

# U.S. Structured Finance Newsletter

Volume 3, Issue 51, December 24, 2007



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## THE CREDIT JUMP-START PLAN BY THE FED AND OTHERS

As the year end approaches, the global credit markets continue to be unstable in spite of several rate reductions as well as government efforts<sup>1</sup> directed at cushioning losses in the mortgage market. While these measures have been positive for the market, they have not had a material impact on curbing the crisis in the credit markets. In continuing its efforts to restore liquidity and stability in the markets, the Federal Reserve (the Fed), in concert with four international banking authorities, released a plan on December 12, 2007, to provide credit markets with additional liquidity.

The plan announced by the Fed includes a new initiative whereby the Fed will offer borrowing based on a Term Auction Facility (TAF). The intention of the TAF is to encourage borrowing by banks on a short-term basis at a marginally lower rate than the rate on funds from the discount window.<sup>2</sup> Also, the TAF is designed to circumvent the stigma attached to borrowing from the discount window, which can be perceived as a "desperate" measure. Advances under the TAF will be fully collateralized against a broad range of collateral (the same as what is accepted at the discount window), which may include mortgage loans, residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDOs) at favorable terms and conditions.<sup>3</sup> Also, the TAF permits anonymous participation, although the Fed will report the total amount borrowed from its 12 member banks.

According to the plan, the Fed will hold auctions twice in each of December 2007 and January 2008. The December auctions were for \$20 billion each, with terms of 28 days and 35 days, respectively. The amounts and terms of the January auctions have not yet been announced. It is expected that the clearing rates from the auctions will fall between the present discount rate of 4.75%<sup>4</sup> and the federal funds target rate of 4.25% and will help to bring down interbank lending rates (LIBOR), motivating banks to be less restrictive with lending. Results from the first auction indicate that the stop-out rate, or clearing rate, was 4.65% (compared with the discount rate of 4.75%), and the bid-to-cover ratio was 3.08 (93 banks bid with total proposals amounting to \$61.6 billion); for the second auction, the stop-out rate was 4.67%, with a bid-to-cover ratio of 2.88 (73 banks bid with total proposals of \$57.7 billion).<sup>5</sup>

The recent steps by the Fed, along with congressional legislation, continue to underscore the effects of the current housing market turmoil on global credit markets. With additional liquidity in the banking system, the hope is that there should be some easing of the credit crunch that began last summer. However, the credit crisis may remain more protracted in the mortgage sector and further measures may be needed. DBRS will continue to monitor any new proposals aimed at relieving strains in the credit markets.

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<sup>1</sup> FHASecure was launched in August 2007 and the fast-track program for loan modifications was announced December 6, 2007.

<sup>2</sup> The discount window lends on a 30-day basis and has no stated cap or frequency on its total lending capacity. See <http://www.frbdiscountwindow.org/faqs.cfm?hdrID=14&dtIID=75>.

<sup>3</sup> <http://www.frbdiscountwindow.org/discountmargins.pdf>.

<sup>4</sup> <http://www.marketwatch.com> 12/12/2007.

<sup>5</sup> See <http://www.federalreserve.gov/newsevents/press/monetary/20071219c.htm> and <http://www.federalreserve.gov/newsevents/press/monetary/20071221a.htm>.