April 2, 2008

TO: Board of Governors

FROM: Scott G. Alvarez, Richard M. Ashton, Mark E. Van Der Weide, and Heatherun S. Allison

SUBJECT: The authority of the Federal Reserve to provide an extension of credit in connection with the acquisition by JPMorgan Chase of Bear Stearns.

ISSUE: May the Federal Reserve Bank of New York ("FRBNY") extend credit to a limited liability company ("LLC") that acquires $30 billion in assets from The Bear Stearns Companies Inc. ("Bear Stearns"), and secures the credit exclusively with those assets, in connection with the proposed acquisition by JPMorgan Chase & Co. ("JPMC") of Bear Stearns (the "FRBNY special facility").

SUMMARY: The Board may authorize the FRBNY to provide the FRBNY special facility under the authority provided by section 13(3) of the Federal Reserve Act. This memorandum documents the legal advice provided to the Board on March 14, 2008, and the succeeding days.

FACTUAL BACKGROUND: On Friday, March 14, 2008, the Board authorized the FRBNY to extend credit to Bear Stearns through its clearing bank, JPMorgan Chase Bank, N.A. ("JPMC Bank"). On that day, the FRBNY made an overnight discount window loan of $12.9 billion to JPMC Bank on a non-recourse basis and took as collateral certain assets of Bear Stearns.

On Sunday, March 16, 2008, JPMC agreed to acquire Bear Stearns. That same day, in connection with the acquisition agreement, the Board voted unanimously to authorize the FRBNY to provide non-recourse credit in an amount up to $30 billion, secured by a pledge of up to $30 billion of identified, less liquid assets of Bear Stearns. The Board approved a rate for the credit equal to the primary credit rate charged by the Reserve Banks to depository institutions that borrow primary credit through the discount window.[1]

As explained more fully below, based on its review of the facts and circumstances, and in accordance with the requirements of section 13(3) of the Federal Reserve Act and with the Board's authorization, the FRBNY agreed to provide senior secured financing of $29 billion in connection with JPMC's acquisition of Bear Stearns. The financing would be provided to an LLC that would acquire from Bear Stearns a portfolio of assets identified by the FRBNY as in need of funding. The facility would be secured by the portfolio of Bear Stearns assets held by the LLC (including the proceeds of any sale or repayment at maturity of such assets and any income earned from the reinvestment of such proceeds). The facility would have a maturity of ten years (unless extended by the FRBNY) and would earn interest at the primary credit rate (currently 2.50 percent). JPMC would provide $1 billion of subordinated financing to the LLC. The JPMC facility also would have a maturity of ten years (subject to the same extension authority) and would earn interest at the primary credit rate plus 4.50 percent (for a current rate of 7.00 percent).

The portfolio of assets to be purchased by the LLC from Bear Stearns had a market value on March 14, 2008, of $30 billion (representing a discount from par). The FRBNY has hired an independent third-party investment adviser – Blackrock Financial Management Inc. – to manage the LLC's assets with a view toward maximizing repayment of the LLC's obligations, including the FRBNY special facility, with minimum disruption

[1] The March 14 loan by the FRBNY was repaid in full by JPMC Bank on Monday, March 17, 2008. For an analysis of the legal basis for the March 14 loan, see the Memorandum on the March 14 loan from the

to the financial markets. Under the terms of the FRBNY special facility, the FRBNY would be entitled to a return of its principal plus interest before JPMC received any repayment on its loan to the LLC. JPMC next would be entitled to receive full repayment of its principal and interest on its loan to the LLC. If proceeds on the sale and maturity of the LLC's collateral exceed the aggregate amount of the principal and interest owed both to the FRBNY and JPMC, the excess proceeds would accrue to the FRBNY.

As discussed in more detail below, in the days and weeks preceding the Board's authorization of the FRBNY special facility, the financial markets were particularly fragile and vulnerable to disruption. The Board's intent in authorizing the transaction was to avoid a potentially severe disruption in the financial markets by contributing to the orderly stabilization of Bear Stearns, a major participant in the troubled repo and residential mortgage-backed securities ("RMBS") markets.

LEGAL BACKGROUND: The Federal Reserve Act empowers the Federal Reserve System to extend credit to a variety of counterparties in a variety of circumstances. One of these powers is contained in section 13(3) of the Federal Reserve Act. Section 13(3) provides in its entirety that:

- "In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal Reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 14, subdivision (d), of this Act, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: provided, that before discounting any such note, draft, or bill of exchange for an individual, partnership, or corporation the Federal reserve bank shall obtain evidence that such

Legal Division to the Board dated April 2, 2008.

> individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe."[2]

DISCUSSION: The FRBNY special facility represents the exercise of authority expressly provided by section 13(3) of the Federal Reserve Act. The Federal Reserve must satisfy five principal conditions to use this authority. First, section 13(3) lending by a Reserve Bank must be authorized by the Board, which generally may authorize section 13(3) lending only with the affirmative vote of at least five members of the Board. Second, the Board may authorize section 13(3) lending only in "unusual and exigent circumstances." Third, the Reserve Bank that engages in section 13(3) lending must obtain evidence prior to making the loan that the individual, partnership, or corporation ("IPC") borrower "is unable to secure adequate credit accommodations from other banking institutions." Fourth, the Reserve Bank must establish the rates for section 13(3) lending in accordance with the provisions of section 14(d) of the Federal Reserve Act. Fifth, section 13(3) lending must be in the form of a "discount" of "notes, drafts, and bills of exchange" of the IPC. The FRBNY special facility meets all of these conditions.

A. <u>Approval by five members of the Board</u>

The Board must authorize section 13(3) lending by a Reserve Bank and generally may only authorize section 13(3) lending with the affirmative vote of at least five members of the Board.[3] The Board

[2] 12 USC 343.
[3] Section 11(r) of the Federal Reserve Act contains an exception to the five-member approval requirement. 12 USC 248(r). This exception is not relevant to an assessment of the adequacy of the authorization of the FRBNY special facility.

authorized the FRBNY special facility by the affirmative vote of all five members of the Board at a meeting of the Board on March 16, 2008.

B. Unusual and exigent circumstances

To authorize credit extensions to IPCs under section 13(3) of the Federal Reserve Act, the Board must find that "unusual and exigent circumstances" exist. These terms are not defined in the Federal Reserve Act and are committed to the Board's discretion.[4] In the past, the Board has based a finding of unusual and exigent circumstances on general market conditions. For example, at the time Congress enacted section 13(3) of the Federal Reserve Act in July 1932, bank credit was extremely scarce and many banks were closed. Congress was concerned that general market conditions prevented many creditworthy borrowers from obtaining credit. These general market conditions motivated the Board to activate the Federal Reserve's section 13(3) authority from 1932 to 1936.[5]

The Board also has based a finding of unusual and exigent circumstances on the potential disruption associated with the disorderly collapse of a single firm or group of firms. On July 1, 1966, the Board authorized a program under section 13(3) pursuant to which the Reserve Banks could make credit facilities available to savings associations and other similar depository institutions that were not members of the Federal Reserve System.[6] The Board took this action because of the possibility that some of these depository institutions might be subjected to unusual withdrawals of

[4] Courts generally are required to defer to interpretations of statutes made by the administrative agency with specific jurisdiction to implement the statute where the statutory language is ambiguous and the interpretation is reasonable. See, e.g., Chevron U.S.A., Incorporated v. Natural Resources Defense Council, Incorporated, et al., 467 U.S. 837 (1984).

[5] See 18 Federal Reserve Bulletin 518 (1932).

[6] At the time, savings associations were unable to access the Federal Reserve's discount window because the Federal Reserve Act permitted only banks that were members of the Federal Reserve System to obtain credit at the discount window.

funds due to legal limits on the interest rates these institutions could pay on deposit accounts. The Board believed that its action could help prevent the insolvency of a substantial number of depository institutions due to lack of liquidity, which in turn could have created a serious financial disturbance in the wider economy.[7] On December 24, 1969, the Board again authorized the Reserve Banks to provide emergency credit facilities to savings associations and other similar depository institutions that were not members of the Federal Reserve System. The Board took this action in 1969 for substantially the same reasons as it authorized section 13(3) lending in 1966. A sharp advance in market yields during the fourth quarter of 1969, unusually large net savings withdrawals at depository institutions in October 1969, and preliminary reports of reduced savings deposits in some areas in December 1969 created some concern about the possibility of substantially increased run-off of deposits at such institutions in the coming months.[8]

Importantly, Congress amended section 13(3) of the Federal Reserve Act in 1991 specifically to expand the ability of the Reserve Banks to extend credit to securities firms.[9] The legislative history of the 1991 amendments makes manifest the Congressional view that an important purpose of the Board's section 13(3) lending authority is to promote liquidity in the financial system in times of market stress, such as the October 1987 market break. The Senate Report accompanying the

[7] See Memorandum from Staff to the Board dated June 27, 1966, entitled "Emergency Credit Facilities for Mutual Savings Banks." Although the program was authorized through March 1, 1967, no credit was extended by the Reserve Banks under the program. Annual Report of the Federal Reserve Board 91-92 (1966).

[8] Although the program was authorized through April 1, 1970, no credit was extended by the Reserve Banks under the program. Annual Report of the Federal Reserve Board 92-93 (1969).

[9] P.L. 102-242, Dec. 19, 1991 (105 Stat. 2236, 2386). As originally enacted, section 13(3) permitted Reserve Banks to discount only notes that were eligible under the Federal Reserve Act for rediscount by a Reserve Bank for a member bank – namely, notes drawn for specific industrial or agricultural purposes that had maturities of 90 days or less. Congress repealed these limitations in 1991 as part of FDICIA.

legislation explains that the amendments were designed to ensure that the Federal Reserve would be able under section 13(3) to provide liquidity "directly to a securities dealer to help preserve market liquidity and avoid market disruption."[10] The Report goes on to state: "With the increasing interdependence of our financial markets, it is essential that the Federal Reserve System have authority and flexibility to respond promptly and effectively in unusual and exigent circumstances that might disrupt the financial system and markets."[11]

Conditions on and around March 16, 2008, represented unusual and exigent circumstances in the financial markets. Financial conditions deteriorated markedly between mid-January and mid-March 2008. Volatility was steadily increasing and liquidity was quickly declining in many credit markets – including in particular the market for RMBS, but also in the markets for other asset-backed securities, corporate securities, and municipal securities. Moreover, many market participants were financing a large portion of their holdings of these long-term securities in short-term collateralized funding markets. Rapid escalation in collateral haircuts in many of the associated term collateralized funding markets produced a self-reinforcing dynamic in which the higher haircuts led to missed margin calls, fire sales of collateral, increased price volatility, and ever higher haircuts and more frequent margin calls and fire sales.

By March 16, liquidity in financial markets was impaired. The dislocations caused by this large and systemic shortfall in liquidity posed severe risks to the integrity of the financial system and, thus, to prospects for economic growth. These circumstances were at least as severe as the

[10] S. Rep. 102-167, at 203 (Sept. 19, 1991).
[11] Id. See also 138 Cong. Rec. 3152 (Feb. 21, 1992).

unusual and exigent circumstances prevailing (i) during the second half of the 1960s when the Board publicly authorized section 13(3) lending to savings associations and other similar depository institutions; and (ii) during the 1987 market break referenced by Congress in the legislative history of the 1991 amendments to section 13(3) of the Federal Reserve Act.[12]

C. Lack of adequate credit accommodations

Section 13(3) of the Federal Reserve Act requires the Federal Reserve Bank to obtain evidence that the borrower "is unable to secure adequate credit accommodations from other banking institutions." The wording of this statutory requirement is ambiguous and is not defined in the statute, and thus the Board would be accorded significant deference in defining the standard.[13] The Board's Regulation A does not require any specific type of evidence for this finding and bases the finding simply on "the judgment of the Reserve Bank" about credit availability.[14]

Because section 13(3) of the Federal Reserve Act speaks of a lack of "adequate credit accommodations," it contemplates that the Federal Reserve Bank could lend to a borrower even when credit might be available at some price or under some conditions, but the price or conditions are not reasonable.[15] Indeed, Congress added section 13(3) to the Federal Reserve

[12] The fact that Congress amended section 13(3) of the Federal Reserve Act in 1991 to further expand its applicability and without adverse comment on the Board's public use of the provision in the 1960s also suggests a Congressional ratification of the Board's 1960s application of the provision in a period of comparatively milder market stress. A canon of statutory interpretation provides that Congress may be presumed to be aware of an agency interpretation of a statutory provision and to adopt that interpretation when it later amends the provision without change to the text that serves as the basis for the agency interpretation. See Haig v. Agee, 453 U.S. 280 (1981); Lorillard v. Pons, 434 U.S. 575, 580-81 (1978).

[13] See, e.g., Chevron U.S.A., Incorporated v. Natural Resources Defense Council, Incorporated, et al., 467 U.S. 837 (1984).

[14] See 12 CFR 201.4(d).

[15] The fact that an IPC may have U.S. Treasury securities or securities issued or guaranteed by a U.S. government agency that could be used to obtain credit would not disqualify the IPC from obtaining credit under section 13(3) of the Federal Reserve Act. The Act itself – in section 13(13) – allows the Reserve Banks to make advances to IPCs based on U.S. Treasury securities and securities issued or guaranteed by a

Act in 1932 to allow the Federal Reserve to extend credit to creditworthy borrowers with sufficient collateral during a nationwide banking crisis when market conditions prevented credit from being available even to borrowers in sound condition. The Board also has been willing to invoke section 13(3) based on the condition of the specific borrower rather than the overall condition of the financial markets. In these cases, the Reserve Banks accumulated evidence that other banking institutions were unwilling to lend to the borrower; the Board in these cases did not require a showing that no institution would lend to the borrower at any price.[16]

Bear Stearns, like most large securities firms, heavily financed itself in the short-term securities repurchase agreement market. This market enables banks and other financial institutions to obtain short-term credit by selling securities for cash and agreeing to repurchase them for cash (with interest) on the following day. A substantial portion of the liabilities of Bear Stearns were short-term repo liabilities, and a substantial portion of these liabilities came due every day.

Bear Stearns was unable to secure adequate credit accommodations from other banking institutions on and around March 14-16, 2008. The situation of Bear Stearns was dire on Friday, March 14. The senior management of Bear Stearns notified the Federal Reserve on the evening of Thursday, March 13, that its pool of liquid assets had shrunk from over $12 billion to about $2 billion on that day because a number of counterparties refused to continue to provide funding to Bear Stearns. In addition, Bear Stearns anticipated that many of its counterparties on Friday

U.S. government agency but does not make use of that facility a precondition of access to credit under section 13(3). See 12 USC 347c.

[16] See, e.g., Memorandum from Mr. Hackley to the Board dated June 16, 1966; Annual Report of the Federal Reserve Board 91-92 (1966); Annual Report of the Federal Reserve Board 92-93 (1969).

would not agree to roll over their repurchase agreements and, therefore, that Bear Stearns would be required on Friday to repay a significant portion of its repurchase agreement liabilities. Bear Stearns expected that it would not have sufficient funds or liquid assets to repay these liabilities as they came due and would not be able during the short period before markets opened on Friday to find a private-sector source of alternative financing. Accordingly, officials at Bear Stearns and the Securities and Exchange Commission informed the Federal Reserve that night that Bear Stearns would likely have to file for bankruptcy protection on Friday, March 14, unless the Federal Reserve were willing to provide Bear Stearns with liquidity.

The imminence of insolvency for Bear Stearns, the large presence of Bear Stearns in several important financial markets (including in particular the markets for repo-style transactions, over-the-counter derivative and foreign exchange transactions, mortgage-backed securities, and securities clearing services), and the potential for contagion to similarly situated firms raised significant concern that financial markets would be seriously disrupted if Bear Stearns were suddenly unable to meet its obligations to counterparties. Most crucially, the consequences of default or insolvency by Bear Stearns – a major borrower and lender in the repurchase agreement market – could have seriously disrupted this very large, important, and increasingly strained market for short-term secured financing. Market participants were likely to respond to the failure of Bear Stearns by withdrawing generally from short-term collateralized funding markets, resulting in a dramatic drop in the overall availability of short-term financing, and threats to the liquidity and possibly the solvency of other large and highly leveraged financial institutions. For these reasons, as explained above, the FRBNY provided secured funding to Bear Stearns on March 14, through JPMC Bank, its clearing bank.

Despite the receipt by Bear Stearns of Federal Reserve funding on March 14, market pressures on Bear Stearns worsened throughout the day on March 14 and continued to worsen during the weekend. In light of the further erosion of confidence in Bear Stearns over the weekend by its chief short-term liquidity providers and capital markets transaction counterparties, Bear Stearns likely would have been unable to avoid bankruptcy on Monday, March 17, without either very large injections of liquidity from the Federal Reserve or an acquisition of Bear Stearns by a more resilient firm.

During the period from March 13 through March 16, Bear Stearns actively sought both capital injections and acquisition partners. JPMC emerged as the only viable bidder for Bear Stearns on Sunday, March 16. Bear Stearns determined that only JPMC offered a credible proposal that would allow Bear Stearns to meet its obligations beginning Monday, March 17. Accordingly, on Sunday, March 16, Bear Stearns accepted the offer to merge with JPMC.

JPMC believed that it would be unable to acquire Bear Stearns, however, if it were required to obtain funding in the strained credit markets for a specified portfolio of less liquid assets of Bear Stearns. Bear Stearns itself was unable to secure adequate credit accommodations for those assets from private sources. Because no other funding source for these assets appeared available, emergency financing from the Federal Reserve with respect to those assets was necessary to facilitate JPMC's prompt acquisition of Bear Stearns, which would alleviate the intense strains in the credit markets described above that were likely to result from the failure of Bear Stearns.

D. Establishment of rate by the Federal Reserve

Section 13(3) of the Federal Reserve Act provides that Reserve Bank lending under section 13(3) must be at rates established in accordance with section 14(d) of the Act. Section 14(d) provides every Reserve Bank the power to establish, subject to review and determination by the Board, rates of discount to be charged by the Reserve Bank. In the case of the FRBNY special facility, the Board reviewed and approved the request of the FRBNY to charge the primary credit rate.

The Board's Regulation A authorizes emergency Reserve Bank credit for IPCs "extended at a rate above the highest rate in effect for advances to depository institutions."[17] The primary credit rate, however, is the lowest rate charged by the Reserve Banks to depository institutions. The FRBNY special facility is a permissible exercise of the Federal Reserve's section 13(3) lending authority because the emergency lending provision of Regulation A does not govern all credit extended to IPCs under section 13(3).

Section 13(3) allows the Board to authorize any Federal Reserve Bank to extend credit to any IPC "during such periods as the said board may determine" and "subject to such limitations, restrictions and regulations as the [Board] may prescribe." The Board, therefore, has complete statutory discretion to determine the timing and the conditions of lending under section 13(3). Regulation A represents one exercise of that authority in the form of an ongoing authorization to the Reserve Banks to lend under section 13(3) when the conditions in Regulation A are met. Regulation A does not limit the Board's power to authorize lending under

[17] 12 CFR 201.4(d).

section 13(3) in other circumstances and under other limitations and restrictions.

This conclusion is supported by the fact that Regulation A does not by its terms purport to be a comprehensive regulation implementing each component of each lending authority of the Federal Reserve System (or even of each emergency lending authority of the Federal Reserve). Nor does the regulatory history of Regulation A suggest that the Board intended the rule to set forth the exclusive methods for the Reserve Banks to extend credit.

E. Discount of a note for an IPC

Section 13(3) of the Federal Reserve Act allows the Board to authorize any Reserve Bank "to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve Bank…." For the following reasons, the FRBNY special facility is a discount of a note for an IPC permitted under section 13(3).

A "discount" of a note for a counterparty under section 13(3) encompasses a broad range of transactions, including a simple advance to the counterparty on a note newly issued or made by the counterparty and a purchase of one or more third-party notes held by the counterparty. Specifically, the Board consistently has viewed the term "discount" under section 13(3) as including a Reserve Bank extension of credit to an IPC (a loan to an IPC by a Reserve Bank on the borrowing IPC's own note) as well as a purchase by a Reserve Bank of third-party notes held by an IPC.[18]

[18] See Board Circular X-7215-a, "Discounts for Individuals, Partnerships and Corporations," 18 Federal Reserve Bulletin 518-519 (Aug. 1932) (Reserve Bank may discount for IPCs notes "which are the obligations of other parties actually owned by such [IPCs], and indorsed by them, or the promissory notes of such [IPCs] indorsed by other parties whose indorsements are satisfactory to the [Reserve Bank]"). Section 13(3) originally required notes discounted by a Reserve Bank under authority of the section to be both indorsed and otherwise secured to the Reserve Bank's satisfaction. When section 13(3) was amended in 1935 to remove this requirement, the Circular was amended to remove the requirement that an IPC's

Furthermore, the Board previously has found that a "discount" of a note is not limited to transactions in which a note is acquired at less than the stated principal amount of the note.[19] Thus, a "discount" of a note under section 13(3) includes the acquisition of a note at its stated principal amount.

For purposes of section 13(3) of the Federal Reserve Act, a note is any written promise to pay a stated amount of money with or without interest or other charges.[20] Although section 13(3) originally required notes discounted by a Reserve Bank under authority of the section to have certain maturities and purposes, Congress removed these restrictions in 1991, and section 13(3) currently places no restrictions on the maturities or purposes of the notes that may be discounted thereunder.[21] Moreover, although section 13(3) originally required notes discounted by a Reserve Bank under authority of the section to be both indorsed and otherwise secured to the Reserve Bank's satisfaction, since 1935, section 13(3) has permitted Reserve Banks to discount notes for IPCs where the notes are either "indorsed or otherwise secured to the satisfaction of the Reserve Bank."

own note must be indorsed by another entity. See 22 Federal Reserve Bulletin 123-124 (Feb. 1936). Thus, a Reserve Bank may discount an unindorsed note of an IPC. See also Memorandum to Board from Mr. Vest (Legal Division), entitled "Authority of one Federal reserve Bank [sic] to discount for another Federal reserve bank member banks' collateral notes held by the latter" (Jan. 30, 1926) ("An investigation of the cases discussing the meaning of the word 'discount' shows that this term applies not only to the purchase of a note from the one who actually owns the same—that is, the payee or other holder, but includes also the transaction by which a loan is made to the maker of a note by the payee thereof").

[19] See "Order Denying Application of General Contract Corporation for an Exemption of Certain Subsidiary Corporations under Section 4(c)(6) of the Bank Holding Company of 1956," 44 Federal Reserve Bulletin 260 (Mar. 1958). The Board observed: "the term 'bank discount' is applied broadly to transactions by which a bank computes interest in advance so that there is the possibility of compound interest, and it seems that any purchase of paper is a 'discount' in that sense since it permits such advance computation and compounding." Id. at 269 (citation omitted).

[20] See generally U.C.C. § 3-104(a), (b), (d) (2003). Although the U.C.C. Article 3 definition requires "notes" to be negotiable, since 1970 the Board has not required that "notes" discounted by Reserve Banks be negotiable. See H. Hackley, "Lending Functions of the Federal Reserve Banks: A History" (May 1973) at 13.

[21] As noted above, section 13(3) originally permitted Reserve Banks to discount only notes that were eligible under the Federal Reserve Act for rediscount by a Reserve Bank for a member bank – namely, notes drawn for specific industrial or agricultural purposes that had maturities of 90 days or less. Congress

Nor does section 13(3) require that a note discounted by a Reserve Bank provide only for payment of principal and a fixed amount of interest or for payments on a certain schedule. Accordingly, nothing in section 13(3) prohibits a Reserve Bank from discounting an IPC's note that provides for payment of principal and interest by the IPC to the Reserve Bank on a flexible schedule and for potential additional payments by the IPC to the Reserve Bank out of the proceeds of the sale or maturity of the collateral securing the note, whether or not the aggregate payments by the IPC to the Reserve Bank are less than or greater than the amount of credit provided by the Reserve Bank to the IPC.

In light of these considerations, the FRBNY special facility is a discount of a note for an IPC for purposes of section 13(3). As explained above, for purposes of section 13(3), a discount of a note includes a purchase of an IPC's own note, and a note is a promise to pay a sum of money. The FRBNY proposes to pay $29 billion to discount a note of the LLC (secured by the LLC's assets) that represents a promise to pay the FRBNY over time an amount equal to $29 billion, plus interest on the $29 billion at the primary credit rate over the term of the note, plus any proceeds remaining in the LLC after liquidation or maturity of the LLC's assets and after repayment of the JPMC facility and payment of the LLC's expenses.[22]

repealed these limitations in 1991 for the express purpose of increasing the ability of the Federal Reserve to extend credit to securities firms during times of stress in the financial markets.

[22] Although the maker of the note being discounted by the FRBNY (that is, the borrower from the FRBNY) in this case is a Delaware limited liability company and not a corporation or partnership under state law, the FRBNY special facility should be viewed as a discount of a note <u>of an IPC</u>. The purpose of section 13(3) of the Federal Reserve Act was to enable the Federal Reserve to provide emergency credit to any individual or entity that was previously unable to get such credit from the Federal Reserve. There would have been no public policy reason for Congress to restrict the beneficiaries of the new emergency credit facilities to two particular types of business firm ("partnerships" and "corporations"), and there is no evidence that Congress intended to restrict the availability of emergency credit under section 13(3) to those business firms that were organized as partnerships or corporations under state law. In addition, the Board consistently has subscribed to this broad interpretation of section 13(3) since its enactment, and has included as eligible IPCs savings associations, savings banks, and other companies that are not organized in

In the alternative, if the FRBNY special facility were characterized as an acquisition by the FRBNY of the assets of the LLC or of Bear Stearns, the FRBNY special facility would still be a discount of notes of an IPC permitted under section 13(3). As discussed above, the Board consistently has viewed the term "discount" as including a purchase by a Reserve Bank of third-party notes held by an IPC. The assets of the LLC will consist of third-party notes that are eligible for discount under section 13(3).[23]

CONCLUSION: For the reasons stated above, and in view of all the facts of record, the Board had statutory authority to authorize the FRBNY to provide the FRBNY special facility under section 13(3) of the Federal Reserve Act.

the form of a corporation or partnership under state law. Moreover, a limited liability company is a form of business organization that did not exist in 1932 but is in legal and economic effect a hybrid of the partnership and corporation form of business firm.

[23] A small amount of assets of the LLC that are not notes, drafts, or bills of exchange (for example, cash and hedging instruments) may be discounted by the FRBNY under the incidental powers provision of the Federal Reserve Act. In addition to the express powers of the Federal Reserve Banks set forth in the Federal Reserve Act, the Act provides that each Federal Reserve Bank has the authority to exercise "such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act." 12 USC 341(7th). The Federal Reserve has long held that a power is incidental to an express power in the Federal Reserve Act if it is reasonably necessary to effectuate an express power in the Act. See Memoranda to the FOMC regarding the legality of lending U.S. Government securities by Federal Reserve Banks from Mr. Hackley, FOMC General Counsel, July 10, 1968, September 13, 1968, and August 25, 1969 (p. 1). Acquiring a small amount of assets other than notes in the context of the acquisition of a large portfolio of notes from an IPC would be incidental to the express authority in section 13(3) to discount notes for an IPC.