United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

February 5, 2020

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chairman Powell:

Over September 16 and 17 last year, overnight repurchase agreement rates spiked as high as 10%, resulting in a Secured Overnight Financing Rate (SOFR) of 5.25%[1], more than three points above its three-month average, and an Effective Federal Funds Rate (EFFR) reaching 2.25%[2], 25 basis points above the Fed's target range announced the next day[3].

It was widely reported that the convergence of increased Treasury debt issuance at the same time businesses demanded cash in order to meet quarterly tax obligations caused the spike in rates[4]. However, since the Federal Reserve Bank of New York's (FRBNY) initial announcement that it would expand its overnight repurchase agreement (repo) operations in response to this event, it further expanded that facility several times.[5] Since mid-September 2019, FRBNY has issued 11 statements regarding repurchase activities and engaged in overnight and term repurchase activity that has resulted in a steady daily amount outstanding of around $200 billion – with $173 billion outstanding as of January 30, 2020.[6] Even after the expansion of the Fed's repo activity, Treasury overnight repos were oversubscribed as recently as December 16[7] and mortgage-backed securities repos were oversubscribed as recently as January 14[8]. Finally, after the Federal Open Market Committee meeting on January 29, the Committee instructed FRBNY to continue repurchase activities "at least through April 2020[9]." The shifting volumes and target dates of the Fed's response suggest that other factors may be the cause of this persistent market dislocation, and it is difficult to evaluate the Fed's response in the absence of a clear explanation as to what got us here.

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1 https://fred.stlouisfed.org/series/SOFR
2 https://fred.stlouisfed.org/series/DFF
3 https://www.federalreserve.gov/newsevents/pressreleases/monetary20190918a.htm
4 https://www.washingtonpost.com/business/the-repo-markets-a-mess-whats-the-repo-market/2019/09/19/9633bb7a-db02-11e9-a1a5-162b8a9c9ca2_story.html
5 https://www.newyorkfed.org/markets/opolicy/operating_policy_191212
6 Calculated from data available at: https://apps.newyorkfed.org/markets/autorates/tomo-search-page
7 Ibid.
8 Ibid.
9 https://www.federalreserve.gov/monetarypolicy/files/monetary20200129a1.pdf

While one potential explanation is the convergence of events in September, some market participants have argued that capital and liquidity regulation and supervision are to blame for increased subscription[10], and Vice Chair Quarles suggested in a hearing that Fed supervisors may have been, in part, to blame[11]. On the other hand, you have noted that "firms that are not subject to bank regulation…also seemed reluctant to step in to take advantage of very high repo rates in mid-September[12]."

Though the Fed's actions are consistent with its policy of maintaining the targeted interest rate range, we have not seen interventions of this size and persistence since the financial crisis. In order to better understand the causes of the intervention, the Fed's commitment to repurchase activity as a short-term solution, and its exit plan, we would appreciate responses to the questions below no later than Monday, February 11, prior to your semiannual testimony on monetary policy before the Committee:

1) Has the Fed determined the cause for the protracted, increased demand for reserves that necessitates continued intervention through repo activities? If so, what is/are the cause or causes?

2) Has the Fed analyzed the impact of the availability of this facility on primary dealers' balance sheets and market activity? If so, what has changed in money markets since September 2019? Are other portfolios affected by these adjustments and reallocations?

3) Could a bank use access to this facility to game capital or liquidity standards, and what steps are supervisors taking to ensure that is not the case?

4) Have profits at banks that have access to this facility outpaced profits at similarly situated financial institutions that do not have access or have not participated in the facility? If so, does that suggest anything about the efficiency of overnight repo operations as a transmission mechanism for monetary policy?

5) The facility has reduced the cost of access to cash in the money markets – to what degree has the cost of borrowing been reduced to consumers, specifically those with outstanding loans? In your estimation, do banks or consumers primarily benefit from the operation of this facility?

6) Since September 2019, has the Board discussed the possibility of weakening or otherwise altering liquidity, capital, or other regulatory and supervisory standards in order to address this issue? Does the Board continue to consider any such changes? Has the Board or FRBNY

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[10] https://bpi.com/bank-regulations-and-turmoil-in-repo-markets/

[11] https://www.reuters.com/article/usa-congress/feds-quarles-says-supervisory-practices-may-have-contributed-to-repo-market-issues-idUSL1N28E0SG

[12] Letter to McHenry https://morningconsult.com/wp-content/uploads/2019/12/2019-11-08-Powell-to-PMC-regarding-PMC-2019-10-17-balance-sheet-letter.pdf

considered the possibility that market actors refused to lend into the market, sacrificing short-term profits in order to raise questions about prudential regulation? Would it be feasible for the small network of primary dealers to do so?

Sincerely,

Sherrod Brown
United States Senator

Jack Reed
United States Senator

Elizabeth Warren
United States Senator

Tina Smith
United States Senator

CC: John Williams, President, Federal Reserve Bank of New York