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National Association of Federally-Insured Credit Unions

June 20, 2023

The Honorable Patrick McHenry
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: Tomorrow's Hearing: "The Federal Reserve's Semi-Annual Monetary Policy Report"

Dear Chairman McHenry and Ranking Member Waters:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) regarding tomorrow's Committee hearing with Chairman Powell of the Board of Governors of the Federal Reserve System. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve nearly 137 million consumers with personal and small business financial service products. NAFCU appreciates the opportunity to share the perspective of credit unions before Chairman Powell testifies in front of the Committee.

<u>Operation of the Federal Reserve's Overnight Reverse Repo Facility (ON RRP)</u>

NAFCU has concerns that the current rate offered by the Federal Reserve's Overnight Reverse Repo Facility (ON RRP) is draining deposits from credit unions. The ON RRP was created in the aftermath of the 2007-2009 financial crisis as a tool to lift the federal funds rate and to provide a floor under overnight interest rates by offering money market funds and other financial institutions otherwise ineligible to earn interest on reserve balances (IORB) the ability to purchase government securities. Despite ongoing efforts to reduce the Federal Reserve's balance sheet, the ON RRP interest rate continues to attract money market funds because its current level is set only slightly below the IORB rate. This form of subsidization for uninsured depositors allows money market funds to offer higher rates than the market would ordinarily support and continues to place pressure on credit union liquidity.

NAFCU encourages Congress to investigate the relationship between the rate offered by the ON RRP and its impact on depository institution funding, as well as seek input from the Federal Reserve on whether it may be necessary to reduce the rate offered by the ON RRP to reduce outflows of money from depositories. It is worth emphasizing that these concerns are not entirely unforeseen. In 2015, the Federal Reserve issued a research report (2015 Report) which observed that usage of the facility could correspond with increased financial stability risks: "There may be adverse effects stemming from the possibility that such a facility—particularly if it offers full allotment—could allow a very large, unexpected increase in ON RRP take-up that might enable disruptive flight-to-quality flows during periods of financial stress." Moreover, "All else equal, increased ON RRP usage implies reduced short-term financing for other borrowers. If, for example, [money market mutual funds] quickly shift from investing in commercial paper or repo to holding ON RRPs, they would reduce the availability of short-term credit for private firms and institutions."[1]

The Federal Reserve's own research reveals that that in flight to quality scenarios, cash could move more quickly into the ON RRP instead of deposit accounts at credit unions or banks. The 2015 Report even proposes a solution to the problem that Congress should consider: reducing the ON RRP offering rate (or at least widening the spread with the IORB) to make investments in the ON RRP less attractive. In addition to this short-term policy intervention, Congress might also probe the question of whether the Federal Reserve, through its operation of the ON RRP, can lawfully offer a near equivalent to the IORB rate to money market mutual funds—entities otherwise ineligible to earn the IORB rate because they are not insured depository institutions. As other legal commentators have noted, Congress explicitly authorized the IORB, but not the ON RRP.[2] NAFCU encourages the Committee to explore the legality of the current arrangement to determine whether or not operation of ON RRP conforms with its original purpose and the powers granted by Congress.

Central Bank Digital Currency (CBDC)

Finally, we would like to take this opportunity to reiterate our strong opposition to creating a central bank digital currency (CBDC). NAFCU believes that any advantages of a CBDC are outweighed by a multitude of risks including those related to consumer privacy, financial stability, misallocation of Federal Reserve resources, and government intrusion into banking services traditionally provided by the private sector. Whatever benefits a CBDC might hypothetically provide can be achieved more reliably and with less risk using existing financial sector infrastructure, including the Federal Reserve's soon to launch FedNow service. Furthermore, studies that consider the role of a CBDC in relation to other countries' use of digital currency—particularly China—tend to overlook critical issues around privacy and have not fully considered whether adoption of digital currency in foreign jurisdictions serves primarily a surveillance purpose. Given the strong position of the U.S. dollar today and public wariness of a CBDC as a surveillance tool, near-term attention should be devoted instead to policy actions that can strengthen institutions like credit unions that stand ready to offer affordable and safe financial products and services to millions of Americans without fear of financial institutions acting as a government monitor.

[1] Frost, Josh, Lorie Logan, Antoine Martin, Patrick McCabe, Fabio Natalucci, and Julie Remache (2015). "Overnight RRP Operations as a Monetary Policy Tool: Some Design Considerations," Finance and Economics Discussion Series 2015-010. Washington: Board of Governors of the Federal Reserve System, http://dx.doi.org/10.17016/FEDS.2015.010.

[2] Harvard Law Review, "Federal Reserve Interest Rate Hike on March 22, 2023," 136 Harv. L. Rev. 2028, available at https://harvardlawreview.org/print/vol-136/federal-reserve-interest-rate-hike-on-march-22-2023/.

We thank you for the opportunity to share our thoughts in advance of tomorrow's hearing. Should you have any questions or require any additional information, please contact me or Amber Milenkevich, NAFCU's Senior Associate Director of Legislative Affairs, at amilenkevich@nafcu.org or 703-402-2330.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the House Financial Services Committee