

Interaction between Discount Window and FHLB

Opening Remarks

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The Evolving Landscape of Bank Funding
Federal Reserve Banks of Dallas, Atlanta and Cleveland

What problem are we trying to solve?

- Goal: Ensure system-wide access to liquidity during periods of financial stress, which may become more acute due to ongoing changes in the financial system, including:
 - Faster bank runs (e.g., the SVB episode)
 - Growth in uninsured deposits
 - Growth of NBFIs

The Discount Window (DW) uniquely fulfills the function of a LOLR: providing liquidity at a stable rate, independently of market conditions.

- Issues with the DW:
 1. Stigma
 - There is a reluctance to access the DW because borrowing from the Federal Reserve may signal financial weakness.
 2. Operational preparedness to use the DW
 - Limited readiness among eligible borrowers to access the DW effectively

Q: Does FHLB design and operation aggravate these problems?

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- Issues with the DW:

1. Stigma

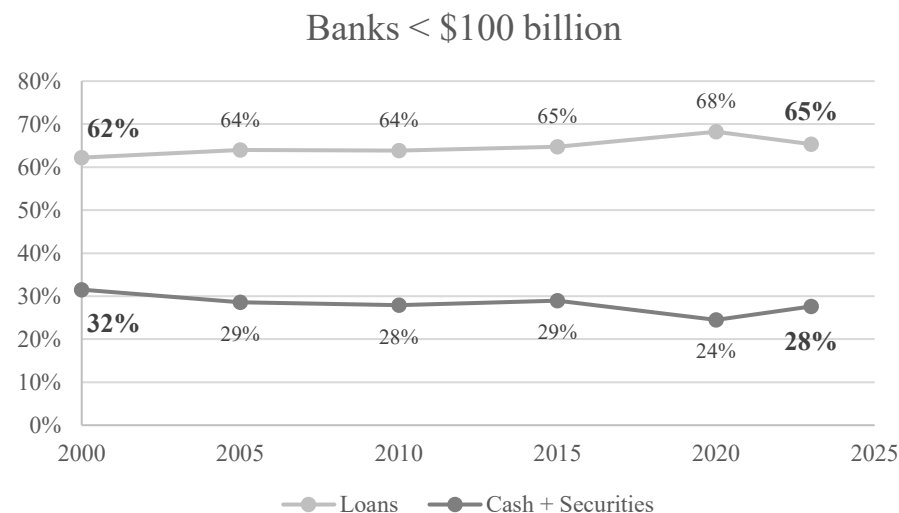
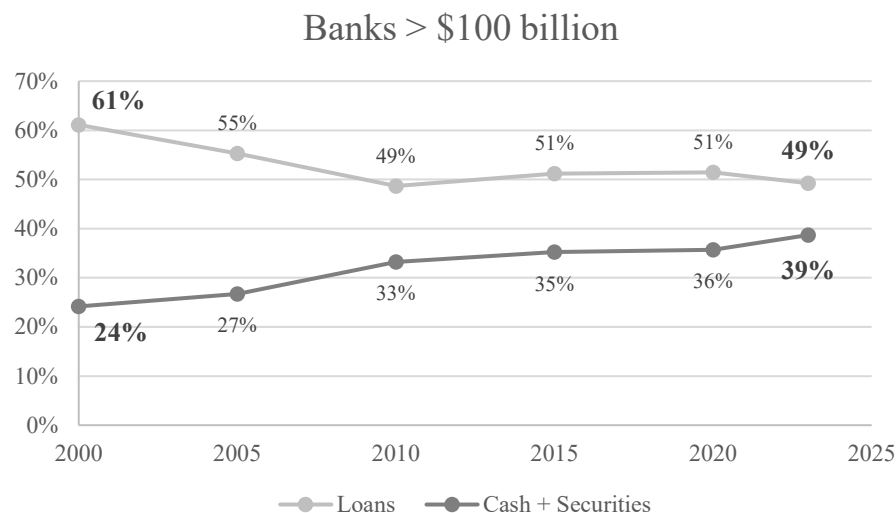
- Disclosure differences between DW and FHLB
 - DW: aggregate amount is disclosed weekly; lagged disclosure of detailed information
 - FHLB: aggregate figures in their quarterly filings (substantial lag); no ex-post bank level disclosure
- Lack of critical mass/normalization of DW use (downside of diversification of sources of liquidity)

Most proposals to address the DW stigma—such as counting DW capacity toward HQLA—have little direct connection to the FHLB

2. Operational preparedness to use the DW

- Overarching idea: A lack of integration and/or preparedness between the DW and FHLB creates frictions in accessing liquidity
 - Most commonly used agreement for FHLB borrowing is a blanket lien (source: FHFA); having collateral at the DW requires carving out these assets from FHLB collateral – easier with securities than with loans (loans are kept with the bank; moving target)

Silver lining in the rise of securities holdings?



- Increasingly, banks take deposits and invest in securities
 - Trend driven by larger banks (Assets > \$100 billion)
 - By contrast, balance sheet shares of smaller banks have been stable
- In cross-section of large banks, faster deposit growth is correlated with slower loan growth and faster cash+securities growth

Background points: FHLB design & importance

- If we object to the FHLB's top spot (USD) in the liquidity hierarchy under both normal and stress conditions, we ought to focus on the sources of cost differentials
- FHLB have become larger with the shift of money market funds away from commercial paper and large bank CDs to GSE paper – true, but not obvious that this aggravates problems with the DW

Improving readiness to use the DW is pivotal and urgent

- Post GFC, banks have been issuing contingent liquidity lines (revolving lines) against pools of assets
- At the core of this trend is the demand for liquidity lines related to the growth of alternative (i.e., illiquid!) assets, private equity and private debt included

Evolution of Private Debt and Private Equity Fundraising

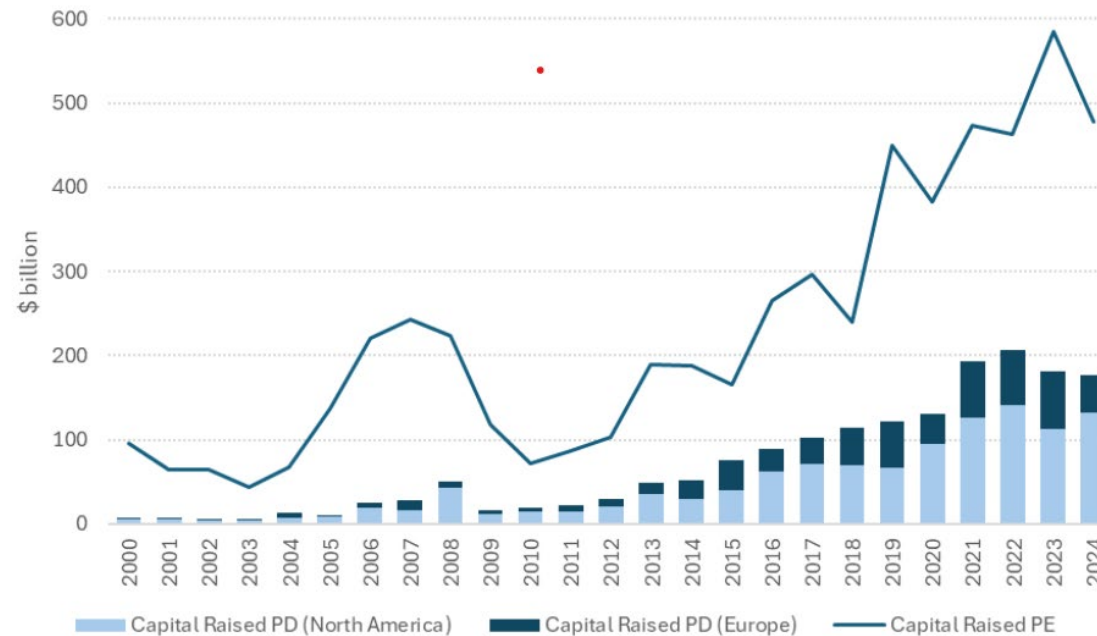
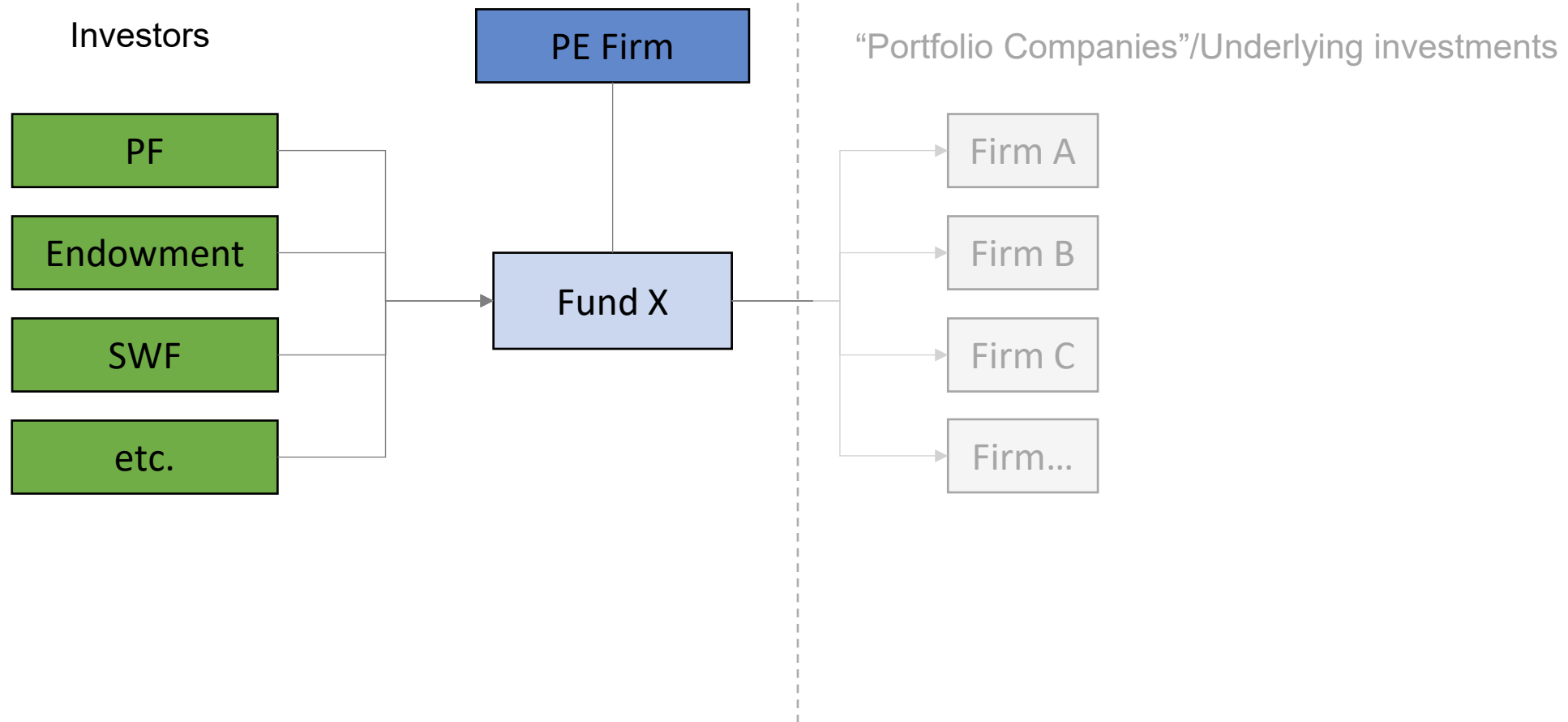
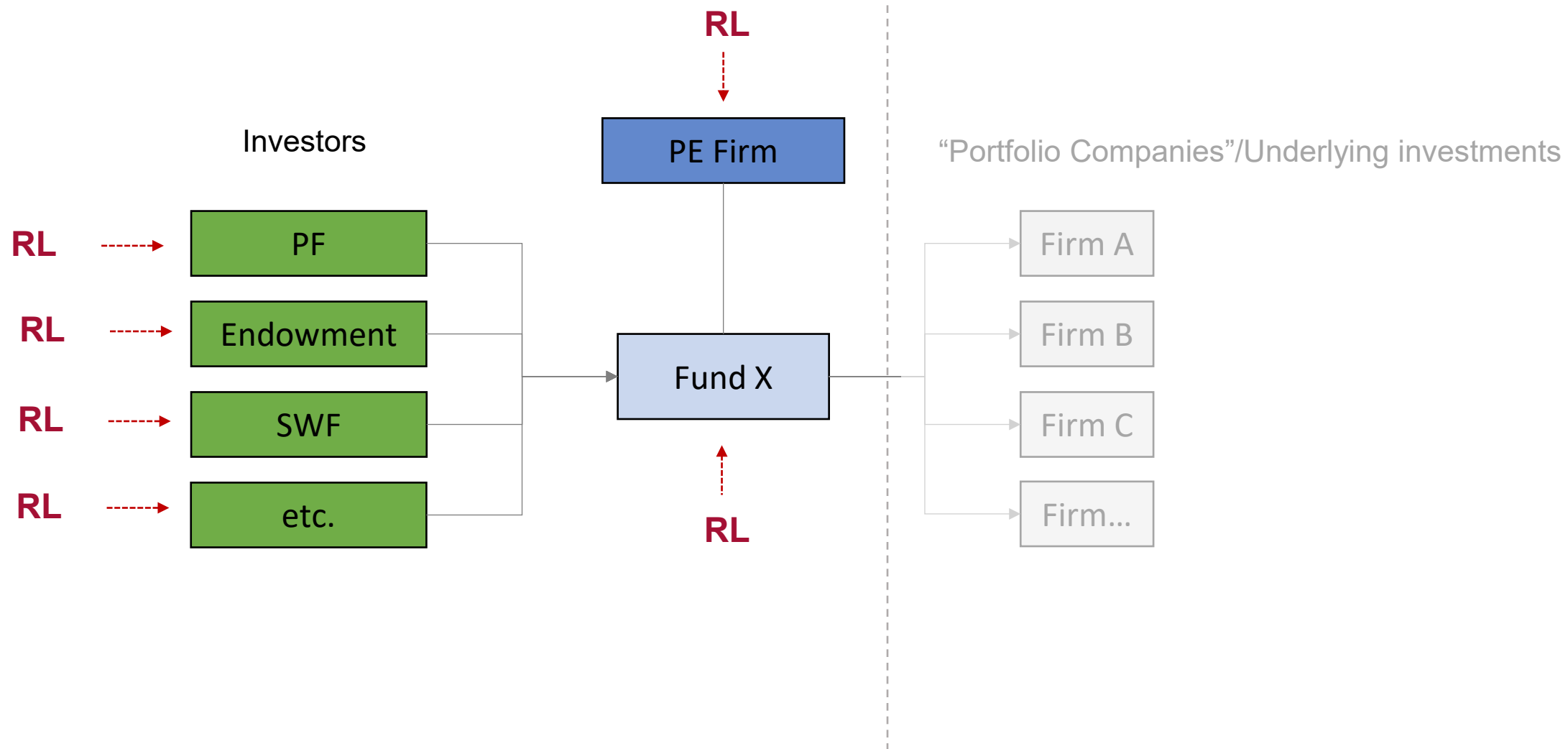


Figure 1 in Ivashina, 2025, "The Role of Private Debt in the Financial Ecosystem"

In 2007:



In 2025:



Improving readiness to use the DW is pivotal and urgent

- Following the GFC, the accelerated growth and ubiquity of alternative, illiquid asset classes have increased demand for revolving lines (RLs) backed by investments — a highly attractive form of credit from a bank capital requirement perspective
 - Banks' revolving lines to BDCs represent only the tip of the iceberg
- In effect, these new RLs function as a form of systemic liquidity insurance provided by banks to the broader financial system
- Notably, this type of credit does not qualify as eligible collateral for FHLB advances