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October 18, 2019

The Honorable Steven T. Mnuchin
Secretary
United States Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Mnuchin:

I write to you in your capacity as Chair of the Financial Stability Oversight Council (FSOC) to request information regarding the recent volatility in the short-term lending market, the "emergency measure" taken by the Federal Reserve Bank of New York (New York Fed) in response to this volatility, and the two extensions announced in response to these efforts in recent weeks.[1] While the Federal Reserve has taken the necessary action to ensure that markets continue to function, I am alarmed that it has been required to engage in money market interventions that have not been used since the 2008 financial crisis, and I write to obtain your understanding of the underlying causes of this fluctuation in the market and how you plan to mitigate them.

During the week of September 16, 2019, borrowing rates for overnight repurchase agreements (repo rates), paid by banks when they borrow money to meet their short-term obligations, jumped from around two percent to ten percent.[2] This sharp and abrupt spike in the repo rate caught market participants off guard, and, while it may have only affected overnight borrowers in the short term, "if the strains last long enough it can affect the rates other businesses and consumers pay."[3]

In response to the rate spike, the New York Fed began cash injections into the repo market and subsequently announced that the Open Market Trading Desk would offer daily overnight repo

[1] Wall Street Journal, "Fed Intervenes to Curb Soaring Short-Term Borrowing Costs," Nick Timiraos and Daniel Kruger, September 17, 2019, https://www.wsj.com/articles/fed-to-conduct-first-overnight-repo-transactions-in-several-years-11568729757.
[2] Wall Street Journal, "Fed Injects More Money Into Money Markets After Banks Bid Heavily for Funds," Paul J. Davies and Sam Goldfarb, September 18, 2019, https://www.wsj.com/articles/short-term-funding-spike-raises-hopes-for-fed-cuts-11568807648.
[3] Wall Street Journal, "Fed Intervenes to Curb Soaring Short-Term Borrowing Costs," Nick Timiraos and Daniel Kruger, September 17, 2019, https://www.wsj.com/articles/fed-to-conduct-first-overnight-repo-transactions-in-several-years-11568729757.

operations "for an aggregate amount of at least $75 billion each" until October 10, 2019.[4] The last time such market interventions occurred was during the 2008 financial crisis.[5]

During the first week of October, the New York Fed issued an additional statement to announce that the operations would continue until at least November 4, 2019.[6] And on October 11, 2019, the New York Fed announced another extension, stating "at least through January of next year, the Desk will conduct overnight and term repo operations to ensure that the supply of reserves remains ample and to mitigate the risk of money market pressures."[7]

I do not question the actions of the New York Fed, but I write to seek clarity on why they were necessary, and the implications of the cause of the spikes. Some have suggested that the rate spike is related to the reduction of cash in the financial system due to quarterly tax payment deadlines coupled with Treasury auction settlements.[8] However, these tax payments and settlements were not a surprise, and such a cash shortage would have been anticipated well before the rate spike occurred.[9] Others have suggested that the Federal Reserve's reduction of their balance sheet may have reduced the overall amount of reserves in the financial system too rapidly.[10] Again, though, this reduction has been going on since 2017 and does not represent the type of unforeseeable circumstance that would have rattled markets so suddenly.[11]

I am also concerned that, "Big U.S. banks are using the recent chaos in short-term funding markets as an opportunity to pressure the Federal Reserve to ease liquidity requirements they have long despised," [12] and that the FSOC might support these efforts. These rules were designed to ensure that banks have enough cash on hand to meet their obligations in the event of another market crash.[13] Banks are reporting profits at record levels, and it would be painfully ironic if

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[4] Federal Reserve Bank of New York, "Statement Regarding Repurchase Operations," September 20, 2019, https://www.newyorkfed.org/markets/opolicy/operating_policy_190920

[5] Wall Street Journal, "Fed Intervenes to Curb Soaring Short-Term Borrowing Costs," Nick Timiraos and Daniel Kruger, September 17, 2019, https://www.wsj.com/articles/fed-to-conduct-first-overnight-repo-transactions-in-several-years-11568729757.

[6] Federal Reserve Bank of New York, "Statement Regarding Repurchase Operations," October 4, 2019, https://www.newyorkfed.org/markets/opolicy/operating_policy_191004.

[7] Federal Reserve Bank of New York, "Statement Regarding Treasury Bill Purchases and Repurchase Operations," October 11, 2019, https://www.newyorkfed.org/markets/opolicy/operating_policy_191011.

[8] New York Times, "An Unusual Rise in Interest Rates Roils a Crucial Financial Market," Matt Phillips, September 16, 2019, https://www.nytimes.com/2019/09/16/business/repo-markets-rates.html

[9] Wall Street Journal, "'Why Were They Surprised?' Repo Market Turmoil Tests New York Fed Chief," Nick Timiraos, September 29, 2017, https://www.wsj.com/articles/why-were-they-surprised-repo-market-turmoil-tests-new-york-fed-chief-11569777702.

[10] Id.

[11] Id.

[12] Reuters, "U.S. bankers seize on repo-market stress to push for softer liquidity rules," Katanga Johnson and David Henry, September 18, 2019, https://www.reuters.com/article/us-usa-fed-repo-banks/us-bankers-seize-on-repo-market-stress-to-push-for-softer-liquidity-rules-idUSKBN1W3288.

[13] Bank Policy Institute, "What Just Happened in the Money Markets, and Why it Matters," Bill Nelson, September 18, 2019, https://bpi.com/what-just-happened-in-money-markets-and-why-it-matters/.

unexplained chaos in a small corner of the banking market became an excuse to further loosen rules that protect the economy from these types of risks. [14]

FSOC is responsible for identifying and responding to emerging risks to the stability of the financial system in the U.S. As Chair of FSOC, you are tasked with overseeing these efforts. Given the lack of clarity about the cause of the current short-term funding strains and whether this cause could relate to a larger problem in financial markets, we ask that you respond to these questions by no later than November 1, 2019.

1. What are the underlying cause(s) of the spike in borrowing rates for overnight repurchase agreements?

    a. What information has FSOC collected or analyzed to reach these conclusions?

    b. Does the Department of Treasury have any information or data that would indicate that these fluctuations could be a manifestation of a separate underlying risk to the financial sector?

    c. What is FSOC doing to mitigate these underlying risks?

2. Has FSOC learned why the Fed announced on October 11, 2019 that overnight operations would be extended "at least through January of next year."?
    a. What are the risks to the economy and to market participants of extended volatility in the overnight repo market?

    b. What additional steps are you taking to mitigate these risks and ensure that the impact of these market disruptions does not trickle down to consumers?

3. In FSOC's 2018 Annual Report, the Council expressed support for the Office of Financial Research's (OFR) proposed rule to collect data on centrally cleared repo transactions.[15] In 2019, that rule was finalized.[16]

    a. How will FSOC and Treasury use these data to gain further understanding of the repo market?

    b. Is this data collection sufficient to monitor the ongoing trends in the short-term lending market?

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[14] American Banker, "Bank industry earnings set yet another record in 2Q: FDIC", Brendan Pedersen, September 05, 2019, https://www.americanbanker.com/news/bank-industry-earnings-set-yet-another-record-in-2q-fdic.
[15] Financial Stability Oversight Council, "2018 Annual Report," revised June 20, 2019, https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf.
[16] Department of Treasury, Office of Financial Research, Federal Register Notice, "Ongoing Data Collection of Centrally Cleared Transactions in the U.S. Repurchase Agreement Market," February 20, 2019, https://www.financialresearch.gov/data/files/fr-notice_ofr_cleared_repo_rule.pdf.

i. If not, what further data collections are needed?

Sincerely,

Elizabeth Warren
United States Senator