FDICIA's Emergency Liquidity Provisions

by Walker F. Todd

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Is there any reason why the American people should be taxed to guarantee the debts of banks, any more than they should be taxed to guarantee the debts of other institutions, including the merchants, the industries, and the mills of the country?

Senator Carter Glass (1933)[1]

Introduction

The Federal Reserve Banks' discount window advances to failing depository institutions have become an increasingly controversial issue within the last 20 years or so. This debate culminated in congressionally mandated limitations on Reserve Banks' advances to undercapitalized banks in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), previously the subject of a Federal Reserve Bank of Cleveland *Economic Commentary*.[2]

In a comparatively little-noticed amendment of the Reserve Banks' lending authority, FDICIA made potentially significant revisions to the emergency liquidity provisions of the Federal Reserve Act. In particular, the Act now permits all nonbank firms — financial or otherwise (called "nonbanks" here for simplicity) — to borrow at the discount window for emergency purposes under the same collateral terms afforded to banks. Ironically, while the principal thrust of FDICIA was to limit or reduce the size and scope of the federal financial safety net, at least as applied to insured depository institutions, this provision effectively *expanded* the safety net. This article describes the historical and theoretical backgrounds of the Reserve Banks' emergency lending authority for nonbanks and analyzes the changes made by FDICIA that affect that authority.

1 See Smith and Beasley (1972), p. 357. Senator Glass offered these remarks during the Senate debate on the Banking Act of June 20, 1933 (Glass–Steagall Act), which established, among other things, the first plan of federal deposit insurance.

2 See Todd (1992a). FDICIA is Public Law No. 102-242 (December 19, 1991). The provisions of FDICIA principally affecting Reserve Banks' discount window operations are Sections 131–133 (prompt corrective action) and Sections 141–142 (least-cost resolutions, systemic-risk exceptions, and lending limitations). On prompt corrective action, see Pike and Thomson (1992); on systemic risk, see Wall (1993); on lending limitations, see Todd (1992a, 1993a).

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I. Background of Emergency Lending Provisions for Nonbanks

Since the creation of the first central banks in Western Europe in the seventeenth century, parliaments have often asked them to rescue enterprises sponsored by the state or sovereign, favored private-sector enterprises, and even, occasionally, the state itself.[3] In the United States, Congress understood quite early that it should avoid the expediency of direct funding of the Treasury by borrowings from the central bank.[4] This maxim of fiscal propriety ("central banks should not undertake fiscal activities") also makes theoretical sense and has been explained as follows regarding the central banks of developing countries:

> Fiscal activities [such as implementing selective credit policies or recapitalizing insolvent financial institutions] involve expenditures that reduce central bank profits and may even produce losses. If central bank losses are not met from government budget appropriations, they must eventually lead to an expansion in central bank money and the abandonment of any monetary policy goal of price stability.[5]

Fiscal and monetary authorities in the United States generally followed this view of the division of their responsibilities during peacetime from 1791 until sometime during 1931–33.[6]

The extension of governmental credit directly to nonbank enterprises historically has been a fiscal operation in the United States, not a monetary policy operation of the type ordinarily undertaken by a central bank.[7] For example, the original Federal Reserve Act of 1913 provided for the extension of Reserve Banks' credit directly to member banks, but did not allow for such credit to or for the account of the Treasury, nonmember banks, or nonbanks. Borrowing by member banks was governed by the applicable sections of the Federal Reserve Act (originally, Section 13), and borrowing by other entities simply was not permitted. The Federal Reserve Act was enacted in an era in which peacetime federal budgets regularly were in surplus, and it apparently was intended that the Reserve Banks' money-creating powers should not be substituted for explicit congressional decisions on the Treasury's funding.

During the presidential election year of 1932, economic pressures generated by the Great Depression caused President Herbert Hoover to propose changing the previously indirect credit relationship between Reserve Banks and nonbanks (the Reserve Banks could lend to banks, but only banks could lend to nonbanks) to a more direct one. Although he had vetoed a prior version of the Emergency Relief and Construction Act that summer because it would have authorized the former Reconstruction Finance Corporation (RFC) to make loans directly to individuals,[8] Hoover allowed Section 13 (3) to be added to the Federal Reserve Act as part of a road construction measure designed to relieve unemployment. Subject to certain restrictions, Section 13 (3) authorized Reserve Banks, "in unusual and exigent circumstances," to extend credit directly to "individuals, partnerships, and corporations."[9]

Section 13 (3) proved to be so restricted that it did not open the floodgates of Reserve Banks'

■ 3 See, for example, Fry (1993), Bordo (1992), Todd (1988), and Humphrey and Keleher (1984).

■ 4 Our Founding Fathers were well aware of the problems created by Treasury borrowings from central banks. Alexander Hamilton, the first Secretary of the Treasury, recommended, and Congress later passed, a bill providing that the First Bank of the United States, our first central bank, should be prohibited from lending more than $50,000 to the Treasury or to any state or foreign prince without the prior, explicit consent of Congress. When the Second Bank of the United States was chartered in 1816, this limit was raised to $500,000. See Hamilton (1967), pp. 31–32, 34.

■ 5 See Fry (1993).

■ 6 See Todd (1993b). Beginning in early October 1931, President Hoover proposed that the Reserve Banks expand their lending authority to include the rescue of insolvent banks during peacetime, but the principal proposals for use of the Reserve Banks' lending authority for fiscal purposes were not enacted until the early months of the New Deal, after March 4, 1933. The most noteworthy of those proposals was the Thomas Amendment to the Agricultural Adjustment Act of May 12, 1933, revised on May 27, 1933, and on many subsequent occasions, added as Sections 14 (b)(3) and 14 (h) of the Federal Reserve Act (expired in 1981). See Moley (1966), pp. 300–03; and Hoover (1952), pp. 395–99.

■ 7 See Todd (1992b) and Martin (1957), pp. 768–69.

■ 8 On the RFC, see generally Todd (1992b), Keeton (1992), and Olson (1988). Strange as it may seem to modern readers, banks' lending to individuals (as opposed to farmers or business associations) before 1933 was commonly regarded as either a kind of speculation more appropriate for investment bankers than for commercial bankers or a charitable act more appropriate for mutual savings banks or benevolent societies than for commercial banks. For a colorful account of this phenomenon, see Grant (1992), pp. 76–95, 267–68.

■ 9 The text of the Emergency Relief and Construction Act of July 21, 1932, Public Law No. 72–302, is found in *Federal Reserve Bulletin*, vol. 18 (August 1932), pp. 520–27. Section 210 of that Act [Section 13 (3)] is at p. 523. The Board's circular authorizing emergency discounts under Section 13 (3) for six months beginning August 1, 1932, is at ibid., pp. 518–20.

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liquidity to the general public in 1932. At least five members of the Board of Governors (the "Board," which then included six regularly appointed and two ex officio members) had to vote affirmatively to find that "unusual and exigent circumstances" warranting implementation of Section 13 (3) existed. The collateral offered by borrowers had to consist of "real bills" and certain Treasury obligations "of the kinds and maturities made eligible for discount for member banks under other provisions of [the Federal Reserve] Act."[10] In essence, the only acceptable collateral would have been near substitutes for cash. The final statutory restriction required the Reserve Banks to find evidence that the borrower was unable to "secure adequate credit accommodations from other banking institutions."[11]

These restrictions made it unlikely that many nonbanks could qualify for emergency advances from Reserve Banks. In fact, due to these restrictions and the availability of credit elsewhere,[12] the Reserve Banks "made loans to only 123 business enterprises [from 1932 until 1936] aggregating only about $1.5 million [under Section 13 (3)]. The largest single loan was for $300,000."[13]

In 1935, the Board requested, and Congress approved, an amendment of Section 13 (3) intended to make nonbanks' borrowing somewhat easier. Despite that statutory change, no such loans actually have been made since the amendment became effective in 1936.[14] Prior to the 1935 amendment, a borrower had to satisfy two relevant conditions: a satisfactory endorsement (by either the borrower or a third-party surety) on the borrower's own note pledged to the Reserve Bank, *and* security (eligible collateral) for the borrower's discounted note or notes. After the 1935 amendment, *either* an endorsement *or* additional security for such notes was required. This change made it easier for a borrower to discount his own note.

After 1935, however, borrowers had a clear choice between the distinct concepts of eligible collateral (what security could be pledged to secure the Reserve Bank's advance) and eligible purpose (the use to which the Reserve Bank's advance would be put). That is, nonbanks could borrow for any purpose as long as they pledged eligible *collateral*. Failing that, they could borrow on their own notes against any satisfactory collateral, including ineligible collateral, as long as they had eligible *purposes* for their borrowings.

Securities firms, mutual funds, and insurance companies, the greater part of whose asset portfolios included ineligible collateral, could not be said to have eligible purposes for borrowing to fund those particular assets. The payment of an ordinary business firm's general operating expenses could qualify as an eligible purpose for borrowing from a Reserve Bank, but eligible expenses normally included such things as the payment of utility bills, regular taxes, payroll, and the purchase of raw materials. Activities deemed speculative, such as the purchase of a portfolio of common stocks or investment securities generally (other than government securities), or the financing of permanent fixed investments with instruments maturing in more than 90 days, were ineligible purposes.[15] As the principal historian of the subject explained this point,

■ 10 Real bills, for the purposes discussed here, are "notes, drafts, and bills of exchange arising out of actual commercial transactions," with remaining maturities of not more than 90 days [therefore, self-liquidating], "issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes," as distinguished from "speculative," investment, or working-capital purposes. See Section 13 (2) of the Federal Reserve Act (12 U.S.C. Section 343) and Hackley (1973), pp. 37 and 129.

■ 11 See Hackley (1973), pp. 127–28. Under another provision of the Federal Reserve Act, Section 13 (13)(12 U.S.C. Section 347c), added in 1933, nonbanks may borrow directly from Reserve Banks without a finding of financial emergency ("unusual and exigent circumstances") by the Board, but only on the security of the U.S. government or (since 1968) U.S. government agency obligations.

■ 12 In particular, after 1934, the Federal Reserve was authorized to mount a rival program to extend credit directly to individuals, partnerships, and corporations "for working capital purposes" under former Section 13b of the Federal Reserve Act (expired in 1958). However, the operations of the RFC expanded greatly after 1933 and displaced the direct credit extension role earlier foreseen for the Reserve Banks under Sections 13 (3), 13b, and 13 (13). Regarding former Section 13b, see discussions in Schwartz (1992), pp. 61–62, and Hackley (1973), pp. 133–45.

■ 13 Hackley (1973), p. 130.

■ 14 The Board has reactivated Section 13 (3) rarely since the 1930s, but this emergency lending authority has not actually been used since 1936. It was activated for savings and loan associations, mutual savings banks, and nonmember commercial banks in 1966 and 1969 (Hackley [1973], p. 130). Its use also was contemplated for assistance to New York City (said to be a "municipal corporation") in 1975. The potential use of Section 13 (3) for depository institutions became unnecessary when the Monetary Control Act of 1980 added Section 19 (b)(7) to the Federal Reserve Act (12 U.S.C. Section 461) to authorize routine advances of Reserve Banks' credit to "any depository institution in which transaction accounts or nonpersonal time deposits are held." Such routine advances are secured by any satisfactory assets (not limited to eligible collateral) and are available at nonpenalty rates, even for nonmember depository institutions. Thus, there has been no need for emergency discounts for those institutions that could be secured only by collateral that was a near substitute for cash.

■ 15 See generally Hackley (1973), pp. 34–38. At p. 129, he discusses the use of a borrower's own note under Section 13 (3).

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> [T]he reason why the Reserve Banks were prohibited from extending credit on stocks and bonds [under Section 13] was that the [Reserve] Banks were intended to assist commercial banking and not investment banking. Paper eligible for discount was confined to self-liquidating paper arising out of commercial rather than investment transactions.[16]

While securities firms and other nonbank financial firms could borrow for the eligible purpose of funding the types of current operating expenses described above, their liabilities for such expenses normally would constitute only a small fraction of their balance sheets. In contrast, their loans to carry customers' accounts invested in securities (other than government securities) are ineligible purposes but potentially require much greater funding than the proportion of their assets related to eligible purposes. It apparently was the intent of Congress to remove these ineligible collateral/ineligible purpose restrictions on nonbanks' borrowings from Reserve Banks that underlay the 1991 amendment of Section 13 (3).

II. Amendments of Section 13 (3) in FDICIA

Section 13 (3) has been discussed very little since the 1930s, so it might seem unusual to find Section 473, amending Section 13 (3), inserted in the final stages of the congressional deliberations on FDICIA in November 1991. Increasingly, however, since the stock market crash of October 1987, some policymakers had been discussing the potential use of the Reserve Banks' discount windows to relieve nonbank financial firms' liquidity crises directly. Procedurally, there were enough obstacles to such use of the discount window to discourage financial firms from relying on Section 13 (3) to rescue them in a liquidity crisis: The procedural starting point always was an emergency declaration approved by at least five members of the Board. Also, the practical obstacles appeared insurmountable: For borrowings secured by eligible collateral, nonbank financial firms typically held comparatively few unpledged assets that would qualify, and borrowings said to be for eligible purposes typically would be quite limited.

Another issue that was not, but probably should have been, raised explicitly during congressional deliberations on FDICIA was that any consideration of altering the Reserve Banks' collateral or purpose of borrowing standards to accommodate nonbanks' asset portfolios under Section 13 (3) clearly would shift a portion of the risk of loss previously borne by the nonbanks' creditors onto the Reserve Banks and, thus, indirectly onto the taxpayer.[17] One of the potentially troublesome aspects of the FDICIA amendment of Section 13 (3) is that it appears to reflect a motive or spirit that contradicts that of the FDICIA provisions intended both to limit Reserve Banks' loans to undercapitalized depository institutions and to make it more difficult for the Federal Reserve to treat an institution as too big to fail. If the amendment was intended to provide a vehicle for possible Federal Reserve treatment of a failing securities firm as too big to fail, then it arguably constitutes a contradictory extension of the same federal safety net that was retrenched in other parts of FDICIA and apparently enlarges the moral hazard problem of deposit insurance.

Of the issues just identified regarding the amendment of Section 13 (3), only restrictions based on the types of collateral that nonbank borrowers could offer were discussed explicitly during the congressional deliberations on FDICIA in 1991. It appears that, having satisfied itself that the risks from expanding the collateral limits were minimal and that it might prove helpful to provide the Reserve Banks with this additional, liquidity-maximizing policy tool for a financial emergency, Congress adopted the revisions of Section 13 (3) as Section 473 of FDICIA without extensive discussion or debate, leaving a rather sketchy legislative history for this statute. However, by altering the collateral standards explicitly, FDICIA implicitly rendered Section 13 (3)'s purpose of borrowing restrictions largely superfluous because the prior standards for eligible purposes were binding only on nonbanks that could not pledge eligible collateral.

■ 16 Hackley (1973), p. 38. Depository institutions may, however, obtain extensions of Reserve Bank credit under Section 10B (12 U.S.C. Section 347b) even on ineligible stock or bond collateral ("any satisfactory assets"), but the amounts available might be limited under Section 11 (m)(12 U.S.C. Section 248 [m]), added in 1916.

■ 17 The Reserve Banks' operations create an indirect gain or loss for the taxpayer because the operating profits are rebated to the Treasury as a miscellaneous receipt offsetting part of the federal government's operating expenses. In fiscal year 1992, those receipts were $27.1 billion, of which the Reserve Banks contributed $22.9 billion (Council of Economic Advisers [1993], p. 437). Losses incurred on Reserve Banks' operations would reduce those receipts. While material losses for Reserve Banks have been rare since World War II, they are not inconceivable for central banks that attempt to subsidize fiscal operations on their balance sheets. See Fry (1993).

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The actual statutory language change made by Section 473 of FDICIA was comparatively minor. The restrictive phrase in quotation marks below was deleted from the part of Section 13 (3) that described the collateral acceptable for emergency discounts for nonbanks. Prior to the change, a Federal Reserve Bank could discount for any individual, partnership, or corporation any notes, drafts, and bills of exchange when these instruments were endorsed or otherwise secured to the satisfaction of the Reserve Bank and, when endorsed, were "of the kinds and maturities made eligible for discount for member banks under other provisions of this Act ...." It generally was understood that this reference was primarily to the types of financial instruments meeting the eligible purpose standards as illustrated in Section 13 (2), but also included instruments described in other parts of Sections 13 and 14 of the Federal Reserve Act.

Since FDICIA, Reserve Banks' emergency advances to nonbanks may be based on the types of collateral acceptable for depository institutions under an entirely different provision of the Federal Reserve Act, Section 10B, which permits "advances ... secured to the satisfaction of ... [the] Federal Reserve Bank," or "any satisfactory assets."[18] Because nonbanks' emergency borrowings need not be secured by eligible collateral, eligibility of purpose of borrowing has become moot. The only collateral test remaining under revised Section 13 (3) is "satisfactory security," the same test that applies to borrowings by depository institutions under Section 10B.

III. Analysis of Potential Ramifications

The changes made by FDICIA expanded emergency discount window access for nonbanks of all types, not merely securities firms, because any satisfactory assets (not just marketable securities, for example) may be pledged to secure the borrower's own note. Whether these changes will have practical consequences is an open question. After all, Section 13 (3) is an *emergency* lending provision that has been and presumably will continue to be invoked very rarely and that requires the affirmative vote of five Federal Reserve Board governors. It is important to keep in mind that nonbanks' behavior depends in part on how they expect the Federal Reserve to manage its emergency lending powers.

The few, scattered public statements regarding congressional intent with respect to Section 473 of FDICIA do indicate that the intended beneficiaries were securities firms, and no other type of nonbank was mentioned explicitly.[19] Although a brief reference was made during the FDICIA deliberations to the absence of any discounts under Section 13 (3) since 1936, the potentially increased taxpayer risk from alteration of the collateral and purpose standards was not discussed.[20]

How could a new element of taxpayer risk arise? One possible source is derived from the *moral hazard* aspects of the increased availability of Reserve Banks' loans to nonbanks during financial emergencies. Nonbanks lacking eligible collateral or eligible purposes for borrowing must manage their affairs and conduct their relations with creditors and clients so as to be able to survive financial market emergencies. Now, with increased potential for assistance during emergencies, nonbanks' managers might have less incentive to avoid recourse to the Federal Reserve. Although nonbanks still have strong incentives to run their firms prudently, their managers now have potential access to another funding source during financial crises. Whether this potential access alters nonbanks' business decisions — so as to make their calling upon that funding source more likely — remains to be seen.

More troubling, however, are the macro implications of these incentive changes. The extension of the federal financial safety net to nonbanks may increase the probability of market liquidity crises that appear to require Federal Reserve emergency lending. This could happen during periods of market stress if the costs of risky investment and funding strategies are not fully borne by the managers and shareholders of nonbank firms, but instead are perceived as being partially or fully underwritten

■ **18** See Hackley (1973), pp. 109–12, and Eccles (1951), pp. 171–73.

■ **19** During the floor debate in the Senate on the version of FDICIA that was enacted, Senator Christopher Dodd of Connecticut spoke as follows in support of the bill:

> It [FDICIA] also includes a provision I offered to give the Federal Reserve greater flexibility to respond in instances in which the overall financial system threatens to collapse. My provision allows the Fed more power to provide liquidity, by enabling it to make fully secured loans to securities firms in instances similar to the 1987 stock market crash.

See *Congressional Record* (1991), p. S18619. For similar legal interpretations of Section 473 of FDICIA, see FDICIA (1992), pp. 37 and 92. See also Holland (1991).

■ **20** See U.S. Senate Report No. 102-167 (October 1, 1991), pp. 202–03.

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by U.S. taxpayers.[21] Self-correcting market forces that help to insulate financial markets from macroeconomic shocks could be eroded by what nonbanks regard as implicit taxpayer guarantees of nonbank losses and, thereby, increase the probability that a real-sector shock would become translated into a financial crisis.

A certain amount of *adverse selection* also might compound the Federal Reserve's difficulties: It becomes increasingly likely that better-capitalized firms would remain outside the Reserve Banks' lending net (in order to avoid the perceived stigma of borrowing). It also is likely that only the worst-capitalized firms could not raise adequate funds during financial market emergencies.

The other main source of taxpayer risk from the revision of Section 13 (3) is derived from the accounting principles that would be used in evaluating the collateral offered for emergency loans. Nonbanks' previously ineligible assets, including corporate equity securities and mortgages on real estate in the case of securities firms and institutional investors, tend to be illiquid under the market emergency conditions that would conceivably give rise to the Board's authorization of Section 13 (3) loans. In an emergency, whatever market value satisfactory (but formerly ineligible) assets that nonbanks already had could undergo severe downward market pressures, triggering wide gaps between par and market collateral valuations. Although all discount window advances are expected to be extended against collateral that is thought to be both sound and ample, there is reason to be concerned about accurate valuation of nonbanks' assets in periods of intense financial distress.

The expansion of the collateral limits for Reserve Banks' extensions of credit under Section 13 (3) might appear to be somewhat at odds with the principal thrust of the other discount window provisions of FDICIA, Sections 141 and 142, which, together with the prompt corrective action provisions, Sections 131–33, were intended to reduce taxpayers' potential risk of loss due to loans to insured banks. The lending criteria applicable to undercapitalized depository institutions were tightened, and more exacting and publicly accountable procedures for such lending decisions were established. In Section 141 of FDICIA, provision for a "systemic risk" exception to normal supervisory intervention and closing requirements was limited to circumstances in which both two-thirds of the Board and two-thirds of the FDIC's Board of Directors approved the exception, with the further concurrence of the Secretary of the Treasury, after consultation with the President.[22] The clear objective of that provision was limiting the taxpayer's potential exposure to loss through increased procedural hurdles that had to be overcome to invoke the exception.

IV. Conclusion

The removal of the collateral barriers for Reserve Banks' extensions of credit under Section 13 (3) seems to conflict with the spirit of the other discount window provisions of FDICIA, Sections 141 and 142. These provisions, along with the Act's prompt corrective action provisions, Sections 131–133, were intended to lessen taxpayers' potential exposure to loss resulting from loans to insured banks.

In contrast, Section 473, by removing the eligible collateral threshold, may have marginally increased taxpayers' potential risk of loss. This risk could arise from the moral hazard associated with the perceived availability of the equivalent of a federal guarantee for nonbanks. Consequently, increased access to the discount window by nonbanks carries with it some of the same kinds of risks that arose during the savings and loan debacle: Adverse selection and misaligned agency incentives could increase, together with the probability of use of the emergency lending facility and the implicit underwriting of nonbank losses by taxpayers.

The increased degree of discount window access for nonbanks was not accompanied by some of the safeguards normally applicable to discount window access, such as annual examinations by the federal bank supervisory authorities, maintenance of required reserves and clearing balances at Reserve Banks, and requirements to meet minimum regulatory capital adequacy standards. Moreover, by extending a component of the federal safety net, the Reserve Banks' discount windows, to nonbanks without limitations on too-big-to-fail rescues, Section 473 of FDICIA contradicts the spirit of the limitations on the too-big-to-fail doctrine enacted for depository institutions in FDICIA.

21 Comparable perverse incentives for insured depository institutions' behavior are described in the deposit insurance literature. See Barth and Brumbaugh (1992), pp. 7–12; National Commission (1993), pp. 62–68; and Kane (1989), pp. 95–114.

22 See Todd (1992a). Systemic risk, as described in Section 141 of FDICIA, is a condition in which the closing of an insured institution, without redemption of uninsured claims at par, "would have serious adverse effects on economic conditions or financial stability." The connection between systemic risk for banks and for securities firms is made strikingly and explicitly in Wall (1993), p. 10.

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Finally, it is unclear that there was a real (as opposed to a perceived) need for revision of Section 13 (3). Section 473 of FDICIA apparently was intended to deal primarily with situations like the aftermath of the stock market crash of October 19, 1987, in which securities firms, mutual funds, and other nonbank holders of large investment portfolios consisting of ineligible collateral would have found it helpful to obtain credit from Reserve Banks instead of from banks, insurance companies, investment banks, and other usual providers of funds to nonbank financial firms.

Normally, financial markets treat eligible collateral as high-quality instruments that are close substitutes for cash. Firms holding large, unpledged amounts of such collateral ordinarily could be expected to be able to obtain sufficient extensions of credit without having recourse to direct loans from Reserve Banks, even during market conditions approximating financial emergencies, as long as financial markets had adequate supplies of liquidity that the Federal Reserve could ensure through open-market operations. In fact, aggressive use of open-market operations in October 1987 provided sufficient aggregate liquidity to prevent the stock market crash from generating substantive harm to the economy.

The changes effected by Section 473 of FDICIA should prove quite harmless if the statute is implemented in a straightforward, risk-averse manner. However, perverse incentives, continued observance of a too-big-to-fail doctrine (in this case, for nonbanks), and the absence of adequate procedural safeguards could increase Reserve Banks' and, ultimately, taxpayers' losses from Section 13 (3) lending activities in the future. Furthermore, greater potential access to the federal financial safety net could boost the risk-taking incentives for nonbanks, thereby increasing the probabilities that they will request discount window lending during financial emergencies.

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