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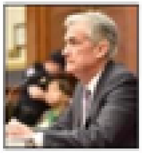
Without Any Legislative Powers, the Fed Is Rewriting the Law and Creating a Permanent $500 Billion Bailout Facility for Wall Street

By Pam Martens and Russ Martens: August 8, 2022 ~


Jerome (Jay) Powell, Chairman of the Federal Reserve Board

The Fed is doing something it's never been allowed to do in its 109 years of operation. And, it's doing it without any pushback from Congress.

The Fed draws its statutory authority from the Federal Reserve Act of 1913 which created the Fed's "discount window" for making loans to Fed member banks which are engaged in making loans for "agricultural, industrial or commercial purposes…." The Federal Reserve Act strictly prohibited the Fed from making loans "for the purpose of carrying or trading in stocks, bonds, or other investment securities…."

After Wall Street trading casinos blew up the U.S. economy in 1929 and brought on the Great Depression of the 30s, Congress enacted the Glass-Steagall Act in 1933 which established federal deposit insurance for commercial banks and outlawed the merger of those federally-insured banks with Wall Street trading casinos (investment banks and brokerage firms). The Glass-Steagall legislation protected the U.S. banking system for 66 years until its repeal by Congress in 1999. Today, all of the megabanks on Wall Street own both federally-insured banks *and* sprawling trading firms.

On July 28 of last year, the Fed announced that it was creating a $500 billion *permanent* bailout facility for the trading houses ("primary dealers") on Wall Street to support "smooth market functioning." The Fed gave the facility the bland sounding name of "Standing Repo Facility" or SRF. What the Fed was effectively doing was creating a new "discount window" where both Fed member banks and Wall Street trading houses could obtain billions of dollars in cumulative loans if a liquidity crisis arose.

The resolution issued by the Fed in conjunction with the announcement indicates that the $500 billion ceiling can be "temporarily increased at the discretion of the Chair." That means that Fed Chair Jerome Powell, who just recently started a new four-year term, has the power, without any advice and consent from Congress, to throw unlimited amounts of money at the trading houses on Wall Street.

The resolution also puts this unlimited bailout facility under the auspices of the New York Fed – the same regional Fed bank responsible for the majority of the $29 trillion Wall Street bailout during and after the 2008 financial crisis.

The New York Fed is *literally* owned by some of the biggest banks on Wall Street, including [redacted] Goldman Sachs

Cohen makes numerous other noteworthy admissions during his interview. In response to one question, Cohen concedes that he was personally involved in the amendment contained in the Federal Deposit Insurance Corporation Improvement Act (FDICIA) that he interpreted as changing the Fed's emergency lending powers under Section 13(3) of the Federal Reserve Act.

Cohen also admits that during his negotiations on behalf of the Board of Bear Stearns, he effectively provided a legal interpretation of the law to the Fed. Cohen stated during the interview: "We did say that we thought 13(3) provided broad power; that the ability was there if the Fed could satisfy itself on the collateral."

In fact, all that the amendment to Section 13 says in the FDICIA legislation is this: "Section 13 of the Federal Reserve Act (12 U.S.C. 343) is amended in the third paragraph by striking 'of the kinds and maturities made eligible for discount for member banks under other provisions of this Act.' "

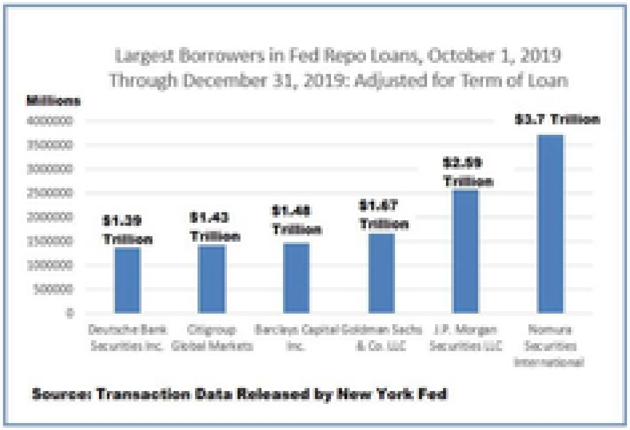
Cohen acknowledges in the interview that his law firm represented major Wall Street beneficiaries of his interpretation of the law. In addition to the Fed's extraordinary assistance to Sullivan & Cromwell clients Bear Stearns and AIG, other Sullivan & Cromwell clients that received extraordinary loans from the Fed under the Primary Dealer Credit Facility and other programs included Morgan Stanley, Citigroup, JPMorgan Chase and Goldman Sachs. Just Morgan Stanley and Citigroup received revolving loans from the Fed that cumulatively totaled more than $4.5 *trillion*, according to an audit conducted by the Government Accountability Office (GAO).

The Federal Reserve, followed by a consortium of Wall Street firms, battled the media in court to prevent the public disclosure of those vast sums of lending by the Fed, which creates its money electronically at the push of a button. (See The Official Video from the Federal Reserve on How It Creates Electronic Money.)

In a preliminary draft report issued by the FCIC, it specifically mentions the involvement of Rodgin Cohen in the 13(3) amendment as follows: (The reference to Cohen was removed in the final report from the FCIC.)

> "In 1991, Goldman Sachs and other large securities firms sought legislation that would give them greater access to the Fed's emergency lending facility under Section 13(3) of the Federal Reserve Act. Goldman and the other firms were concerned about 'the absence of a safety net beneath Wall Street firms' in light of (i) the reluctance of some commercial banks to provide credit to securities broker-dealers during the 1987 stock market crash, and (ii) the failure of Drexel in 1990. At the suggestion of H. Rodgin Cohen, a banking lawyer with Sullivan & Cromwell in New York City, the securities firms urged Congress to include an amendment to Section 13(3) in FDICIA.

For why we feel confident that these SRF loans will amount to trillions of dollars, consider the chart below showing the amounts the Fed pumped out to Wall Street's trading houses in the last quarter of 2019 – long before COVID-19 had become a threat. The Fed did not release the names of the borrowers or the amounts borrowed until two years after the fact – because it called these loans part of its "open market operations." Even more alarming, when it did release the shocking data and names, not one mainstream media outlet reported the story. (See our report: Mainstream Media Has Morphed from Battling the Fed in Court in 2008 to Groveling at its Feet Today.)



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Wall Street, including JPMorgan Chase, Citigroup, Goldman Sachs and Morgan Stanley. (See our report: These Are the Banks that Own the New York Fed and Its Money Button.)

The Fed's resolution also notes that the loans will be made as "open market operations." By calling these loans "open market operations" instead of emergency loans under the Federal Reserve Act's Section 13(3), the Fed has effectively repealed the restrictions imposed on it by Congress under the Dodd-Frank financial reform legislation of 2010. The Dodd-Frank Act required that emergency loans made by the Fed under Section 13(3) receive the "prior approval of the Secretary of the Treasury"; cannot be made to insolvent institutions or to help those institutions avoid a bankruptcy filing; and the names of the borrowers and amounts borrowed had to be given to the Senate Banking and House Financial Services Committees within seven days. Under its new Standing Repo Facility, the Fed has effectively taken Congress out of the loop.

Last Friday morning, the New York Fed quietly added the federally-insured banks — Morgan Stanley Bank, N.A. and Morgan Stanley Private Bank, N.A. — to its list of counterparties at its Standing Repo Facility. Morgan Stanley & Co., the trading unit of the megabank, is already a counterparty to the SRF as one of the Fed's primary dealers. This means that Morgan Stanley will be able to make three separate requests for loans from the Fed's Standing Repo Facility. Likewise, both Goldman Sachs and Citigroup (Citibank) have both a trading unit and their federally-insured bank listed as counterparties to the SRF.

To understand just how unprecedented this action by the Fed is, we recommend that you listen to an audio tape of an interview conducted on August 5, 2010 by investigators for the Financial Crisis Inquiry Commission (FCIC), the body convened under the Fraud Enforcement Recovery Act of 2009 to investigate the 2008 financial collapse on Wall Street. The interview is with Rodgin (Rodge) Cohen, Senior Chair of Sullivan & Cromwell, the law firm that played a major role during the 2008 financial crisis.

During Cohen's interview, he is asked if the Fed's financial assistance to the Bear Stearns trading house (in the spring of 2008) was the first time the Fed had used its 13(3) emergency lending authority to help a nonbank. Cohen states that "To my knowledge it is the first time and the initial but fleeting reaction was we've never done it before, what sort of precedent are we creating for ourselves."

It was not the first time the Fed had used its Section 13(3) emergency lending to assist a nonbank. It was simply the first time the Fed had made loans to a collapsing trading house on Wall Street. According to a history provided by David Fettig, a Senior Advisor to the Minneapolis Fed, Section 13(3) "was used sparingly, and just 123 loans were made" from 1932 to 1936. The loans totaled \$1.5 million – that's about \$32 million in today's dollars. That's a pretty far cry from the \$29 trillion the Fed secretly pumped out to bail out Wall Street from December 2007 through June 2010.

> "The enacted 1991 amendment to Section 13(3) authorized the Fed to make emergency loans to nonbanking firms as long as those loans are 'secured to the satisfaction of the [Fed],' and the amendment also gave the Fed broad discretion to accept almost any type of collateral from the borrowing firms."

That last sentence above is a highly questionable interpretation of what the amendment to 13(3) actually allowed the Fed to do, making it all the more interesting that it was removed from the final FCIC report.

At the height of the financial crisis, the Wall Street Journal profiled Rodgin Cohen as follows on October 9, 2008:

> "With virtually all of Wall Street as his client, [Cohen] has solidified his role as one of the most influential private-sector players in the financial crisis. Over the past five weeks alone, Mr. Cohen and his team have advised Fannie Mae, Lehman Brothers Holdings Inc., Wachovia, Barclays PLC, American International Group Inc., J.P. Morgan Chase & Co. and Goldman Sachs Group Inc. in a blitz of mergers, rescues and cash infusions."

The year after the Section 13(3) amendment became part of the FDICIA, Anna Schwartz, then a Senior Research Fellow at The National Bureau of Economic Research, wrote a seminal paper on its inherent dangers. Schwartz wrote:

> "Despite the restraint in the Act with respect to recapitalizing the FDIC, restraint is absent from another provision. The Act amended Section 13 of the Federal Reserve Act that deals with the Federal Reserve's authority to discount for nonbanks. The amendment eliminated the requirement that the notes, drafts or bills tendered by nonbanks be eligible for discount by member banks. As interpreted by Sullivan & Cromwell, a New York law firm, for its clients in a memorandum of December 2, 1991, this provision enables the Fed to lend directly to security firms in emergency situations. Traditionally, commercial banks, knowing they had access to the discount window, have lent to brokerage firms and others short of cash in a stock market crash. It is not clear why the traditional practice was deemed unsatisfactory. In my view, the provision in the FDIC Improvement Act of 1991 portends expanded misuse of the discount window."

Anna Schwartz passed away in 2012. It is highly unlikely that she could have ever imagined the day when the Fed would simply flip the bird to Congress and effectively rewrite the Federal Reserve Act, giving itself the power to make trillions of dollars in cumulative loans to Wall Street's trading houses.

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