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# Report to Congress Pursuant to Section 13(3) of the Federal Reserve Act: Primary Dealer Credit Facility

Federal Reserve System: Board of Governors

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## Overview

On March 17, 2020, the Board of Governors of the Federal Reserve System (Board), by the unanimous vote of its five members and with the approval of the Secretary of the Treasury, approved under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343(3)) the establishment of the Primary Dealer Credit Facility (PDCF) and authorized the Federal Reserve Bank of New York (the Reserve Bank) to lend under that program. The PDCF is a term loan facility that provides funding to primary dealers in exchange for a broad range of collateral and is intended to foster the functioning of financial markets more generally. The facility will allow primary dealers to support smooth market functioning and facilitate the availability of credit to businesses and households.

## Background and Details on the PDCF

Primary dealers are designated banks and securities broker-dealers with which the Reserve Bank trades U.S. government and select other securities and are the trading counterparties for the Federal Reserve in its execution of open market operations to carry out U.S. monetary policy.[1] In addition, the primary dealers serve a key role in providing liquidity in the market for government securities, which is in turn critical to the implementation of monetary policy.

Recent events have significantly and adversely impacted global financial markets. The spread of the Coronavirus Disease 2019 (COVID-19) has halted economic activity in many countries. Financial markets have experienced all-time high volatility and continue to be stressed, including the triparty repurchase agreement market in which primary dealers finance themselves.

In these circumstances, conditions indicated that lending to the primary dealers by the Federal Reserve was necessary to maintain the orderly function of financial markets. As a result, the Board determined that unusual and exigent circumstances existed and approved the establishment of the PDCF. In order to prevent disruptions in the financial markets from presenting a significant threat to

[1] A list of primary dealers can be found at https://www.newyorkfed.org/markets/primarydealers.

the U.S. economy, the Board voted to authorize the Reserve Bank to establish the PDCF to provide term loans to primary dealers for up to 90 days. The PDCF will help alleviate funding market strains by providing credit directly to primary dealers against a broad range of collateral for term.

## Structure and Basic Terms

Under the PDCF, the Federal Reserve provides collateralized credit to primary dealers (credit is extended to primary dealers through their clearing banks) for a term of up to 90 days. The following provides an overview of the terms and conditions that govern the PDCF. The Board and Reserve Bank continue to monitor the affected financial markets and consult with market participants, and, accordingly, the terms and conditions governing the facility may be modified in the future, if appropriate.

***Advances.*** Advances under the PDCF are for terms of up to 90 days. The lending rate is equal to the Discount Window primary credit rate in effect at the Reserve Bank. For the PDCF, dealers communicate their requests for funding to their clearing banks. The clearing bank verifies that a sufficient amount of eligible collateral has been pledged by each borrower and notifies the Reserve Bank accordingly. Once the Reserve Bank receives notice that a sufficient amount of margin-adjusted eligible collateral has been assigned to the Reserve Bank's account, the Reserve Bank transfers the amount of the loan to the clearing bank for credit to the primary dealer.

***Collateral Eligibility and Valuation.*** Collateral eligible for pledge under the PDCF includes all collateral eligible for pledge in open market operations (OMOs);[2] plus investment grade corporate debt securities, international agency securities, commercial paper, municipal securities, mortgage-backed securities, and asset-backed securities;[3] plus equity securities.[4] Foreign currency-denominated securities are not eligible for pledge under the PDCF at this time. Collateral that is not priced by the clearing bank will not be eligible for pledge under the PDCF.

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[2] An addition to OMO-eligible securities are Treasury strips.

[3] For the following securities types, only AAA-rated securities are accepted: commercial mortgage-backed securities, collateralized loan obligations, and collateralized debt obligations. Other eligible securities as specified above are accepted if rated investment grade (such that BBB-securities and above). Specifically, investment grade commercial paper is accepted: commercial paper rated both A1/P1 and A2/P2.

[4] The following equities would not be eligible: exchange traded funds, unit investment trusts, mutual funds, and rights and warrants.

Additional collateral may become eligible at a later date upon further analysis.

The pledged collateral will be valued by Bank of New York Mellon according to a schedule designed to be similar to the margin schedule for lending by the Discount Window, to the extent possible.

***Termination Date***. PDCF lending commenced on March 20, 2020, and will remain available for at least six months, or longer if conditions warrant.

***Requirements Imposed on Recipients***. The PDCF will not impose any new requirements on primary dealers with respect to employee compensation, distribution of dividends, or any other corporate decision in exchange for the assistance.

***Expected Costs***. The Board does not expect that lending under the PDCF will result in any losses to the Federal Reserve or the taxpayer. Such loans are made with recourse beyond the pledged collateral to the broker-dealer entity itself. While losses could occur in the event of a broker-dealer bankruptcy, the risk of loss is mitigated by haircuts on collateral value and daily revaluation of the collateral.