Proposal: 1652 (7100-AF40) Reg D - Reserve Requirements of Depository Institutions

Description:

Comment ID: 133528

From: Michael Fellman

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Subject: R-1652; Reg D - Reserve Requirements of Depository Institutions

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Comments:

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To whom it may concern:

Scaling back or limiting IOER is counter-productive on several fronts, and the concerns of the FRB about so-called PTIEs are unwarranted. I will address those concerns in turn.

Monetary Policy Implementation:

It strains credulity to assert that allowing the private sector to strengthen the rate floor created by IOER would somehow weaken the transmission mechanism of monetary policy. On the contrary, it would provide an even firmer price floor for the short term funding markets. Concerns about rate volatility in the Federal Funds market are also overblown. Frankly, under a system of IOR which exists today, it is the expected path of rates paid on balances at the Fed, not overnight interbank lending that serves as a benchmark to price other forms of short term lending and even long dated securities. Fed Funds trades include non-negligible counter-party risk, thus while a widening spread between IOR and the Federal Funds rate would undoubtedly signal a heightened period of financial stress, it does not reflect the stance of monetary policy per se.

Balance Sheet Issues:

The release rightly points out that if the Federal Reserve allows the establishment of PTIEs, that it would in effect be supplying an unlimited quantity of reserve balances to the market. To accommodate this, the Fed would likely need to maintain a large balance sheet for the indefinite future. However, it is unclear why a shift out of Treasury bills and into reserve balances is undesirable on its face. Reserve balances are just one of many liabilities issued by the consolidated Federal government. Proper debt management would dictate that the demand for reserve balances be fully accommodated. The shifting out of Treasury bills and into reserve balances would merely be the marketplace substituting a more desirable financial asset for another. If anything, this would strengthen, not weaken financial stability.

On balance, PTIEs are a promising way to both strengthen the rate floor and improve Federal debt management. Furthermore, by acting as intermediaries between the Fed and public, PTIEs are an excellent avenue for the Fed to create a rock solid floor for short term rates without having to interface directly with individuals or businesses. In sum, the Fed should welcome the emergence of PTIEs, not seek to constrain it.

Respectfully Submitted,
Michael Fellman