NOTE

THE FEDERAL RESERVE'S QUESTIONABLE LEGAL BASIS FOR FOREIGN CENTRAL BANK LIQUIDITY SWAPS

*Alexander R. Perry**

The 2008 financial crash precipitated a liquidity crisis of global proportions. With dollar funding shortages threatening the global financial system, the Federal Reserve turned to foreign central bank liquidity swaps as a key component of its crisis response. First used in the 1960s during the Bretton Woods era, foreign central bank liquidity swaps are essentially contracts between two central banks to lend each other currency. While many analysts praised the Fed's swap lines for—at least temporarily—easing liquidity strains during the crisis, this Note argues that the Fed acted without statutory authority in establishing a network of swap lines providing aid to foreign economies. Exacerbating this tension, in 2013 the Fed converted its temporary network of swap lines into standing arrangements that select foreign central banks can draw on at any time. This extension of the Fed's enumerated powers represents a democratically unsanctioned incursion into the realm of foreign affairs. To address this problem, this Note suggests that absent explicit legislative authority for foreign central bank liquidity swaps, the Fed should refashion its network of swap lines as an exercise of its emergency powers under Section 13(3) of the Federal Reserve Act, as amended by Dodd–Frank. While such a change is not without significant cost, doing so would imbue transparency, accountability, and legal legitimacy into the Fed's swap network.

INTRODUCTION

In response to the 2008 financial crisis, the Federal Reserve implemented a bevy of lending programs that dramatically altered the composition of the central bank's balance sheet and helped restore dollar liquidity in certain distressed markets both at home and abroad.[1] A major reason

---

* J.D. Candidate 2020, Columbia Law School. Many thanks to Professor Kathryn Judge for her guidance and support in writing this Note. Thank you to Benjamin Marrow for helping to kickstart this research, as well as to the staff of the *Columbia Law Review* for their fantastic editorial assistance. Lastly, special thanks to my grandma and the rest of my family for their endless support and encouragement.

1. While the subprime crisis and toxic array of mortgage-based financial products (such as collateralized debt obligations and credit default swaps) originated in the United States, the modern proliferation of cross-border flows of capital ensured that a crisis would reverberate far beyond its borders. See John Cassidy, The Real Cost of the 2008 Financial Crisis, New Yorker (Sept. 10, 2018), https://www.newyorker.com/magazine/2018/09/17/

the world avoided an unmitigated international banking disaster was the Fed's injection of trillions of dollars of liquidity into the global banking system.[2] One of the Fed's most innovative facilities during the crisis was its revival of foreign central bank liquidity swaps (or swap lines). In broad strokes, the Fed used swap lines during the financial crisis to lend substantial amounts of U.S. dollars to foreign central banks, which in turn distributed the borrowed currency to dollar-needy financial institutions in their respective jurisdictions.[3] These swap lines have largely flown under the radar in public discourse, despite some expert opinions that "the swap lines with which the Fed pumped dollars into the world economy were perhaps the decisive innovation of the crisis."[4]

The Fed first used foreign central bank liquidity swaps in the early 1960s as a tool to protect the value of the dollar in foreign exchange markets during the Bretton Woods era.[5] More recently, the Fed repurposed the swap lines during the financial crisis to help address disruptions

the-real-cost-of-the-2008-financial-crisis (on file with the *Columbia Law Review*) ("Although the major international banks were domiciled and regulated in their individual countries, they were operating in a single, integrated capital market. So, when the crisis struck and many sources of short-term bank funding dried up, the European banks were left tottering.").

2. See, e.g., Adam Tooze, The Forgotten History of the Financial Crisis, Foreign Aff., Sept./Oct. 2018, https://www.foreignaffairs.com/articles/world/2018-08-13/forgotten-history-financial-crisis (on file with the *Columbia Law Review*) [hereinafter Tooze, The Forgotten History] ("[B]etween December 2007 and August 2010, the Fed provided its Asian, European, and Latin American counterparts with just shy of $4.5 trillion in liquidity, of which the ECB alone took $2.5 trillion.").

3. At the program's peak in December 2008, outstanding swaps totaled more than $580 billion. Jon Hilsenrath, A Primer on the Fed's Swap Lines with Europe, Wall St. J.: Real Time Econ. (May 10, 2010), https://blogs.wsj.com/economics/2010/05/10/a-primer-on-the-feds-swap-lines-with-europe/ (on file with the *Columbia Law Review*). For more on the mechanics of foreign central bank liquidity swaps, see infra section I.A.

4. Adam Tooze, Crashed: How a Decade of Financial Crises Changed the World 11, 210–15 (2018) [hereinafter Tooze, Crashed] ("The absence of a euro-dollar or a sterling-dollar currency crisis was one of the remarkable features of 2008 . . . . It was the swap lines that did the trick."); see also William A. Allen & Richhild Moessner, The International Liquidity Crisis of 2008–2009, World Econ., Apr.–June 2011, at 183, 184 ("[T]he financial stability problems faced by several of the recipient countries would have been much more severe had the swap facilities not been made available.").

5. See Michael D. Bordo, Owen F. Humpage & Anna J. Schwartz, The Evolution of the Federal Reserve Swap Lines Since 1962, at 1 (Nat'l Bureau of Econ. Research, Working Paper No. 20755, 2014), https://www.nber.org/papers/w20755.pdf [https://perma.cc/D637-H98G] [hereinafter Bordo et al., Evolution of the Federal Reserve Swap Lines] ("What started out as a device to provide central banks with cover for unwanted dollar positions had returned as a way to finance global lender-of-last-resort operations . . . ."). The Bretton Woods Agreement of 1944 established an international monetary system that pegged the dollar to gold and fixed the currencies of cooperating nations within a one-percent band of the dollar. The Bretton Woods system lasted until 1971. See infra notes 35–62 and accompanying text.

in dollar funding of banks in foreign jurisdictions.[6] The swap lines have continued to serve this purpose ever since. In May 2010, amid the Eurozone crisis, the Fed reestablished temporary liquidity swap facilities with four major central banks to "help improve liquidity conditions in U.S. dollar funding markets and to prevent the spread of strains to other markets and financial centers."[7] Shortly after, in 2013, the Fed transformed this web of currency swaps into standing arrangements as part of "a prudent liquidity backstop" to "ease strains in financial markets and mitigate their effects on economic conditions."[8] These swap lines have constituted a significant portion of the Fed's balance sheet,[9] and the Fed operates with stark autonomy in authorizing foreign central bank liquidity swaps.[10]

Despite the modern expansion of swap lines and the corresponding shift in their use, the Fed has continued to rely upon an attenuated interpretation of Section 14 of the Federal Reserve Act[11] that was developed in

6. See Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 1; see also Tooze, Crashed, supra note 4, at 214 ("What the Fed had done for money markets, the central banks now did for the global provision of dollar bank funding.").

7. Press Release, Bd. of Governors of the Fed. Reserve Sys., FOMC Statement: Federal Reserve, European Central Bank, Bank of Canada, Bank of England, and Swiss National Bank Announce Reestablishment of Temporary U.S. Dollar Liquidity Swap Facilities (May 9, 2010), https://www.federalreserve.gov/newsevents/pressreleases/monetary20100509a.htm [https://perma.cc/8Y4M-LMJT] [hereinafter FOMC Press Release, May 9, 2010].

8. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Convert Temporary Bilateral Liquidity Swap Arrangements to Standing Arrangements (Oct. 31, 2013), https://www.federalreserve.gov/newsevents/pressreleases/monetary20131031a.htm [https://perma.cc/G3AF-G2YZ] [hereinafter Fed. Press Release, Oct. 31, 2013] (adding the Bank of Japan to this network of bilateral liquidity swap arrangements).

9. See Credit and Liquidity Programs and the Balance Sheets: Balance Sheet Trends—Accessible, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/monetarypolicy/bst_recenttrends_accessible.htm [https://perma.cc/FST9-YM4C] (last visited Nov. 5, 2019) (recording the highest amount of central bank liquidity swaps outstanding on December 17, 2008, when they comprised approximately 26% of the Federal Reserve's assets). According to the New York Federal Reserve Bank's tally of central bank liquidity swap operations, as of October 30, 2019, there were forty-one million dollars' worth of outstanding liquidity swaps, thirty-six million of which were issued to the European Central Bank (ECB) and five million of which to the Bank of England. Central Bank Liquidity Swap Operations, Fed. Reserve Bank of N.Y., https://apps.newyorkfed.org/markets/autorates/fxswap [https://perma.cc/6DGY-ZMMC] (last visited Nov. 5, 2019).

10. See Colleen Baker, The Federal Reserve's Use of International Swap Lines, 55 Ariz. L. Rev. 603, 607–09 (2013) [hereinafter Baker, Swap Lines] (noting that the Fed neither needs to seek Congressional approval nor relies upon emergency legal authority to activate the swap lines).

11. Section 14 is a catchall provision that governs open market operations, which are generally under the purview of the Federal Open Markets Committee (FOMC). Notably, the provisions of Section 14 contain no language dealing directly with foreign central bank liquidity swaps. See Federal Reserve Act, Pub. L. No. 63-43, § 14, 38 Stat. 251, 264–65 (1913) (codified as amended at 12 U.S.C. §§ 353–355 (2018)).

the 1960s as authority to create and enter into liquidity swaps.[12] In light of the extensive and controversial[13] power wielded by the Fed in entering into foreign central bank liquidity swaps, the academic discussion of the Federal Reserve's *legal* basis for using these arrangements has been surprisingly sparse.[14] The Fed contends that Congress has provided tacit approval for the Fed's swap lines since their initial use in the early 1960s.[15] To the contrary, this Note argues that the Fed's legal theory supporting its foreign central bank liquidity swaps is inadequate to justify the swap network in its current form. To legitimize the Fed's use of foreign central bank liquidity swaps, Congress should provide clear legislative authority for the Fed to issue and maintain swap lines. In the absence of such explicit direction, this Note contends that the current statutory framework contains a firmer legal basis that can justify the Fed's liquidity swaps. As the ensuing analysis seeks to demonstrate, the Fed would be on stronger

12. See Central Bank Liquidity Swaps, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/monetarypolicy/bst_liquidityswaps.htm [https://perma.cc/MB8T-R6QV] [hereinafter Fed Explainer on Central Bank Liquidity Swaps] (last updated Oct. 17, 2018) ("The Federal Reserve operates these swap lines under the authority of [S]ection 14 of the Federal Reserve Act . . . ."). For more on the circumstances and debate during the 1960s over the Fed's legal power to intervene in foreign exchange markets, see infra section II.A.

13. For one, the Fed has no means to track who ultimately receives the dollars distributed by foreign central banks that draw on swap lines with the Fed. See Monetary Policy and the State of the Economy: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. 55–56 (2009) (recording a dramatic exchange between Fed Chairman Ben Bernanke and Congressman Alan Grayson, in which Bernanke admitted he did not know who specifically received $533 billion from central bank liquidity swaps during the financial crisis). Furthermore, experts have accused the Fed of cultivating moral hazard by selectively lending to large foreign institutions and by bailing out failing foreign monetary systems. See, e.g., Gerald P. O'Driscoll Jr., The Federal Reserve's Covert Bailout of Europe, Wall St. J. (Dec. 28, 2011), https://www.wsj.com/articles/SB10001424052970204464404577118682763082876 (on file with the *Columbia Law Review*) ("No matter the legalistic interpretation, the Fed is, working through the ECB, bailing out European banks and, indirectly, spendthrift European governments.").

14. While a number of scholars and commentators, such as Colleen Baker and Peter Conti-Brown, have acknowledged that the Fed's swap lines rest on shaky legal grounds, the analysis of the relevant law as it relates to the current incarnation of central bank liquidity swaps largely seems to have stopped there. See, e.g., Baker, Swap Lines, supra note 10, at 610 (pointing out that "[t]he legal authority for the Federal Reserve's swap lines is antiquated and woefully inadequate" and that to the author's knowledge "this is the first law review article to offer a theoretical analysis" of the Fed's swap lines); Peter Conti-Brown, The Institutions of Federal Reserve Independence, 32 Yale J. on Reg. 257, 258–63 (2015) ("The Article explains the context and historical change of the many mechanisms of Fed independence, providing for the first time an explanation of how the Fed's funding, appointments, and removability protections have evolved since they were first installed by the Federal Reserve Act of 1913 . . . .").

15. See, e.g., Robert L. Hetzel, Sterilized Foreign Exchange Intervention: The Fed Debate in the 1960s, Fed. Res. Bank Richmond Econ. Q., Spring 1996, at 21, 39 n.9 [hereinafter Hetzel, Fed Debate in the 1960s] (noting that Congress has been fully aware of the Fed's swap line activity since 1962, yet Congress has not acted to restrict the authority of the Federal Reserve to engage in these operations).

footing if it reconstructed its liquidity swap framework as an emergency power under Section 13(3) of the Federal Reserve Act, as amended by the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank).[16]

This Note proceeds in three parts. Part I explains the mechanics of foreign central bank liquidity swaps, the circumstances that prompted the Fed to first use liquidity swaps in the 1960s, and the subsequent evolution of the swap lines during and after the financial crisis. Part II outlines the Fed's current legal basis for the swap lines and analyzes a number of instances when Congress has amended relevant provisions of the Federal Reserve Act, pushing back against the argument that Congress has tacitly approved the swap lines in their current form. Finally, Part III analyzes Section 13(3) and the Fed's emergency powers as an alternative and superior legal basis for the Fed's central bank liquidity swaps.

I. THE MECHANICS AND USE OF FOREIGN CENTRAL BANK LIQUIDITY SWAPS

To set the stage for the analysis of the Fed's legal authority over foreign central bank liquidity swaps, section I.A outlines exactly what swap lines are and how they work. Section I.B then provides historical background for the Fed's use of liquidity swaps during the Bretton Woods era. This brief historical recitation is necessary to explain the legal debate that caused the Fed to use swap lines as a tool to intervene in foreign exchange markets in the first place. Section I.C concludes with a discussion of how the Fed's swap lines transformed during the financial crisis and subsequently expanded into standing arrangements.

A. *What Are Foreign Central Bank Liquidity Swaps?*

A foreign central bank liquidity swap is an agreement between two central banks to temporarily exchange currencies.[17] When the Fed establishes a swap line with a foreign central bank, it generally agrees to a two-part transaction.[18] First, the Fed provides its foreign counterpart with a fixed amount of U.S. dollars in return for an equivalent amount of that bank's local currency, usually (but not always) at the prevailing market exchange rate.[19] The Fed holds the foreign currency in an account at the

16. See Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank), Pub. L. No. 111-203, § 1101, 124 Stat. 1376, 2113–15 (2010) (codified at 12 U.S.C. § 343).

17. For a basic explainer on swap line arrangements, see Frequently Asked Questions: U.S. Dollar and Foreign Currency Liquidity Swaps, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/monetarypolicy/bst_swapfaqs.htm [https://perma.cc/UPR9-ZABY] [hereinafter FAQs: Foreign Currency Liquidity Swaps] (last updated Feb. 16, 2017).

18. Fed Explainer on Central Bank Liquidity Swaps, supra note 12.

19. Swap lines can also use "policy rates," rather than market rates, reflecting the noncommercial relationship between the central banks. See id; see also Baker, Swap Lines,

foreign central bank, and deposits the dollars into the foreign central bank's account at the Federal Reserve Bank of New York.[20] Once swapped, the foreign central bank is free to distribute the dollars it received from the Fed to banks in its own jurisdiction.[21] Under this arrangement, the Fed has no contractual relationship with the institutions receiving dollar funding from the foreign central bank.[22]

The second part, or "forward leg," of the swap line transaction consists of a binding agreement for the foreign central bank to buy back its currency on a specified future date, at the same exchange rate plus interest.[23] The length of the swap has traditionally ranged from overnight to ninety days.[24] Because the terms of the transaction are set in advance, it insulates the Fed from the risk of potential fluctuations in exchange rates.[25] Thus, the Fed receives the same nominal amount of dollars that it exchanged in the first leg of the swap, although it may experience a gain or loss following the repurchase of the currency in real terms.[26] This second transaction effectively unwinds the first, although the Fed does not have to pay interest on the currency it held as part of the initial swap transaction.[27]

The Fed's swap lines are contracts that essentially enshrine a secured loan between two central banks.[28] These swap lines include all of the material features of a loan: The principal is the amount of dollars swapped, the interest is paid by the central bank drawing on the swap line, and the collateral is the foreign currency held in the Fed's account at the foreign central bank.[29] As an example, the U.S. Dollar–Euro Swap Agreement Dated as of January 16, 2014 is an eight-page document signed by representatives of both the Federal Reserve Bank of New York and the European Central Bank (ECB).[30] It contains various terms, including those on the parties' commitment to purchase and repurchase currency, establish accounts

---

supra note 10, at 622–23 & n.117 (citing Perry Mehrling, Essential Hybridity: A Money View of FX, 41 J. Comp. Econ. 355, 360–61 (2013)).

20. Fed Explainer on Central Bank Liquidity Swaps, supra note 12.

21. Foreign central banks distribute the dollars from the swap line "through a variety of methods, including variable-rate tenders, fixed-rate tenders, bilateral transactions, and foreign exchange swap tenders against various types of collateral . . . ." FAQs: Foreign Currency Liquidity Swaps, supra note 17.

22. Id.

23. Fed Explainer on Central Bank Liquidity Swaps, supra note 12.

24. Id.

25. FAQs: Foreign Currency Liquidity Swaps, supra note 17.

26. See Baker, Swap Lines, supra note 10, at 624.

27. See Fed Explainer on Central Bank Liquidity Swaps, supra note 12.

28. See Baker, Swap Lines, supra note 10, at 622 & nn.114, 116.

29. Id.

30. U.S. Dollar–Euro Swap Agreement Dated as of January 16, 2014, Fed. Reserve Bank of N.Y. (Jan. 16, 2014), https://www.newyorkfed.org/medialibrary/media/markets/USD_Euro_swap_agreement.pdf [https://perma.cc/87GS-DK54] [hereinafter U.S. Dollar–Euro

at each of the respective central banks, and determine the applicable exchange rate.[31]

B. *The Dollar Crisis of the Bretton Woods Era: How and Why Swap Lines Were First Used*

From 1962 to 1971, when the U.S. dollar was still pegged to gold, the Federal Reserve used swap lines, sometimes known as reciprocal currency arrangements, as a key policy instrument to defend U.S. gold reserves.[32] The swap lines defended the U.S. gold stock by temporarily forestalling the implications of the dollar's global reserve currency status under the Bretton Woods Agreement.[33] Relatedly, swap lines during this time allowed foreign central banks to obtain temporary increases in their dollar liquidity and signaled support of the Bretton Woods system.[34]

Under the international monetary system that emerged from the Bretton Woods Agreement of 1944, the United States pegged the dollar to gold—at a fixed rate of thirty-five dollars per ounce—while other cooperating countries agreed to fix their currencies within a one-percent band of

---

Swap Agreement, Jan. 2016]. Compared to contracts for private swaps and derivatives, which can span hundreds of pages, swap arrangements between central banks are significantly shorter. See Katharina Pistor, A Legal Theory of Finance 17 (Columbia Law Sch. Pub. Law & Legal Theory Working Paper Grp., Paper No. 13-348, 2013), https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3286&context=faculty_scholarship [https://perma.cc/8UZZ-XFTF] (commenting on how "swap agreements between major central banks meant to secure the global payment system occupy only seven pages of text even as they deal with billions of dollars, euros, francs, pounds or yens").

31. See U.S. Dollar–Euro Swap Agreement, Jan. 2016, supra note 30.

32. See Michael Bordo, Owen F. Humpage & Anna J. Schwartz, U.S. Intervention During the Bretton Woods Era: 1962–1973, at 23 (Fed. Reserve Bank of Cleveland, Working Paper No. 11-08, 2011) [hereinafter Bordo et al., U.S. Intervention During the Bretton Woods Era], https://ssrn.com/abstract=1807117 (on file with the *Columbia Law Review*).

33. A fundamental tension—known as the "Triffin Paradox"—confronted the United States during the Bretton Woods era. Because the United States supplied the global reserve currency, it faced what was, in essence, a misalignment of short- and long-term incentives. During the Bretton Woods era, the expanding global economy increased demand for the dollar as a means of payment and settlement. This pushed the United States to increase the dollar supply. A tension developed because of the dollar's peg to gold. As the global stock of dollars rose relative to the inelastic stock of gold, it became increasingly difficult for the United States to convert gold at the original pegged price. The United States thus faced the Triffin Paradox: Refusing to raise the stock of dollars would stunt trade and global economic growth; meanwhile increasing the price of gold would renege on a critical commitment under the Bretton Woods Agreement. When countries realized that the Bretton Woods arrangement was bound to result in long-term inflation (i.e. devaluation of the dollar), they would likely choose to leave the system. See 2 Allan H. Meltzer, A History of the Federal Reserve, Bk. 1, 1951–1969, at 221–23 (2009) [hereinafter Meltzer, History of the Fed]. The swap lines—a kind of dollar loan—gave the United States a temporary means through which to inject dollars into the global economy without immediately contributing to inflation.

34. See Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 8–10 ("The mere existence of the lines raised the potential cost of continued speculation against a deficit country's currency. In many years during the Bretton Woods era, a substantial amount of the available swap lines went unused, attesting to their signaling quality . . . .").

the dollar.[35] The system vested the United States with responsibility for adjusting the supply of dollars to keep the price of gold stable and for maintaining confidence in its convertibility.[36] Propping up the system proved difficult because the United States rapidly piled up dollar liabilities, eventually culminating to the point when, by 1960, outstanding dollar liabilities exceeded the entire U.S. gold stock.[37] This state of affairs diminished confidence in the Bretton Woods system because the imbalance suggested that the United States could not fulfill its obligation to sell gold at the official price.[38] Reflecting this unease, the price of gold in London reached forty dollars per ounce in 1960.[39] This increase exacerbated the situation, as central banks faced greater incentives to exchange their dollar reserves for gold with the U.S. Treasury in order to sell it for a profit in London.[40]

In response, the Fed established a network of swap lines to stave off what would otherwise have been a catastrophic run on the U.S. gold stock.[41] With such concerns in mind, the U.S. Treasury dabbled in foreign-exchange market intervention at least as early as March 1961.[42] The Treasury did so by using money from the Exchange Stabilization Fund (ESF) to purchase and sell foreign exchange in spot and forward markets.[43] The Fed viewed the Treasury's intervention as a clear success, but a lack of ESF resources limited its impact.[44] In seeking to effectuate similarly

35. Michael D. Bordo, Owen F. Humpage & Anna J. Schwartz, Bretton Woods, Swap Lines, and the Federal Reserve's Return to Intervention 2 (Fed. Reserve Bank of Cleveland, Working Paper No. 12-32, 2012) [hereinafter Bordo et al., Bretton Woods, Swap Lines, and the Fed], https://www.clevelandfed.org/newsroom-and-events/publications/working-papers/2012-working-papers/wp-1232-bretton-woods-swap-lines-and-the-federal-reservers-return-to-intervention.aspx (on file with the *Columbia Law Review*).

36. See id.

37. Id. at 4. While Professor Triffin would have attributed these circumstances to a fundamental flaw in the Bretton Woods system, see supra note 33, the Eisenhower and Kennedy administrations attributed the worsening of the U.S. balance-of-payments position "largely to transitory factors stemming from U.S. military and economic aid commitments, recent cyclical developments, and the reemergence of Western Europe and Japan as global competitors." Bordo et al., Bretton Woods, Swap Lines, and the Fed, supra note 35, at 5.

38. See Bordo et al., Bretton Woods, Swap Line, and the Fed, supra note 35, at 2.

39. See id.

40. See id. at 4.

41. Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 3.

42. Meltzer, History of the Fed, supra note 33, at 348.

43. Id. The legal basis for the ESF is the Gold Reserve Act of 1934, Pub. L. No. 73-87, 48 Stat. 337.

44. See Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Sept. 12, 1961, at 44, https://www.federalreserve.gov/monetarypolicy/files/fomchistmin19610912.pdf [https://perma.cc/KL3R-8VRR] [hereinafter FOMC Minutes, Sept. 12, 1961] ("[T]he volume of foreign exchange . . . is, of course, limited by the size of the fund . . . of which a large amount is already tied up by stabilization agreements); see also id. at 50 (recalling the understanding of FOMC Board member Karl Bopp, who said "at the time of the Bretton Woods Agreements the Stabilization Fund was reduced to something like its present size, one reason being to cut down the power of the Treasury"). According

successful intervention, the Fed decided to turn to foreign central bank swap lines as a means to achieve its policy objective.[45] At the time, policymakers at the Fed reasoned that swap lines would be an effective way to tread the delicate ground between intervening to safeguard the value of the dollar and engaging in disequilibrating, rather than equilibrating, activity in foreign exchange markets.[46]

The Fed established its first swap line with the Bank of France in 1962.[47] By the end of that year, it had set up lines with nine other countries: Austria, Belgium, Canada, England, France, Germany, Italy, the Netherlands, and Switzerland.[48] The network of swap lines continued to grow, and by the closing of the U.S. gold window in 1971 it encompassed fourteen central banks, having added Denmark, Japan, Mexico, Norway, Sweden, and the Bank for International Settlements (BIS).[49] From 1962 to 1971, the Fed drew nearly $11.6 billion worth of foreign exchange through these various swap lines, primarily to provide cover (or protection) to foreign central banks for temporary, unwanted dollar exposure that the banks would otherwise have converted for gold.[50] In a typical cover operation, the Fed would draw foreign exchange from its swap line with a foreign central bank, sending the foreign bank an equivalent amount of dollars. In an immediately subsequent transaction, the Fed would sell this foreign currency back to the foreign central back for those same dollars, thus leaving the total dollar holdings of the foreign bank unchanged.[51] The difference after the cover transaction was that the forward leg of the swap transaction, which entailed selling these dollars back to the Fed at a guaranteed exchange rate, insulated the foreign central bank from the risk that the dollar would further depreciate.[52] Because banks considered these

---

to then-Federal Reserve Chairman William McChesney Martin, "There was no question but that this country was going to be in the business of foreign exchange operations in one way or another." Id. This sentiment was backed up by a statement from William Treiber, a board alternate present at the FOMC meeting. The Treasury's activity in foreign exchange markets persuaded Mr. Treiber "that United States['] intervention in the foreign exchange markets is a potentially highly effective instrument for defending the international position of the dollar and that further use of this instrument should be explored [by the Fed] vigorously." Id.

45. For a discussion of the legal debate surrounding the Fed's intervention into foreign exchange markets in the 1960s, see infra section II.A.

46. See FOMC Minutes, Sept. 12, 1961, supra note 44, at 56. The Fed's decision to intervene was made only after extensive deliberation over the legality of foreign exchange operations by the Fed, potential alternatives to Fed intervention (e.g., expanding the ESF), and whether collaboration with the Treasury in this area would conflict with Fed independence. See Meltzer, History of the Fed, supra note 33, at 348.

47. Bordo et al., U.S. Intervention During the Bretton Woods Era, supra note 32, at 24.

48. Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 4.

49. Id.

50. Id. at 5–7 & tbl.1.

51. Id. at 6.

52. See Bordo et al., Bretton Woods, Swap Lines, and the Fed, supra note 35, at 11–12 (using the swap line between the Federal Reserve and Swiss National Bank as an example of

swaps relatively safe, they were readily available without conditions and could be accessed with only a two-day notice period.[53]

Over the course of about a decade beginning in 1962, this network of swaps evolved from a small short-term credit facility into a large intermediate-term facility.[54] Initially, the maturity rate of a typical swap was three months, with only a single option to renew.[55] Over time, the term of a typical swap drawing doubled to six months.[56] Confronted with relatively short maturity dates, the Fed had to act quickly to find opportunities to acquire the foreign exchange necessary to fulfill its end of the swap obligation. This was not always easy, especially because the Federal Open Markets Committee (FOMC) prohibited the Fed's foreign-exchange desk from buying foreign currencies trading above their parity values, which was often the case for currencies from countries that were accumulating unwanted dollar balances.[57] If the Fed encountered a problem unwinding its swap obligations, the U.S. Treasury generally served as a backstop, willing (and with greater legal flexibility) to take on the exposure to the foreign-currency debt.[58] Naturally, this coordination with the Treasury raised concerns about the Fed's independence.[59]

Despite frequently confronting difficulties in fulfilling its swap obligations, the Fed's deployment of swap lines seemed to, at least for a time, staunch outflows of gold from the U.S. Treasury to countries intent on

---

how the swap operations could help foreign central banks cover for unwanted dollars). In one of a series of monthly Fed policy reviews, Charles A. Coombs, the special manager of the FOMC for foreign-exchange operations, explained that these swaps worked to protect the U.S. gold stock by allowing the Fed to "purchase from a central bank dollars in excess of those that the bank would ordinarily hold, in effect absorbing or mopping up these dollars for the period of the swap." Charles A. Coombs, Treasury and Federal Reserve Foreign Exchange Operations, Fed. Res. Bank of N.Y. Monthly Rev., Mar. 1963, at 39, 39, https://fraser.stlouisfed.org/files/docs/publications/frbnyreview/rev_frbny_196303.pdf [https://perma.cc/S9QB-Q937].

53. See Bordo et al., U.S. Intervention During the Bretton Woods Era, supra note 32, at 23–24 ("[T]he central bank that drew on the swap line tended to profit from the operation, because it sold foreign exchange against its own currency when its own currency was trading below par and bought foreign exchange to repay the line when its currency had appreciated.").

54. Bordo et al., Bretton Woods, Swap Lines, and the Fed, supra note 35, at 10 & fig.2.

55. Id. at 8.

56. Id. at 10–11.

57. Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 7–8.

58. The Treasury played this role by selling foreign currency—denominated certificates of indebtedness and Roosa bonds—to foreign central banks and then shifting the proceeds to the Fed. See id. at 8. For more information on Roosa bonds, which were Treasury-issued bonds that were bought with dollars but denominated and repaid in foreign currency, see John H. Makin, Swaps and Roosa Bonds as an Index of the Cost of Cooperation in the "Crisis Zone," 85 Q.J. Econ. 349, 349–51 (1971).

59. See Hetzel, Fed Debate in the 1960s, supra note 15, at 21 ("The Treasury has primary responsibility for official foreign exchange operations in the United States. Hence, participation with the Treasury in foreign exchange operations could jeopardize Fed independence.").

converting their unwanted dollar reserves.[60] While swap lines might have helped delay the disintegration of the Bretton Woods system, they did not address the system's inherent flaws.[61] In 1971, in the wake of a recession, rising U.S. inflation, and increasing cross-rate adjustment problems, President Nixon closed the gold window—in other words, stopped allowing foreign central banks to redeem their dollars for gold—thus spelling the end of the Bretton Woods monetary system.[62]

C. *The Evolution of Foreign Central Bank Liquidity Swaps During and After the Financial Crisis*

Following the collapse of the Bretton Woods system, the Fed retained the network of swap lines,[63] but generally curtailed its use.[64] By the end of 1998, the Fed officially terminated the swap network, except for its swap arrangements with the central banks of Canada and Mexico.[65] In the years leading up to the elimination of these swap lines, the general tenor of the FOMC seemed to presage the dismantling of the swap network.[66] During

---

60. See Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 8–9; see also Makin, supra note 58, at 349–51, 355 ("The evidence presented here suggests . . . that Swaps and Roosa Bonds have in fact served as a portfolio substitute for gold.").

61. There is a lot more to the economic and political history of the Bretton Woods system than can be covered in this section. For a broader overview of how U.S. fiscal and monetary policy played into the demise of the Bretton Woods system, see generally Allan H. Meltzer, U.S. Policy in the Bretton Woods Era, 73 Fed. Res. Bank St. Louis: Rev. 54 (1991).

62. Bordo et al., U.S. Intervention During the Bretton Woods Era, supra note 32, at 54–55.

63. See Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 12–19 (outlining the Fed's sparing use of swap lines in the decades following the fall of the Bretton Woods system, including the establishment of swap lines with Mexico and Canada in 1994 as part of the North American Framework Agreement).

64. See Edwin M. Truman, The Federal Reserve Engages the World (1970–2000): An Insider's Narrative of the Transition to Managed Floating and Financial Turbulence, *in* The Federal Reserve's Role in the Global Economy: A Historical Perspective 128, 167 (Michael D. Bordo & Mark A. Wynne eds., 2016) (noting that by 1996, "aside from the Bank of Mexico, no central bank had drawn on the swap network since the Swedish Riksbank did in 1981").

65. Id. at 168; see also Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Nov. 17, 1998, https://www.federalreserve.gov/fomc/minutes/19981117.htm [https://perma.cc/JW2Z-Y5GW] (relating the closure of several swap arrangements with European banks to "the formation of the European Central Bank and . . . 15 years of disuse" and deeming them to "no longer be necessary in view of the well established present-day arrangements for international monetary cooperation").

66. For example, at the July 3, 1996 meeting of the FOMC, Cathy Minehan, then-President of the Federal Reserve Bank of Boston, remarked, "Swap lines, as I understand them, were put in place to provide currency balances where none existed. So, having foreign exchange balances and swap lines at the same time is a lot like having a belt and suspenders, too." Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, July 2–3, 1996, at 99, https://www.federalreserve.gov/monetarypolicy/files/FOMC19960703meeting.pdf [https://perma.cc/3P6G-SMY8] [hereinafter FOMC Minutes, July 2–3, 1996]. Expressing a similar sentiment, Thomas Hoenig, then-President of the Federal Reserve Bank of Kansas City, said, "As they have evolved over the years, our swap

the debates over the future of the policy, prescient voices on the committee brought attention to the specter of dollar liquidity demands of foreign central banks that might arise if dollar funding were to be unexpectedly withdrawn from foreign banks.[67] At the turn of the twenty-first century following the September 11th attacks, the Fed resurrected its swap network to address this very concern.[68]

1. *Central Bank Liquidity Swaps During the Financial Crisis.* — In 2007, the issue of dollar liquidity grew urgent, as the global financial crisis heightened credit risk worldwide and precipitated a massive shortage of dollars that posed a grave threat to all economies with significant dollar-denominated assets and liabilities.[69] When the bubble in the U.S. housing market and mortgage system burst, wholesale lenders of U.S. dollars realized that banks held more bad assets than previously realized.[70] With the true extent of the subprime dollar-asset contagion unknown, wholesale lending froze, which caused the world to "witness[] a trillion-dollar, transnational bank run."[71] The BIS estimated that by mid-2007, European banks would have needed to raise somewhere between $1 and $1.2 trillion to cover the gaps on their balance sheets between dollar assets and dollar funding.[72]

---

lines have been of very limited use, and I think they present a confusing picture about our role and intentions going forward." Id. at 101.

67. See Truman, supra note 64, at 167–68. A number of members on the FOMC were attentive to this issue, including Edward Boehne, then-President of the Federal Reserve Bank of Philadelphia: "I am not arguing about whether we need the swaps per se. I am just saying that we need the means [to provide dollar liquidity in foreign exchange markets]. . . . I do not think we ought to give them up until we are sure we have something else." FOMC Minutes, July 2–3, 1996, supra note 66, at 106–07.

68. Following the terrorist attacks of September 11, 2001, the Federal Reserve established temporary reciprocal swap arrangements with the ECB and the Bank of England and expanded its existing line with the Bank of Canada. These new and updated facilities expired after thirty days. Bd. of Governors of the Fed. Reserve Sys., Treasury and Federal Reserve Foreign Exchange Operations, 87 Fed. Res. Bull. 757, 760–61 (2001). Conventionally, in a crisis caused by an exogenous event, such as 9/11, "the standard prescription [is to] flood the market with liquidity," with an eye toward increasing borrowers' confidence in the lending market and stabilizing the value of currency. See Kathryn Judge, The First Year: The Role of a Modern Lender of Last Resort, 116 Colum. L. Rev. 843, 846 (2016) [hereinafter Judge, Role of a Modern Lender of Last Resort] ("When the cause of the problem is exogenous to the system, liquidity alone will often suffice to restore market functioning and the shortages will be finite.").

69. In basic terms, the global shift from retail banking to wholesale banking made banks more leveraged and exposed to risk than ever before. See Tooze, The Forgotten History, supra note 2 (describing the circumstances that led to the financial crash and the Fed's innovative response to the crisis). Consequently, if the money markets from which foreign banks acquired U.S. dollars were disrupted, the borrowing banks faced immediate risk of failure. Id.

70. Id.

71. Id.

72. Patrick McGuire & Götz von Peter, The US Dollar Shortage in Global Banking and the International Policy Response 15 (Bank for Int'l Settlements, Working Paper No. 291, 2009), https://www.bis.org/publ/work291.pdf [https://perma.cc/LQ6M-QN6J].

One of the ways the Fed countered this impending liquidity catastrophe was by revolutionizing its swap lines to supply dollars to fragile foreign financial institutions (not to sovereign states, as was done during Bretton Woods).[73] In other words, the swaps provided foreign central banks with the capacity to deliver dollar funding to institutions in their jurisdictions during a time of market stress, which the Fed could not otherwise do directly.[74] As a descriptive matter, the network of central bank swap lines supplemented the panoply of lender-of-last-resort programs and facilities[75] the Fed already used as "an emergency replacement[s] of lost private sector balance sheet capacity by the public sector."[76] To further the comparison, the Term Auction Facility (TAF) specifically aimed to address domestic dollar funding pressures by offering emergency loans to U.S. depository institutions,[77] while the swap lines served essentially the same function, but for foreign banks.[78]

The FOMC approved temporary swap lines with fourteen central banks between December 2007 and mid-2009.[79] The Fed established the first of these swap lines on December 12, 2007, when it introduced swap

---

73. This represented a "metamorphosis" in the Fed's use of swap lines because of their new function as a "mechanism for channeling foreign-currency liquidity to strapped commercial banks." Michael D. Bordo, Owen Humpage & Anna J. Schwartz, Epilogue: Foreign-Exchange-Market Operations in the Twenty-First Century 2–3 (Nat'l Bureau of Econ. Research, Working Paper No. 17984, 2012), https://www.nber.org/papers/w17984.pdf [https://perma.cc/3Q73-6T8E] [hereinafter Bordo et al., Epilogue].

74. Michael J. Fleming & Nicholas J. Klagge, The Federal Reserve's Foreign Exchange Swap Lines, Fed. Res. Bank N.Y. Current Issues Econ. & Fin., Apr. 2010, at 1, 3.

75. These include the Primary Dealer Credit Facility (PDCF), the Term Auction Facility (TAF), the Money Market Investor Funding Facility (MMIFF), the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility (CPFF), and the Term Asset-Backed Securities Loan Facility (TALF). Darrell Duffie, Replumbing Our Financial System: Uneven Progress, Int'l J. Cent. Banking, Jan. 2013, at 251, 255. Notably, "when broken down by function, [the Fed's liquidity facilities] mapped directly onto each of the key elements of the shadow banking system: the asset-backed commercial paper market, repo lending, the market for the mortgage-backed securities, [and] currency swaps." Tooze, Crashed, supra note 4, at 206.

76. Tooze, Crashed, supra note 4, at 207 (internal quotation marks omitted) (quoting Tobias Adrian & Hyun Song Shin, Prices and Quantities in the Monetary Policy Transmission Mechanism, Int'l J. Cent. Banking, Dec. 2009, at 131, 136).

77. Some foreign financial institutions were able to tap into the Fed's emergency programs, such as TAF, via U.S. branches or affiliates. Indeed, more than half of the total dollar amount of TAF and CPFF loans made went to U.S. branches and subsidiaries of foreign institutions. Foreign banks also made heavy use of the Fed's discount window during the crisis. See J. Lawrence Broz, The Federal Reserve as Global Lender of Last Resort, 2007–2010, at 7–8 (London Sch. of Econ. & Political Sci., Systemic Risk Centre Discussion Paper No. 30, 2015), http://eprints.lse.ac.uk/60951/1/dp-30.pdf (on file with the *Columbia Law Review*). Evidently, the Fed did not view these emergency lending programs as sufficient to address the global dollar liquidity crisis.

78. Bordo et al., Epilogue, supra note 73, at 8 (pointing out that swap lines "essentially extended the [TAF's] reach beyond U.S. borders by financing term dollar funding facilities for foreign banks").

79. Id.

arrangements with the ECB and the Swiss National Bank (SNB).[80] Initially, these lines provided up to twenty billion dollars to the ECB and four billion dollars to the SNB for use in their jurisdictions and were to be available for a period of six months.[81] On September 16, 2008, two days after the collapse of the investment bank Lehman Brothers, the FOMC authorized the foreign currency subcommittee "to enter into swap agreements with the foreign central banks as needed to address strains in money markets in other jurisdictions."[82] On September 18, 2008, two days after this resolution empowering the subcommittee, the Fed increased its existing swap lines with the ECB and SNB to $110 billion and twenty-seven billion dollars, respectively, and created three new swap lines with Canada, the United Kingdom, and Japan.[83] Less than a week later, on September 24, 2008, the Fed extended swap lines to Australia, Denmark, Norway, and Sweden.[84] By the end of September 2008, the Fed had offered swaps to nine central banks, and the total swap line capacity had grown from twenty-four billion dollars to $620 billion.[85]

---

80. See Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Announce Measures Designed to Address Elevated Pressures in Short-Term Funding Markets (Dec. 12, 2007), https://www.federalreserve.gov/newsevents/pressreleases/monetary20071212a.htm [https://perma.cc/4753-C44G] (announcing the establishment of these swap lines under the same banner as the Term Auction Facility, which were both intended "to address elevated pressures in short-term funding markets").

81. Id. Upon tapping into the swap line, the ECB would distribute dollars to private banks by executing fixed-rate tenders, typically lasting between one and three months, at the lowest rates at which bids were accepted for the most recent TAF auctions. Fleming & Klagge, supra note 74, at 3.

82. Bd. of Governors of the Fed. Reserve Sys., Meeting of the Federal Open Market Committee on September 16, 2008, at 18 (2008), https://www.federalreserve.gov/monetarypolicy/files/FOMC20080916meeting.pdf [https://perma.cc/CMS2-54ZH]. The understanding of the FOMC was that the subcommittee had the authority to extend swap lines to G10 central banks, but that swaps beyond that group or to emerging market economies would need to be run by the full FOMC. See The Spread of Central Bank Currency Swaps Since the Financial Crisis, Council on Foreign Relations, https://www.cfr.org/interactives/central-bank-currency-swaps-since-financial-crisis#!/%23intro [https://perma.cc/8FHK-AKZ8] (last visited Oct. 17, 2019).

83. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Announce Further Measures to Address Elevated Pressures in Funding Markets (Sept. 18, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20080918a.htm [https://perma.cc/QG4P-H8WB]. The swap lines extended up to sixty billion dollars to the Bank of Japan, up to forty billion dollars to the Bank of England, and up to ten billion dollars to the Bank of Canada. The Fed authorized these lines for nearly five months, through January 30, 2009. Id.

84. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Announce Additional Measures to Address Elevated Pressures in Funding Markets (Sept. 24, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20080924a.htm [https://perma.cc/L5F8-QDAW] (announcing the creation of swap lines "in amounts of up to $10 billion each" by the central banks of Australia and Sweden and "in amounts of up to $5 billion each" by the central banks of Denmark and Norway).

85. Tooze, Crashed, supra note 4, at 212.

Despite the Fed's liquidity operations, market conditions continued to deteriorate to such an extent that in October 2008, the Fed removed the caps from its swap lines with the ECB, SNB, Bank of England, and Bank of Japan, giving these banks access to as many dollars as their local commercial banks demanded.[86] Correspondingly, these selected banks altered the channels through which they supplied dollar liquidity to banks in their respective jurisdictions.[87] At this time, the Fed also opened up swap lines with five more banks: the Bank of Brazil, the Bank of Korea, the Bank of Mexico, the Bank of New Zealand, and the Monetary Authority of Singapore.[88] As the transcript from the October 28–29, 2008 meeting illustrates, the FOMC did not take the decision to extend swap lines to a select few emerging market economies (EMEs) lightly.[89] In selecting these particular countries, the Fed homed in on economies it perceived as "large and systemically important," as well as those "in which their policies have been strong and it appears that they are largely being influenced by contagion."[90] In other words, the Fed believed that "a further intensification of stresses in . . . these countries could trigger unwelcome spillovers for both the U.S. economy and the international economy more generally."[91] Other EMEs apparently approached the United States for swap lines, but the Fed was worried that expanding access too far would lead to

86. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Other Central Banks Announce Further Measures to Provide Broad Access to Liquidity and Funding to Financial Institutions (Oct. 13, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081013a.htm [https://perma.cc/BD7E-L6GN].

87. Whereas previously these central banks offered limited-amount tenders at one- and three-month maturities, the unlimited swap lines allowed them to offer fixed-rate tenders for uncapped amounts at one-week, one-month, and three-month maturities. Participating central banks set the rates for these operations, rather than drawing from the Fed's TAF program. Fleming & Klagge, supra note 74, at 4.

88. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve, Banco Central do Brasil, Banco de Mexico, Bank of Korea, and Monetary Authority of Singapore Announce the Establishment of Temporary Reciprocal Currency Arrangements (Oct. 29, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081029b.htm [https://perma.cc/V79B-AV5F]; see also Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve and Reserve Bank of New Zealand Announce the Establishment of a Temporary Reciprocal Currency Agreement (Oct. 28, 2008), https://www.federalreserve.gov/newsevents/pressreleases/monetary20081028a.htm [https://perma.cc/CD4Z-CUWK].

89. Bd. of Governors of the Fed. Reserve Sys., Meeting of the Federal Open Market Committee on October 28–29, 2008, at 16–43 (2008), https://www.federalreserve.gov/monetarypolicy/files/FOMC20081029meeting.pdf [https://perma.cc/J2WB-MBDN] [hereinafter FOMC Transcript, Oct. 28–29] (discussing the proposal to extend the swap lines to certain EMEs, as well as concerns about stigmatizing the economies of countries not in the U.S. swap network).

90. Id. at 33. These are the words of economist Nathan Sheets, who presented to the FOMC on the proposal to extend the dollar swap facilities to certain EMEs. Id. at 3.

91. Id. at 10.

a slippery slope of credit risk vis-à-vis the foreign central bank and political pressure to address these additional requests.[92]

At the program's peak in December 2008, the total amount outstanding on these various swap lines totaled more than $580 billion, constituting over twenty-five percent of the Fed's total assets.[93] The Fed's liquidity facilities helped reassure markets, as it demonstrated the Fed's willingness to coordinate with other central banks to meet huge demands for dollars without forcing them to deplete their exchange reserves to a more critical level.[94] By 2009, foreign demand for dollar liquidity through the swap lines had declined as foreign banks were able to take advantage of improving market conditions to attain foreign exchange funds at lower costs elsewhere.[95] The Fed discontinued the program on February 1, 2010, and the last outstanding loan under the swap network matured on February 12, 2010.[96] In describing the consequence of the Fed's swap line facilities, Professor Adam Tooze explains that the Fed "assured key players in the global system . . . that if private funding were to become unexpectedly difficult, there was one actor in the system that would cover marginal imbalances with an unlimited supply of dollar liquidity. That precisely was the role of the global lender of last resort."[97]

2. *Central Bank Liquidity Swaps Following the Financial Crisis: The Euro Sovereign Debt Crisis and the Permanent Extension of Swap Lines.* — The pause in the use of swap lines in February 2010 proved to be short-lived, as the sovereign debt crisis in the Eurozone soon after roiled short-term dollar-funding markets.[98] On May 9, 2010, the Fed reestablished swap lines with the Bank of Canada, the Bank of England, the ECB, and the SNB, with the hopes of establishing similar measures with the Bank of Japan shortly

---

92. See id. at 30, 35–36 (referencing other countries that approached the United States about central bank liquidity swaps, although the names of these countries are redacted from the record); see also Bordo et al., Evolution of the Federal Reserve Swap Lines, supra note 5, at 22–23 ("Other emerging market countries apparently asked for similar swap lines, but broadening such access could saddle the Fed with credit risk vis-à-vis the foreign central bank and could increase moral hazard concerns.").

93. Fleming & Klagge, supra note 74, at 5.

94. See Tooze, Crashed, supra note 4, at 212–15 (documenting the scale and effectiveness of the Fed's lending programs).

95. Fleming & Klagge, supra note 74, at 5.

96. Id.

97. Tooze, Crashed, supra note 4, at 215.

98. Similar to the crisis just a few years prior, the global interconnectedness of financial markets meant that stress in the Eurozone threatened to blow back onto America. Thus, a crisis in the Eurozone posed a threat to the United States. See Europe's Sovereign Debt Crisis: Causes, Consequences for the United States and Lessons Learned: Hearing Before the H. Comm. on Oversight & Gov't Reform, 112th Cong. 15–17 (2012) [hereinafter 2012 Bernanke Statement Before House Oversight Comm.] (statement of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System); Tooze, Crashed, supra note 4, at 335–36.

thereafter.[99] Just like the previous arrangements, these swap lines were open ended, except for the line with the Bank of Canada, which maintained a thirty billion dollar limit.[100] Foreign banks tapped into these swap lines sparingly until November 30, 2011, when the central banks coordinated to lower the interest rate on dollar funding, thus making the swap lines more attractive.[101] At the same time, the Fed announced as a contingency measure that the Bank of Canada, the Bank of England, the Bank of Japan, the ECB, and the SNB decided to extend temporary swaps to each other so that emergency liquidity was available in any of the other central banks' currencies.[102] Thereafter these swap lines were periodically extended.[103]

On October 31, 2013, the Fed announced, along with the ECB, the Bank of Japan, the Bank of England, the Bank of Canada, and the SNB, that they were converting their existing temporary bilateral liquidity swap arrangements to standing arrangements—that is, these swap lines were to remain in place indefinitely.[104] The Fed has explained that these temporary swap lines were converted to standing arrangements to "further support[] financial stability by reducing uncertainties among market participants as to whether and when these arrangements would be renewed."[105] According to the resolution approved by the FOMC during its October 29–30, 2013 meeting, the Chairman, along with the Foreign Currency Subcommittee, has authority to approve drawings on the currency liquidity swaps.[106] Furthermore, "[t]he Foreign Currency Subcommittee will consult with the [FOMC] prior to the initial drawing on the dollar or foreign currency liquidity swap lines if possible . . . [whereas] authority to

---

99. FOMC Press Release, May 9, 2010, supra note 7 ("These facilities are designed to help improve liquidity conditions in U.S. dollar funding markets and to prevent the spread of strains to other markets and financial centers.").

100. Id.

101. See Press Release, Bd. of Governors of the Fed. Reserve Sys., Coordinated Central Bank Action to Address Pressures in Global Money Markets (Nov. 30, 2011), https://www.federalreserve.gov/newsevents/pressreleases/monetary20111130a.htm [https://perma.cc/4D2J-P6UJ] [hereinafter Fed. Press Release, Nov. 30, 2011]. According to Bernanke, "The lower cost to the ECB and other foreign central banks has . . . allowed them to reduce the cost of short-term dollar loans they provide to financial institutions in their jurisdictions. As was noted, the swap line increased considerably and peaked at $109 billion in mid-February." 2012 Bernanke Statement Before House Oversight Comm., supra note 98, at 16.

102. Fed. Press Release, Nov. 30, 2011, supra note 101.

103. See, e.g., Kristina Peterson, Fed Swaps Continue for Foreign Lenders, Wall St. J. (Dec. 13, 2012), https://www.wsj.com/articles/SB10001424127887324296604578177334021564270 (on file with the *Columbia Law Review*) ("The U.S. central bank said it will continue to run its dollar swap lines with the Bank of Canada, the Bank of England, the European Central Bank and the Swiss National Bank through Feb. 1, 2014.").

104. Fed. Press Release, Oct. 31, 2013, supra note 8.

105. FAQs: Foreign Currency Liquidity Swaps, supra note 17.

106. Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Oct. 29–30, 2013, at 2, https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20131030.pdf [https://perma.cc/BLZ7-ZT9M].

approve subsequent drawings of a more routine character . . . may be delegated to the Manager, in consultation with the Chairman."[107] For disclosure purposes, the central banks have published weekly the aggregate swap activity in each currency with each foreign central bank.[108]

This permanent extension of the central bank swap lines that had been so crucial to stabilizing global financial markets during the preceding crisis gave a select six of the world's major central banks unlimited access to foreign exchange liquidity. Notably, none of the world's most fragile emerging markets were included in this "central banking club class."[109] This kind of selective policy to determine which allies receive certain benefits, whether in trade, military support, etc., is usually subject to some degree of political accountability. In this instance, however, Congress left direct support of allies' financial systems—a decision with serious political implications—to the Fed, a politically insulated decisionmaker.[110]

Perhaps just as notable was the lack of attention and publicity that this significant expansion of the Fed's authority garnered.[111] No doubt contributing to this lack of notoriety was the fact that the Fed implemented swap lines as administrative measures, without congressional approval.[112] As Professor Tooze recounts, "Five years on from the crisis, while markets remained unsettled and the American political system was racked by dissension, the global dollar system was being given a new and unprecedently expansive foundation."[113] In essence, this network of central banks in relatively strong countries came together to grant each other unlimited access to their high-demand currencies, while leaving out weaker countries, precisely when they

107. Id.

108. This information can be found on the Federal Reserve Bank of New York's Foreign Exchange Swap Agreement webpage. See Central Bank Liquidity Swap Operations, Fed. Reserve Bank of N.Y., https://apps.newyorkfed.org/markets/autorates/fxswap [https://perma.cc/TC86-JBMG] (last visited Nov. 4, 2018).

109. See Katharina Pistor, Central Banking's New Club Class, Project Syndicate (Dec. 2, 2013), https://www.project-syndicate.org/commentary/katharina-pistor-crticizes-the-new-great-divide-in-international-monetary-management (on file with the *Columbia Law Review*) [hereinafter Pistor, Central Banking's New Club Class] (noting that the selection of these banks was "an inherently political act" and that there are serious legal questions about whether central banks can "create permanent swap lines with just a few other central banks of their choosing").

110. See Peter Conti-Brown & David Zaring, Shining a Light on the Federal Reserve's Foreign Affairs, Wharton Pub. Pol'y Initiative: Issue Briefs, Feb. 2019, at 1, 4, https://publicpolicy.wharton.upenn.edu/live/files/310-a [https://perma.cc/E5MM-ZGDH] ("It is worth underscoring how selective the Fed was, even among the U.S.'s diplomatic allies . . . . [It] entered swaps with Brazil, but not Argentina, Japan but not China, and Singapore but not Malaysia . . . . [T]he appearance . . . of the decision also reflects the irreducibly political and diplomatic nature of the Fed's foreign relations.").

111. See Tooze, Crashed, supra note 4, at 483 ("The swap-lines story stayed buried on the interior pages of the *Financial Times* and the *Wall Street Journal*. There was no fanfare, no new Bretton Woods Conference." (footnote omitted)).

112. Id.

113. Id.

were at their most vulnerable.[114] The widespread political implications of this coordinated decision make it all the more important that it be legally justified and not perceived as mere administrative favoritism.

II. THE FEDERAL RESERVE'S RECENT USE OF FOREIGN CENTRAL BANK LIQUIDITY SWAPS

This Part explains the Fed's legal basis for its central bank liquidity swaps and why the argument supporting the Fed's current swap lines is tenuous.[115] Section II.A explores the context for and contours of the legal theory the Fed has used to support its foreign central bank liquidity swaps since 1962. As an initial matter, this section contends that the Fed's initial reliance on Section 14 of the Federal Reserve Act for its liquidity swaps was attenuated even in the context of the Fed's foreign exchange market intervention during the 1960s. More recently, the Fed stretched this legal basis even further as swap lines have transformed into tools to provide liquidity to distressed financial institutions abroad. Section II.B analyzes two important amendments to the Federal Reserve Act to demonstrate that Congress has not tacitly approved the Fed's current use of central bank liquidity swaps. The first legislative development is the Monetary Control Act of 1980,[116] which was the last time Congress amended Section 14. The second is the recent passage of Dodd–Frank,[117] which ushered in dramatic changes to financial regulation and the Fed's authority. The ensuing analysis reveals that neither piece of legislation clearly evinces tacit Congressional approval of the Fed's current use of foreign central bank liquidity swaps.

---

114. See Pistor, Central Banking's New Club Class, supra note 109 ("Having been left outside the club, these countries have no option but to self-insure by accumulating foreign-exchange reserves."). But see Tooze, Crashed, supra note 4, at 483 (describing the regional subnetworks of swap line arrangements that allowed dollar liquidity to percolate throughout the system).

115. In short, nowhere does the Federal Reserve Act explicitly authorize the Fed to influence the value of the dollar by intervening in the market for foreign exchange or to acquire foreign exchange by establishing swap lines with foreign central banks. This omission likely occurred because the Fed was founded at a time when the United States was on the gold standard. The founders of the Fed also accepted the real bills doctrine, which contended that central banks should extend credit only on the basis of debt arising from the financing of real productive activity, as in the case of commercial paper or short-term bills of exchange. The premise of selling foreign exchange instead of gold to influence the exchange rate is inconsistent with the real bills doctrine, a basis of the Federal Reserve Act. See Meltzer, History of the Fed, supra note 33, at 348–49; Hetzel, Fed Debate in the 1960s, supra note 15, at 30.

116. Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act of 1980), Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).

117. Dodd–Frank, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

A. *The Current Legal Basis for Central Bank Liquidity Swaps: Section 14 of the Federal Reserve Act*

Broadly conceived, there is a deep distinction in the United States (unlike in other countries, such as the United Kingdom) between international and domestic monetary policy.[118] According to Stephen Axilrod, the former head of domestic monetary policy at the Federal Reserve Bank of New York, the Fed is "totally and utterly independent when making a domestic monetary policy decision . . . . The international arena is more complicated: here [the extent of] the Fed's independence is unknown and has not been fully tested . . . . The Treasury controls international finance."[119]

In the 1960s, Congress had not explicitly authorized the Fed to engage in foreign exchange transactions even though the Fed had dabbled in such activity during the 1920s.[120] In 1933, Senator Carter Glass, who is sometimes referred to as the father of the Federal Reserve Act, criticized these transactions as "stabilization operations" that were inconsistent with the intent of the Federal Reserve Act.[121] One might argue that Congress further precluded such operations in 1934 with the passage of the Gold Reserve Act, which established the ESF, controlled by the Treasury, specifically to intervene in foreign exchange markets.[122]

During the Bretton Woods era, an express legislative proclamation regarding the Fed's power to intervene in foreign exchange markets would have eased any concerns about the legality of the Fed's power to use liquidity swaps. To this day, Congress has not expressly granted such power.[123] Nevertheless, in the early 1960s, amid the raging legal debate over the Fed's powers to respond to the Bretton Woods crisis, Fed Chairman William McChesney Martin[124] took the stance that the Fed's involvement

---

118. Hetzel, Fed Debate in the 1960s, supra note 15, at 21.

119. Id. (internal quotation marks omitted) (quoting Stephen Axilrod).

120. For example, at least seven times between 1924 and 1929 the Federal Reserve Bank of New York extended credit to foreign central banks to shore up their reserves. In 1925, the Federal Reserve Bank of New York offered $200 million worth of gold to the Bank of England in exchange for its placing the proceeds from such sales of gold into a pound sterling account. Bordo et al., U.S. Intervention During the Bretton Woods Era, supra note 32, at 15 (chronicling the instances of foreign exchange transactions by the Federal Reserve in the 1920s).

121. Id.

122. Id.; see also Gold Reserve Act of 1934, Pub. L. No. 73-87, 48 Stat. 337.

123. Experts have raised this omission in Congressional testimony over the years. For example, Dr. Robert Auerbach stated to a subcommittee of the House Financial Services Committee that "since 1962, [the Fed] makes loans to foreign countries without Congressional authorization." Audit the Fed: Dodd–Frank, QE3, and Federal Reserve Transparency: Hearing Before the Subcomm. on Domestic Monetary Policy and Tech. of the H. Comm. on Fin. Servs., 112th Cong. 14 (2011) (statement of Dr. Robert Auerbach).

124. William McChesney Martin Jr. served as chairman of the Fed's Board of Governors from 1951–1970, under five administrations. Godfrey Hodgson, Obituary: William McChesney Martin, Indep. (Aug. 21, 1998), https://www.independent.co.uk/arts-entertainment/obituary-william-mcchesney-martin-1172986.html [https://perma.cc/9H58-MZCS]. He famously

in foreign-exchange operations was a fait accompli. For example, when the FOMC first formally discussed the Fed's participation in foreign exchange operations in September 1961, Chairman Martin said there was "no question but that this country was going to be in the business of foreign exchange operations in one way or another."[125] Less than a year later at the FOMC's February 1962 meeting, Chairman Martin proclaimed, "[T]en years from now operations in foreign currencies probably would be just as much a part of the System as open market operations in Government securities."[126]

Indeed, the Federal Reserve has transacted in foreign exchange ever since. As the legal basis for its power to transact in foreign exchange, the Fed has cited Section 14 of the Federal Reserve Act,[127] which governs open market operations.[128] Howard Hackley, a former general counsel to the FOMC, first articulated the argument to use this provision as the legal basis for central bank liquidity swaps in a memorandum presented to the House Committee on Banking and Currency in 1962.[129] The Hackley Memorandum still stands as the foundation of the legal argument supporting the Fed's holding of and transacting in foreign exchange.[130] Despite its persistent salience, Hackley's argument is not necessarily authoritative, as it does not possess the weight of a legislative declaration by Congress and no single congressional committee holds the power to bind all of Congress.[131]

---

said that the role of the Federal Reserve was to "take away the punch bowl just when the party gets going." Melody Petersen, William McChesney Martin, 91, Dies; Defined Fed's Role, N.Y. Times (July 29, 1998), https://www.nytimes.com/1998/07/29/business/william-mcchesney-martin-91-dies-defined-fed-s-role.html?_r=0 [https://perma.cc/B3DV-AQX8].

125. FOMC Minutes, Sept. 12, 1961, supra note 44, at 44.

126. Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Feb. 13, 1962, at 78, https://www.federalreserve.gov/monetarypolicy/files/fomchistmin19620213.pdf [https://perma.cc/W7A4-59UD].

127. See Fed Explainer on Central Bank Liquidity Swaps, supra note 12 ("The Federal Reserve operates these swap lines under the authority of [S]ection 14 of the Federal Reserve Act and in compliance with authorizations, policies, and procedures established by the Federal Open Market Committee (FOMC).").

128. The FOMC has exercised its authority to purchase and sell securities expansively—for example, it has used Section 14 to transact in foreign currencies via central bank liquidity swaps, buy and sell American sovereign debt, and even take positions in troubled real estate assets. See David Zaring, Law and Custom on the Federal Open Market Committee, 78 Law & Contemp. Probs. 157, 172 & nn.49–51 (2015) (explaining how the FOMC has exercised its power to engage in open market operations to buy Treasury securities and to facilitate public–private partnerships during the financial crisis).

129. See Meltzer, History of the Fed, supra note 33, at 350 n.138 (outlining the history of the Federal Reserve's legal debate over foreign exchange intervention during the 1960s).

130. See id. ("Hackley's memo remains as the legal basis of the Federal Reserve's holding of foreign exchange by purchase or 'warehousing[]' . . . .").

131. As Meltzer further explains, during the early 1960s, "Congressional committees held hearings on Federal Reserve and Treasury operations without formally approving or disapproving. This is treated as evidence of implied consent, but that is mainly wishful thinking. No committee can bind Congress, and a failure to reject the operation is not the same as approval." Id.

Writing to the FOMC during the policy debates over the Fed's intervention in foreign exchange markets during the Bretton Woods era, Hackley ceded, "There is, of course, no provision of present law that specifically refers to foreign currency or foreign exchange operations by the Federal Reserve System: and, accordingly, it cannot be said that there is explicit and clear authority for such operations."[132] In 1962, Robert H. Knight, then-general counsel of the Treasury, explained to Hackley his reservations about seeking such legislative authority from Congress.[133] He reasoned that the Federal Reserve System should move forward without legislation, in part because "there was a range of ideas on the Hill with regard to the Federal Reserve System, including varying views with respect to the operation and organization of the System. Legislation, if sought, might become a vehicle for adding various amendments the nature of which could not be foretold."[134] With the possibility of legislation off the table, the Fed's only option was to reinterpret its pre-existing statutory power to include foreign exchange intervention.[135] In so doing, Hackley proposed that the Fed's swap line authority emanated from the interplay between three provisions of Section 14 of the Federal Reserve Act: 1) Section 14's first paragraph; 2) Section 14(a); and 3) Section 14(e).[136]

The first paragraph of Section 14 of the Federal Reserve Act reads in its entirety:

> Any Federal reserve bank may, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this chapter made eligible for rediscount, with or without the indorsement of a member bank.[137]

---

132. Bretton Woods Agreements Act Amendment: Hearing on H.R. 10162 Before the H. Comm. on Banking & Currency, 87th Cong. 156 (1962) [hereinafter Hackley Memo] (including Memorandum of Howard Hackley, General Counsel, Federal Open Markets Committee).

133. Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open Market Committee, Jan. 9, 1962, at 60–61, https://www.federalreserve.gov/monetarypolicy/files/fomchistmin19620109.pdf [https://perma.cc/4PP8-22WL] [hereinafter FOMC Minutes, Jan. 9, 1962] ("[T]o the extent that the problem was one of obtaining clarifying legislation, it was felt that it might be better to seek such legislation after the Open Market Committee had had some experience in order to determine what its problems and limitations were.").

134. Bordo et al., U.S. Intervention During the Bretton Woods Era, supra note 32, at 84 n.34 (quoting FOMC Minutes, Jan. 9, 1962, supra note 133, at 61).

135. Some observers contend that Hackley was determined to interpret the Federal Reserve Act in a way that would support intervention, instead of interpreting the statute objectively. See id. at 83 n.27.

136. See Hackley Memo, supra note 132, at 155–56.

137. 12 U.S.C. § 353 (2018) (emphasis added). This section has remained unchanged from the original Federal Reserve Act. Federal Reserve Act, Pub. L. No. 63-43, § 14, 38 Stat. 251, 264–65 (1913).

At first blush, this provision does not explicitly permit transacting in foreign currency, although lawmakers and the Fed have considered cable transfers to be claims to foreign currency.[138] Provided that Congress drafted the Federal Reserve Act when the gold standard and real bills doctrine reigned, the most plausible understanding of the original intent of this language in Section 14 is that it empowered the Fed to buy and sell foreign exchange to facilitate transactions abroad in "real bills," such as gold or bankers' acceptances.[139] Despite this historical understanding about transactions in foreign exchange, there has been a decades-long debate about whether currency swap lines between two central banks—effectively temporary bilateral contracts for foreign exchange that are signed with the currency issuer, itself—are financial instruments "purchased and sold in the open market," so as to fit under the terms of Section 14 of the Federal Reserve Act.[140]

As for the next provision cited in the Hackley Memorandum, Section 14(a) of the Federal Reserve Act outlines the powers of Federal Reserve banks to engage in certain transactions involving gold.[141] This was particularly relevant in the context of the international monetary system based on the gold standard following the Bretton Woods Agreement.[142]

Lastly, Section 14(e) permits the Fed "to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries *wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange* . . . ."[143] Thus, according to Hackley,

---

138. See Meltzer, History of the Fed, supra note 33, at 349 & n.136 (noting that Carter Glass made some statements to the effect of precluding currency purchases, but that Hackley decided to "reinterpret the law somewhat differently"). When Congress passed the Federal Reserve Act in 1913, cable transfers were the method used to purchase foreign exchange. See David H. Small & James Clouse, The Scope of Monetary Policy Actions Authorized Under the Federal Reserve Act, Topics Macroeconomics, art. 6, 2005, at 1, 22 n.57.

139. Hetzel, Fed Debate in the 1960s, supra note 15, at 30–31 (citing H. Parker Willis, Federal Reserve Banking Practice 488 (1926)). However, the Federal Reserve's strict limit on legitimate lending under the real bills doctrine did not last long. In 1917, Congress amended the Federal Reserve Act to, inter alia, expand the number of participating banks and the types of acceptable collateral, thus evincing a shift away from the real bills doctrine to reduce the cost of financing World War I. Sarah Binder & Mark Spindel, The Myth of Independence: How Congress Governs the Federal Reserve 86 (2017).

140. See Meltzer, History of the Fed, supra note 33, at 351–58 (recounting the historical debate as to whether the swap lines fell under the jurisdiction of the Federal Reserve Board or the FOMC); see also Baker, Swap Lines, supra note 10, at 645 ("[I]t is unclear how closely the swap lines resemble typical open market operations. Instead, swap lines with select foreign central banks, potentially at nonmarket policy rates, seem to more closely resemble targeted discount window lending.").

141. Section 14(a) provides, in relevant part, "Every Federal reserve bank shall have power to deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion . . . ." 12 U.S.C. § 354.

142. See supra section I.B.

143. 12 U.S.C. § 358 (emphasis added).

the provision permitted the Fed to open accounts in foreign countries, where it could maintain holdings of foreign currency that arose "through open market purchases of cable transfers and bills of exchange, through sales of gold to foreign banks, and through the establishment of cross-credits or reciprocal balances between a Federal Reserve bank and a foreign bank."[144] For Hackley, the "wheresoever may be deemed best" language in Section 14(e) does much of the work. Instead of reading this provision as restricting the Fed's ability to open foreign accounts when seeking to facilitate the purchase, sale, and collection of bills of exchange,[145] Hackley suggested the Fed might interpret this language to grant it the discretion to maintain accounts for other reasons, such as financial stability.[146] He pointed to the last sentence of Section 14(e) to support this broad interpretation of the statutory language.[147] He reasoned that this last sentence implied that when "one Reserve bank opens foreign accounts or appoints foreign correspondents or agencies, *other* Reserve banks may conduct through such accounts, correspondents, or agencies not only transactions in bills of exchange but *any* transactions authorized by Section 14—even *non*-open market transactions, such as dealings in gold."[148] It would

144. Hackley Memo, supra note 132, at 156.

145. At the beginning of the memo, Hackley cites to a number of internal letters circulated within the Federal Reserve system evincing the Board's previous interpretation of Section 14(e). In 1933, the Federal Reserve Board wrote to the Federal Reserve Bank of New York that "it is the Board's view that such accounts may be opened and maintained only for the purpose of facilitating the purchase, sale, and collection of bills of exchange and the conduct of other open market transactions of the kind specified in [S]ection 14 of the Federal Reserve Act." Id. at 145. In another letter, the Board said its view is "that the deposit balance with the Bank for International Settlements should be reduced as soon as practicable to the minimum amount which is actually needed for the purpose of facilitating the purchase, sale, and collection of bills of exchange." Id.

146. See id. at 145–46 ("[That phrase] is susceptible of the construction that such accounts may be opened wherever geographically it may be reasonably contemplated that they *might* be used at some time for such purpose but that they need not be limited to that purpose."); see also Conti-Brown & Zaring, supra note 110, at 38 ("The Fed has suggested that this language might be interpreted to give the Fed the discretion to maintain accounts not only for transactions, but also for other reasons, like financial stability.").

147. The final sentence of Section 14(e) provides:

> Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Board of Governors of the Federal Reserve System, any other Federal reserve bank may, with the consent and approval of the Board of Governors of the Federal Reserve System, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the board.

12 U.S.C. § 358.

148. Hackley Memo, supra note 132, at 146.

therefore be illogical, Hackley argued, for the law to prohibit such activity only by the Reserve bank that opened such an account.[149]

Hackley's sophisticated legal argument shows that the Fed's authority to issue swap lines is not immediately apparent from the text of the Federal Reserve Act. As Peter Conti-Brown and David Zaring point out, swap lines are largely unrelated to the "bills of exchange" contemplated by Section 14(e).[150] They are also qualitatively distinct from the "accounts in foreign countries"[151] permitted by that same section, even if such accounts are a necessary prerequisite to a foreign central bank liquidity swap. On any account, the Federal Reserve has exercised extraordinary discretionary power to enter into central bank swap lines based on a highly debatable interpretation of its statutory powers. The weakness in this legal argument is all the more noteworthy in the twenty-first century because the Fed has dramatically transformed this network of swap lines into a vast standing facility offering dollar liquidity to foreign jurisdictions facing money market disruptions.[152] The following sections examine subsequent legislative developments that may shed light on Congress's intentions relating to the current use and purpose of the Fed's foreign central bank liquidity swaps.

B. *Amendments to the Federal Reserve Act and Implied Congressional Assent for Foreign Central Bank Liquidity Swaps*

Since its creation in 1913, the Federal Reserve has undergone periodic transformations because of Congressional amendments to the Federal Reserve Act.[153] While most recognize policymakers at the Fed as "independent," this does not mean the Fed is impervious to political forces or legislative declarations by Congress.[154] In fact, the Fed's purported policy independence is predicated on legislative (and thus political) support from Congress.[155] Naturally, the dramatic expansion of the size and complexity of the financial system helps to explain the Fed's increasing global

149. Id.

150. See Conti-Brown & Zaring, supra note 110, at 38.

151. Id.

152. See supra sections I.C.1–.2.

153. For a convenient summary of relevant Congressional reforms of the Fed from 1913 to 2015, see Binder & Spindel, supra note 139, at 19 tbl.1.1.

154. See id. at 2 ("[W]e challenge the most widely held tenet about the modern Fed: central bankers independently craft monetary policy, free from short-term political interference. Instead, we suggest that Congress and the Fed are *interdependent.*"); see also Conti-Brown, supra note 14, at 258–63 (arguing that the text of the Federal Reserve Act cannot fully illuminate the institutional development of the Fed's independence, because of the integral roles played by statutory *implementation* and "the subtle but steady drip of change exerted by individual personalities, outside forces, and the influence of chance").

155. Sarah Binder and Mark Spindel explain that "[i]nstitutions are political not because they are permeated by partisan decision making but rather because political forces endow them with the power to exercise public authority on behalf of a diverse and at times

economic influence and why legislators have revisited the appropriate authority, governance, and mission of the Fed.[156] As demonstrated by the previous discussion, these contextual factors also provide an explanation of why the Fed initially turned to foreign central bank liquidity swaps, as well as why the central bank subsequently transformed them into standing liquidity facilities for foreign financial institutions.[157]

Thus, to comprehensively assess the validity of the Fed's legal basis for its liquidity swaps, it is necessary to delve into Congressional statements and legislative activity that might relate to the Fed's revitalized foreign central bank liquidity swaps. Section II.B.1 discusses the Monetary Control Act of 1980, which represents the last time Congress reopened Section 14 of the Federal Reserve Act.[158] This section argues that the timing and content of these amendments to the Federal Reserve Act do not demonstrate Congressional approval of the current network of foreign central bank liquidity swaps. Section II.B.2 skips forward to 2010 with the passage of Dodd–Frank. Through this sweeping law, Congress dramatically reshaped the Fed's lending authority, in part, by demanding more accountability and transparency from the central bank in the aftermath of the financial crisis.[159] A review of Dodd–Frank's changes to the Federal Reserve's lender-of-last-resort authority shows that Congress does not clearly sanction foreign central bank liquidity swaps in their current form.

1. *Depository Institutions Deregulation and the Monetary Control Act of 1980.* — Congress most recently amended Section 14 of the Federal Reserve Act in 1980, as part of the Monetary Control Act.[160] With its passage, Congress amended Section 14(b)(1) of the Federal Reserve Act to give the Fed the authority to invest its holdings of foreign currencies arising from

---

polarized nation." Binder & Spindel, supra note 139, at 6; see also id. at 7 ("Congress periodically clips the Fed's power and rejects centralizing reforms. But lawmakers' efforts to revamp the Fed have on balance made the Fed more powerful and more transparent.").

156. See id. at 7.

157. See supra sections I.B–.C (outlining the circumstances that led the Federal Reserve to use and reform central bank liquidity swaps beginning in 1962).

158. Depository Institutions Deregulation and Monetary Control Act of 1980 (Monetary Control Act), Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).

159. Dodd–Frank, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

160. This influential law deregulated the banking sector and expanded the Fed's powers over monetary policy. In broad strokes, the Monetary Control Act permitted all banks, not just member banks, to access the Fed's discount window, in exchange for subjecting all banking institutions to the Fed's rules and policies, including the Fed's reserve requirements. Binder & Spindel, supra note 139, at 193–94; Chad Emerson, The Illegal Actions of the Federal Reserve: An Analysis of How the Nation's Central Bank Has Acted Outside the Law in Responding to the Current Financial Crisis, 1 Wm. & Mary Bus. L. Rev. 109, 119 (2010). For more information on the discount window, which is the lending facility that eligible institutions draw on to borrow from the Fed for short-term liquidity needs, see The Discount Window, Fed. Reserve Bank of N.Y. (July 2015), https://www.newyorkfed.org/aboutthefed/fedpoint/fed18.html [https://perma.cc/23W3-SKMK].

foreign exchange operations in interest-bearing obligations of foreign governments.[161] This amendment presupposed the Fed's transactions in foreign currency, seemingly providing tacit acceptance of the Fed's prior use of central bank liquidity swaps.[162] The Ranking Member of the House Subcommittee on Domestic Monetary Policy, Rep. George Hansen, communicated as much at a hearing related to the Monetary Control Act: "Currency swap arrangements with other central banks are part and parcel of the Federal Reserve's operations in foreign exchange markets, aimed at stabilizing the international value of the U.S. dollar."[163]

While some could construe this statement from 1983 as an example of congressional approval of the Fed's swap line network that existed at that point in history, it provides weak support for the current incarnation of central bank swap lines that the Fed has used to selectively address dollar funding disruptions in certain economies. The hearing at which Rep. Hansen made this statement was convened to address the concern that Section 14(b)(1) of the Federal Reserve Act "might be used to assist foreign governments which are experiencing financial difficulties,"[164] or might turn the Federal Reserve into "a lender of last resort for foreign as well as domestic financial institutions."[165] Perhaps ironically, this is precisely the role the current network of swap lines has recently played in the global economy.[166]

To elucidate the history of Section 105(b)(2) of the Monetary Control Act, Charles Partee, a member of the Fed's Board of Governors, explained to Congress that "[t]he only use we have made of the investment authority has been to invest foreign-currency holdings arising from our foreign-exchange operations, and we believe that is the only use compatible with the purpose and legislative history of the provision."[167] Partee went on to

161. Monetary Control Act § 105(b)(2), 94 Stat. at 140. Note that this law did not amend Sections 14(a) or (e), the provisions of the Federal Reserve Act used as the legal basis for central bank liquidity swaps. See supra section II.A.

162. See Hetzel, Fed Debate in the 1960s, supra note 15, at 39 n.9 (sketching out the basis for the Fed's argument that Congress has tacitly approved the Fed's central bank liquidity swaps).

163. Oversight Hearing on Section 14(b)(1) of the Federal Reserve Act as Amended by Section 105(b)(2) of the Monetary Control Act of 1980: Hearing Before the Subcomm. on Domestic Monetary Policy of the H. Comm. on Banking, Fin. & Urban Affairs, 98th Cong. 4 (1983) [hereinafter Hearing on Section 14(b)(1) of the Federal Reserve Act] (statement of Hon. George Hansen, Ranking Member, Subcomm. on Domestic Monetary Policy) (emphasis added).

164. Id. at 3 (opening statement of Hon. Walter E. Fauntroy, Chairman, Subcomm. on Domestic Monetary Policy).

165. Id. at 4 (statement of Hon. George Hansen, Ranking Member, Subcomm. on Domestic Monetary Policy) (internal quotation marks omitted).

166. See supra section I.C.1.

167. Hearing on Section 14(b)(1) of the Federal Reserve Act, supra note 163, at 6 (statement of Hon. J. Charles Partee). During the Senate's consideration of the Monetary Control Act, Senator William Proxmire provided support for this interpretation when he said the purpose of the authority to purchase obligations of foreign governments is "to provide a

explain how limitations on the Fed's authority provide "ample safeguards to prevent Section 105(b)(2) from being used by the Federal Reserve as a basis for assisting foreign governments in financial difficulty."[168] These assurances still have not stopped some economists from describing the Monetary Control Act as putting "the Fed into the role of a silent partner, or even a surrogate, of the State Department for bailing out bankrupt foreign governments who had unmanageable debts due to several large banks in the United States."[169]

2. *Dodd–Frank's Title VIII and the Federal Reserve as a Lender of Last Resort.* — The central bank in the United States, as well as in most other jurisdictions, functions as a lender of last resort (LOLR).[170] For the Fed, its LOLR function gives it the authority to provide collateralized loans to banks, primarily via its discount window and open market operations,[171] and to nonbanks in "unusual and exigent circumstances."[172] Many trace the logic underpinning a central bank's function as a LOLR to Walter Bagehot's claim from the late 19th century that "when significant liquidity shortfalls plague the market, a central bank should step in and provide liquidity by lending freely against any collateral that had been considered good collateral prior to the crisis."[173] During the financial crisis the Federal

vehicle whereby such foreign currency holdings could be invested in obligations of foreign governments and thereby earn interest. This authority would be used only to purchase such obligations with foreign currencies balances acquired by the Federal Reserve in the normal course of business." Id. at 7 (statement of Hon. J. Charles Partee) (internal quotation marks omitted) (quoting Sen. Proxmire).

168. Id. at 8 (statement of Hon. J. Charles Partee) (highlighting the "clear legislative history of Section 105(b)(2), including Chairman Volcker's 1979 testimony on behalf of the Board, the further restrictions imposed by the FOMC, and the limited list of currencies that have traditionally been eligible for Federal Reserve purchase and sale").

169. Richard H. Timberlake, Jr., Legislative Construction of the Monetary Control Act of 1980, 75 Am. Econ. Rev. 97, 101 (1985) (describing representatives of the Fed as using "misdirection and subterfuge" to inveigle "an unwary Congress into doing its bidding" during the deliberations on the Monetary Control Act).

170. See, e.g., Judge, Role of a Modern Lender of Last Resort, supra note 68, at 850–55.

171. See 12 U.S.C. § 347b(a) (2018). The Fed's discount window permits regional Federal Reserve Banks to relieve liquidity strains for individual depository institutions by providing a backup source of funding. Section 10B of the Federal Reserve Act largely outlines the statutory framework governing such lending to depository institutions. See Discount Window Lending, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/regreform/discount-window.htm [https://perma.cc/YV5Y-WFKA] (last updated Sept. 28, 2018). For a more thorough account of the Fed's discount window and how the Fed fulfilled its role as the lender of last resort during the financial crisis, see generally Kathryn Judge, Three Discount Windows, 99 Cornell L. Rev. 795 (2014) (explaining how during the financial crisis the Fed served as a lender of last resort via its discount window, which is a standing program that promotes market stability by allowing eligible banks to borrow from the Fed in times of need).

172. See 12 U.S.C. § 343(3)(A). For more on the Fed's emergency powers to loan to nondepository institutions, see infra section III.A.

173. Kathryn Judge, The Federal Reserve: A Study in Soft Constraints, 78 Law & Contemp. Probs. 65, 78 (2015) (citing Walter Bagehot, Lombard Street: A Description of the Money Market 56 (1873)).

Reserve extended its LOLR capacities in innovative and unprecedented ways, including (but not limited) to its central bank liquidity swaps.[174]

In 2010, with the passage of Dodd–Frank,[175] Congress updated the Fed's last-resort lending authority by permitting it to provide credit or liquidity assistance to designated financial market utilities in "unusual or exigent circumstances."[176] Provided that the Fed's revived central bank liquidity swaps injected emergency liquidity into foreign jurisdictions as a sort of international LOLR,[177] one might be tempted to look to this new LOLR authority for evidence of Congressional approval of the Fed's swap line network. Upon closer inspection, it is clear that the LOLR authority codified in Dodd–Frank's Title VIII does not extend to foreign central banks.[178]

Title VIII cabins the Fed's new authority to "designated financial market utilities" in unusual or exigent circumstances and after consultation with the Treasury Secretary.[179] Furthermore, the utility must show that it cannot secure credit from any other banking institution.[180] The law defines "financial market utilities" as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."[181] For a financial market utility to be "designated," it must be one of those "financial market

174. See, e.g., Frederic S. Mishkin & Eugene N. White, Unprecedented Actions: The Federal Reserve's Response to the Global Financial Crisis in Historical Perspective, *in* The Federal Reserve's Role in the Global Economy 220, 226–30 (Michael D. Bordo & Mark A. Wynne eds., 2016) ("The Fed also became an international [LOLR] to central banks during the crisis. In December 2007, the Fed set up swap lines for the [ECB] and the [SNB] to allow them to borrow dollars from the Fed so that they could make dollar loans to their domestic banks.").

175. Dodd–Frank, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

176. § 806(b), 124 Stat. at 1811–12 (codified at 12 U.S.C. § 5465). Note the disjunctive "or," rather than the conjunctive "and" used in Section 13(3) to describe the relevant circumstances. This statutory language potentially permits a more expansive set of circumstances in which the Fed can invoke its § 806(b) lending powers. Colleen Baker, The Federal Reserve as Last Resort, 46 U. Mich. J.L. Reform 69, 110 (2012) [hereinafter Baker, Last Resort]; see also infra section III.B for more on how Dodd–Frank changed the Fed's LOLR powers under Section 13(3) of the Federal Reserve Act.

177. See supra section I.C.1.

178. "The Board of Governors may authorize a Federal Reserve bank under Section 10B of the Federal Reserve Act (12 U.S.C. [§] 347b) to provide to a *designated financial market utility* discount and borrowing privileges only in *unusual or exigent circumstances* . . . ." Dodd–Frank § 806(b) (emphasis added).

179. Id.

180. Id.

181. Dodd–Frank § 803(6)(A). Broadly speaking, payment, clearing, and settlement services are financial intermediaries that process and complete financial transactions. Following the financial crisis, Title VIII gave the Federal Reserve explicit oversight authority with respect to systematically important elements of this financial infrastructure. See Donna Nordenberg & Marc Labonte, Cong. Research Serv., R41529, Dodd–Frank Act, Title VIII: Supervision of Payment, Clearing, and Settlement Activities 1–7 (2010).

utilities or payment, clearing, or settlement activities that the [Financial Stability Oversight] Council [(FSOC)] determines are, or are likely to become, systemically important."[182]

Instead of legitimizing the current use of the Fed's central bank swap lines, Title VIII of Dodd–Frank is better suited to further the proposal by some regulators to set up swap lines between central clearing parties (CCPs)[183] and central banks in a financial crisis.[184] As Colleen Baker notes, if "the Federal Reserve were to be called upon and actually provide last-resort dollar funding to foreign-located CCPs, then it would truly have become the last resort."[185] While the Fed might be able to manipulate Title VIII of Dodd–Frank to extend the use of its liquidity swaps to certain foreign financial market utilities,[186] this presupposes that the Fed is on a solid legal foundation to issue liquidity swaps under Section 14 of the Federal Reserve Act. In seeking an alternative means with which to legitimize the Fed's network of swap lines, this discussion will now turn to the Fed's emergency powers under Section 13(3) of the Federal Reserve Act as a more fitting legal basis that the Fed should consider using when creating swap lines with foreign central banks.

182. Dodd–Frank § 804(a)(1). To date, the FSOC has designated eight financial market utilities as systemically important. The eight designated financial market utilities are: The Clearing House Payments Company, L.L.C.; CLS Bank International; Chicago Mercantile Exchange, Inc.; The Depository Trust Company; Fixed Income Clearing Corporation; ICE Clear Credit L.L.C.; National Securities Clearing Corporation; and, The Options Clearing Corporation. See Designated Financial Market Utilities, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm [https://perma.cc/Z5J4-K3HW] (last updated Jan. 29, 2015).

183. CCPs, which have become crucial nodes in global financial networks, act as intermediaries between the buyer and seller of an original trade in a financial market. In essence, CCPs guarantee the obligations under contracts agreed between two parties. The CCPs, instead of the contracting parties, are exposed to the risk that a counterparty defaults. CCPs are expected to become even more systemically important, making it essential that they properly manage the risk they are taking on. See Amandeep Rehlon & Dan Nixon, Central Counterparties: What Are They, Why Do They Matter and How Does the Bank Supervise Them?, Bank of Eng. Q. Bull., Q2 2013, at 147, 147–49.

184. See, e.g., Baker, Last Resort, supra note 176, at 121–22 ("[T]he establishment of central bank liquidity swap lines between central banks and CCPs has been proposed as a way to meet foreseeable future last-resort liquidity needs by international CCPs."); see also Baker, Swap Lines, supra note 10, at 636 n.202 (making the same point about the potential extension of swap lines to clearinghouses).

185. Baker, Last Resort, supra note 176, at 122.

186. Baker explains that such a future arrangement is implied by § 11(s)(4)(B) of the Federal Reserve Act, which defines the statutory term "covered transaction." In broad strokes, "covered transactions" are Federal Reserve lending transactions that are subject to certain transparency requirements under the Federal Reserve Act. See Baker, Last Resort, supra note 176, at 122 n.312; see also 12 U.S.C. § 248(s)(2)(B), (4)(B) (2018). Included in this definition of "covered transaction" is "any open market transaction with a nongovernmental third party conducted under [S]ection 353 of this title . . . ." 12 U.S.C. § 248(s)(4)(B)(i). This statutory provision (12 U.S.C. § 353) is the cornerstone of the Federal Reserve's swap line authority. Baker, Last Resort, supra note 176, at 122 n.312.

III. An Alternative Legal Basis to Legitimize the Federal Reserve's Swap Lines: 13(3) Emergency Powers and Dodd–Frank

Since 1962, the Fed's network of central bank swap lines has evolved from a limited tool to protect the value of the dollar in foreign exchange markets into a vast source of dollar liquidity that select foreign central banks can tap into to when they so choose.[187] Despite this dramatic shift in purpose, the legal basis for the Fed's network of swap lines has remained unchanged. Instead of relying on an attenuated interpretation of statutory text from Section 14 of the Federal Reserve Act, this Part contends that the Fed could imbue accountability and legitimacy into its liquidity swaps if it reinterpreted the legal basis for its liquidity swaps under its Section 13(3) emergency powers, as amended by Dodd–Frank. A shift to this legal basis would necessarily entail serious tradeoffs, including limiting the Fed's ability to engage in swap line transactions to "unusual and exigent" circumstances and requiring additional transparency requirements.[188]

As an initial matter, Section 13(3) permits the Fed to discount certain financial instruments (i.e., notes, drafts, and bills of exchange) for any participant in any program or facility with broad-based eligibility.[189] In this context, "discounting" has a precise meaning—when a bank "discounts" (or loans) a financial instrument for a borrower, the bank accepts that instrument as collateral and lends out an amount of money less than the face value of that instrument.[190] This Note takes for granted that swap transactions possess all of the traditional features of a loan[191] and that the statutory language permits the Fed to invoke Section 13(3) in swap-like transactions. Section III.A explains the contours of the Fed's emergency powers under Section 13(3). Section III.B explains how changes implemented by Dodd–Frank suggest that Section 13(3) is a stronger, more legitimate legal basis for the Fed's swap lines.

A. *Section 13(3) of the Federal Reserve Act: The Fed's Emergency Powers*

A series of amendments passed during the Great Depression added Section 13(3) to the Federal Reserve Act,[192] which outlines the Fed's powers to provide extensive emergency financial assistance in "unusual and exigent circumstances."[193] The provision remained largely dormant until the

187. See supra sections I.B–.C.

188. See 12 U.S.C. § 343(3)(A) (outlining the Fed's emergency powers).

189. Id.

190. Alexander Mehra, Legal Authority in Unusual and Exigent Circumstances: The Federal Reserve and the Financial Crisis, 13 U. Pa. J. Bus. L. 221, 225–26 (2010) (citing Black's Law Dictionary (2d ed. 1910)).

191. See supra notes 28–29 and accompanying text.

192. See David Fettig, The History of a Powerful Paragraph, Fed. Res. Bank Minneapolis: Region, June 2008, at 33, 34 (outlining key legislative dates and events in the history of the Fed's emergency powers under Section 13(3)).

193. 12 U.S.C. § 343(3)(A); see also Baker, Last Resort, supra note 176, at 87.

Fed aggressively revived its Section 13(3) powers during the recent financial crisis as a critical component of its policy response.[194] Under normal authority, the Fed operates under statutory limitations on whom it may lend to and the types of collateral it may accept.[195] These emergency powers enable the Fed to lend to a broader category of agents other than depository institutions and to do so with less stringent collateral requirements[196]—such nonbank financial institutions do not usually have access to the Federal Reserve's last resort liquidity facilities.[197] Furthermore, the Fed generally does not know the identities of the institutions that will be helped by its emergency powers[198]—and in the case of central bank liquidity swaps, the Fed may never know the institutions that ultimately receive the injection of liquidity.[199] Another difference related to Section 13(3) emergency powers is that, unlike depository institutions, the entities likely

---

194. See An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. 8 (2009) [hereinafter 2009 Bernanke Statement Before H. Fin. Servs. Comm.] (statement of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System) ("Prior to 2008, credit had not been extended under [13(3)] authority since the 1930's. However responding to the extraordinary stressed conditions in financial markets the Board has used this authority on a number of occasions over the past year."). In 2009, some members of the House Committee on Financial Services were surprised to learn that the Federal Reserve Act granted emergency lending powers to the Federal Reserve. For example, during a hearing in 2009, then-Chairman of the House Financial Services Committee Barney Frank remarked, "As the Chairman of the Federal Reserve points out in his statement, [the emergency powers provision] was not much used, and maybe not at all from the 1930's to recently. And I will tell you, I was surprised myself to learn about it, having been on this committee for some time, and having been chairman since January of 2007." Id. at 1.

195. Marc Labonte, Cong. Research Serv., R44185, Federal Reserve: Emergency Lending 1 (2016) [hereinafter Labonte, Emergency Lending].

196. The Fed's Section 13(3) emergency powers now read as follows:

> In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members, may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of [S]ection 357 of this title [Section 14(d) of the Federal Reserve Act], to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal Reserve bank: *Provided*, That before discounting any such note, draft, or bill of exchange, the Federal reserve bank shall obtain evidence that such participant in any program or facility with broad-based eligibility is unable to secure adequate credit accommodations from other banking institutions. All such discounts for any participant in any program or facility with broad-based eligibility shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.

12 U.S.C. § 343(3)(A).

197. Baker, Swap Lines, supra note 10, at 639.

198. See id.

199. See supra note 13 and accompanying text.

to receive assistance from emergency facilities are probably not subject to the Federal Reserve's ex ante supervision.[200] Indeed, in the case of the Fed's central bank liquidity swaps, the foreign financial institutions ultimately benefitting from the injection of dollar liquidity are likely not within the Fed's jurisdiction at all.

During the financial crisis, the Fed used its Section 13(3) powers to implement liquidity and lending facilities that went beyond those tools usually available to the Fed's traditional borrowers (such as banks and other depository institutions).[201] In other words, the Fed's emergency programs during the financial crisis supplied loans to nonbank borrowers, investors, and financial firms.[202] Using its Section 13(3) authority, the Fed created six facilities to provide liquidity to "primary dealers" (that is, certain large investment firms) and spark demand for commercial paper and other asset-backed securities.[203] For instance, the first modern invocation of Section 13(3) occurred in March 2008, when the Fed announced the creation of the Term Securities Lending Facility (TSLF).[204] The TSLF aimed to alleviate the liquidity problem for broker dealers by lending them Treasury securities in exchange for collateral in the form of mortgage-backed securities (MBS).[205] Another emergency lending program was the Commercial Paper Funding Facility (CPFF), which the New York Fed used to purchase commercial paper in order to inject liquidity into corporate credit markets.[206] In a particularly controversial extension of Section 13(3), the Fed also used its emergency authority to provide tailored assistance to firms deemed too big to fail,[207] which included a thirty billion

200. Baker, Swap Lines, supra note 10, at 639.

201. See Binder & Spindel, supra note 139, at 212–13 ("These programs reached well beyond the banking sector, providing liquidity for the 'shadow' banking system—mutual funds, hedge funds, investment banks, and other nonbank financial institutions.").

202. Id.

203. See Labonte, Emergency Lending, supra note 195, at 3 (summarizing the facilities the Fed created during the financial crisis using its powers under Section 13(3)).

204. See Thomas C. Baxter, Jr., Gen. Counsel & Exec. Vice President, Fed. Reserve Bank of N.Y., Presentation at the London School of Economics, The Legal Position of the Central Bank: The Case of the Federal Reserve Bank of New York 7 (Jan. 19, 2009) (on file with the *Columbia Law Review*) (noting the uncertainty involved with invoking these emergency powers because "when relying on a statute that had not been used to lend since the Great Depression, the Fed could not know exactly how the market would react").

205. Id.; see also Labonte, Emergency Lending, supra note 195, at 3 ("The Fed made short-term loans through the [Primary Dealer Credit Facility] and TSLF to primary dealers to ensure that other primary dealers did not experience liquidity crises in the wake of the primary dealer Bear Stearns's financial difficulties.").

206. Binder & Spindel, supra note 139, at 213.

207. See Labonte, Emergency Lending, supra note 195, at 6 (noting that the Fed's use of Section 13(3) to prevent the failure of four large financial firms was "motivated by concerns that the failure of any of these firms would increase financial instability—in other words, the Fed viewed the firms as . . . too interconnected to fail"). For more information on the Fed's use of Section 13(3) to prevent the failure of systematically important financial institutions, see generally Marc Labonte, Cong. Research Serv., R42150, Systematically Important or "Too Big to Fail" Financial Institutions (2018).

dollar emergency loan facilitating the merger of JPMorgan Chase and Bear Sterns.[208] The eventual disclosure of the Fed's lending during the financial crisis revealed that corporate America and global finance benefitted to the tune of approximately $1.2 trillion in lending.[209]

As explained in Part II, the Fed does not invoke its emergency powers when it creates currency swap lines with central banks.[210] Given the contentious interpretation of Section 14 the Fed has used to justify central bank liquidity swaps, as well as their use as a tool to ameliorate short-term dollar liquidity shortages in foreign jurisdictions, the Fed should consider reassessing the legal basis it has used for its liquidity swaps. Section III.B argues that the Fed should turn to Section 13(3) as the prevailing legal authority for these tools.

As an initial matter, foreign central banks are not the domestic nondepository entities that Section 13(3) has historically contemplated as eligible for emergency lending from the Fed. It is easy to address this technicality, as the counterparty central banks involved in the Fed's liquidity swaps are merely intermediaries between the Fed and the ultimate beneficiaries of the dollar liquidity[211]—the statutory language does not preclude such lending so long as the recipients are "any participant in any program or facility with broad-based eligibility."[212] Furthermore, as Colleen Baker notes in developing a new theoretical framework for the Fed's use of foreign central bank liquidity swaps, it could provide foreign financial institutions an inappropriate advantage if domestic, nondepository financial institutions receive credit and liquidity assistance only in emergencies,

---

208. In simplistic terms, the Fed created a special purpose vehicle (SPV), called Maiden Lane, LLC. The Fed lent Maiden Lane approximately twenty-nine billion dollars and JPMorgan Chase approximately one billion dollars. Under Section 13(3), Maiden Lane used the loan proceeds to acquire Bear assets, which transformed Bear into a viable merger target for JPMorgan Chase. See Baxter, supra note 204, at 11–12. For a discussion of why this transaction might have exceeded the Fed's legal authority, cf. Emerson, supra note 160, at 128–29 (explaining that purchasing assets that fell outside the categories provided by the Federal Reserve Act was an improper exercise of statutory authority).

209. See Binder & Spindel, supra note 139, at 213–14 (citing Bradley Keoun & Phil Kuntz, Wall Street Aristocracy Got $1.2 Trillion in Secret Loans, Bloomberg (Aug. 22, 2011), https://www.bloomberg.com/news/articles/2011-08-21/wall-street-aristocracy-got-1-2-trillion-in-fed-s-secret-loans (on file with the *Columbia Law Review*)) (noting that this $1.2 trillion in lending included loans to Ford Motor Company, Toyota, Morgan Stanley, and Citigroup, as well as major foreign banks).

210. See supra section II.A; see also 2009 Bernanke Statement Before H. Fin. Servs. Comm., supra note 194, at 8–9 ("Other components of the Federal Reserve's credit programs, including our lending to depository institutions, liquidity swaps with other central banks, and purchases of agencies and securities make no use of the powers conferred by [S]ection 13(3).").

211. See Baker, Swap Lines, supra note 10, at 639.

212. 12 U.S.C. § 343(3)(A) (2018); see also Mehra, supra note 190, at 264–65 (pointing out that following the passage of Dodd–Frank, the Fed can no longer use Section 13(3) to lend to "any individual, partnership or corporation," but instead can lend to "any participant in any program or facility with broad-based eligibility").

but similarly situated overseas institutions have access to emergency dollar liquidity all of the time.[213]

An additional benefit of looking to Section 13(3) as the legal basis for the Fed's central bank liquidity swaps is related to the clear expression of congressional intent represented by Dodd–Frank's recent passage.[214] Politicians demanded further transparency for past and future lending decisions when Congress passed Dodd–Frank.[215] This was in part a response to the public outrage sparked by the Fed's use of its emergency powers to lend to a broad range of bank and nonbank institutions.[216] Section III.B analyzes the changes Congress made to the Federal Reserve Act with the passage of Dodd–Frank to suggest that prevailing law calls for significant changes to the Fed's network of foreign central bank liquidity swaps.

B. *Dodd–Frank's Reforms to the Fed's Emergency Powers, Congressional Intent, and Central Bank Liquidity Swaps*

The Fed's actions under Section 13(3) during the financial crisis were highly controversial and incentivized Congress to amend the Federal Reserve Act's emergency powers provision under Dodd–Frank.[217] Driven both by public anger and pragmatic considerations over the Fed's response to the financial crisis, the provisions in Dodd–Frank concerning the Fed's Section 13(3) powers are geared toward preventing the Fed from bailing out failing firms, increasing transparency, and preserving enough of the Fed's discretion to continue allowing it to implement emergency facilities to address exigent market-access problems during a crisis.[218]

---

213. Baker, Swap Lines, supra note 10, at 639 ("If domestic, nondepository financial institutions, whose identity is known to the Federal Reserve, receive . . . credit and liquidity assistance only in emergencies, this limitation on assistance should also apply to unknown overseas institutions. Otherwise, overseas financial institutions could receive an advantage over domestic ones.").

214. The stated aim of Dodd–Frank is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes." Dodd–Frank, Pub. L. No. 111-203, pmbl., 124 Stat. 1376, 1376 (2010) (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.).

215. Id.

216. For example, Congressman Walter Jones (R-NC), upon the disclosure of the Fed's extensive lending during the crisis, said, "Why in hell does the Federal Reserve seem to be able to find the way to help these entities that are gigantic? They get help when the average business person . . . can't even go to a bank they've been banking with for 15 or 20 years and get a loan . . . ." Binder & Spindel, supra note 139, at 214 (citation omitted) (quoting Keoun & Kuntz, supra note 209).

217. Binder & Spindel, supra note 139, at 201 ("[T]he Fed's unconventional, untested, and exigent central bank tools blurred the lines between monetary and fiscal policy, exacerbating the Fed's already-tense relationship with Congress at a time of severe economic stress.").

218. See id. at 16 ("[C]hanneling public anger from the Left and Right about the Fed's unconventional policies during the crisis, Congress also imposed more transparency on the

With the passage of Dodd–Frank in 2010, Congress reopened the Federal Reserve Act and, in so doing, both expanded and contracted the Fed's regulatory powers. On the one hand, Dodd–Frank bolstered the Fed's financial regulatory responsibilities and gave it more supervisory powers over large financial institutions. On the other, Dodd–Frank circumscribed the Fed's role as the lender of last resort and imposed several accountability requirements on its exercise of emergency powers.[219] First, Title XI of Dodd–Frank, which contains provisions related to the Federal Reserve System, prohibits the use of the Fed's Section 13(3) emergency power to assist an individual financial institution or to loan to an insolvent firm.[220] Instead, the law now provides that the Fed should deploy Section 13(3) powers only to provide liquidity to a "participant in any program or facility with broad-based eligibility."[221] The Fed promulgated a final rule implementing Section 1101 of Dodd–Frank in which it defined "broad-based eligibility" to mean a minimum of five eligible participants.[222]

If the Fed seeks to fit its foreign central bank liquidity swaps under the post-Dodd–Frank Section 13(3), it must ensure it meets this statutory broad-based eligibility requirement. The Fed might be able to do so under multiple theories. As currently comprised, the standing liquidity swap lines are available to five foreign central banks, which might be sufficient to meet this criterion.[223] Alternatively, the Fed might be able to argue that the broad-based criteria is fulfilled regardless of the number of central banks that have access to swap lines because of the many financial institutions that may ultimately receive these dollars. One potential issue that the Fed might face is that it does not currently possess the regulatory or supervisory capacity to ensure that financial institutions that receive the dollar liquidity use it for its intended purposes[224]—for instance, once a foreign

Fed and clipped its lender of last resort authority."); see also Labonte, Emergency Lending, supra note 195, at 10 (citing H.R. Rep. No. 111-517, at 875–76 (2010) (Joint Explanatory Statement of the Comm. of Conf.)).

219. See § 1101, 124 Stat. at 2113 (codified as amended at 12 U.S.C. § 343 (2018)); Binder & Spindel, supra note 139, at 1, 216 (describing the general effect of reforms under Dodd–Frank).

220. Dodd–Frank § 1101(a)(6)(B)(i)–(ii).

221. Dodd–Frank § 1101(a)(2)–(5).

222. Extensions of Credit by Federal Reserve Banks, 80 Fed. Reg. 78959, 78960 (Dec. 18, 2015) (to be codified at 12 C.F.R. § 201.4(d)). For an overview of the major components of the Fed's final rule implementing Section 1101 of Dodd–Frank, see Labonte, Emergency Lending, supra note 195, at 12 tbl.2.

223. See supra section II.B.

224. See Baker, Swap Lines, supra note 10, at 639–40 (highlighting the Fed's limited supervisory abilities when extending dollar liquidity abroad). According to the minutes of the FOMC's Oct. 28–29, 2008 meeting, when deliberating about setting up swap lines with Mexico, Brazil, Korea, and Singapore, members of the committee "pointed to the international reserves held by the countries and the importance of ensuring that these temporary swap lines, like the others that had been established during this period, be used only for the purposes intended." Bd. of Governors of the Fed. Reserve Sys., Minutes of the Federal Open

central bank draws on a swap line, the Fed does not have the ability to prevent the dollars from being used to bail out an insolvent firm, in violation of Section 1101(a) of Dodd–Frank.

A further accountability measure imposed on the Fed by Dodd–Frank provides that the Fed must seek approval from the Treasury to make use of Section 13(3) emergency powers.[225] In addition, the Fed is required to submit a report to the Senate Banking, Housing, and Urban Affairs Committee and the House Financial Services Committee within seven days of authorizing any loan or financial assistance under Section 13(3).[226] Provisions of Dodd–Frank outline the details that this report to Congress must contain, including the justification for the exercise of Section 13(3) emergency authority, the identity of the recipients of the assistance, the dates and amounts of borrowing, and the material terms of the loans.[227] The Fed might be hard-pressed to provide Congress with the necessary list of recipients of the financial assistance to conform central bank liquidity swaps to these reporting requirements.[228] As an additional problem, this mandatory disclosure regime could heighten financial instability, as the public might perceive firms that accessed liquidity facilities to be weak, which could cause a rush to divest and disassociate from such institutions.[229] Nevertheless, it is clear following the passage of Dodd–Frank that Congress has demanded greater transparency for the Fed's past and future lending programs than was exhibited during the financial crisis.[230] Although the banking industry has remained vehemently opposed to disclosure of loans they receive from central banks, the Fed would head off a source of major criticism and act in accordance with Congress's manifest

---

Market Committee, Oct. 28–29, 2008, at 2, https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20081029.pdf [https://perma.cc/A28W-M6AG].

225. Dodd–Frank § 1101(a)(6)(B)(iv) ("The Board may not establish any program or facility under this paragraph without the prior approval of the Secretary of the Treasury.").

226. Dodd–Frank § 1101(a)(C)(i).

227. See id. Material terms of such assistance include the duration of the loan, any pledged collateral, interest, fees, and any other requirements imposed on the loan recipient. Dodd–Frank § 1101(a)(C)(i)(IV).

228. As previously discussed, the Fed does not keep track of the ultimate recipients of the dollars sent to the foreign central bank. See supra notes 13, 169, 198–199 and accompanying text.

229. See Marc Labonte, Cong. Research Serv., R42079, Federal Reserve: Oversight and Disclosure Issues 13 (2017) ("The Fed has argued that allowing the public to know which firms are accessing its facilities could undermine investor confidence in the institutions . . . . A loss of investor confidence could potentially lead to destabilizing runs . . . [which may cause] the institutions [to] be wary of participating in the Fed's programs.").

230. See Binder & Spindel, supra note 139, at 213–16 ("Given the Fed's resistance to disclosure, it took legal and ultimately congressional action to force the Fed to reveal the recipients of its emergency loans . . . . Lawmakers from both parties rejected the Fed's position that disclosure would undermine the effectiveness of their emergency lending programs.").

desire for more transparency if it sought to keep track of the ultimate recipients of the dollars drawn from the swap lines.[231]

Dodd–Frank also requires the Fed to sufficiently collateralize emergency lending to "protect taxpayers from losses."[232] In relevant part, the law provides:

> [T]he Board shall establish . . . policies and procedures . . . to ensure that any emergency lending program or facility is for the purpose of providing liquidity to the financial system, and not to aid a failing financial company, and that the security for emergency loans is sufficient to protect taxpayers from losses and that any such program is terminated in a timely and orderly fashion. The policies and procedures established by the Board shall require that a Federal reserve bank assign, *consistent with sound risk management practices and to ensure protection for the taxpayer, a lendable value to all collateral for a loan executed by a Federal reserve bank under this paragraph* in determining whether the loan is secured satisfactorily for purposes of this paragraph.[233]

Prior to the passage of Dodd–Frank, emergency lending only needed to be collateralized to "the satisfaction of the Federal Reserve Bank."[234] According to two economists in the Division of Monetary Affairs at the Board of Governors, this language from 13(3) provided "virtually no restrictions on the form a written credit instrument must take in order to be eligible for discount."[235] While Dodd–Frank did not take this language out of Section 13(3), it did refine the standard for acceptable collateral by providing that the Reserve Banks must assign a "lendable value" in a manner consistent with "sound risk management practices."[236] Furthermore, the security for emergency loans must be "sufficient to protect taxpayers from losses."[237] Although foreign central bank liquidity swaps

231. The lack of disclosure and transparency regarding the Fed's lending programs has drawn the ire of politicians on both sides of the aisle. See id. at 214–15 (describing calls from both Republicans and Democrats for more transparency from the Fed). As an example of the critics' call for more transparency, Mark Calabria, director of financial regulation studies at the libertarian Cato Institute, has asked, "How do we protect against conflicts of interest . . . and how do we evaluate the effectiveness of these efforts, without knowing where the money went?" Nancy Watzman, With Fed Foreign Currency Swaps on the Rise, Mystery Remains Which Foreign Banks Benefit, Sunlight Found. (Oct. 19, 2011), https://sunlightfoundation.com/2011/10/19/with_fed_foreign_currency_swaps_on_the_rise/ [https://perma.cc/2Xf7-GEDS].

232. Dodd–Frank § 1101(a)(B)(i).

233. Id. (emphasis added).

234. Federal Reserve Act § 13(3), 12 U.S.C. § 343 (2006); see also Mehra, supra note 190, at 223, 228–29 ("The phrase 'secured to the satisfaction of' indicate[d] that a Reserve Bank ha[d] some measure of discretion in the collateral it cho[se] to accept. But it d[id] not follow that the Reserve Bank enjoy[ed] absolute discretion. It would seem that the borrower ha[d] to provide *some* appropriate security . . . .").

235. Small & Clouse, supra note 138, at 13.

236. Dodd–Frank § 1101(a)(B)(i).

237. Id.

cannot plainly be classified as typical loans backed by collateral, the low amount of risk they entail and the offsetting amount of foreign currency the Fed receives when another central bank draws on its swap line mean that taxpayers are likely to be sufficiently protected from loss to fit within this requirement from Dodd–Frank.

CONCLUSION

Following Ben Bernanke's eight years as Fed Chairman, he wrote in his memoir, "If I had learned one thing in Washington, it was that no economic program can succeed, no matter how impeccable the arguments supporting it, if it is not politically feasible."[238] This statement belies the common conception of Fed independence and acknowledges the politically sensitive position of the Federal Reserve. Although successful on many counts, the Fed's response to the financial crisis of 2008 sparked a degree of political and public outrage that tarnished its reputation and led to sweeping reform of the regulatory architecture of the financial system through Dodd–Frank.

Ever since the 1960s, when the swap lines were first implemented, the Fed has relied on a strained interpretation of Section 14 of the Federal Reserve Act to justify their use. Successive Congressional proclamations do not clearly provide tacit acceptance of the Fed's revamped use of its swap lines. This means that as long as the Fed continues to justify using them under flimsy legal authority, it must confront pressing questions about the legitimacy and accountability of its activity. If another crisis were to occur, public outrage might center on certain, legally dubious Fed activities, such as these swap lines. To head off such a possibility, it would behoove the Fed to curtail its use of liquidity swaps by bringing them within the ambit of its Section 13(3) emergency powers. By doing so, the Fed would be responding to Congress's clear desire to imbue the central bank with more transparency and accountability, and consequently, would be protecting its liquidity swaps as valuable market stabilizing tools.

238. Binder & Spindel, supra note 139, at 232 (quoting Ben S. Bernanke, Courage to Act (2015)).