Federal Reserve Bank of Dallas

Primary and Secondary Credit Programs

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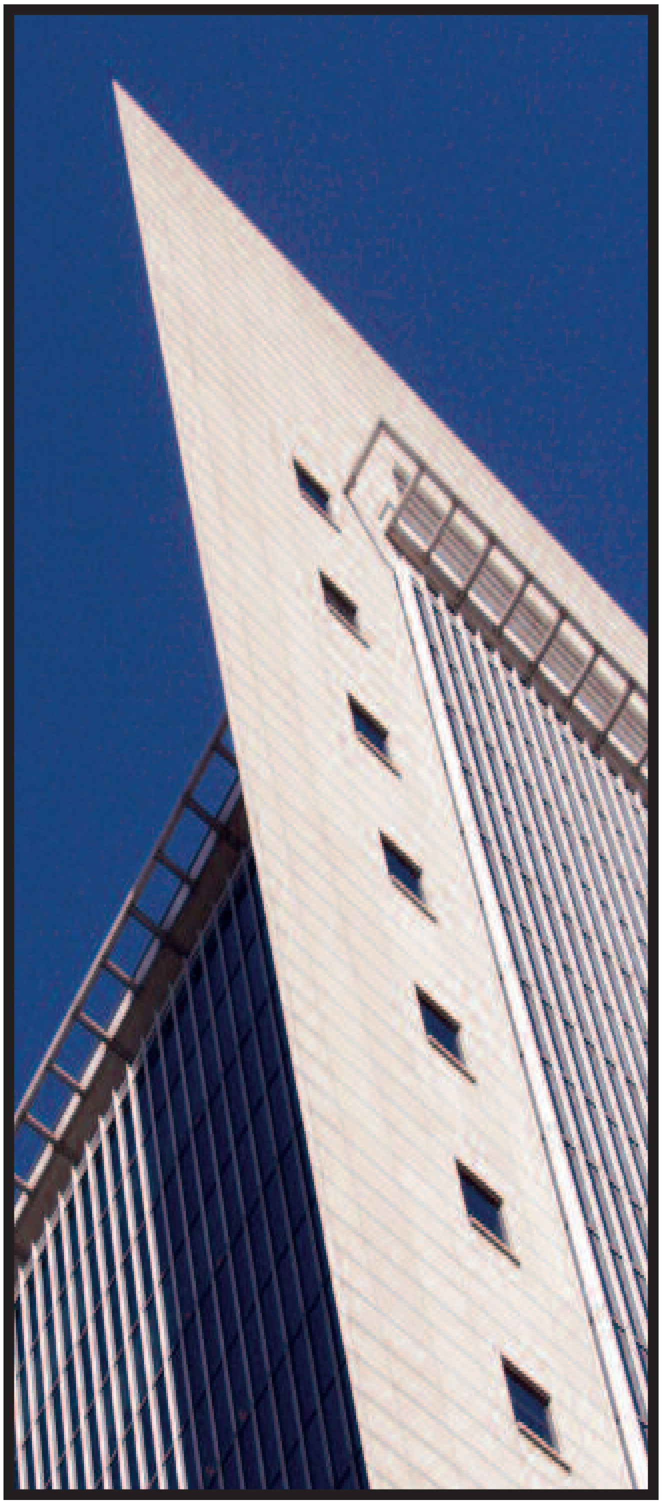

Overview

When the Federal Reserve System was established in 1913, lending reserve funds through the Discount Window was intended as the principal instrument of central banking operations. Although the Discount Window was superseded long ago by Federal Reserve open market operations as the most important tool of monetary policy, it still plays a complementary role. The Discount Window functions as a safety valve for relieving pressures in reserve markets; extensions of credit can help relieve liquidity strains in a depository institution and in the banking system as a whole. The Discount Window also helps ensure the basic stability of the payment system more generally by supplying liquidity during times of systemic stress.

Discount Window policies and programs have evolved in response to the changing needs of the economy and financial system. Currently, primary credit is a principal safety valve for ensuring adequate liquidity in the banking system and a backup source of short-term funds for generally sound depository institutions. Most depository institutions qualify for primary credit. Secondary credit may be available to meet backup funding needs of depository institutions that do not qualify for primary credit.

Description of Programs

The Discount Window is administered in accordance with the Federal Reserve Act, Regulation A and Operating Circular 10. Federal Reserve credit is available to eligible banks, savings and loans, and credit unions.

Primary Credit. Primary credit is available to generally sound depository institutions on a very short-term basis, typically overnight, at a rate above the Federal Open Market Committee's target rate for federal funds. Depository institutions are not required to seek alternative sources of funds before requesting occasional primary credit advances. The Federal Reserve expects that given the above-market pricing of primary credit, institutions will use the Discount Window as a backup rather than a regular source of funding.

Secondary Credit. Secondary credit may be available to financial institutions that are not eligible for primary credit. The purpose of secondary credit is to help institutions return to market funding sources. Some secondary credit loans are subject to the frequency limitations in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

Terms

• Institutions that Reserve Banks deem generally sound are eligible to obtain primary credit. Eligibility is based largely on an institution's supervisory examination rating and capital status. Typically, institutions with composite CAMEL(S) ratings of 1, 2 or 3 that are at least adequately capitalized are eligible for primary credit.

• Generally, primary credit will be extended on a very short-term basis. Primary credit may be extended up to a few weeks to small institutions that cannot obtain temporary funds in the market at reasonable terms, so long as they are in sound financial condition.

• Institutions need not seek alternate sources of funds before requesting occasional short-term advances from the primary credit program.

• There is no prohibition against using primary credit to fund sales of federal funds.

• Depository institutions will not be questioned about the reason for borrowing primary credit, except in unusual circumstances.

• The secondary credit program entails a higher level of Reserve Bank administration and oversight than primary credit.

• All Discount Window loans must be secured by acceptable collateral.

Rates

Primary credit is granted at a rate of 100 basis points above the Federal Open Market Committee's federal funds target rate. The secondary credit rate is 50 basis points higher than the primary credit rate. These spreads, which were announced when the primary and secondary credit programs were launched, are subject to change.

Contingency Planning

By enhancing the availability of Discount Window credit, the Federal Reserve's primary credit program offers depository institutions an additional source of backup funds for managing short-term liquidity risks and thus can enhance the diversification of contingency funds. Liquidity contingency planning is critical to the ongoing maintenance of any financial institution's safety and soundness.

Interagency guidance dated July 23, 2003, notes that sound liquidity plans include adequate diversification of the potential sources of funds to be used in a contingency. If an institution incorporates primary credit into its contingency plans, the guidance indicates the institution should ensure that it has in place the necessary documentation and collateral. This is particularly important when the intended collateral consists of loans or other assets that may involve significant processing or lead time for pledging to the Reserve Bank.

It is a long-established practice for institutions to periodically test all sources of contingency funding. Accordingly, if an institution incorporates primary credit in its contingency plans, management should occasionally test the institution's ability to borrow at the Discount Window. The goal of such testing is to ensure that there are no unexpected impediments or complications should such contingency lines be required.

Finally, the guidance notes that occasional use of primary credit for short-term contingency funding should be viewed as appropriate and unexceptional by both management and supervisors. At the same time, the guidance emphasizes that the primary facility is only one of many tools institutions may use in managing their backup liquidity needs and that institutions should maintain access to a diversified array of funding sources. The use of primary credit, or any other potential source of contingency funding, is a management decision that must be made in the context of safe and sound management practices.

Documentation Requirements

Prior to borrowing, certain basic legal documents must be executed as set forth in Operating Circular 10. Reserve Bank staff can assist you in completing these documents.

Pledging Collateral

All loans made by Reserve Banks must be secured by acceptable collateral, including, but not limited to, U.S. government and agency obligations, municipal securities, CMOs, and commercial, consumer and real estate loans. Our credit analysts will be happy to discuss options with you, including borrower-in-custody arrangements, and walk you through the pledging process.

Borrowing and Repayment

Once the necessary legal agreements and collateral are in place, an authorized individual from your institution may contact the Discount and Credit Department by telephone to request a loan. A credit will typically be made to your master account with the Reserve Bank on the day the loan is requested. An automatic debit is made to the same account on the day the loan matures. You may prepay your loan, either partially or in full, prior to maturity. Your institution may request a loan or make payment from 8 a.m. until the close of Fedwire (typically 5:30 p.m. Central time), Monday through Friday. Except in unusual circumstances, credits and debits will post to your account at the close of Fedwire on the day of borrowing or payment.

For More Information

For additional information on these credit programs and policies, please contact the Discount and Credit Department of the Federal Reserve Bank of Dallas at:

Toll-free telephone	877-682-3256
Fax	214-922-5334

You may also access Discount Window information on our web site at **www.frbdiscountwindow.org**.

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