

Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress

By Bob Ivry, Bradley Keoun and Phil Kuntz • Bloomberg News

November 28, 2011 – The Federal Reserve and the big banks fought for more than two years to keep details of the largest bailout in U.S. history a secret. Now, the rest of the world can see what it was missing.

The Fed didn't tell anyone which banks were in trouble so deep they required a combined \$1.2 trillion on Dec. 5, 2008, their single neediest day. Bankers didn't mention that they took tens of billions of dollars in emergency loans at the same time they were assuring investors their firms were healthy. And no one calculated until now that banks reaped an estimated \$13 billion of income by taking advantage of the Fed's below-market rates, Bloomberg Markets magazine reports in its January issue.

Saved by the bailout, bankers lobbied against government regulations, a job made easier by the Fed, which never disclosed the details of the rescue to lawmakers even as Congress doled out more money and debated new rules aimed at preventing the next collapse.

A fresh narrative of the financial crisis of 2007 to 2009 emerges from 29,000 pages of Fed documents obtained under the Freedom of Information Act and central bank records of more than 21,000 transactions. While Fed officials say that almost all of the loans were repaid and there have been no losses, details suggest taxpayers paid a price beyond dollars as the secret funding helped preserve a broken status quo and enabled the biggest banks to grow even bigger.

'Change Their Votes'

"When you see the dollars the banks got, it's hard to make the case these were successful institutions," says Sherrod Brown, a Democratic Senator from Ohio who in 2010 introduced an unsuccessful bill to limit bank size. "This is an issue that can unite the Tea Party and Occupy Wall Street. There are lawmakers in both parties who would change their votes now."

The size of the bailout came to light after



On Nov. 26, 2008, then-Bank of America Corp. Chief Executive Officer Kenneth D. Lewis wrote to shareholders that he headed "one of the strongest and most stable major banks in the world." He didn't say that his firm owed the central bank \$86 billion that day.

Photo: Joshua Roberts/Bloomberg

Bloomberg LP, the parent of Bloomberg News, won a court case against the Fed and a group of the biggest U.S. banks called Clearing House Association LLC to force lending details into the open.

The Fed, headed by Chairman Ben S. Bernanke, argued that revealing borrower details would create a stigma – investors and counterparties would shun firms that used the central bank as lender of last resort – and that needy institutions would be reluctant to borrow in the next crisis. Clearing House Association fought Bloomberg's lawsuit up to the U.S. Supreme Court, which declined to hear the banks' appeal in March 2011.

\$7.77 Trillion

The amount of money the central bank parceled out was surprising even to Gary H. Stern, president of the Federal Reserve Bank of Minneapolis from 1985 to 2009, who says he "wasn't aware of the magnitude." It dwarfed the Treasury Department's better-known \$700 billion Troubled Asset Relief Program, or TARP.

Add up guarantees and lending limits, and the Fed had committed \$7.77 trillion as of March 2009 to rescuing the financial system, more than half the value of everything produced in the U.S. that year.

“TARP at least had some strings attached,” says Brad Miller, a North Carolina Democrat on the House Financial Services Committee, referring to the program’s executive-pay ceiling. “With the Fed programs, there was nothing.”

Bankers didn’t disclose the extent of their borrowing. On Nov. 26, 2008, then-Bank of America Corp. Chief Executive Officer Kenneth D. Lewis wrote to shareholders that he headed “one of the strongest and most stable major banks in the world.” He didn’t say that his Charlotte, North Carolina-based firm owed the central bank \$86 billion that day.

‘Motivate Others’

JPMorgan Chase & Co. CEO Jamie Dimon told shareholders in a March 26, 2010, letter that his bank used the Fed’s Term Auction Facility “at the request of the Federal Reserve to help motivate others to use the system.” He didn’t say that the New York-based bank’s total TAF borrowings were almost twice its cash holdings or that its peak borrowing of \$48 billion on Feb. 26, 2009, came more than a year after the program’s creation.

Howard Opinsky, a spokesman for JPMorgan, declined to comment about Dimon’s statement or the company’s Fed borrowings. Jerry Dubrowski, a spokesman for Bank of America, also declined to comment.

The Fed has been lending money to banks through its so-called discount window since just after its founding in 1913. Starting in August 2007, when confidence in banks began to wane, it created a variety of ways to bolster the financial system with cash or easily traded securities. By the end of 2008, the central bank had established or expanded 11 lending facilities catering to banks, securities firms and corporations that couldn’t get short-term loans from their usual sources.

‘Core Function’

“Supporting financial-market stability in times of extreme market stress is a core function of

central banks,” says William B. English, director of the Fed’s Division of Monetary Affairs. “Our lending programs served to prevent a collapse of the financial system and to keep credit flowing to American families and businesses.”

The Fed has said that all loans were backed by appropriate collateral. That the central bank didn’t lose money should “lead to praise of the Fed, that they took this extraordinary step and they got it right,” says Phillip Swagel, a former assistant Treasury secretary under Henry M. Paulson and now a professor of international economic policy at the University of Maryland.

The Fed initially released lending data in aggregate form only. Information on which banks borrowed, when, how much and at what interest rate was kept from public view.

The secrecy extended even to members of President George W. Bush’s administration who managed TARP. Top aides to Paulson weren’t privy to Fed lending details during the creation of the program that provided crisis funding to more than 700 banks, say two former senior Treasury officials who requested anonymity because they weren’t authorized to speak.

Big Six

The Treasury Department relied on the recommendations of the Fed to decide which banks were healthy enough to get TARP money and how much, the former officials say. The six biggest U.S. banks, which received \$160 billion of TARP funds, borrowed as much as \$460 billion from the Fed, measured by peak daily debt calculated by Bloomberg using data obtained from the central bank. Paulson didn’t respond to a request for comment.

The six – JPMorgan, Bank of America, Citigroup Inc., Wells Fargo & Co., Goldman Sachs Group Inc. and Morgan Stanley – accounted for 63 percent of the average daily debt to the Fed by all publicly traded U.S. banks, money managers and investment-services firms, the data show. By comparison, they had about half of the industry’s assets before the bailout, which lasted from August 2007 through April 2010. The daily debt figure excludes cash that banks passed along to money-market funds.

Bank Supervision

While the emergency response prevented financial collapse, the Fed shouldn't have allowed conditions to get to that point, says Joshua Rosner, a banking analyst with Graham Fisher & Co. in New York who predicted problems from lax mortgage underwriting as far back as 2001. The Fed, the primary supervisor for large financial companies, should have been more vigilant as the housing bubble formed, and the scale of its lending shows the "supervision of the banks prior to the crisis was far worse than we had imagined," Rosner says.

Bernanke in an April 2009 speech said that the Fed provided emergency loans only to "sound institutions," even though its internal assessments described at least one of the biggest borrowers, Citigroup, as "marginal."

On Jan. 14, 2009, six days before the company's central bank loans peaked, the New York Fed gave CEO Vikram Pandit a report declaring Citigroup's financial strength to be "superficial," bolstered largely by its \$45 billion of Treasury funds. The document was released in early 2011 by the Financial Crisis Inquiry Commission, a panel empowered by Congress to probe the causes of the crisis.

'Need Transparency'

Andrea Priest, a spokeswoman for the New York Fed, declined to comment, as did Jon Diat, a spokesman for Citigroup.

"I believe that the Fed should have independence in conducting highly technical monetary policy, but when they are putting taxpayer resources at risk, we need transparency and accountability," says Alabama Senator Richard Shelby, the top Republican on the Senate Banking Committee.

Judd Gregg, a former New Hampshire senator who was a lead Republican negotiator on TARP, and Barney Frank, a Massachusetts Democrat who chaired the House Financial Services Committee, both say they were kept in the dark.

"We didn't know the specifics," says Gregg, who's now an adviser to Goldman Sachs.

"We were aware emergency efforts were going on," Frank says. "We didn't know the specifics."

Disclose Lending

Frank co-sponsored the Dodd-Frank Wall Street Reform and Consumer Protection Act, billed as a fix for financial-industry excesses. Congress debated that legislation in 2010 without a full understanding of how deeply the banks had depended on the Fed for survival.

It would have been "totally appropriate" to disclose the lending data by mid-2009, says David Jones, a former economist at the Federal Reserve Bank of New York who has written four books about the central bank.

"The Fed is the second-most-important appointed body in the U.S., next to the Supreme Court, and we're dealing with a democracy," Jones says. "Our representatives in Congress deserve to have this kind of information so they can oversee the Fed."

The Dodd-Frank law required the Fed to release details of some emergency-lending programs in December 2010. It also mandated disclosure of discount-window borrowers after a two-year lag.

Protecting TARP

TARP and the Fed lending programs went "hand in hand," says Sherrill Shaffer, a banking professor at the University of Wyoming in Laramie and a former chief economist at the New York Fed. While the TARP money helped insulate the central bank from losses, the Fed's willingness to supply seemingly unlimited financing to the banks assured they wouldn't collapse, protecting the Treasury's TARP investments, he says.

"Even though the Treasury was in the headlines, the Fed was really behind the scenes engineering it," Shaffer says.

Congress, at the urging of Bernanke and Paulson, created TARP in October 2008 after the bankruptcy of Lehman Brothers Holdings Inc. made it difficult for financial institutions to get loans. Bank of America and New York-based Citigroup each received \$45 billion from TARP. At

the time, both were tapping the Fed. Citigroup hit its peak borrowing of \$99.5 billion in January 2009, while Bank of America topped out in February 2009 at \$91.4 billion.

No Clue

Lawmakers knew none of this.

They had no clue that one bank, New York-based Morgan Stanley, took \$107 billion in Fed loans in September 2008, enough to pay off one-tenth of the country's delinquent mortgages. The firm's peak borrowing occurred the same day Congress rejected the proposed TARP bill, triggering the biggest point drop ever in the Dow Jones Industrial Average. The bill later passed, and Morgan Stanley got \$10 billion of TARP funds, though Paulson said only "healthy institutions" were eligible.

Mark Lake, a spokesman for Morgan Stanley, declined to comment, as did spokesmen for Citigroup and Goldman Sachs.

Had lawmakers known, it "could have changed the whole approach to reform legislation," says Ted Kaufman, a former Democratic Senator from Delaware who, with Brown, introduced the bill to limit bank size.

Moral Hazard

Kaufman says some banks are so big that their failure could trigger a chain reaction in the financial system. The cost of borrowing for so-called too-big-to-fail banks is lower than that of smaller firms because lenders believe the government won't let them go under. The perceived safety net creates what economists call moral hazard – the belief that bankers will take greater risks because they'll enjoy any profits while shifting losses to taxpayers.

If Congress had been aware of the extent of the Fed rescue, Kaufman says, he would have been able to line up more support for breaking up the biggest banks.

Byron L. Dorgan, a former Democratic senator from North Dakota, says the knowledge might have helped pass legislation to reinstate the Glass-Steagall Act, which for most of the last century separated customer deposits from the riskier practices of investment banking.

"Had people known about the hundreds of billions in loans to the biggest financial institutions, they would have demanded Congress take much more courageous actions to stop the practices that caused this near financial collapse," says Dorgan, who retired in January.

Getting Bigger

Instead, the Fed and its secret financing helped America's biggest financial firms get bigger and go on to pay employees as much as they did at the height of the housing bubble.

Total assets held by the six biggest U.S. banks increased 39 percent to \$9.5 trillion on Sept. 30, 2011, from \$6.8 trillion on the same day in 2006, according to Fed data.

For so few banks to hold so many assets is "un-American," says Richard W. Fisher, president of the Federal Reserve Bank of Dallas. "All of these gargantuan institutions are too big to regulate. I'm in favor of breaking them up and slimming them down."

Employees at the six biggest banks made twice the average for all U.S. workers in 2010, based on Bureau of Labor Statistics hourly compensation cost data. The banks spent \$146.3 billion on compensation in 2010, or an average of \$126,342 per worker, according to data compiled by Bloomberg. That's up almost 20 percent from five years earlier compared with less than 15 percent for the average worker. Average pay at the banks in 2010 was about the same as in 2007, before the bailouts.

'Wanted to Pretend'

"The pay levels came back so fast at some of these firms that it appeared they really wanted to pretend they hadn't been bailed out," says Anil Kashyap, a former Fed economist who's now a professor of economics at the University of Chicago Booth School of Business. "They shouldn't be surprised that a lot of people find some of the stuff that happened totally outrageous."

Bank of America took over Merrill Lynch & Co. at the urging of then-Treasury Secretary Paulson after buying the biggest U.S. home lender, Countrywide Financial Corp. When the Merrill Lynch purchase

was announced on Sept. 15, 2008, Bank of America had \$14.4 billion in emergency Fed loans and Merrill Lynch had \$8.1 billion. By the end of the month, Bank of America's loans had reached \$25 billion and Merrill Lynch's had exceeded \$60 billion, helping both firms keep the deal on track.

Prevent Collapse

Wells Fargo bought Wachovia Corp., the fourth-largest U.S. bank by deposits before the 2008 acquisition. Because depositors were pulling their money from Wachovia, the Fed channeled \$50 billion in secret loans to the Charlotte, North Carolina-based bank through two emergency-financing programs to prevent collapse before Wells Fargo could complete the purchase.

"These programs proved to be very successful at providing financial markets the additional liquidity and confidence they needed at a time of unprecedented uncertainty," says Ancel Martinez, a spokesman for Wells Fargo.

JPMorgan absorbed the country's largest savings and loan, Seattle-based Washington Mutual Inc., and investment bank Bear Stearns Cos. The New York Fed, then headed by Timothy F. Geithner, who's now Treasury secretary, helped JPMorgan complete the Bear Stearns deal by providing \$29 billion of financing, which was disclosed at the time. The Fed also supplied Bear Stearns with \$30 billion of secret loans to keep the company from failing before the acquisition closed, central bank data show. The loans were made through a program set up to provide emergency funding to brokerage firms.

'Regulatory Discretion'

"Some might claim that the Fed was picking winners and losers, but what the Fed was doing was exercising its professional regulatory discretion," says John Dearie, a former speechwriter at the New York Fed who's now executive vice president for policy at the Financial Services Forum, a Washington-based group consisting of the CEOs of 20 of the world's biggest financial firms. "The Fed clearly felt it had what it needed within the requirements of the law to continue to lend to Bear and Wachovia."

The bill introduced by Brown and Kaufman in April 2010 would have mandated shrinking the six largest firms.

"When a few banks have advantages, the little guys get squeezed," Brown says. "That, to me, is not what capitalism should be."

Kaufman says he's passionate about curbing too-big-to-fail banks because he fears another crisis.

'Can We Survive?'

"The amount of pain that people, through no fault of their own, had to endure – and the prospect of putting them through it again – is appalling," Kaufman says. "The public has no more appetite for bailouts. What would happen tomorrow if one of these big banks got in trouble? Can we survive that?"

Lobbying expenditures by the six banks that would have been affected by the legislation rose to \$29.4 million in 2010 compared with \$22.1 million in 2006, the last full year before credit markets seized up – a gain of 33 percent, according to OpenSecrets.org, a research group that tracks money in U.S. politics. Lobbying by the American Bankers Association, a trade organization, increased at about the same rate, OpenSecrets.org reported.

Lobbyists argued the virtues of bigger banks. They're more stable, better able to serve large companies and more competitive internationally, and breaking them up would cost jobs and cause "long-term damage to the U.S. economy," according to a Nov. 13, 2009, letter to members of Congress from the FSF.

The group's website cites Nobel Prize-winning economist Oliver E. Williamson, a professor emeritus at the University of California, Berkeley, for demonstrating the greater efficiency of large companies.

'Serious Burden'

In an interview, Williamson says that the organization took his research out of context and that efficiency is only one factor in deciding whether to preserve too-big-to-fail banks.

"The banks that were too big got even bigger, and the problems that we had to begin with are magnified

in the process,” Williamson says. “The big banks have incentives to take risks they wouldn’t take if they didn’t have government support. It’s a serious burden on the rest of the economy.”

Dearie says his group didn’t mean to imply that Williamson endorsed big banks.

Top officials in President Barack Obama’s administration sided with the FSF in arguing against legislative curbs on the size of banks.

Geithner, Kaufman

On May 4, 2010, Geithner visited Kaufman in his Capitol Hill office. As president of the New York Fed in 2007 and 2008, Geithner helped design and run the central bank’s lending programs. The New York Fed supervised four of the six biggest U.S. banks and, during the credit crunch, put together a daily confidential report on Wall Street’s financial condition. Geithner was copied on these reports, based on a sampling of e-mails released by the Financial Crisis Inquiry Commission.

At the meeting with Kaufman, Geithner argued that the issue of limiting bank size was too complex for Congress and that people who know the markets should handle these decisions, Kaufman says. According to Kaufman, Geithner said he preferred that bank supervisors from around the world, meeting in Basel, Switzerland, make rules increasing the amount of money banks need to hold in reserve. Passing laws in the U.S. would undercut his efforts in Basel, Geithner said, according to Kaufman.

Anthony Coley, a spokesman for Geithner, declined to comment.

‘Punishing Success’

Lobbyists for the big banks made the winning case that forcing them to break up was “punishing success,” Brown says. Now that they can see how much the banks were borrowing from the Fed, senators might think differently, he says.

The Fed supported curbing too-big-to-fail banks, including giving regulators the power to close large financial firms and implementing tougher supervision for big banks, says Fed General Counsel Scott G. Alvarez. The Fed didn’t take a position on

whether large banks should be dismantled before they get into trouble.

Dodd-Frank does provide a mechanism for regulators to break up the biggest banks. It established the Financial Stability Oversight Council that could order teetering banks to shut down in an orderly way. The council is headed by Geithner.

“Dodd-Frank does not solve the problem of too big to fail,” says Shelby, the Alabama Republican. “Moral hazard and taxpayer exposure still very much exist.”

Below Market

Dean Baker, co-director of the Center for Economic and Policy Research in Washington, says banks “were either in bad shape or taking advantage of the Fed giving them a good deal. The former contradicts their public statements. The latter – getting loans at below-market rates during a financial crisis – is quite a gift.”

The Fed says it typically makes emergency loans more expensive than those available in the marketplace to discourage banks from abusing the privilege. During the crisis, Fed loans were among the cheapest around, with funding available for as low as 0.01 percent in December 2008, according to data from the central bank and money-market rates tracked by Bloomberg.

The Fed funds also benefited firms by allowing them to avoid selling assets to pay investors and depositors who pulled their money. So the assets stayed on the banks’ books, earning interest.

Banks report the difference between what they earn on loans and investments and their borrowing expenses. The figure, known as net interest margin, provides a clue to how much profit the firms turned on their Fed loans, the costs of which were included in those expenses. To calculate how much banks stood to make, Bloomberg multiplied their tax-adjusted net interest margins by their average Fed debt during reporting periods in which they took emergency loans.

Added Income

The 190 firms for which data were available would have produced income of \$13 billion, assuming all of

the bailout funds were invested at the margins reported, the data show.

The six biggest U.S. banks' share of the estimated subsidy was \$4.8 billion, or 23 percent of their combined net income during the time they were borrowing from the Fed. Citigroup would have taken in the most, with \$1.8 billion.

"The net interest margin is an effective way of getting at the benefits that these large banks received from the Fed," says Gerald A. Hanweck, a former Fed economist who's now a finance professor at George Mason University in Fairfax, Virginia.

While the method isn't perfect, it's impossible to state the banks' exact profits or savings from their Fed loans because the numbers aren't disclosed and there isn't enough publicly available data to figure it out.

Opinsky, the JPMorgan spokesman, says he doesn't think the calculation is fair because "in all likelihood, such funds were likely invested in very short-term investments," which typically bring lower returns.

Standing Access

Even without tapping the Fed, the banks get a subsidy by having standing access to the central bank's money, says Viral Acharya, a New York University economics professor who has worked as an academic adviser to the New York Fed.

"Banks don't give lines of credit to corporations for free," he says. "Why should all these government guarantees and liquidity facilities be for free?"

In the September 2008 meeting at which Paulson and Bernanke briefed lawmakers on the need for TARP, Bernanke said that if nothing was done, "unemployment would rise – to 8 or 9 percent from the prevailing 6.1 percent," Paulson wrote in "On the Brink" (Business Plus, 2010).

Occupy Wall Street

The U.S. jobless rate hasn't dipped below 8.8 percent since March 2009, 3.6 million homes have been foreclosed since August 2007, according to data provider RealtyTrac Inc., and police have clashed with Occupy Wall Street protesters, who say government policies favor the wealthiest citizens, in New York, Boston, Seattle and Oakland, California.

The Tea Party, which supports a more limited role for government, has its roots in anger over the Wall Street bailouts, says Neil M. Barofsky, former TARP special inspector general and a Bloomberg Television contributing editor.

"The lack of transparency is not just frustrating; it really blocked accountability," Barofsky says. "When people don't know the details, they fill in the blanks. They believe in conspiracies."

In the end, Geithner had his way. The Brown-Kaufman proposal to limit the size of banks was defeated, 60 to 31. Bank supervisors meeting in Switzerland did mandate minimum reserves that institutions will have to hold, with higher levels for the world's largest banks, including the six biggest in the U.S. Those rules can be changed by individual countries.

They take full effect in 2019.

Meanwhile, Kaufman says, "we're absolutely, totally, 100 percent not prepared for another financial crisis."

–Editors: Robert Friedman, John Voskuhl

Wall Street Aristocracy Got \$1.2 Trillion in Secret Loans

By Bradley Keoun and Phil Kuntz • Bloomberg News

August 22, 2011 – Citigroup Inc. and Bank of America Corp. were the reigning champions of finance in 2006 as home prices peaked, leading the 10 biggest U.S. banks and brokerage firms to their best year ever with \$104 billion of profits.

By 2008, the housing market's collapse forced those companies to take more than six times as much, \$669 billion, in emergency loans from the U.S. Federal Reserve. The loans dwarfed the \$160 billion in public bailouts the top 10 got from the U.S. Treasury, yet until now the full amounts have remained secret.

Fed Chairman Ben S. Bernanke's unprecedented effort to keep the economy from plunging into depression included lending banks and other companies as much as \$1.2 trillion of public money, about the same amount U.S. homeowners currently owe on 6.5 million delinquent and foreclosed mortgages. The largest borrower, Morgan Stanley, got as much as \$107.3 billion, while Citigroup took \$99.5 billion and Bank of America \$91.4 billion, according to a Bloomberg News compilation of data obtained through Freedom of Information Act requests, months of litigation and an act of Congress.

"These are all whopping numbers," said Robert Litan, a former Justice Department official who in the 1990s served on a commission probing the causes of the savings and loan crisis. "You're talking about the aristocracy of American finance going down the tubes without the federal money."

Foreign Borrowers

It wasn't just American finance. Almost half of the Fed's top 30 borrowers, measured by peak balances, were European firms. They included Edinburgh-based Royal Bank of Scotland Plc, which took \$84.5 billion, the most of any non-U.S. lender, and Zurich-based UBS AG, which got \$77.2 billion. Germany's Hypo Real Estate Holding AG borrowed \$28.7 billion,



Citigroup Inc., along with Morgan Stanley and Citigroup Inc., were the biggest borrowers under seven U.S. Federal Reserve emergency-lending programs.

Photographer: Robert Caplin/Bloomberg

an average of \$21 million for each of its 1,366 employees.

The largest borrowers also included Dexia SA, Belgium's biggest bank by assets, and Societe Generale SA, based in Paris, whose bond-insurance prices have surged in the past month as investors speculated that the spreading sovereign debt crisis in Europe might increase their chances of default.

The \$1.2 trillion peak on Dec. 5, 2008 – the combined outstanding balance under the seven programs tallied by Bloomberg – was almost three times the size of the U.S. federal budget deficit that year and more than the total earnings of all federally insured banks in the U.S. for the decade through 2010, according to data compiled by Bloomberg.

Peak Balance

The balance was more than 25 times the Fed's pre-crisis lending peak of \$46 billion on Sept. 12, 2001, the day after terrorists attacked the World Trade Center in New York and the Pentagon. Denominated in \$1 bills, the \$1.2 trillion would fill



Morgan Stanley, along with Citigroup Inc., and Bank of America Corp., were the biggest borrowers under seven Fed emergency-lending programs. The three banks' combined \$298.2 billion in hidden Fed loans was triple what they received in publicly disclosed bailouts from the U.S. Treasury.

Photographer: Peter Foley/Bloomberg

539 Olympic-size swimming pools.

The Fed has said it had “no credit losses” on any of the emergency programs, and a report by Federal Reserve Bank of New York staffers in February said the central bank netted \$13 billion in interest and fee income from the programs from August 2007 through December 2009.

“We designed our broad-based emergency programs to both effectively stem the crisis and minimize the financial risks to the U.S. taxpayer,” said James Clouse, deputy director of the Fed’s division of monetary affairs in Washington. “Nearly all of our emergency-lending programs have been closed. We have incurred no losses and expect no losses.”

While the 18-month U.S. recession that ended in June 2009 after a 5.1 percent contraction in gross domestic product was nowhere near the four-year, 27 percent decline between August 1929 and March 1933, banks and the economy remain stressed.

Odds of Recession

The odds of another recession have climbed during the past six months, according to five of nine economists on the Business Cycle Dating Committee of the National Bureau of Economic Research, an academic panel that dates recessions.

Bank of America’s bond-insurance prices last week surged to a rate of \$342,040 a year for coverage on \$10 million of debt, above where Lehman Brothers Holdings Inc.’s bond insurance was priced at the start of the week before the firm collapsed. Citigroup’s shares are trading below the split-adjusted price of \$28 that they hit on the day the bank’s Fed loans peaked in January 2009. The U.S. unemployment rate was at 9.1 percent in July, compared with 4.7 percent in November 2007, before the recession began.

Homeowners are more than 30 days past due on their mortgage payments on 4.38 million properties in the U.S., and 2.16 million more properties are in foreclosure, representing a combined \$1.27 trillion of unpaid principal, estimates Jacksonville, Florida-based Lender Processing Services Inc.

Liquidity Requirements

“Why in hell does the Federal Reserve seem to be able to find the way to help these entities that are gigantic?” U.S. Representative Walter B. Jones, a Republican from North Carolina, said at a June 1 congressional hearing in Washington on Fed lending disclosure. “They get help when the average businessperson down in eastern North Carolina, and probably across America, they can’t even go to a bank they’ve been banking with for 15 or 20 years and get a loan.”

The sheer size of the Fed loans bolsters the case for minimum liquidity requirements that global regulators last year agreed to impose on banks for the first time, said Litan, now a vice president at the Kansas City, Missouri-based Kauffman Foundation, which supports entrepreneurship research. Liquidity refers to the daily funds a bank needs to operate, including cash to cover depositor withdrawals.

The rules, which mandate that banks keep enough cash and easily liquidated assets on hand to survive a 30-day crisis, don’t take effect until 2015. Another proposed requirement for lenders to keep “stable funding” for a one-year horizon was postponed until at least 2018 after banks showed they’d have to raise as much as \$6 trillion in new long-term debt to comply.

‘Stark Illustration’

Regulators are “not going to go far enough to prevent this from happening again,” said Kenneth Rogoff, a former chief economist at the International Monetary Fund and now an economics professor at Harvard University.

Reforms undertaken since the crisis might not insulate U.S. markets and financial institutions from the sovereign budget and debt crises facing Greece, Ireland and Portugal, according to the U.S. Financial Stability Oversight Council, a 10-member body created by the Dodd-Frank Act and led by Treasury Secretary Timothy Geithner.

“The recent financial crisis provides a stark illustration of how quickly confidence can erode and financial contagion can spread,” the council said in its July 26 report.

21,000 Transactions

Any new rescues by the U.S. central bank would be governed by transparency laws adopted in 2010 that require the Fed to disclose borrowers after two years.

Fed officials argued for more than two years that releasing the identities of borrowers and the terms of their loans would stigmatize banks, damaging stock prices or leading to depositor runs. A group of the biggest commercial banks last year asked the U.S. Supreme Court to keep at least some Fed borrowings secret. In March, the high court declined to hear that appeal, and the central bank made an unprecedented release of records.

Data gleaned from 29,346 pages of documents obtained under the Freedom of Information Act and from other Fed databases of more than 21,000 transactions make clear for the first time how deeply the world’s largest banks depended on the U.S. central bank to stave off cash shortfalls. Even as the firms asserted in news releases or earnings calls that they had ample cash, they drew Fed funding in secret, avoiding the stigma of weakness.

Morgan Stanley Borrowing

Two weeks after Lehman’s bankruptcy in September 2008, Morgan Stanley countered

concerns that it might be next to go by announcing it had “strong capital and liquidity positions.” The statement, in a Sept. 29, 2008, press release about a \$9 billion investment from Tokyo-based Mitsubishi UFJ Financial Group Inc., said nothing about Morgan Stanley’s Fed loans.

That was the same day as the firm’s \$107.3 billion peak in borrowing from the central bank, which was the source of almost all of Morgan Stanley’s available cash, according to the lending data and documents released more than two years later by the Financial Crisis Inquiry Commission. The amount was almost three times the company’s total profits over the past decade, data compiled by Bloomberg show.

Mark Lake, a spokesman for New York-based Morgan Stanley, said the crisis caused the industry to “fundamentally re- evaluate” the way it manages its cash.

“We have taken the lessons we learned from that period and applied them to our liquidity-management program to protect both our franchise and our clients going forward,” Lake said. He declined to say what changes the bank had made.

Acceptable Collateral

In most cases, the Fed demanded collateral for its loans – Treasuries or corporate bonds and mortgage bonds that could be seized and sold if the money wasn’t repaid. That meant the central bank’s main risk was that collateral pledged by banks that collapsed would be worth less than the amount borrowed.

As the crisis deepened, the Fed relaxed its standards for acceptable collateral. Typically, the central bank accepts only bonds with the highest credit grades, such as U.S. Treasuries. By late 2008, it was accepting “junk” bonds, those rated below investment grade. It even took stocks, which are first to get wiped out in a liquidation.

Morgan Stanley borrowed \$61.3 billion from one Fed program in September 2008, pledging a total of \$66.5 billion of collateral, according to Fed documents. Securities pledged included \$21.5 billion of stocks, \$6.68 billion of bonds with a junk credit rating and \$19.5 billion of assets with an “unknown rating,” according to the documents. About 25 percent of the collateral was foreign-denominated.

‘Willingness to Lend’

“What you’re looking at is a willingness to lend against just about anything,” said Robert Eisenbeis, a former research director at the Federal Reserve Bank of Atlanta and now chief monetary economist in Atlanta for Sarasota, Florida-based Cumberland Advisors Inc.

The lack of private-market alternatives for lending shows how skeptical trading partners and depositors were about the value of the banks’ capital and collateral, Eisenbeis said.

“The markets were just plain shut,” said Tanya Azarchs, former head of bank research at Standard & Poor’s and now an independent consultant in Briarcliff Manor, New York. “If you needed liquidity, there was only one place to go.”

Even banks that survived the crisis without government capital injections tapped the Fed through programs that promised confidentiality. London-based Barclays Plc borrowed \$64.9 billion and Frankfurt-based Deutsche Bank AG got \$66 billion. Sarah MacDonald, a spokeswoman for Barclays, and John Gallagher, a spokesman for Deutsche Bank, declined to comment.

Below-Market Rates

While the Fed’s last-resort lending programs generally charge above-market interest rates to deter routine borrowing, that practice sometimes flipped during the crisis. On Oct. 20, 2008, for example, the central bank agreed to make \$113.3 billion of 28-day loans through its Term Auction Facility at a rate of 1.1 percent, according to a press release at the time.

The rate was less than a third of the 3.8 percent that banks were charging each other to make one-month loans on that day. Bank of America and Wachovia Corp. each got \$15 billion of the 1.1 percent TAF loans, followed by Royal Bank of Scotland’s RBS Citizens NA unit with \$10 billion, Fed data show.

JPMorgan Chase & Co., the New York-based lender that touted its “fortress balance sheet” at least 16 times in press releases and conference calls from October 2007 through February 2010, took as much as \$48 billion in February 2009 from TAF. The facility, set up in December 2007, was a temporary



Bank of America Corp., along with Morgan Stanley and Citigroup Inc. was one of the biggest borrowers under the U.S. Federal Reserve’s emergency-lending programs. The three banks’ combined \$298.2 billion in hidden Fed loans was triple what they received in publicly disclosed bailouts from the U.S. Treasury.

Photographer: Jeremy Bales/Bloomberg

alternative to the discount window, the central bank’s 97-year-old primary lending program to help banks in a cash squeeze.

‘Larger Than TARP’

Goldman Sachs Group Inc., which in 2007 was the most profitable securities firm in Wall Street history, borrowed \$69 billion from the Fed on Dec. 31, 2008. Among the programs New York-based Goldman Sachs tapped after the Lehman bankruptcy was the Primary Dealer Credit Facility, or PDCF, designed to lend money to brokerage firms ineligible for the Fed’s bank-lending programs.

Michael Duvally, a spokesman for Goldman Sachs, declined to comment.

The Fed’s liquidity lifelines may increase the chances that banks engage in excessive risk-taking with borrowed money, Rogoff said. Such a phenomenon, known as moral hazard, occurs if banks assume the Fed will be there when they need it, he said. The size of bank borrowings “certainly shows the Fed bailout was in many ways much larger than TARP,” Rogoff said.

TARP is the Treasury Department’s Troubled Asset Relief Program, a \$700 billion bank-bailout fund that provided capital injections of \$45 billion each to Citigroup and Bank of America, and \$10 billion to Morgan Stanley. Because most of the

Treasury's investments were made in the form of preferred stock, they were considered riskier than the Fed's loans, a type of senior debt.

Dodd-Frank Requirement

In December, in response to the Dodd-Frank Act, the Fed released 18 databases detailing its temporary emergency-lending programs.

Congress required the disclosure after the Fed rejected requests in 2008 from the late Bloomberg News reporter Mark Pittman and other media companies that sought details of its loans under the Freedom of Information Act. After fighting to keep the data secret, the central bank released unprecedented information about its discount window and other programs under court order in March 2011.

Bloomberg News combined Fed databases made available in December and July with the discount-window records released in March to produce daily totals for banks across all the programs, including the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Commercial Paper Funding Facility, discount window, PDCF, TAF, Term Securities Lending Facility and single-tranche open market operations. The programs supplied loans from August 2007 through April 2010.

Rolling Crisis

The result is a timeline illustrating how the credit crisis rolled from one bank to another as financial contagion spread.

Fed borrowings by Societe Generale, France's second-biggest bank, peaked at \$17.4 billion in May 2008, four months after the Paris-based lender announced a record 4.9 billion-euro (\$7.2 billion) loss on unauthorized stock-index futures bets by former trader Jerome Kerviel.

Morgan Stanley's top borrowing came four months later, after Lehman's bankruptcy. Citigroup crested in January 2009, as did 43 other banks, the largest number of peak borrowings for any month during the crisis. Bank of America's heaviest borrowings came two months after that.

Sixteen banks, including Plano, Texas-based Beal

Financial Corp. and Jacksonville, Florida-based EverBank Financial Corp., didn't hit their peaks until February or March 2010.

Using Subsidiaries

"At no point was there a material risk to the Fed or the taxpayer, as the loan required collateralization," said Reshma Fernandes, a spokeswoman for EverBank, which borrowed as much as \$250 million.

Banks maximized their borrowings by using subsidiaries to tap Fed programs at the same time. In March 2009, Charlotte, North Carolina-based Bank of America drew \$78 billion from one facility through two banking units and \$11.8 billion more from two other programs through its broker-dealer, Bank of America Securities LLC.

Banks also shifted balances among Fed programs. Many preferred the TAF because it carried less of the stigma associated with the discount window, often seen as the last resort for lenders in distress, according to a January 2011 paper by researchers at the New York Fed.

After the Lehman bankruptcy, hedge funds began pulling their cash out of Morgan Stanley, fearing it might be the next to collapse, the Financial Crisis Inquiry Commission said in a January report, citing interviews with former Chief Executive Officer John Mack and then-Treasurer David Wong.

Borrowings Surge

Morgan Stanley's borrowings from the PDCF surged to \$61.3 billion on Sept. 29 from zero on Sept. 14. At the same time, its loans from the Term Securities Lending Facility, or TSLF, rose to \$36 billion from \$3.5 billion. Morgan Stanley treasury reports released by the FCIC show the firm had \$99.8 billion of liquidity on Sept. 29, a figure that included Fed borrowings.

"The cash flow was all drying up," said Roger Lister, a former Fed economist who's now head of financial-institutions coverage at credit-rating firm DBRS Inc. in New York. "Did they have enough resources to cope with it? The answer would be yes, but they needed the Fed."

While Morgan Stanley's Fed demands were the

most acute, Citigroup was the most chronic borrower among the largest U.S. banks. The New York-based company borrowed \$10 million from the TAF on the program's first day in December 2007 and had more than \$25 billion outstanding under all programs by May 2008, according to Bloomberg data.

Tapping Six Programs

By Nov. 21, when Citigroup began talks with the government to get a \$20 billion capital injection on top of the \$25 billion received a month earlier, its Fed borrowings had doubled to about \$50 billion.

Over the next two months the amount almost doubled again. On Jan. 20, as the stock sank below \$3 for the first time in 16 years amid investor concerns that the lender's capital cushion might be inadequate, Citigroup was tapping six Fed programs at once. Its total borrowings amounted to more than twice the federal Department of Education's 2011 budget.

Citigroup was in debt to the Fed on seven out of every 10 days from August 2007 through April 2010, the most frequent U.S. borrower among the 100 biggest publicly traded firms by pre-crisis market valuation. On average, the bank had a daily balance at the Fed of almost \$20 billion.

'Help Motivate Others'

"Citibank basically was sustained by the Fed for a very long time," said Richard Herring, a finance professor at the University of Pennsylvania in Philadelphia who has studied financial crises.

Jon Diat, a Citigroup spokesman, said the bank made use of programs that "achieved the goal of instilling confidence in the markets."

JPMorgan CEO Jamie Dimon said in a letter to shareholders last year that his bank avoided many government programs. It did use TAF, Dimon said in the letter, "but this was done at the request of the Federal Reserve to help motivate others to use the system."

The bank, the second-largest in the U.S. by assets,

first tapped the TAF in May 2008, six months after the program debuted, and then zeroed out its borrowings in September 2008. The next month, it started using TAF again.

On Feb. 26, 2009, more than a year after TAF's creation, JPMorgan's borrowings under the program climbed to \$48 billion. On that day, the overall TAF balance for all banks hit its peak, \$493.2 billion. Two weeks later, the figure began declining.

"Our prior comment is accurate," said Howard Opinsky, a spokesman for JPMorgan.

'The Cheapest Source'

Herring, the University of Pennsylvania professor, said some banks may have used the program to maximize profits by borrowing "from the cheapest source, because this was supposed to be secret and never revealed."

Whether banks needed the Fed's money for survival or used it because it offered advantageous rates, the central bank's lender-of-last-resort role amounts to a free insurance policy for banks guaranteeing the arrival of funds in a disaster, Herring said.

An IMF report last October said regulators should consider charging banks for the right to access central bank funds.

"The extent of official intervention is clear evidence that systemic liquidity risks were under-recognized and mispriced by both the private and public sectors," the IMF said in a separate report in April.

Access to Fed backup support "leads you to subject yourself to greater risks," Herring said. "If it's not there, you're not going to take the risks that would put you in trouble and require you to have access to that kind of funding."

– *With assistance from Dawn Kopecki and Michael J. Moore in New York*

– *Editors: Robert Friedman, John Voskuhl*

Morgan Stanley at Brink of Collapse Got \$107 Billion From Fed

By Bradley Keoun • Bloomberg News

August 23, 2011 – As markets convulsed in September 2008, Morgan Stanley Treasurer David Wong briefed the Federal Reserve on a “dark” scenario in which the U.S. firm would need at least \$10 billion of emergency loans from the central bank.

It got 10 times darker by month’s end. Morgan Stanley borrowed \$107.3 billion, the most of any bank, according to data compiled by Bloomberg News using information released in response to Freedom of Information Act requests, related court orders and an act of Congress.

Morgan Stanley’s borrowing – more than twice the amount all banks got from the Fed in the market squeeze that followed the Sept. 11 terrorist attacks – peaked after hedge funds pulled \$128.1 billion from the firm in two weeks, documents released by the Financial Crisis Inquiry Commission show.

The first comprehensive examination of the Fed’s emergency lending reveals how close the New York-based bank came to running out of cash because of a run on its prime brokerage, the unit that finances hedge funds’ trades and holds their cash and securities. The Fed loans also show the degree to which Morgan Stanley and other banks depended on such brokerage accounts for funding, even though clients could close them on short notice.

“These were like hot-money deposits that could flee in an instant,” said Tanya Azarchs, a former Standard & Poor’s analyst who covered Morgan Stanley during the crisis and is now a consultant in Briarcliff Manor, New York. The firm “never thought that the hedge funds would get that spooked.”

29,346 Pages

Morgan Stanley’s Fed loans – tallied in a Bloomberg News database assembled from government records of more than 21,000



Morgan Stanley’s Fed loans – tallied in a Bloomberg News database assembled from government records of more than 21,000 transactions and 29,346 pages obtained under a Freedom of Information Act lawsuit – open a window on Wall Street’s secretive, lucrative and risky dealings with hedge funds.

Photographer: Daniel Acker/Bloomberg

transactions and 29,346 pages – open a window on Wall Street’s secretive, lucrative and risky dealings with hedge funds.

(View the Bloomberg interactive graphic to chart the Fed’s financial bailout.)

The bank never told investors about the extent of its Fed borrowings, even as they rose to the most in the 97-year history of emergency lending by the U.S. central bank. Citigroup Inc., the New York-based lender whose balance sheet is more than twice the size of Morgan Stanley’s, was the second-largest Fed borrower, with a balance of \$99.5 billion in January 2009.

At the peak of Morgan Stanley’s Fed borrowings, on Sept. 29, 2008, the firm reported that liquidity was “strong,” without mentioning how dependent its cash stores had become on the government lifeline. Liquidity refers to the daily funds a bank needs to operate, including cash to cover withdrawals.

‘Black Box’

Neither Morgan Stanley nor its competitors in prime brokerage – Goldman Sachs Group Inc., JPMorgan Chase & Co., Citigroup and Credit Suisse Group AG – disclose the size of their hedge-fund balances, leaving shareholders dependent on regulators who previously failed to rein in the risks.

“It remains a black box,” said Adam Hurwich, a former member of the Financial Accounting Standards Board’s Investors Technical Advisory Committee who’s now a portfolio manager at New York-based investment firm Ulysses Management LLC. “They don’t give you the information to be able to decipher whether they have changed anything.”

Prime brokers facilitate short trades, the sale of borrowed stock in the hope of buying it back later at a lower price. They also make margin loans to finance stock purchases. In exchange, hedge funds usually keep their cash and stock in accounts at the prime-brokerage companies.

Frozen Assets

Few analysts understood how dependent the brokerages had become on such balances as a cheap source of funding, said Frank Suozzo, a former head of growth financial-services research at AllianceBernstein LP.

“Prime brokerage was presumed to be a pretty secure business, where the funding was not actually part of the liquidity of the bank,” said Suozzo, now president of advisory firm FXS Capital LLC in Goldens Bridge, New York. “So if clients pulled their money out, the view was that money had not been lent out, so the cash would have been sitting there able to hand over. It turns out that that was not entirely correct.”

In reality, “prime brokers were able to reuse clients’ assets to raise cash for their own activities,” the financial crisis commission wrote in its final report, published in January. Azarchs said that in her years covering Morgan Stanley for S&P she never heard executives discuss the risk that the funding might evaporate.

Lehman Brothers Holdings Inc.’s bankruptcy changed matters when it froze at least \$65 billion of

assets held by that firm’s London-based prime brokerage. For hedge funds, it was a lesson not to bank with companies perceived to be at risk of failure, according to the commission report. So hedge funds moved quickly to pull their money from Morgan Stanley, viewed as the next weakest securities firm after Lehman, according to the report.

Unregulated, Unrated

Mark Lake, a spokesman for Morgan Stanley, declined to disclose the bank’s current hedge-fund balances.

“The financial crisis of 2008 caused the industry to fundamentally re-evaluate the way it manages liquidity,” Lake said. “We have taken the lessons we learned from that period and applied them to our liquidity-management program to protect both our franchise and our clients going forward.”

Lake wouldn’t say what practices the firm has changed.

Hedge funds are mostly private, unregulated and unrated investment pools that often try to increase trading returns by supplementing their own capital with stock and cash borrowed from Wall Street’s prime-brokerage divisions.

Prime-Brokerage Revenue

The world’s 10 largest investment banks garnered about \$10 billion in revenue from prime brokerage in 2010, almost as much as they made trading stocks, according to London-based research firm Coalition Development Ltd. The top 25 hedge-fund managers earned \$22.1 billion in 2010, according to AR magazine.

Prior to the crisis, prime brokerage was one of Morgan Stanley’s most profitable businesses, generating at least \$2 billion of revenue a year, according to Brad Hintz, a former Morgan Stanley treasurer who now follows the firm as an analyst at Sanford C. Bernstein & Co. in New York. The bank doesn’t disclose how much revenue it gets from the business.

Any requirement that prime brokers keep more cash on hand to survive a hedge-fund run may cut into the profitability of the business. That’s because

cash and Treasury securities that can be liquidated easily in a squeeze are less profitable to hold than loans and bonds that pay higher interest rates. Also, prime brokers may have to issue more long-term debt, which would force them to pay higher interest rates, said Richard Lindsey, a former prime-brokerage chief at Bear Stearns Cos.

‘Infinitely Lived Borrowing’

“The safest way to fund something is to take out long-term debt or, even better, equity, which is essentially infinitely lived borrowing,” said Lindsey, now principal of Callcott Group LLC in New York, which advises pension funds and endowments on portfolio risks. “The problem of course is that those are the most expensive forms of financing.”

In July 2008, Morgan Stanley said in a regulatory filing that its policies were designed “to ensure adequate funding over a wide range of market environments.” The firm’s “contingency” plan anticipated a “potential, prolonged liquidity contraction over a one-year time period,” according to the filing. Resources included a \$5 billion credit line from a group of banks that could be used in an emergency.

At the end of August, Morgan Stanley had \$179 billion of liquidity, filings show. The firm had \$2 billion of Fed loans outstanding on Aug. 31, according to data compiled by Bloomberg.

As of Sept. 29, its liquidity had shrunk 44 percent to \$99.8 billion, according to internal reports released by the crisis commission. By then, the firm had \$107.3 billion of Fed loans outstanding, the Bloomberg data show.

‘Adverse Funding Flows’

The bank didn’t mention the Fed loans in a press release about its financial condition that day. Two weeks later, in another filing, the firm disclosed it was benefiting from “expanded sources of funding and liquidity resulting from the Fed’s current policies,” without specifying the amount.

Staffers at the Federal Reserve Bank of New York were astonished at how quickly Morgan Stanley’s cash dwindled, e-mails released by the crisis

commission show.

At 11:05 p.m. on Sept. 15, 2008, William Brodows, a bank supervision officer at the New York Fed, wrote to colleagues that Wong, 44, the Morgan Stanley treasurer at the time, and two other executives had called him at home that night. They wanted “to express their concern that MS had experienced some adverse funding flows late in the day from prime brokerage accounts,” Brodows, 61, wrote.

Free Credit

Executives had already begun estimating Morgan Stanley’s potential use of the Fed’s Primary Dealer Credit Facility, a program created that year to supply emergency funds to securities firms. Such companies lacked access to the central bank’s discount window, its last-resort lending program.

“In their ‘dark’ scenario, they felt their PDCF usage would increase to \$10-\$15 billion,” Brodows wrote in the e-mail.

At 6:59 a.m. the next morning, the concerns were echoed in an e-mail by Matthew Eichner, 46, then an assistant director at the Securities and Exchange Commission, to Brodows and other New York Fed employees.

“Definitely some major outflows of PB balances at both GS (\$5 b) and MS (\$7 b),” Eichner wrote, referring to prime-brokerage balances at Goldman Sachs and Morgan Stanley. “Not pretty.”

It got uglier. At 10:18 p.m. that night, a New York Fed “on-site primary dealer update” stated that Morgan Stanley’s prime brokerage had suffered “free credit withdrawals of \$20 billion over the last two days, contributing to a \$23 billion decline in the parent company liquidity pool to \$106 billion.” Free credit is an industry term for hedge-fund cash balances, according to Lindsey.

‘Catastrophic Scenario’

Two hours later, at 12:30 a.m. on Sept. 17, New York Fed Senior Vice President Til Schuermann forwarded the update to Brodows. Under Morgan Stanley’s “catastrophic scenario,” Schuermann wrote, “they expect to lose \$21.5 bn over the first 2 weeks – not 2 days – from PB!”

Jack Gutt, a spokesman for the New York Fed, declined to comment. Eichner now works for the Fed in Washington.

Morgan Stanley's shares fell 24 percent that day, and then- Chief Executive Officer John Mack sent a memo to the firm's 46,000 employees saying "there is no rational basis for the movements in our stock."

"We're in the midst of a market controlled by fear and rumors, and short-sellers are driving our stock down," Mack, 66, wrote, adding that "we have talked to" Henry Paulson, U.S. Treasury secretary at the time, and then-SEC Chairman Christopher Cox about the issue. He reiterated that the firm had \$179 billion of liquidity as of Aug. 31. He didn't mention that the figure had since dwindled to \$117.7 billion, even as the firm drew an additional \$38.5 billion from the Fed.

Chanos Withdrawal

Jim Chanos, president and founder of New York-based hedge fund Kynikos Associates LP, which specializes in short selling, decided to pull \$1 billion out of Morgan Stanley because he was angry that Mack had put out a memo demonizing short sellers, a person with knowledge of the matter said.

Chanos, 53, has since returned to Morgan Stanley as a prime-brokerage client, partly because the firm in September 2009 announced that Mack would give up his daily operational role as CEO, while remaining chairman, the person said.

On Sept. 19, 2008, Citigroup representatives told Fed staffers that "Goldman and Credit Suisse are actively pursuing Morgan's prime business clients," according to an internal report that afternoon. The flows from Morgan Stanley and Goldman Sachs were coming in so quickly that Citigroup barely had time to vet the new clients, the report said.

Counterparty Risk

Within a week of Lehman's bankruptcy, Morgan Stanley had lost \$84.8 billion of prime-brokerage free credits, according to a Morgan Stanley treasurer's report released by the crisis commission. The next week, \$43.3 billion more flowed out.

By Sept. 29, the bank was borrowing \$61.3 billion from the PDCF through units in the U.S. and London

and getting \$36 billion from the Term Securities Lending Facility. The TSLF allowed broker-dealers to swap mortgage bonds for liquid Treasuries that could then be sold or pledged for cash close to their face value. Morgan Stanley also received \$10 billion from the Fed's single-tranche open-market operations, another emergency-lending program for broker-dealers.

The firm, which routinely demands collateral from hedge funds to guard against default, faced a bigger risk when clients suddenly began worrying the bank might not survive.

"This was a world turned on its head," said Bernstein's Hintz. "Who would have guessed that hedge funds would have worried about the counterparty risk of Morgan Stanley? Morgan Stanley worried about the counterparty risks to hedge funds, not the other way around."

Mitsubishi Stake

The bank's draws from the Fed began to ebb after Sept. 29, 2008, when the firm announced an agreement for Tokyo-based Mitsubishi UFJ Financial Group Inc. to invest \$9 billion in Morgan Stanley for a 21 percent equity stake.

"This \$9 billion investment will further bolster Morgan Stanley's strong capital and liquidity positions," the firm said in a press release that day.

Colm Kelleher, 54, Morgan Stanley's chief financial officer at the time, disclosed on Dec. 18, 2008, that the firm's prime-brokerage balances had tumbled 46 percent to about \$150 billion as of Nov. 30 from \$280 billion on Aug. 31. On a conference call that day, Kelleher said the erosion was "clearly a function of the downsizing of the hedge-fund business."

'Safer Place'

While many hedge funds have since returned to Morgan Stanley, the firm doesn't provide detailed updates on its prime-brokerage balances.

"Prime-brokerage revenues were up significantly" over the previous quarter, while client balances "continued to grow modestly," Ruth Porat, 53, who replaced Kelleher as CFO, said on a call with investors on July 21, without disclosing amounts.

Morgan Stanley's liquidity stood at \$182 billion as of June 30 and represents 22 percent of total assets, up from 18 percent just before the crisis.

"Nobody could withstand a run on liquidity, except, of course, the government," Morgan Stanley CEO James Gorman, 53, said in a May 24 speech in New York. "Hopefully we're in a much safer place as a result of it."

In a brief interview afterward, Gorman declined to comment on what changes the firm had made in its prime brokerage.

"We give out as much as we feel is appropriate on that business," he said.

A new rule adopted in December by the Basel Committee on Banking Supervision, an international panel of regulators, requires global banks to keep enough cash or cash-like reserves on hand to survive a 25 percent run-off of balances in "clearing, custody or cash-management" accounts during a crisis lasting 30 days. The rule doesn't take effect until 2015.

'Almost Impossible'

While Morgan Stanley's liquidity has increased, "it's almost impossible" to judge whether it's enough, Hintz said.

"You don't know whether the liquidity pool is required by the ratings agencies, or whether it is required by the Federal Reserve," Hintz said. "I suspect there's something of both. But it's a recognition that the old contingency funding plans had a flaw, and that these events can happen very quickly."

Hedge funds have changed their business

practices to protect themselves from the collapse of a prime broker, limiting the amount of funding that securities firms can get from such relationships, said Allan Yip, a former in-house prime-brokerage lawyer for Bear Stearns.

Repledging Assets

Many funds now restrict the ability of securities firms to repledge assets to obtain funding, a process known as "rehypothecation," Yip said. More funds stipulate that their cash must be held in separate bank accounts.

"This has been a market-driven change, in terms of what liquidity can be obtained by the banks," said Yip, who now advises hedge funds on prime-brokerage and trading documentation as a partner in London at law firm Simmons & Simmons LLP.

Not that the funds have to worry. It's probable the central bank would again lend to a big firm such as Morgan Stanley if another crisis hit, said Viral Acharya, a New York University finance professor who serves as an academic adviser to the Fed, according to the university's website.

For hedge funds, "it's basically like you get the too-big-to-fail benefit from being connected to a large financial firm," Acharya said. "If you dealt with a small prime broker, say a boutique investment firm, it's unlikely to be bailed out."

—With assistance from Phil Kuntz in New York

—Editors: Robert Friedman, John Voskuhl

Fed Gave Banks Crisis Gains on Secretive Loans Low as 0.01%

By Bob Ivry • Bloomberg News

May 26, 2011— Credit Suisse Group AG, Goldman Sachs Group Inc. and Royal Bank of Scotland Group Plc each borrowed at least \$30 billion in 2008 from a Federal Reserve emergency lending program whose details weren't revealed to shareholders, members of Congress or the public.

The \$80 billion initiative, called single-tranche open-market operations, or ST OMO, made 28-day loans from March through December 2008, a period in which confidence in global credit markets collapsed after the Sept. 15 bankruptcy of Lehman Brothers Holdings Inc.

Units of 20 banks were required to bid at auctions for the cash. They paid interest rates as low as 0.01 percent that December, when the Fed's main lending facility charged 0.5 percent.

"This was a pure subsidy," said Robert A. Eisenbeis, former head of research at the Federal Reserve Bank of Atlanta and now chief monetary economist at Sarasota, Florida-based Cumberland Advisors Inc. "The Fed hasn't been forthcoming with disclosures overall. Why should this be any different?"

The Federal Reserve Bank of New York, which oversaw ST OMO, posted aggregate data about the program on its website after each auction, said Jeffrey V. Smith, a New York Fed spokesman. By increasing the availability of short-term financing when private lenders were under pressure, "this program helped alleviate strains in financial markets and support the flow of credit to U.S. households and businesses," he said.

Not in Dodd-Frank

Congress overlooked ST OMO when lawmakers required the central bank to publish its emergency lending data last year under the Dodd-Frank law.

"I wasn't aware of this program until now," said U.S. Representative Barney Frank, the Massachusetts



The U.S. Federal Reserve building stands in Washington, D.C. on March 31, 2011.

Photographer: Joshua Roberts/Bloomberg

Democrat who chaired the House Financial Services Committee in 2008 and co-authored the legislation overhauling financial regulation. The law does require the Fed to release details of any open-market operations undertaken after July 2010, after a two-year lag.

Records of the 2008 lending, released in March under court orders, show how the central bank adapted an existing tool for adjusting the U.S. money supply into an emergency source of cash. Zurich-based Credit Suisse borrowed as much as \$45 billion, according to bar graphs that appear on 27 of 29,000 pages the central bank provided to media organizations that sued the Fed Board of Governors for public disclosure.

New York-based Goldman Sachs's borrowing peaked at about \$30 billion, the records show, as did the program's loans to RBS, based in Edinburgh. Deutsche Bank AG, Barclays Plc and UBS AG each borrowed at least \$15 billion, according to the graphs, which reflect deals made by 12 of the 20 eligible banks during the last four months of 2008.

No Exact Amounts

The records don't provide exact loan amounts for each bank. Smith, the New York Fed spokesman, would not disclose those details. Amounts cited in this article are estimates based on the graphs.

One effect of the program was to spur trading in mortgage-backed securities, said Lou Crandall, chief U.S. economist at Jersey City, New Jersey-based Wrightson ICAP LLC, a research company specializing in Fed operations. The 20 banks – previously designated as primary dealers to trade government securities directly with the New York Fed – posted mortgage securities guaranteed by government-sponsored enterprises such as Fannie Mae or Freddie Mac in exchange for the Fed's cash.

ST OMO aimed to thaw a frozen short-term funding market and not necessarily to aid individual banks, Crandall said. Still, primary dealers earned spreads by using the program to help customers, such as hedge funds, finance their mortgage securities, he said.

'Spreads Vary'

"Spreads vary from one transaction to another," making any calculation of dealers' profits on the Fed loans impossible, Crandall said.

The Fed opposed disclosing details of its open market operations because doing so would probably cause borrowers "substantial competitive harm," according to a March 2009 declaration by Christopher R. Burke, vice president of the New York Fed's markets group. The declaration is filed in federal court.

Revealing the borrowing "could lead market participants to inaccurately speculate that the primary dealer was having difficulty finding term funding against its collateral in the open market and that the dealer itself must therefore be in financial trouble," Burke said in opposing a media request for records about the borrowing.

Bidding Interest Rates

The New York Fed conducted 44 ST OMO auctions, from March through December 2008,

according to its website. Banks bid the interest rate they were willing to pay for the loans, which had terms of 28 days. That was an expansion of longstanding open-market operations, which offered cash for up to two weeks.

Outstanding ST OMO loans from April 2008 to January 2009 stayed at \$80 billion. The average loan amount during that time was \$19.4 billion, more than three times the average for the 7 1/2 years prior, according to New York Fed data. By comparison, borrowing from the Fed's discount window, its main lending program for banks since 1914, peaked at \$113.7 billion in October 2008, Fed data show.

In March 2008, ST OMO was "desperately needed," because of the shaken state of short-term credit markets, said Michael Greenberger, a professor at the University of Maryland School of Law in Baltimore and former director of the division of markets and trading at the Commodities Futures Trading Commission. After the Fed created other lending mechanisms and the Treasury Department began distributing money from the Troubled Asset Relief Program in October, ST OMO became "just a way for banks to have at it," he said.

'Profit-Making Enterprise'

"At such low interest rates, it's no longer a rescue, it's a profit-making enterprise," Greenberger said. "By December, a lot of money was made off this program."

Goldman Sachs, led by Chief Executive Officer Lloyd C. Blankfein, tapped the program most in December 2008, when data on the New York Fed website show the loans were least expensive. The lowest winning bid at an ST OMO auction declined to 0.01 percent on Dec. 30, 2008, New York Fed data show. At the time, the rate charged at the discount window was 0.5 percent.

Stephen Cohen, a spokesman for Goldman Sachs, declined to comment.

December Peak

As its ST OMO loans peaked in December 2008, Goldman Sachs's borrowing from other Fed facilities topped out at \$43.5 billion, the 15th highest peak of all



The headquarters of the Goldman Sachs Group Inc., center, stands in this aerial photograph taken over New York.

Photographer: Andrew Harrer/Bloomberg

banks assisted by the Fed, according to data compiled by Bloomberg. That month, the bank's Fixed Income, Currencies and Commodities trading unit lost \$320 million, according to a May 6, 2009, regulatory filing.

Under ST OMO, cash changed hands through repos, or repurchase agreements, which the central bank has used to move money in and out of the banking system for at least 60 years. In a repo, the dealer sells securities to the Fed and agrees to buy them back for a higher price after a set period of time.

Open-market operations traditionally use repos to influence the federal funds rate, which is banks' cost of short-term borrowing, said Sherrill Shaffer, the officer in charge of the discount window at the Federal Reserve Bank of Philadelphia from 1994 to 1997. He's now a banking professor at the University of Wyoming in Laramie.

When the central bank increases the money supply – by paying cash for securities in repos – interest rates tend to fall. When it drains cash from the system by selling securities in reverse repos, rates can climb.

Pedal to Metal

Using repos to provide emergency cash, a step the Fed announced on March 7, 2008, was a departure from that process, said John H. Cochrane, a finance professor at the University of

Chicago Booth School of Business.

“The Fed was slamming the pedal to the metal in the lender-of-last-resort category,” Cochrane said. “What they did was so far from what we conventionally think of as monetary policy.”

Credit Suisse's borrowing peaked at about \$45 billion in September 2008, the Fed charts show. Steven Vames, a Credit Suisse spokesman in New York, declined to comment.

RBS's use of ST OMO hit about \$30 billion in October 2008. The U.K. government has had a stake in the bank since Oct. 13, 2008. “RBS no longer makes any use of these emergency Federal Reserve lending programs and all money borrowed from the Fed has been repaid in full with interest,” said Michael Geller, a spokesman for RBS Global Banking & Markets in Stamford, Connecticut.

Annual Report

Frankfurt-based Deutsche Bank's use peaked at about \$20 billion in October 2008, its chart shows. The bank had 87 billion euros (\$122 billion) in repurchase agreements with all central banks as of the end of 2008, according to its annual report. John Gallagher, a bank spokesman, declined to comment.

London-based Barclays's peak reached about \$20 billion in December 2008, the chart said. Mark Lane, a Barclays spokesman, declined to comment.

UBS, based in Zurich, borrowed as much as about \$15 billion in late 2008, the chart shows.

“UBS's usage of those facilities should be seen in the context of our overall desire to maintain flexibility and diversification in our funding sources, even during the crisis,” said Kelly Smith, a spokeswoman for UBS in New York. “Given UBS's substantial presence and commitment to U.S. dollar-denominated markets, utilization of such facilities was relatively modest.”

Other Banks

Other banks listed in the Fed charts borrowed less than their peers. New York-based Morgan Stanley and Paris-based BNP Paribas, France's biggest bank by assets, took no more than about \$10 billion. Citigroup Inc., JPMorgan Chase & Co. and Merrill

Lynch & Co., which is now part of Bank of America Corp., borrowed less than \$5 billion each.

Mary Claire Delaney, a spokeswoman for Morgan Stanley, Jon Diat, a Citigroup spokesman in New York, Howard Opinsky, a spokesman for New York-based JPMorgan Chase, and Megan Stinson, a spokeswoman in New York for BNP Paribas, declined to comment on their banks' borrowings.

"Look at it in hindsight and these programs did exactly what they were intended to do – stabilize the financial system, provide liquidity and instill confidence," said Jerry Dubrowski, a spokesman for Charlotte, North Carolina-based Bank of America.

The bar charts were included in the Fed's court-ordered March 31 disclosure under the Freedom of Information Act. The release was mandated after the U.S. Supreme Court rejected an industry group's attempt to block it. Bloomberg LP, the parent company of Bloomberg News, and News Corp.'s Fox News Network LLC had sued the central bank after it refused to release lending records under the FOIA.

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Bloomberg News Responds to Bernanke Criticism of Coverage

By Bloomberg News

December 7, 2011 – Federal Reserve Chairman Ben S. Bernanke said in a letter to four senior lawmakers yesterday that recent news articles about the central bank’s emergency lending programs contained “egregious errors.”

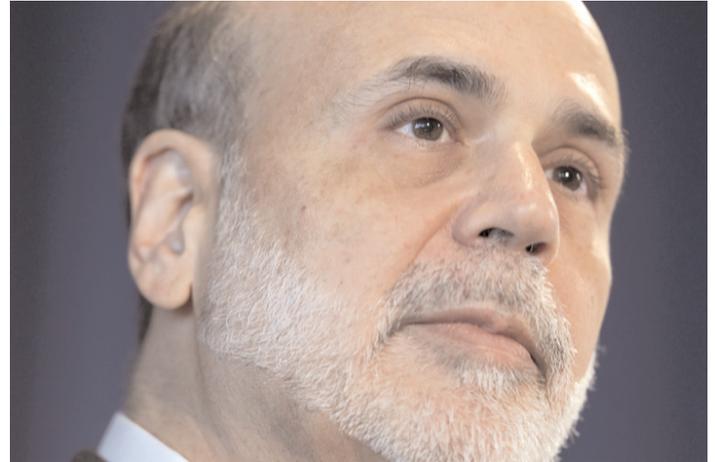
While Bernanke’s letter and an accompanying four-page staff memo posted on the Fed’s website didn’t mention any news organizations by name, Bloomberg News has published a series of articles this year examining the bailout. The latest, “Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress,” appeared Nov. 28.

“Bloomberg stands by its reporting,” said Matthew Winkler, editor-in-chief of Bloomberg News, who responded to the criticisms today on “Surveillance Middy” with Tom Keene.

Here is a point-by-point response by Bloomberg News to the Fed staff memo.

From Fed memo: “These articles have made repeated claims that the Federal Reserve conducted ‘secret’ lending that was not disclosed either to the public or the Congress. No lending program was ever kept secret from the Congress or the public. All of the programs were publicly announced when they were initiated, and information about all lending under the programs was publicly released – both on a weekly basis through the Federal Reserve’s public balance sheet release and through detailed monthly reports to Congress, both of which were also posted on the Federal Reserve’s website.”

Response: Bloomberg’s Nov. 28 story about Fed lending reported that the central bank published regular reports on the scope of borrowings from the discount window and other emergency or temporary programs. The loans were described as “secret” because the amounts, names of borrowers, dates and, often, interest rates weren’t disclosed. The stories reported that the



Ben S. Bernanke, chairman of the U.S. Federal Reserve.

Photographer: Andrew Harrer/Bloomberg

Fed’s rationale for keeping the loans secret was to prevent bank runs.

From Fed memo: “The Federal Reserve took great care to ensure that Congress was well-informed of the magnitude and manner of its lending.”

Response: Bloomberg’s story said Congress wasn’t fully apprised of the details of the Fed’s efforts. “We were aware emergency efforts were going on,” U.S. Representative Barney Frank, who served as chairman of the House Financial Services Committee, said in the Nov. 28 story. “We didn’t know the specifics.” Other members of Congress on both sides of the aisle also said they weren’t aware of the details.

From Fed memo: “Congress was well informed of the volume of borrowing by large banks. For instance, the monthly reports showed the daily average borrowing during the month in the aggregate for the five largest discount window borrowers, the next five, and the rest. Similar information was also provided for lending at the emergency facilities.”

Response: Because the Fed didn't provide the names of borrowers, it was impossible to add up how much each bank received across all the programs. Nor did the Fed release these figures in aggregate form for each institution when it released data under the Dodd-Frank Act or Bloomberg's Freedom of Information Act requests.

In fact, the Fed released separate databases on each of the programs, and several of the databases identified borrowers by the name of the subsidiary that got the loan. None of the releases showed how much money each borrower was in debt to the Fed on specific dates.

Bloomberg built a database to combine subsidiaries with their parent companies and to add the total loans outstanding by each institution across all programs. Bloomberg undertook this project in the belief that a full accounting of the Fed's lending efforts was possible only by tallying what each company borrowed across all programs.

From Fed memo: "One article asserted that the Federal Reserve lent or guaranteed more than \$7.7 trillion during the financial crisis. Others have estimated the amounts to be \$16 trillion or even \$24 trillion. All of these numbers are wildly inaccurate.

"The inaccurate and misleading estimates could be based on several errors, including double-counting."

Response: Bloomberg News reported that Fed lending peaked at \$1.2 trillion, a figure that didn't include any double-counting. Instead of adding all the outstanding Fed loans to get a large number, Bloomberg used peak loan amounts that were outstanding on a single day. On the day after the Nov. 28 story, the Fed published that \$1.2 trillion figure, affirming Bloomberg's calculation.

The \$16 trillion number cited by the Fed may refer to a Government Accountability Office report of July 21, 2011, that used a different methodology. Bloomberg built its database to show amounts outstanding, while the GAO tallied cumulative loans. For example, if a bank borrowed \$1 billion overnight for 100 nights, Bloomberg would say the bank had a \$1 billion balance at the Fed for 100 days; the GAO would say the bank borrowed \$100

billion. The former is a more useful economic measurement. While the GAO also assessed the scope of the lending on what it called a term-adjusted basis, yielding a total of \$1.14 trillion, some websites and commentators cited the higher figure.

The programs included in Bloomberg's examination of Fed lending were: the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Commercial Paper Funding Facility, discount window, Primary Dealer Credit Facility, Term Auction Facility, Term Securities Lending Facility and single-tranche open market operations.

From Fed memo: "Other inaccuracies may occur if total potential lending is counted as actual lending."

Response: In a March 31, 2009, story, Bloomberg News tallied the potential commitments of the Fed using as sources statements the central bank made and its weekly balance sheet. The amount, \$7.77 trillion, was never characterized by Bloomberg as money lent by the Fed, though other commentators have mistakenly used it in that context. Rather, Bloomberg has said that that amount represents what the Fed "lent, spent or committed" or the total of all "guarantees and lending limits." Bloomberg has been careful to characterize this number as total commitments, not loans that went out the door.

From Fed memo: "The articles make no mention that the emergency loans and other assistance have generated considerable income for the American taxpayers. As reported in the Annual Report of the Board of Governors, alongside the Board's audited financial statements, the emergency lending programs have generated an estimated \$20 billion in interest income for the Treasury. Moreover, in 2009 and 2010, the Federal Reserve returned to the taxpayers over \$125 billion in excess earnings on its operations, including emergency lending. These amounts have been publicly announced and are reflected in the Office of Management and Budget's financial statements for the government and have been verified by the Federal Reserve's independent outside auditors."

Response: In an Aug. 22 story, “Wall Street Aristocracy Got \$1.2 Trillion in Fed’s Secret Loans,” Bloomberg wrote: “The Fed has said it had ‘no credit losses’ on any of the emergency programs, and a report by the Federal Reserve Bank of New York staffers in February said the central bank netted \$13 billion in interest and fee income from the programs from August 2007 through December 2009.”

The Nov. 28 story quoted Fed officials saying almost all of the loans were repaid and that there had been no credit losses.

From Fed memo: “The articles discuss lending made to large banks but never note that Federal Reserve lending programs went far beyond such institutions – all in furtherance of supporting the provision of credit to U.S. households and businesses. Literally hundreds of institutions borrowed from the Federal Reserve – not just large banks. The TAF had some 400 borrowers and the discount window some 2,100 borrowers. The TALF made more than 2,000 loans, while the commercial paper funding facility provided direct assistance to some 120 American businesses.”

Response: Bloomberg reported in Aug. 22 and Nov. 28 stories that the Fed programs extended beyond large banks. The Aug. 22 story mentioned borrowings by Plano, Texas-based Beal Financial Corp. and Jacksonville, Florida-based EverBank Financial Corp.

Bloomberg reported in the Nov. 28 story that the six largest U.S. banks accounted for 63 percent of the average borrowings by all U.S. financial institutions from the Fed, even though these firms only represented half of industry assets. Bloomberg also created an interactive website that allows users to chart Fed borrowings by more than 400 firms. The smallest detailed there is Wood & Huston Bancorporation Inc., which had \$5 million outstanding on Feb. 12, 2009. The graphic can be found here.

From Fed memo: “The articles also fail to note that the lending directly helped support American businesses by providing emergency funding so that they could meet weekly payrolls and on-going

expenses. The Commercial Paper Funding Facility, for example, provided support to businesses as diverse as Harley-Davidson and National Rural Utilities, when the usual market mechanism for their day-to-day funding completely dried up.”

Response: Bloomberg’s interactive graphic details Commercial Paper Funding Facility borrowings by non-bank borrowers, including Harley-Davidson Inc. and National Rural Utilities Cooperative Finance Corp. A Dec. 2, 2010, story, “Fed May Be ‘Central Bank of the World’ After UBS, Barclays Aid,” mentioned Harley-Davidson and General Electric Co., the largest non-bank borrower from the commercial-paper program.

From Fed memo: “The articles fail to mention altogether that one facility, the TALF, supported nearly 3 million auto loans, more than 1 million student loans, nearly 900,000 loans to small businesses, 150,000 other business loans and millions of credit card loans.”

Response: Bloomberg didn’t include TALF in its examination of the Fed’s rescue of the banking system because that program didn’t cater primarily to banks.

From Fed memo: “The articles misleadingly depict financial institutions receiving liquidity assistance as insolvent and in ‘deep trouble.’”

Response: Bloomberg never described any of the financial institutions mentioned in its bailout stories as insolvent.

The New York Fed’s report on Jan. 14, 2009, called Citigroup Inc.’s financial strength “marginal” and dependent on \$45 billion in TARP funding. Citigroup’s Fed borrowing peaked six days later at \$99 billion. Other numbers tell a similar story. Morgan Stanley’s borrowing totaled \$107 billion on a single day. Royal Bank of Scotland got \$84.5 billion from the Fed at about the same time it was taken over by the U.K. government.

The largest banks later had to raise billions of dollars of capital to assuage investor concerns that they might not be solvent, and they took capital injections from the Treasury Department. Former

Treasury Secretary Henry Paulson wrote in his book, “On the Brink,” that “our banking system was massively undercapitalized.”

Under the terms of the Fed’s lending programs, the determination of whether a bank is “solvent” is based on the opinions of bank supervisors. These examinations are confidential.

From Fed memo: “Finally, one article incorrectly asserted that banks ‘reaped an estimated \$13 billion of income by taking advantage of the Fed’s below-market rates.’ Most of the Federal Reserve’s lending facilities were priced at a penalty over normal market rates so that borrowers had economic incentive to exit the facilities as market conditions normalized, and the rates that the Federal Reserve charged on its lending facilities did not provide a subsidy to borrowers.”

Response: As noted in the Nov. 28 Bloomberg article, the \$13 billion figure was based on a metric banks regularly report called the net interest margin – the difference between what they earn on loans and investments and their borrowing expenses. Those expenses include interest paid to the Fed for their loans.

To calculate how much banks stood to make,

Bloomberg multiplied their tax-adjusted net interest margins by their average Fed debt during reporting periods in which they took emergency loans. The 190 firms for which data were available would have produced income of \$13 billion, assuming all of the bailout funds were invested at the margins reported, according to data compiled by Bloomberg. The calculation by Bloomberg excluded loans from the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility because that cash was passed along to money-market funds.

The Fed says it charges a “penalty rate” that would be above rates typically seen in a normal market. That rate became cheaper when borrowing costs surged during the financial crisis.

Bloomberg’s Nov. 28 story contained the following paragraph: “The Fed says it typically makes emergency loans more expensive than those available in the marketplace to discourage banks from abusing the privilege. During the crisis, Fed loans were among the cheapest around, with funding available for as low as 0.01 percent in December 2008, according to data from the central bank and money-market rates tracked by Bloomberg.”

–*Editors: Robert Friedman, John Voskuhl*