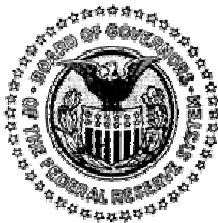




What is the Discount Rate?



The Discount Rate is the interest rate that banks pay when they borrow money directly from the Fed.

The rate has been largely symbolic in the past because hardly any banks utilized this source or method of obtaining funds. These days, with the ailing financial market, this window is one of but a few options for banks and financial institutions in dire need of liquidity.

There are primarily two ways that participating Banks use the discount window to get short term:

- Issuing "commercial paper" – these are short term "IOU's" of typically one to ninety days that are sold on the open market to Wall Street investors. Interest rates on these short term loans are often better than the discount rate offered by the Fed
- Borrowing money from other financial institutions using the Fed Funds Rate (Also see "Fed Funds Rate" description). In most cases, this rate is also better than the discount rate offered by the Fed.

What is the Fed Funds Target Rate?



The Fed Funds Rate is the overnight interest rate at which depository institutions lend to other depository institutions. This rate is determined by the Fed because banks in the U.S. are part of the Federal Reserve System.

Adjustments to the Fed Funds Target Rate are made by the [Federal Open Market Committee \(FOMC\)](#), usually at regularly scheduled meetings; but can also be adjusted at any time using emergency meetings.

The Fed's main role is to maintain "monetary stability" which they attempt to do by keeping a close eye on the flow of money throughout the economy using the Fed Funds and Discount Rates.

What is LIBOR?



The "London Interbank Offered Rate" (LIBOR) is the interest rate that banks pay one another, when borrowing money from other banks anywhere in the world (This is primarily facilitated at the international wholesale money market based in London).

There are various types of LIBOR rates including the 1 week LIBOR, 1 month LIBOR, 6 month LIBOR, and 1 year LIBOR; these are the rates banks would pay if they want to borrow funds for 1 week, 1 month, 6 months, etc.

Although Rate calculations contain complex variables such as time, maturity and currency rates, LIBOR rates are very closely related to the Fed, in that LIBOR most often changes when the market anticipates that the Fed will change their Fed Funds Rate.

LIBOR is also the base rate that is used on most adjustable rate mortgages (ARMs) in the US and large corporate / commercial loans. The reason LIBOR is used most often for US adjustable rate mortgages is because LIBOR is really the most accurate measure of a bank's cost of borrowing funds since most banks do business internationally these days.

What is Prime Rate?



Prime Rate is the base interest rate that is charged to the most credit worthy bank consumers. These loans are typically extended to things such as credit cards and home equity lines of credit, as well as most small business loans.

Like LIBOR, the Prime Rate is also tied to the Fed Funds Rate, normally 3 points higher than the published Fed Funds Rate.

Adjustments to the prime lending rate are usually made by banks at the same time; although, the prime rate does not adjust on any regular basis. After the Fed changes the Fed Funds rate, the Prime Rate will change at the beginning of the subsequent month.

Rates are based upon the prime rates published on the first day of each respective month.