction process thus seems to be an efficient stigma mitigating factor.

F. Collateral

A responsible collateral policy applied to discount window and emergency lending contributes to the Fed's accountability and buttresses its independence. It reduces the risk of taxpayers' loss as well as any fiscal implication on the Fed's balance sheet by further protecting the flow of the Fed's remittances to the Treasury.

Regulation A provides with respect to discount window lending an extensive list of asset classes considered as acceptable collateral, the value and enforcement of which are determined according to published margin

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388 *See* Haltom, *supra* note 369.
389 *See* Adam B. Ashcraft et al., *The Federal Home Loan Bank System: The Lender of Next to Last Resort?*, FED. RSRV. BANK OF N.Y., Staff Report No. 357, 2-3 (2008). *See also* Kathryn Judge, *Three Discount Windows*, 99 CORNELL L. REV. 795, 814-16 (2014).
390 FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 275. *See also* Efraim Benmelech, *An Empirical Analysis of the Fed's Term Auction Facility* (Nat'l Bureau of Econ. Rsch, Working Paper No. 18304, 2012).
391 *See* Olivier Armantier et al., *The Federal Reserve's Term Auction Facility*, FED. RSRV. BANK OF N.Y., 14 Current Issues in Econ. and Fin. 8 (2008). *See also* Allen N. Berger et al., *The Federal Reserve's Discount Window and TAF Programs:* "*Pushing on a String?*" (Univ. of PA, Wharton Sch., Weiss Ctr 8-9, Working Paper No. 14-06 , 2014).
392 *See* Michael J. Fleming et al., *The Term Securities Lending Facility: Origins, Design and Effects*, FED. RSRV. BANK OF N.Y., 15 Current Issues in Econ. and Fin. 1 (2009).
393 *See* Viral V. Acharya et al., *Dealer Financial Conditions and Lender-of-Last Resort Facilities*, FED. RSRV. BANK OF N.Y., Staff Report No. 673, 10, 20 (2014).

tables and guidelines and pledging procedures usually granting the Fed a priority ranking.[394] Any asset posted as collateral in connection with discount window lending is assigned a lendable value, being the maximum amount that the Fed could lend against the collateral and determined by deducting a "haircut" amount from the value of the collateral, such that the amount of the loan remains less than the collateral. This accounts for additional protection against any partial or total defaults on discount window loans.[395]

Prior to the Dodd-Frank Act, a Section 13(3) loan only had to be "*indorsed or otherwise secured to the satisfaction of the Fed,*" a wide discretion practically allowing the Fed to lend against any type of collateral.[396] Could the Fed make unsecured emergency lending if no collateral whatsoever was deemed necessary? A wide interpretation of pre-2010 Section 13(3) admitted the possibility that the Fed could extend uncollateralized Section 13(3) loans.[397] Another less liberal construction of former Section 13(3) insisted that there must be a collateral of some sort, but that the Fed was free to accept a weaker collateral.[398]

The Fed was reproached for its lax collateral policy during the Financial Crisis.[399] The PDCF accepted Caa/CCC-rated and even unrated collateral.[400] The CPFF authorized the purchase of unsecured commercial paper.[401] The Fed would have had no recourse over the assets of AMLF intermediaries had the pledged collateral by ultimate borrowers been insufficient for loan recovery. Neither the CPFF nor the AMLF applied haircuts to pledged collateral. In defense of the Fed however, the facts proved it right. All of the Section 13(3) programs during the Financial Crisis were profitable; principal was reimbursed with interests.[402] Related collateral terms were not that imprudent after all. PDCF loans were made with recourse and had total collateral-to-loan value exceeding 100%.[403] They generally used government securities and investment grade corporate, mortgage-backed and asset-backed securities as collateral.[404] Commercial paper sold to the CPFF had to be rated at least A-1/P-1/F-1. Issuers of unsecured commercial paper paid a

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394 12 C.F.R. § 201 (2021).
395 FED. RSRV., THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS, *supra* note 42, at 43.
396 12 U.S.C. §343 (2010).
397 *See* HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 42 (FOUNDATION PRESS 2009).
398 *See* Posner, *supra* note 357, at 1539.
399 *See* Thomas M. Humphrey, *Lender of Last Resort: What It Is, Whence It Came, and Why The Fed Isn't It*, 30 Cato J. 333 (2010).
400 *See* REGULATORY REFORM, *Primary Dealer Credit Facility*, *supra* note 79.
401 U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87, at 90.
402 *Id.* at 99.
403 *See* REGULATORY REFORM, *Primary Dealer Credit Facility*, *supra* note 79.
404 *Id.*

credit surcharge to account for any probable losses or guaranteed their paper by the FDIC.[405] A maximum purchase amount per single commercial paper issuer and a registration fee as insurance premium mitigated credit risk.[406] Asset-backed commercial paper that were rated A-1/P-1/F-1 with a negative watch were not purchased through the AMLF.[407] TAF loans were made with recourse and collateralized using discount window haircut procedures.[408] TSLF loans were auction-based and imposed haircuts on pledged collateral.[409]

The Dodd-Frank Act's legal regime required the Fed, with respect to any Section 13(3) program or facility, to "*assign a lendable value to all collateral for the program or facility, consistent with sound risk management practices and to ensure protection for the taxpayer*."[410] As a result of this lendable value condition, it now requires more collateral for the same amount of loan and further protects taxpayers' money. It clears any ambiguity as to whether the Fed could extend uncollateralized Section 13(3) loans - it cannot. It also preserves the Fed's ability to choose among a wide range of collateral. It is a good judgment that the Fed resisted calls for limiting, in its Final Rule, the types of collateral eligible in connection with emergency lending and deferred only to its already established collateral valuation procedures pursuant to Regulation A.[411] Highly protective collateral in normal times may rapidly deteriorate under strained liquidity circumstances due to the strong correlation among similar assets and the entanglement of financial institutions. They may also prove insufficient in guaranteeing the Fed against potential losses in connection with emergency lending and would therefore require the backing of lesser quality collateral. The loss of confidence in the market increases information sensitivity. Without adequate information providing clarity as to which specific asset or collateral is bad, the perception that all assets or collateral are equally deplorable becomes prevalent. It is

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[405] *Commercial Paper Funding Facility: Program Terms and Conditions*, FED. RSRV. BANK OF N.Y. (June 25, 2009), https://www.newyorkfed.org/markets/CPFF_Terms.
[406] *Id.*
[407] *See Asset Backed Commercial Paper (ABCP) Money Market Mutual Fund (MMMF) Liquidity Facility Terms and Conditions*, FED. RSRV., https://www.frbdiscountwindow.org/Archive/Asset-Backed-Commercial-Paper-ABCP-Money-Market-Mutual-Fund-MMMF-Liquidity-Facility-Terms-and-Conditions (last update Feb. 5, 2010).
[408] *See* Term Auction Facility Questions and Answers, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/taffaq.htm (last update Jan. 12, 2009).
[409] *See* Credit and Liquidity Programs and the Balance Sheet, *Collateral Eligibility, Valuation, and Haircuts by Program*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/monetarypolicy/bst_ratesetting.htm (last update Nov. 9, 2016).
[410] 12 C.F.R. § 201.4(d)(6)(ii) (2021).
[411] 80 Fed. Reg. 78,962 (Dec. 18, 2015).

therefore important that the Fed maintains a certain flexibility in deciding over its collateral policy as part of its emergency lending.

The additional taxpayer protection obligation imposed by the Dodd-Frank Act on the Fed in its determination whether an extension of a Section 13(3) credit is secured to its satisfaction[412] only memorializes in the law what some had interpreted as an implied covenant of good faith in the former version of Section 13(3) and fortifies the Fed's independence.[413]

Section 13(3) programs created for the first time during the Global Pandemic, in addition to those re-launched from the Financial Crisis, had generally good collateral and protection policy. The PMCCF and the SMCCF only purchased investment grade bonds. Bonds were callable at par, providing further flexibility for the Fed to terminate the facilities.[414] Qualified lenders' retention percentage of loan participations in the Main Street Facilities lessened the credit risk exposure of the Fed.[415] PPP loans originated under the PPPLF were pledged as collateral at face value.[416]

G. Penalty Rate

The Fed unjustly caught flack for not having charged so-called penalty rates on its Section 13(3) loans during the Financial Crisis. At that time, the Fed had a wide discretion in setting its emergency lending rates. The only requirement was that these rates be fixed "*with a view of accommodating commerce and business*" and "*[…] every fourteen days, or oftener if deemed necessary by the [Fed].*"[417] Lombard Street prescribed that emergency loans "*be made at a very high rate of interest.*"[418] In Bagehot's mind, this "*heavy fine*" sanctions the unreasonable, keeps at bay those that do not need emergency lending or those that apply for it "*out of idle precaution without paying well for it,*" and preserves central banking reserves as far as possible.[419] A so-called penalty rate also attenuates moral hazard as it communicates to the public that emergency lending is not free money. Bagehot never wrote however that rates should be high above current market rates. If prevailing market conditions become excessive, it would be

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412 12 U.S.C. §343(B)(i).
413 *See* Posner, *supra* note 357, at 1541-42.
414 *See Primary Market Corporate Credit Facility Term Sheet*, *supra* note 304; *see also Secondary Market Corporate Credit Facility Term Sheet*, *supra* note 304.
415 Policy Tools, *Main Street Lending Program*, *supra* note 120.
416 *See Paycheck Protection Program Liquidity Facility Term Sheet* (June 25, 2021), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20210625a1.pdf.
417 12 U.S.C. §357 (2021).
418 BAGEHOT, *supra* note 17, at 187.
419 *Id.* at 187-88.

counterproductive to charge more on emergency lending, at least beyond what is required to compensate for any potential taxpayer loss. This could further augment the stigma problem. Participants in Section 13(3) programs would give the impression that they need the funds at any cost.[420]

The Fed reasonably priced its Section 13(3) programs during the Financial Crisis. Interest rates on PDCF and AMLF loans were only low in absolute terms. In fact, they tracked the then discount window's primary credit rate, set at a minimum record of zero-to-25 basis points over the target rate.[421] Depending on their unsecured or asset-backed feature, commercial paper sold to the CPFF had an all-in-cost of 200 or 300 basis points above the daily 3-month overnight index swap ("OIS") rate that denotes market anticipations of the Fed's target rate.[422] The auction formats of the TAF and the TSLF made their rates more dependable on challenging bids, and accordingly market forces. TALF loans were made with markups above the effective federal funds rate or LIBOR.[423] The initial LIBOR plus 8.5 percent rate of the revolving credit facility to AIG was reduced in November 2008 to LIBOR plus 3 percent and a 0.75% fee was imposed on undrawn amounts.[424] The Fed feared that the first rate would be too excessive and could put into question the viability of the AIG deal. The revised rate was significantly below then offered yields on distressed debt but was definitely not inexpensive in a normally functioning market. In sum, each rate set for a Section 13(3) program or facility during the Financial Crisis was above market under normal circumstances.[425]

The penalty rate of a Section 13(3) program or facility under the Dodd-Frank Act's legal regime "*is a premium to the market rate in normal circumstances; affords liquidity in unusual and exigent circumstances; and encourages repayment of the credit and discourages use of the program or facility as the unusual and exigent circumstances […] recede*."[426] Such criteria give the Fed a fair steering compass for pricing its Section 13(3) programs and facilities. Interest rates would be set separately from their crisis environment and at levels that would not defeat the liquidity provision

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[420] *See* LABONTE, CONG. RSCH. SERV., *supra* note 64, at 28.
[421] *See* BAIRD WEBEL & MARC LABONTE, CONG. RSCH. SERV., R41073, GOVERNMENT INTERVENTIONS IN RESPONSE TO FINANCIAL TURMOIL 17 (2010).
[422] *See Commercial Paper Funding Facility 2020: Program Terms and Conditions* (March 17, 2020), BD. OF GOVERNORS OF THE FED. RSRV. SYS., https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200317a1.pdf.
[423] *See* U.S. GOV'T ACCOUNTABILITY OFFICE (GAO), *supra* note 87, at 90, 224.
[424] *See Id.* at 167-68.
[425] *See* 80 Fed. Reg. 78,963 (Dec. 18, 2015).
[426] 12 C.F.R. § 201.4(d)(7)(ii) (2021).

purposes of the underlying loans by aggravating the borrowers' financial conditions.

In its determination of an emergency lending rate, the Fed is also invited under the Dodd-Frank Act's legal regime to consider general market conditions, historical rates and maturities for analogous loans in normal times, in addition to the amount, duration, purpose, repayment risk, and collateral of the credit, as well as any other factor compensating for taxpayer risk.[427] This non-exhaustive list of criteria and factors, together with the ability of the Fed to organize auction rate facilities,[428] provides the Fed further flexibility than Congress-proposed bills having brusquely urged a single penalty rate for all Section 13(3) programs.[429] Borrowers under any one Section 13(3) program during the Financial Crisis were treated equally. They paid interest and posted collateral pursuant to the same eligibility requirements. Any differentiation among them was objectively founded and applied consistently in sub-categories of borrowers. Applying a single penalty rate across all Section 13(3) programs, regardless of their respective purposes, the circumstances surrounding each of them, and far ahead of their establishment, would be grossly unfair, impractical at best.

The Fed had to be ingenuously versatile in setting up its emergency lending rates during the Global Pandemic so that the relevant Section 13(3) programs could reach their innumerable destinations. Rates varied not only between programs but also within certain programs according to multiple factors. Rates on bonds issued to the PMCCF or the SMCCF would hinge on the terms of the primary offerings or on fair market value in the secondary market. Rates on loans under the TALF 2020 would vary depending on the asset-backed securities involved and would be over either the average secured overnight financing rate (SOFR), the OIS rate, or the top of the Fed's target rate range.[430] Rates on loans under the MMLF would hang on the collateral securing the loans and would range from the primary credit rate to

[427] 12 C.F.R. § 201.4(d)(7)(iii) (2021).
[428] 12 C.F.R. § 201.4(d)(7)(i) (2021).
[429] *See* Bailout Prevention Act of 2015, 114th Cong. (2015-2016); Bailout Prevention Act of 2015, H.R.2625, 114th Cong. (2015-2016). The bill of the Bailout Prevention Act of 2015 proposed a single interest rate on any emergency lending program of at least 500 basis points over referenced Treasury securities. *See also* Fed Oversight Reform and Modernization Act of 2015, H.R. 3189, 114th Cong. (2015). This bill proposed applying a single minimum interest rate for all emergency lending programs that is the sum of (a) the most recent 90-day average of the secondary discount rate of all Federal Reserve Banks, and (b) the most recent 90-day average of the difference between a distressed corporate bond yield index and a Treasury yield.
[430] *See Term Asset-Backed Securities Loan Facility, supra* note 302.

100 basis points above that rate.[431] Extension of credit under the PPPLF would be made at 35 basis points.[432] Under the CPFF 2020, commercial paper rated A1/P1/F1 would be priced based on the then-current 3-month OIS rate plus 110 basis points, and commercial paper of lesser quality would be priced on the same OIS rate plus 200 basis points.[433] The Fed was therefore right in its rejection in the Final Rule of a single rate policy for emergency lending.[434]

H. Backdoor Channeling of Discount Window Loans to Non-Commercial Banks

The stage for Federal Reserve lending dividing between commercial and non-commercial banks has not changed since 1932. Commercial banks could tap the discount window at any time and upon their own initiative, subject to capitalization standards and maturity limitations. Discount window's interest rates and collateral policy would be known in advance. Non-commercial banks have no access to the discount window in ordinary times and could only hope that a frantic need for liquidity, in unusual and exigent circumstances, would be satisfied by the Fed's emergency lending. The Fed would decide the eligibility, financial and collateral terms of its Section 13(3) programs on an *ad hoc* basis.

It is worth mentioning that the Fed rigorously respected the discount window's earmark for depository institutions during the Financial Crisis and the Global Pandemic. It made sure the AMLF was authorized pursuant to Section 13(3), in addition to Section 10B, to direct discount window funds to the money market via bank holding companies, depository institutions, and broker-dealer subsidiaries thereof.[435] Purchases of loans from depository institutions to fund borrowers of all kinds were authorized by the Main Street Lending Program under Section 13(3). The Fed further took precautions not to mingle any credit to investment banks and securities dealers with discount window funds, even when the terms of such credit were very similar to those of the discount window, such as for the PDCF and the PDCF 2020.[436]

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[431] *See* Press Release, *Federal Reserve Board broadens program of support for the flow of credit to households and businesses by establishing a Money Market Mutual Fund Liquidity (MMLF)*, *supra* note 116.
[432] *See Paycheck Protection Program Liquidity Facility Term Sheet*, *supra* note 416.
[433] Rated A2/P2/F2.
[434] *See* 80 Fed. Reg. 78,963 (Dec. 18, 2015).
[435] Discount Window, *Asset Backed Commercial Paper (ABCP) Money Market Mutual Fund (MMMF) Liquidity Facility Terms and Conditions*, *supra* note 407.
[436] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 294. *See also FAQs: Primary Dealer Credit Facility* (May 7, 2020), FED. RSRV. BANK OF N.Y., https://www.newyorkfed.org/markets/primary-dealer-credit-facility/primary-dealer-credit-facility-faq.

Title VI of the Dodd-Frank Act deepened the vertical separation between commercial and non-commercial banks with respect to discount window lending by further restricting any indirect routing of discount window loan proceeds by commercial banks to their non-commercial bank affiliates.[437]

Sections 23A and 23B of the Federal Reserve Act impose limitations on certain transactions of commercial banks with their non-commercial bank affiliates, regardless of whether any such transactions have been negotiated at arm's length, are consistent with market practice, or are even to the benefit of the commercial banks.[438] The Dodd-Frank Act amended these sections to further restrict transactions between commercial banks and their non-commercial bank affiliates by increasing their cost, widening the scope of "covered transactions" and "affiliates," and raising collateral burdens in relation to lending transactions.[439] Derivative and repurchase agreements, as well as securities financing transactions between commercial banks and their non-commercial bank affiliates have consequently become more restricted. The revisions to Sections 23A and 23B of the Federal Reserve Act have been perceived as weakening the Fed's lender of last resort powers because commercial banks could not freely transmit anymore discount window funds to their broker-dealer and non-commercial bank affiliates as they used to do via repo and other transactions.[440]

We understand the rationale behind the Dodd-Frank Act's amendments to Sections 23A and 23B of the Federal Reserve Act. If discount window lending is to be opened to non-commercial banks, then this should not be done via some kind of backdoor channeling of discount window funds to non-commercial banks. Instead, it should be realized through the exploration of a major reform of the Fed's lending of last resort structure by giving access to non-commercial banks to the discount window or by creating a specific standard liquidity backstop to non-commercial banks in ordinary times, subject to stringent solvency and collateral conditions to minimize moral hazard risks.

I. Legislative Trend

Subjecting Section 13(3) programs to the Treasury's approval called into question the Fed's status of lender of last resort. Broad-based eligibility excluded individual Fed rescues. These two limitations to the Fed's emergency lending powers should be reversed. Other limitations of the Dodd-Frank Act to the Fed's lender of last resort powers such as borrowers'

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[437] Federal Reserve Act §§ 23A and 23B; Dodd-Frank Act § 608; 12 U.S.C. § 371c.
[438] Federal Reserve Act §§ 23A and 23B; 12 U.S.C. § 371c.
[439] Federal Reserve Act §§ 23A, 23B; Dodd-Frank Act § 608.
[440] SCOTT, *supra* note 261, at 104.

solvency and the new collateral and interest rate policies are more understandable, provided there is reasonable wiggle room in their interpretation and execution.

Unfortunately, the legislative trend has leaned towards more restrictions to the Fed's emergency lending in several bills examined in Congress following the Dodd-Frank Act. The only bill to have passed one of the legislative houses, the Fed Oversight Reform and Modernization Act of 2015, almost cripples the Fed's lender of last resort role.[441] Unusual and exigent circumstances would be "*limited only to those circumstances posing a threat to U.S. financial stability*" and could be claimed with the affirmative vote of not less than nine presidents of Reserve Banks, in addition to the already supermajority vote of five members of the Fed's Board of Governors.[442] Collateral for Section 13(3) loans may not be equity securities and would be limited only to specific asset classes. A borrower solvency determination would be based solely on a certification by the Fed and the federal banking agencies with supervision powers over the borrower. Self-certification by the borrower of its solvency would no longer be possible. Access to the lender of last resort would be restricted to "*participants that are financial institutions, excluding federal, state, and local government agencies activities.*"[443]

As with the Dodd-Frank Act, the main deficiency of the recent legislative approaches to the Fed's emergency lending authority is that they reduce such authority, when in fact they should have enlarged it, at least in the manner described in Part VI. The Consolidated Appropriations Act also raised concerns about further restrictions to the Fed's emergency lending. We assess these concerns in Part V below.

V. THE CONSOLIDATED APPROPRIATIONS ACT AND THE FED'S LENDER OF LAST RESORT ROLE

The Consolidated Appropriations Act rescinded all obligated and disbursed CARES Act funds that the Treasury has used or committed to use for Section 13(3) programs and that were not needed to meet the commitments, as of January 9, 2021, of such programs.[444] It suppressed, effective on January 9, 2021, all $454 billion of CARES Act funds to be used in connection with Section 13(3) programs or facilities.[445]

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[441] *See* Fed Oversight Reform and Modernization Act of 2015, H.R. 318, 114th Cong. (2015-2016) (passed by the House on November 19, 2015 but was never passed by the Senate).
[442] H.R. 3189 § 11.
[443] H.R. 3189.
[444] Consolidated Appropriations Act, 2021, H.R. 133, 116th Cong. § 1003(a)(2)(B)(ii).
[445] *Id.* § 1003(b).

The Consolidated Appropriations Act also barred the Fed, after December 31, 2020, from making any loans or purchases of any assets, obligations or interests pursuant to Section 13(3) programs in which the Treasury injected CARES Act funds, or from making any modifications to such loans or purchases, subject to a few exceptions.[446] Such exceptions notably included the purpose of minimizing costs to taxpayers.[447] It rendered the ESF unavailable for any future Section 13(3) program or facility that is the same as any such program or facility in which the Treasury made an investment pursuant to the CARES Act, except for the TALF 2020.[448]

These restrictions appear to limit the Fed's emergency lending powers, but it is not the case. The prohibition to extend liquidity via programs that used CARES Act funds practically ended the PMCFF, the SMCFF, the TALF 2020, the MLF and the Main Street Lending Program. It does not prevent the Fed from establishing similar but unidentical programs in the future. The Fed could also still extend credit via Section 13(3) programs that did not incorporate CARES Act funds, such as the PDCF 2020 and the PPPLF, or that did not use CARES Act funds that were allocated to them such as the CPFF 2020 and the MMLF; in each case until the termination of the relevant program. Obviously, the Fed may revive these programs at any given time if the right circumstances arise. The inability to take advantage of the ESF for future Section 13(3) programs that are replicas of those which used CARES Act funds, except for the TALF 2020, does not seem too restrictive either. The ESF could still be used for Section 13(3) programs that are similar to, but not a reprise of, programs in which CARES Act funds were used, or for entirely different Section 13(3) programs. The TALF 2020 may be re-created "as is" without the Fed losing the support of the ESF. Other Treasury-sponsored funds than the ESF could evidently still be used to capitalize Section 13(3) programs. In a word, the Fed retains its freedom to create Section 13(3) programs, whether similar or not to those implemented during the Global Pandemic.[449]

The rule of construction in section 1006 of the Consolidated Appropriations Act partly reads as follows: "*[…] nothing in this Act shall be construed to modify or limit the authority of the Board of Governors of the [Fed] under [Section 13(3)] as of the day before the date of enactment of the*

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[446] *Id.* § 1005.
[447] *Id.*
[448] *Id.*
[449] See Douglas Landy, *Unlucky: Do the Recent Changes to the Federal Reserve's Powers Under Section 13(3) of the Federal Reserve Act Inhibit Future Action?*, WHITE & CASE LLP (Jan. 7, 2021), https://www.whitecase.com/publications/alert/unlucky-do-recent-changes-federal-reserves-powers-under-section-133-federal.

CARES Act."[450] The formulation is rather clumsy as the CARES Act had no effect on Section 13(3). The intention was to convey that the Fed's emergency lending authority as it stands since the Dodd-Frank Act remains the same.

VI. THE UNFINISHED REFORM; THE FED AS PURCHASER OF LAST RESORT

The Fed is allowed to purchase assets only as part of open market operations. These assets are generally debt securities issued by the U.S. government, states, municipalities, or foreign governments, or backed by the foregoing.[451] They may also be private debt eligible for purchase by the Fed: cable transfers, bankers' acceptances, and bills of exchange, subject to certain limitations.[452] The Federal Reserve Act does not expressly authorize other forms of asset purchases. It is specifically on this ground that the Fed encountered the most virulent critics during the Financial Crisis as certain of its then Section 13(3) loans were accused of disguising asset purchases that fall outside of the contours of its emergency lending powers. Committing illegality is a far more serious allegation than any of the other reproaches made to the Fed.

It was contended that the Maiden Lane loans stretched the limits of the Fed's statutory authority.[453] Among the conditions to obtaining a Section 13(3) loan is the evidence that the borrower has exhausted all private remedies.[454] The Maiden Lane companies have not attempted to receive private sector loans. It would have been bizarre for entities expressly created by the Fed for liquidity provision purposes to do so. Moreover, the urgency to attend to the credit crunch between March and December 2008, when the financial system teetered on the edge of collapse, did not lend itself to saving appearances. The clarification that the Fed gave to the exhaustion of private remedies requirement during the Global Pandemic confirms *a posteriori* that the Maiden Lane entities have not committed illegality by not pitching for private credit.

Another criticism of the Maiden Lane loans is the audacious interpretation by the Fed of Section 13(3) allowing it to form a subsidiary with no past economic reality and extend to it emergency lending, as if it

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[450] *Id.* § 1006.
[451] Federal Reserve Act § 14(b)(1); 12 U.S.C. § 355.
[452] Federal Reserve Act §§ 13(4), 14(1), & 14(2)(c); 12 U.S.C. § 353; 12 U.S.C. § 356; 12 U.S.C. § 344. *See also* Small & Clouse, supra note 41, at 25, 26, 30.
[453] Emerson, *supra* note 3, at 125, 28.
[454] *See supra* Part IV(C).

were a third-party.[455] Technically, the Fed would be lending to itself and the assets purchased by the controlled subsidiary would be consolidated in its own balance sheet. In form, the Maiden Lane transactions were also structured as loans to SPVs, the proceeds of which were employed to purchase assets. In substance though, and looking through the legal acrobatics, the transactions were clearly purchases of assets.[456] However, this would not have been the first time that legal form prevails over substance. In a triangular merger, the merger between a purchaser's subsidiary with the target company covers up the mere acquisition of the target company by the purchaser. Courts would generally accept to elevate form over substance if the ensuing transaction does not contravene what the law tries to accomplish.[457] The purchases of assets in the Maiden Lane transactions were legally structured as loans precisely to comply with the letter of Section 13(3).[458] They also did not violate the spirit of the Federal Reserve Act whose ultimate policy objective in the matter of emergency lending is not the lending itself, but more fundamentally, the provision of liquidity. Through the Maiden Lane transactions, the Fed purchased illiquid MBS from Bear Stearns and AIG, as well as CDOs held by AIG's counterparties. These were in fact purchases of debt securities, which economically speaking is the equivalent of a loan. More importantly, they were instrumental in stopping the runs on the two companies. Bear Stearns lost $16 billion of cash in just three days (between March 13 and 16, 2008)![459] Any Fed direct liquidity assistance *per se* to the failing investment bank would have come too late. The Fed would be "lending into a run." The Fed's $85 billion credit facility to AIG, despite such amount's full coverage of AIG's CDS exposure to the subprime mortgage market and other illiquid obligations, could not have saved the day either for the insurance giant.[460] More than cash, Bear Stearns and AIG needed to dump their holdings of toxic assets so that their counterparties could have enough confidence dealing with them again. The Fed thought it more plausible to stop the run on Bear Stearns by reinstating the confidence of the market in its ability to survive through a private takeover and the removal of the poisonous assets from its balance sheet.[461] A private suitor arrangement for AIG could have been possible but for the loss of whatever remaining trust in the market after Lehman Brothers went

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[455] Emerson, *supra* note 3, at 129.
[456] *Id.*
[457] *See* WILLIAM A. KLEIN ET AL., BUSINESS ORGANIZATION AND FINANCE, LEGAL AND ECONOMIC PRINCIPLES 120-22 (11th ed. 2010).
[458] FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 290.
[459] *Id.*, at 289.
[460] *Id.* at 288, 289, & 350.
[461] *Id.* at 297, 349, & 350.

under.[462] It is the isolation of MBS and other illiquid securities from AIG's books through the Maiden Lane transactions, the parallel purchase of CDOs from AIG's counterparties and the corresponding termination of related CDS that restored the lost investor trust in AIG and ended the run.

The loans by the Fed to the Maiden Lane entities allegedly had the economic attributes of equity investments as the Fed shared the downside of the losses and would receive most of the return on investment.[463] In fact, the loans to Maiden Lane LLC and Maiden Lane II LLC implied for the Fed that it would take losses on those loans only after Bear Stearns' and AIG's portfolios of toxic assets depreciated beyond JPMorgan's and AIG's respective subordinated loan amounts.[464] The Fed also was reimbursed its loan to Maiden Lane III LLC before AIG received any residual gains on its equity in the company.[465] Such contractual and structural subordination on the contrary confirms the "debt" aspect of the Fed's loans to the Maiden Lane entities. Also, whether the Fed's performance on these loans depended on the underlying portfolios' returns is the risk of any debt investment and is not only specific to equity. The non-recourse feature of the loans made them even less "equity-like" as the lender had no option to lay claims on the Maiden Lane entities' assets had the collateral been insufficient.[466]

The CPFF worked similarly to the Maiden Lane transactions but for the whole commercial paper market. It created a special purpose vehicle, the CPFF LLC, to purchase asset-backed and other qualified commercial paper from large issuers with funds borrowed from the Fed.[467] The selling of such assets to the CPFF by multisector issuers spanning the banking, telecommunications, automobile, and other manufacturing industries, reinvigorated a waning commercial paper market during the Financial Crisis, and general credit incidentally. This time, no financial institution in particular was at stake, but whole industries. The CPFF and its 2020 equivalent worked respectively in tandem with the AMLF and the MLF, which in passing, also used depository and non-depository institutions as conduits for the purchase of commercial paper.[468] During the Global Pandemic, the CPFF 2020, the PMCF, the SMCF and the Main Street Lending Program all used the same approach of purchasing debt securities

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[462] *Id.* at 349. *See also* ALAN S. BLINDER, AFTER THE MUSIC STOPPED, THE FINANCIAL CRISIS, THE RESPONSE, AND THE WORK AHEAD 135-36 (2014).
[463] ERIC A. POSNER, LAST RESORT, THE FINANCIAL CRISIS AND THE FUTURE OF BAILOUTS 59-61 (2018).
[464] *Id.*
[465] *Id.* at 84.
[466] *Id.* at 60-61.
[467] *Id.* at 62.
[468] LABONTE, CONG. RSCH. SERV., *supra* note 64, at 7-12.

or interests from governmental and private issuers or lenders through special purpose vehicles.[469]

Congress should therefore reverse section 1101 of the Dodd-Frank Act that prohibits the removal of "*assets from the balance sheet of a single and specific company*."[470] This ties in with our previous argument in favor of individual Fed rescues.[471] Future legislation should also weigh in amendments to the Federal Reserve Act that explicitly permit the temporary purchases by the Fed of a varied repertoire of debt securities, the issuance of which has become such popular fundraising, or even private loan interests, for purposes of soothing liquidity strains. Congress already subtly validated Section 13(3) asset purchases by referring to them in the Consolidated Appropriations Act.[472] Fed Chair Jerome Powell's response letter to the Treasury's return of funds request also cited Section 13(3) asset purchases.[473]

In a market-based system, the Fed should consider all options for promoting liquidity, by taking on the role of "market-maker of last resort," in addition to its customary role of lender of last resort. As the extension of credit alone would do little in bridging overly wide financial chasms, the Fed could "purchase its way through" and unfreeze credit markets by mediating the resumption of transactions between borrowers and lenders. This could even entail the Fed substituting itself to FMUs by purchasing from them illiquid portfolios so that the trades of the underlying securities could be matched. Confidence would be rebuilt between counterparties by eliminating elements of mistrust and uncertainty. Indirect asset purchases by the Fed during the Financial Crisis contributed in removing toxic assets from the market (90% of all MBS!), and with them, the suspicion that all transactions would be burdened by such assets.[474] According to economist Perry Mehrling, the Fed "*was essentially forced to bring the shadow banking system onto its own balance sheet [...] until private balance sheets [were] willing to take it back*."[475] Indirect asset purchases by the Fed created a readily available market for securities and interests that no one wanted anymore during both the Financial Crisis and the Global Pandemic. They enhanced general liquidity and paved the way for transactions to recommence. The Fed has the luxury of time when it holds assets. It can wait

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[469] *Id.*
[470] 12 U.S.C. § 343(3)(B)(iii).
[471] *See supra* Part IV(A).
[472] *See* Consolidated Appropriations Act § 1005.
[473] *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS., FOIA, *Letter from Chair Powell to Secretary Mnuchin regarding emergency lending facilities*, *supra* note 355.
[474] Perry Mehrling, *Why central banking should be re-imagined* 110 (Bank for Int'l Settlements, Working Paper No. 79, 2014).
[475] *Id.* at 113.

longer than any private entity for its purchased assets to gain in value before selling them. When assets no longer have a market value but need to be disposed of so that liquidity regenerates, what bank, other than the central banking system, would give these assets a pricing floor or reduce the spread between their bid and ask prices?[476]

An express authority for the Fed to purchase assets should be restricted however to debt instruments and their related derivatives. Such authority should not allow the purchase of equity or quasi-equity (such as warrants or convertible bonds) positions, traditionally a measure carried out by the Treasury, as was the case for the TARP's equity purchase program to recapitalize viable financial institutions[477] or the CARES Act's requirement that the Treasury receives warrants and equity interests in return for government loans.[478]

The AIG equity acquisition by the Treasury via a Fed trust during the Financial Crisis was rightly found to be illegal exaction under the Federal Reserve Act by the Federal Claims Court in Starr International Co. v. United States.[479] Here, it was a direct purchase of assets, which makes it different from the Maiden Lane transactions. Furthermore, it consisted in the taking of an equity position in AIG. The Supreme Court declined to hear the Starr case.[480] It would have been interesting though to see the weight that the highest court in the land would have given to the merits of the case, particularly to the Government's allegation that the equity purchase in AIG was both necessary and incidental to the Fed's exercise of its emergency lending powers[481] because it "*provide[d] a return to adequately compensate for the significant risk of lending to AIG.*"[482]

CONCLUSION

The Fed saw its emergency lending powers curtailed by the Dodd-Frank Act after the Financial Crisis.[483] Several legislative proposals thereafter attempted to narrow the Fed's emergency lending powers even further.[484] The Consolidated Appropriations Act, without changing the wording or the

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476 *Id.* at 116.
477 *See supra* Part IV(D).
478 CARES Act § 4003(d).
479 Starr Int'l Co. v. United States, 856 F.3d 953, 975 (Fed. Cir. 2017).
480 The petition for a writ of certiorari by Starr International Co. was denied by the Supreme Court on March 26, 2018.
481 12 U.S.C. § 341.
482 Starr Int'l Co., 121 Fed. Cl. 428, 462 (Fed. Cl. 2015) (quoting a government expert).
483 *See supra* Part IV.
484 *See supra* Part IV(I).

essence of Section 13(3), prevented the Fed from restarting in the future Section 13(3) programs that were crucial in managing liquidity demands during the Global Pandemic.[485] It seems that after each macroeconomic crisis a new turn of the screw restricts the Fed's emergency lending powers or tries to do so. This article draws the conclusion that such emergency lending powers should be rather strengthened. Such powers rightfully saved the financial system from collapse during the Financial Crisis. The Global Pandemic gave them further credence and reminded us that they are also a key component of the welfare state.

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[485] *See supra* Part V.