What did the Fed do to combat the financial crisis?

- **Provided liquidity**

  As short-term markets froze, the Federal Reserve expanded its own collateralized lending to financial institutions to ensure that they had access to the critical funding needed for day-to-day operations. Normally, the Federal Reserve provides loans only to institutions that take deposits, such as commercial banks, a process known as discount-window lending. However, amid a widespread collapse of confidence in early 2008, investment banks, including those that were primary dealers of government securities, also had trouble obtaining short-term funding and became vulnerable to credit cutoffs similar to bank runs. In March 2008, the Federal Reserve created two programs to provide short-term secured loans to primary dealers similar to discount-window loans provided to banks. Conditions in these markets improved considerably in 2009.

  References:
  The Federal Reserve's Balance Sheet: An Update, speech by Ben S. Bernanke, Chairman, Federal Reserve Board of Governors, at the Federal Reserve Board Conference on Key Developments in Monetary Policy, Washington, DC, October 8, 2009.

- **Supported impaired financial markets**

  The Federal Reserve acted to improve conditions in two vital markets that broke down during the panic in the fall of 2008: money market mutual funds and short-term lending to businesses. Money market mutual funds collect funds from investors and put money into short-term investments such as Treasury bills and unsecured short-term loans to corporations, known as commercial paper. The commercial paper market is a key source of funds for many businesses. But when the investment bank Lehman Brothers declared bankruptcy, investors feared that more failures could make some commercial paper nearly worthless. They began pulling money out of money market mutual funds that held commercial paper. Interest rates on commercial paper skyrocketed. The Federal Reserve provided secured loans to institutions in these markets, ensuring that adequate funding was available. Since then, rates on commercial paper have fallen to low levels and these markets are once again functioning well.

  References:
  The Federal Reserve's Balance Sheet: An Update, speech by Ben S. Bernanke, Chairman, Federal Reserve Board of Governors, at the Federal Reserve Board Conference on Key Developments in Monetary Policy, Washington, DC, October 8, 2009.
Supported systemically important financial institutions

In 2008, the investment bank Bear Stearns nearly failed, which risked a domino effect that would have severely disrupted financial markets. To contain the damage, the Federal Reserve facilitated the purchase of Bear Stearns by the bank JPMorgan Chase by providing loans backed by certain Bear Stearns assets. Several months later, however, the investment bank Lehman Brothers collapsed because no private company was willing to acquire the troubled investment bank and Lehman did not have adequate collateral to qualify for direct loans from the Federal Reserve. As a result, financial panic threatened to spread to several other key financial institutions, including the giant insurance company American International Group (AIG). AIG played a central role guaranteeing financial instruments, so its failure had the potential to lead to a cascade of failures and a meltdown of the global financial system. To contain this threat, the Federal Reserve provided secured loans to AIG.

References:

http://www.frbsf.org/econanswers/response_q1more.htm