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NY Fed Looks to Toughen Funding Standards to Fend off Next Bubble

The Federal Reserve today took a step toward improving the plumbing of the short-term funding markets for banks and securities dealers that locked up during the heat of the financial crisis. The Federal Reserve Bank of New York has set up a task force of Wall Street banks to figure out how to make this market less vulnerable to shocks, and the group issued a status report today.

The market in question is the tri-party repo market, in which banks and dealers use their securities holdings as collateral for short-term funding from cash-rich investors and other banks.

Borrowing in this market soared during the credit boom. It also made Wall Street extremely vulnerable to modern-day runs on a bank; as the crisis worsened, lenders in the tri-party repo market pulled their cash back amidst worries that borrowers would fail or that the securities they used as collateral would fall in value.

In 2008, more than \$2.8 trillion in securities holdings by banks were being financed with short-term money in this market. At the center of it all are two clearing banks - J.P. Morgan and Bank of New York Mellon - which manage the transactions and collateral.

The new group could push for tougher collateral requirements on these loans, the equivalent of demanding that a homeowner put down more equity on a mortgage. They're also narrowing the kinds of securities that can be used as collateral.

The group hopes to complete its work by the end of March 2010 and hopes to make banks less vulnerable to another shock, as tougher rules in the tri-party repo market would make it harder for banks and securities dealers to go on another drunken borrowing binge when the next asset boom emerges.

The participating firms and associations in the "Reform Task Force" are: Bank of America Securities, The Bank of New York Mellon, Barclays Capital, Citadel Investment Group, Citigroup Global Markets, Credit Suisse Securities, The Depository Trust & Clearing Co., Deutsche Bank Securities, Federated Investors, Fidelity Management & Research Co., Goldman Sachs Group Inc., Investment Company Institute, Invesco Ltd., J.P. Morgan Chase, Managed Funds Association, Morgan Stanley & Co., SIFMA, State Street Global Advisors and UBS Investment Bank.