

The Case for an Elastic Reserves System: Recommendations for the Federal Reserve's Balance Sheet Review

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Abstract

Since 2008, the Federal Reserve has implemented monetary policy through an Ample Reserves framework. This operating system requires a historically large balance sheet and the payment of interest on the central bank's primary liability, bank reserves, at an administered rate. Ample Reserves requires active reserve supply management even in calm conditions, subsidizes bank equity holders, shifts debt management and credit allocation decisions to the central bank, persistently influences market prices, and unnecessarily politicizes the Fed. Chair Kevin Warsh has commissioned a balance sheet review task force to reconsider the operating system and the large balance sheet it requires.

The Fed should replace Ample Reserves with an Elastic Reserves system in which reserves are sufficiently scarce that banks routinely turn to a set of Fed lending facilities. A redesigned Standing Repo Facility provides overnight reserves, and a new Term Liquidity Facility auctions four-month funding against a broad, pre-positioned collateral set. The discount window continues to offer emergency liquidity when necessary. This "demand-driven" framework draws on the Bank of England's repo-led operating system and the Federal Reserve's experience with its own Term Auction Facility.

The development of new facilities must be paired with policy changes to reduce structural reserve demand. The Fed should change the structure of current liquidity regulation, require collateral pre-positioning for ongoing borrowing needs, repair dealer intermediation, upgrade the payment system, and shift how it manages the Treasury's General Account. New liquidity facilities and policies to reduce reserve demand are necessary complements; neither effectively delivers a permanently smaller balance sheet without the other.

The author thanks Steve Cecchetti, William Dudley, Darrell Duffie, Bill Nelson, Peter Spiegel, and David Wessel for their comments on earlier drafts.

Generative AI was used to refine the syntax of this report, format and complete footnotes, and prepare graphs and tables. The author reviewed and verified all AI-assisted material and takes full responsibility for the report's analysis, citations, conclusions, and accuracy. The Brookings Institution is committed to quality, independence, and impact. We are supported by a [diverse array of funders](#). In line with our [values and policies](#), each Brookings publication represents the sole views of its author(s).

Summary of Recommendations

The Federal Reserve's Balance Sheet Policy Task Force should set out a clear objective to shift from today's need to preemptively maintain a very large balance sheet to providing reserves in response to system demand. In a new Elastic Reserves framework, Fed facilities specify collateral required for overnight and term lending, and the banking system's demand for reserves determines the quantity supplied. To implement an Elastic Reserves system, this report recommends:

1. **Redesign the Standing Repo Facility (SRF).** The SRF should offer full allotment of overnight reserves at a rate set slightly above the interest rate on reserve balances (IORB), against Treasuries, agency debt, and agency mortgage-backed securities. Collateral requirements and haircuts should be in line with comparable market transactions. Collateral could be delivered at settlement; advance pre-positioning would not be required. The SRF's new purpose would be interest rate control, executed through the provision of marginal reserves.
2. **Create a Term Liquidity Facility (TLF).** Modeled on the crisis-era Term Auction Facility (TAF), the TLF should facilitate a weekly auction of reserves with a four-month term against three published classes of collateral, with minimum spreads that step up by class and with the quantity determined by banks' bids.
3. **Retain the discount window.** The discount window should remain available, but only for emergency lending (what is known today as secondary credit) to institutions requiring supervisory involvement.
4. **Set a target rate for the Secured Overnight Financing Rate (SOFR),** replacing the Effective Federal Funds Rate (EFFR) as the operating target, and use IORB and the SRF and TLF rates to guide SOFR toward the target.
5. **Shift the Fed's permanent securities portfolio** to hold exclusively short-dated Treasuries, phasing out holdings of long-dated Treasuries and mortgage-backed securities. Temporary long-term purchases would remain available when needed for monetary policy purposes.
6. **Require banks to pre-position collateral** at the TLF and execute periodic test transactions.
7. **Update today's liquidity requirements** to new requirements to maintain demonstrably usable liquidity, including through pre-positioned borrowing capacity.
8. **Bring Federal Reserve repo transactions into central clearing** where appropriate so that dealers can net matched positions, thereby reducing balance sheet costs.
9. **Add a liquidity-saving mechanism to Fedwire** so that offsetting payments can settle with less intraday liquidity while preserving final settlement in central-bank money.
10. **Reduce reserve supply volatility created by the Treasury General Account (TGA)** by backing the TGA with Treasury bills.

I. Introduction: The Case for Change

Federal Reserve Chair Kevin Warsh has asked the Balance Sheet Policy Task Force to examine the costs, benefits, and institutional implications of the Federal Reserve’s current balance sheet regime and to assess alternatives to the Fed’s current operating framework, known as Ample Reserves. The task force could pursue this work broadly, with a wholesale reconsideration of the effectiveness of Ample Reserves and the historically large balance sheet it requires, or it could interpret the mandate narrowly, focusing on questions like the asset composition of the Fed’s portfolio or the function of newer standing facilities like the Standing Repurchase Agreement Operations (SRP). The task force should pursue the more ambitious approach, enabling the Federal Open Market Committee (FOMC) to reconsider the performance of Ample Reserves and explore more promising alternatives. A large, fixed stock of reserves is not necessary to implement monetary policy effectively, and the Federal Reserve can reliably do so through a smaller structural stock backed by elastic lending capacity.¹

When not used as a proper noun, ample reserves can describe a state in which banks have enough reserves to settle payments and meet regulatory requirements. In this paper, Ample Reserves describes the Fed’s current operating system: administered rates paid to banks and nonbanks, supported by a large reserve stock intended to avoid the daily open market operations of the pre-crisis Scarce Reserves system. I call the proposed alternative Elastic Reserves, because lending facilities would allow reserve supply to expand and contract with private demand.

The promises and limits of Ample Reserves

We should evaluate Ample Reserves by assessing its effectiveness as a system of monetary policy implementation and, just as importantly, the effects of the large balance sheet it requires on the financial and political systems. Early proponents of Ample Reserves made the case for a new operating system that would separate liquidity provision from monetary policy implementation, in theory enabling the FOMC to ensure that rate control is “exercised primarily through the setting of the Federal Reserve’s administered rates, and in which active management of the supply of reserves is not required.”² The new system, which the Fed began using in earnest as it picked up off the zero lower bound in 2015, relied on a set of administered rates, primarily the interest on reserve balances (IORB), to control the price of short-term credit. No longer would Fed staff need to manage shifts in reserve demand with open market operations, because a set of standing facilities—including IORB, the Overnight Reverse Repo facility, and the eventual Standing Repo Facility (SRF)—would work together to hold short-term rates steady. The FOMC quietly

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¹ Board of Governors of the Federal Reserve System, “Federal Reserve Announces the Leadership and Objectives of Its Task Forces to Advance the Conduct of Monetary Policy,” press release, July 9, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20260709a.htm>; Board of Governors of the Federal Reserve System, “Balance Sheet Policy,” last updated July 9, 2026, <https://www.federalreserve.gov/monetarypolicy/balance-sheet-policy-task-force.htm>.

² Board of Governors of the Federal Reserve System, “Statement Regarding Monetary Policy Implementation and Balance Sheet Normalization,” press release, January 30, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20190130c.htm>. The Committee stated its intention to “continue to implement monetary policy in a regime in which an ample supply of reserves ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Federal Reserve’s administered rates, and in which active management of the supply of reserves is not required.”

decided to make an open-ended commitment to Ample Reserves in a quasi-permanent fashion in 2014, and made its decision official and public in January 2019.³

Some of the promised benefits of Ample Reserves have been realized, and an honest evaluation of the framework should begin with them. The original promise that remunerating reserves allows liquidity provision to be divorced from the stance of policy has held.⁴ The FOMC can expand the balance sheet in a crisis without mechanically lowering the policy rate, and it can change the policy rate without first draining a large quantity of reserves.⁵ At the outset of the COVID pandemic in 2020, interest on reserves, paired with the overnight reverse repo facility, allowed the Fed to inject liquidity at crisis scale while maintaining control over the federal funds rate, for instance. The framework has also kept the Effective Federal Funds Rate (EFFR) inside its target range nearly every day. These successes have attracted many defenders, including two prominent ones instrumental in its development, former New York Fed President Bill Dudley and former SOMA manager and current Dallas Reserve Bank President Lorie Logan.⁶

In making the original case for Ample Reserves, its proponents went beyond the simple promise of untying liquidity provision from monetary policy. Advocates promised a radically simpler, more agile operating system that would not require calibration of system-wide reserves, as its predecessor did.⁷ It would streamline and speed up payment settlement, and it would deliver a safer financial system in which abundant central bank money displaced runnable private substitutes.⁸ Most importantly, the large balance sheet that it engendered would not have meaningful negative effects on the financial system or on the Fed's political position.⁹

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³ For a full consideration of the history of Ample Reserves and the FOMC's pivotal 2014 decision, see Chris Hughes, *Plumbing and Power: The Political Life of the Fed's Operating System*, forthcoming, Princeton University Press.

⁴ Marvin Goodfriend, "Interest on Reserves and Monetary Policy," *Federal Reserve Bank of New York Economic Policy Review* 8, no. 1 (May 2002): 77–84; Todd Keister, Antoine Martin, and James McAndrews, "Divorcing Money from Monetary Policy," *Federal Reserve Bank of New York Economic Policy Review* 14, no. 2 (September 2008): 41–56.

⁵ Robin Greenwood, Samuel G. Hanson, and Jeremy C. Stein, "The Federal Reserve's Balance Sheet as a Financial-Stability Tool" (paper presented at the Federal Reserve Bank of Kansas City Economic Policy Symposium, Jackson Hole, WY, August 2016).

⁶ Lorie K. Logan, "Ample Liquidity for a Safe and Efficient Banking System" (remarks at "The Evolving Landscape of Bank Funding" conference, Federal Reserve Bank of Dallas, October 31, 2025); see also Logan, "Ample Reserves and the Friedman Rule" (remarks before the European Central Bank Conference on Money Markets, Frankfurt, November 10, 2023). For Dudley's defense, see William C. Dudley, "The Fed's \$6 Trillion Balance Sheet Is About Right," *Bloomberg Opinion*, October 28, 2025; and Dudley, "A Smaller Fed Balance Sheet Would Bring Its Own Problems," *Bloomberg Opinion*, November 26, 2025.

⁷ Simon Potter and Lorie Logan, who ran the Open Market Desk in succession, promised a system "simple and efficient to operate." Logan added that there is "no need to forecast specific factors affecting reserves or to conduct discretionary open market operations each day." Board staff said the same: "An ample-reserves regime is simple and efficient to operate."

Lorie K. Logan, "Operational Perspectives on Monetary Policy Implementation: Panel Remarks on 'The Future of the Central Bank Balance Sheet'" (remarks at the Hoover Institution Policy Conference on Currencies, Capital, and Central Bank Balances, Stanford, CA, May 4, 2018), <https://www.newyorkfed.org/newsevents/speeches/2018/log180504>; Simon Potter, "Confidence in the Implementation of U.S. Monetary Policy Normalization" (remarks at the 23rd EMEAP Governors' Meeting, Manila, August 3, 2018), <https://www.newyorkfed.org/newsevents/speeches/2018/pot180803>; Jane Ihrig, Zeynep Senyuz, and Gretchen C. Weinbach, "The Fed's 'Ample-Reserves' Approach to Implementing Monetary Policy," Finance and Economics Discussion Series 2020-022 (Washington, DC: Board of Governors of the Federal Reserve System, February 2020).

⁸ James J. McAndrews and Alexander Kroeger, "The Payment System Benefits of High Reserve Balances," *Journal of Payments Strategy & Systems* 10, no. 1 (2016): 72–83; Robin Greenwood, Samuel Hanson, and Jeremy Stein gave it its most sophisticated form at Jackson Hole in 2016, recasting the swollen balance sheet not as a crisis residue but as a financial-stability tool in its own right. Greenwood, Hanson, and Stein, "The Federal Reserve's Balance Sheet as a Financial-Stability Tool."

⁹ Ben Bernanke and Don Kohn held that "the payment of interest on reserves provides no meaningful subsidy." Bernanke argued in 2016 for "keeping the balance sheet close to its current size in the long run," and Logan, defending the framework in 2023, saw no large costs in supplying the reserves needed to support the Ample Reserves system.

None of these promises have held. The manager of the System Open Market Account (SOMA), responsible for day-to-day monetary policy implementation, must still estimate fluctuation in seasonal reserve demand, how reserves are distributed across the banking sector, and how inflows and outflows in the Treasury's account affect overall demand.¹⁰ The system still requires extensive modeling of reserve demand, just as the previous system did. Instead of triggering open market operations to adjust reserve supply, the current system requires ongoing asset purchases to ensure a large enough balance sheet buffer. In September 2019, with reserves at \$1.4 trillion—more than a hundred times the pre-crisis level, but well below today's \$3 trillion—the secured overnight financing rate (SOFR) rose 315 basis points above IORB in a single day. The Fed had temporarily lost control of short-term financing rates, and regained it only by injecting emergency reserves through repurchase operations and bill purchases.¹¹ In the fall of 2025, rates in the \$12 trillion repurchase agreement (repo) market drifted persistently above the Fed's benchmarks, and by mid-November the share of repo transactions clearing above the interest rate on reserve balances (IORB) had reached levels last seen in the run-up to the September 2019 episode.¹² The Fed once again restarted asset purchases, expanding the balance sheet yet again. New York Fed President John Williams said the system functioned “exactly as designed,” suggesting that the design includes needing ongoing asset purchases in calm markets to deliver the rate control the framework had once promised to make automatic.¹³

The payment system did not become faster because of Ample Reserves. The new operating system changed when banks released payments. Larger reserve balances allowed banks to send them earlier in

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Ben S. Bernanke and Donald Kohn, “The Fed's Interest Payments to Banks,” Brookings Institution, February 16, 2016, <https://www.brookings.edu/articles/the-feds-interest-payments-to-banks/>; Ben S. Bernanke, “Should the Fed Keep Its Balance Sheet Large?,” Brookings Institution, September 2, 2016, <https://www.brookings.edu/articles/should-the-fed-keep-its-balance-sheet-large/>; Logan, “Ample Reserves and the Friedman Rule.”

¹⁰ Lorie K. Logan, “Observations on Implementing Monetary Policy in an Ample-Reserves Regime” (remarks before the Money Marketeers of New York University, April 17, 2019), <https://www.newyorkfed.org/newsevents/speeches/2019/log190417>; Gara Afonso, Domenico Giannone, Gabriele La Spada, and John C. Williams, “Scarce, Abundant, or Ample? A Time-Varying Model of the Reserve Demand Curve,” Federal Reserve Bank of New York Staff Reports, no. 1019 (May 2022, revised November 2025), https://www.newyorkfed.org/research/staff_reports/sr1019.

¹¹ Sriya Anbil, Alyssa Anderson, and Zeynep Senyuz, “What Happened in Money Markets in September 2019?,” FEDS Notes, Board of Governors of the Federal Reserve System, February 27, 2020.

¹² Roberto Perli, “Money Market Conditions and the Federal Reserve's Balance Sheet” (remarks at the 2025 U.S. Treasury Market Conference, Federal Reserve Bank of New York, November 12, 2025), <https://www.newyorkfed.org/newsevents/speeches/2025/per251112>; Alexandra Harris, “Bond Dealers Rebuff NY Fed Tool as Strains in Repo Market Build,” Bloomberg, November 19, 2025. On the size of the market, see Sam Hempel, R. Jay Kahn, and Julia Shephard, “The \$12 Trillion US Repo Market: Evidence from a Novel Panel of Intermediaries,” FEDS Notes, Board of Governors of the Federal Reserve System, July 11, 2025.

¹³ New York Fed President John Williams said in early January 2026: “I fully expect that standing repo operations will continue to be actively used in this way and function exactly as designed. In fact, we just saw this in action over year-end when some of the usual market pressures arose.”

The FOMC's January minutes record money market contacts attributing the better-than-expected outcome “to a variety of factors, including an increase in available liquidity due to the start of reserve management purchases (RMPs) and a lower Treasury General Account (TGA);” the minutes separately note increased take-up of standing repo operations and dealers locking in financing ahead of year-end.

Outside observers diverged. Nellie Liang and Haoxiang Zhu noted dealers' reluctance to use the facility and observed—citing Lorie Logan—that voluntarily clearing transactions with the Fed “could further improve balance sheet netting for bank-affiliated dealers.”

John C. Williams, “A Few Words for the New Year” (remarks at the Council on Foreign Relations, New York, January 12, 2026), <https://www.newyorkfed.org/newsevents/speeches/2026/wil260112>; Board of Governors of the Federal Reserve System, “Minutes of the Federal Open Market Committee, January 27–28, 2026,” February 18, 2026, <https://www.federalreserve.gov/monetarypolicy/fomcminutes20260128.htm>; Nellie Liang and Haoxiang Zhu, “Clearing the Path for Treasury Market Resilience,” Hutchins Center Working Paper 103 (Washington, DC: Brookings Institution, updated February 2026), 21.

the day without waiting for incoming funds or drawing on intraday credit. Banks came to cover temporary gaps in payment flows with reserves held overnight, increasing the size of the Fed's balance sheet to do a job that intraday lending had long performed.¹⁴

Nor did Ample Reserves enhance financial stability as much as some had hoped. In March 2020, as concerns about the pandemic wreaked havoc in financial markets, regulators encouraged banks to draw down their liquidity buffers, but they stubbornly kept their liquidity ratios above the regulatory minimum.¹⁵ All those extra reserves did not, in fact, come in handy in a crisis. In March 2023, institutions reporting liquidity ratios above requirements still managed to fail or need emergency support.¹⁶ Large reserve stocks do not seem to stem bank runs or mitigate rapid shifts toward safe assets when financial turmoil arrives. This is primarily because a significant portion of those reserves were already encumbered by other obligations. Post-crisis liquidity and leverage regulations incentivize banks to hoard liquidity and discourage them from deploying it in times of stress. Additionally, recent research has shown that banks have adapted their business models to Ample Reserves by issuing more demandable deposits and extending more credit lines—i.e. more promises to supply cash on demand. This requires the banks to hold additional reserves, which pushes the reserve demand curve outward. Significantly, banks do not reduce these commitments when the Fed drains reserves, causing a “ratchet effect” in which banks emerge from each injection of reserves with greater liquidity needs than before, complicating the Fed's subsequent efforts to return reserves to their pre-crisis level.¹⁷

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¹⁴ Anton Badev, Lauren Clark, Daniel Ebanks, Jeffrey Marquardt, and David Mills, “Fedwire Funds Service: Payments, Balances, and Available Liquidity,” Finance and Economics Discussion Series 2021-070 (Washington, DC: Board of Governors of the Federal Reserve System, October 2021), 1–3, 23–30, 32–43, <https://doi.org/10.17016/FEDS.2021.070>.

Nor does faster release require trillions in overnight reserves. The United Kingdom's CHAPS system reduced intraday liquidity needs by about 20% through a mechanism that queues and offsets payments while preserving final settlement in central bank money. That gain came from payment system design, not a permanently enlarged balance sheet. Nick Davey and Daniel Gray, “How Has the Liquidity Saving Mechanism Reduced Banks' Intraday Liquidity Costs in CHAPS?,” *Bank of England Quarterly Bulletin* 54, no. 2 (2014): 180–89.

¹⁵ Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, “Statement on the Use of Capital and Liquidity Buffers,” joint press release, March 17, 2020.

Only liquidity above a regulatory minimum predicted additional lending during the 2020 stress. Balances committed to satisfying the requirement did not. R. Matthew Darst, Lucia Gurrieri, Arazi Lubis, and Alexandros P. Vardoulakis, “The Last Taxi: LCR Buffers and Bank Liquidity Provision,” Finance and Economics Discussion Series 2026-051 (Washington, DC: Board of Governors of the Federal Reserve System, July 2026), <https://doi.org/10.17016/FEDS.2026.051>. On banks' reluctance to dip into buffers, see Basel Committee on Banking Supervision, *Early Lessons from the Covid-19 Pandemic on the Basel Reforms* (Basel: Bank for International Settlements, July 2021).

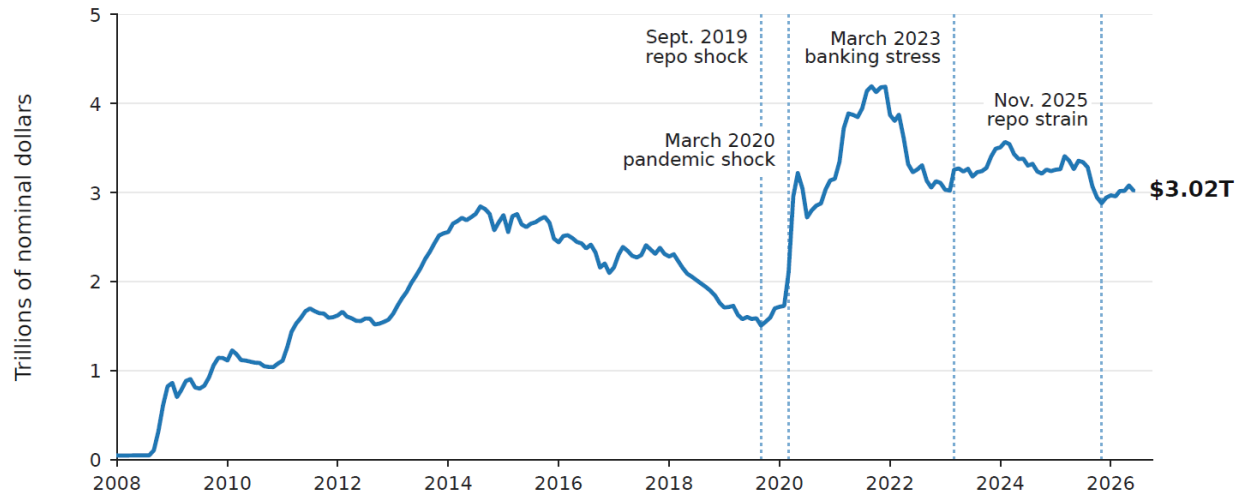
¹⁶ Swiss Financial Market Supervisory Authority and Swiss National Bank, “FINMA and the SNB Issue Statement on Market Uncertainty,” joint press release, March 15, 2023; Credit Suisse Group AG, “Credit Suisse Group Takes Decisive Action to Pre-emptively Strengthen Liquidity and Announces Public Tender Offers for Debt Securities,” media release, March 16, 2023.

¹⁷ Viral V. Acharya, Rahul S. Chauhan, Raghuram Rajan, and Sascha Steffen, “Liquidity Dependence and the Waxing and Waning of Central Bank Balance Sheets,” NBER Working Paper 31050 (March 2023, revised December 2024), <https://www.nber.org/papers/w31050>; Bill Nelson, “How the Federal Reserve Got So Huge, and Why and How It Can Shrink,” BPI Staff Working Paper 2024-1, February 7, 2024, <https://bpi.com/wp-content/uploads/2024/02/How-the-Federal-Reserve-Got-So-Huge-and-Why-and-How-It-Can-Shrink.pdf>. Nelson also discusses the role of liquidity-management practices and supervisory expectations.

Figure 1

The Ratchet Effect: Total Reserves

Reserves of depository institutions, January 2008 to June 2026

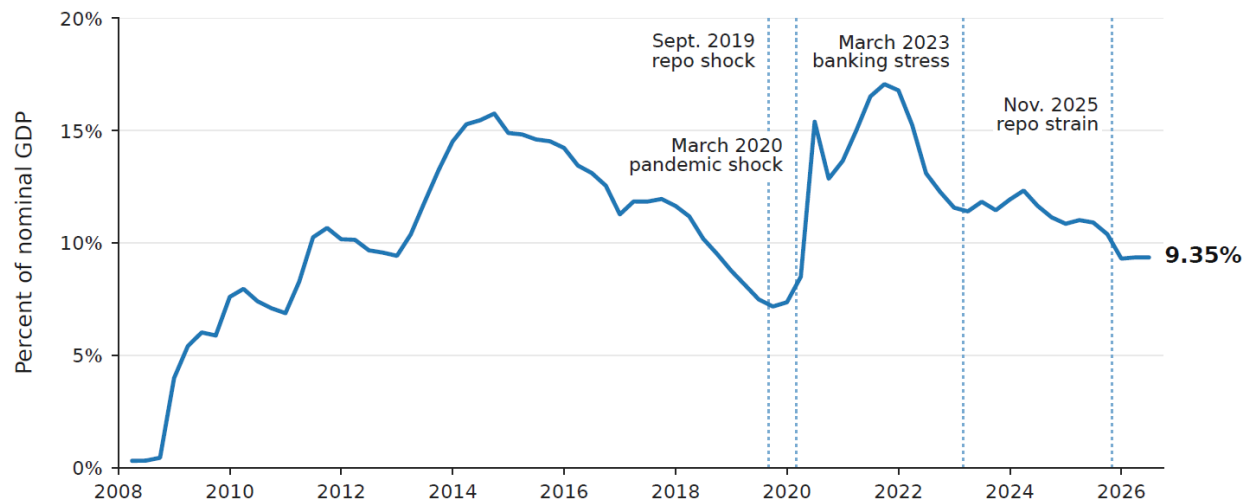


Source: Federal Reserve Board, Reserves of Depository Institutions: Total (FRED: TOTRESNS).
Monthly, not seasonally adjusted. Latest observation: June 2026.

Figure 2

The Ratchet Effect: Reserves as a Share of GDP

Quarterly average reserves as a share of nominal GDP, 2008 Q1 to 2026 Q2



Sources: Federal Reserve Board (FRED: TOTRESNS) and Bureau of Economic Analysis (FRED: GDP).
Monthly reserves averaged within quarters, divided by nominal GDP at an annual rate. Last quarter: 2026 Q2.

The fiscal and distributive costs

A framework that falls short of its goals might be tolerable if it did not have other downsides, but Ample Reserves has significant fiscal and distributive costs. The first is a subsidy to bank equity holders on the deposits created by quantitative easing. When the Fed buys a security from a nonbank investor, the transaction creates both a deposit at the investor's bank and an equivalent reserve balance.¹⁸ Banks earn the difference between the interest rate the Fed pays, IORB, and what they pay to depositors. The subsidy is the extra income banks earn from this spread on the additional deposits created by QE, not on their entire deposit base. Using a baseline assumption that the deposits created by QE earn about 65% of the policy rate, the present value of this deposit-franchise benefit peaked at roughly \$200 billion in 2023, about 1% of banking assets.¹⁹ The gains concentrate at institutions that pay depositors least, particularly the largest banks.²⁰

Some argue that payments on reserves simply replace interest the government would otherwise pay on Treasury bills, leaving the consolidated Fed-Treasury balance sheet little changed. In other words, while it is true that if the Fed had not purchased so many Treasuries and created so many reserves its interest expense would be lower, this would be offset by the fact that the Treasury's interest expense (to private holders of Treasuries) would be higher.²¹ But consolidation does not resolve the distributional question. Treasury securities are available to households and nonbank investors as well as banks, whereas only eligible depository institutions, mostly commercial banks, can access interest-bearing reserves. And ample reserves forces depository institutions to hold over \$3 trillion in aggregate, 100 times the pre-crisis size.²²

In addition to the deposit franchise subsidy, Ample Reserves creates a much smaller subsidy for the American branches of foreign banks through the federal funds market. Foreign banks borrow about \$100 billion overnight at rates just below IORB (from lenders who cannot earn IORB), and then park those funds at the Fed and earn IORB.²³ This is an arbitrage trade for the foreign banks because they do not pay

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¹⁸ Available estimates suggest that banks were the ultimate sellers of no more than a few percent of the securities acquired through large-scale asset purchases (roughly \$150 billion out of \$3 trillion) with the overwhelming majority coming from nonbanks. Seth Carpenter, Selva Demiralp, Jane E. Ihrig, and Elizabeth C. Klee, "Analyzing Federal Reserve Asset Purchases: From Whom Does the Fed Buy?," Finance and Economics Discussion Series 2013-32 (Washington, DC: Board of Governors of the Federal Reserve System, 2013).

¹⁹ The assumed marginal deposit beta of 0.65 reflects a mix of wholesale and retail balances associated with QE; it is a modeling assumption, not an estimate for every bank deposit. Chris Hughes and Josh Younger, "The Price of the Floor: Quantifying the Cost of Ample Reserves in U.S. Monetary Policy Implementation" (Brookings Institution, February 2026), 26–28 and appendix A.

²⁰ Hughes and Younger, "The Price of the Floor," 36–38.

²¹ See, e.g., Sam Schulhofer-Wohl, "Monetary Policy Implementation and the Consolidated Government Balance Sheet," *Dallas Fed Economics* (blog), Federal Reserve Bank of Dallas, April 15, 2025.

²² The claim here speaks only to the deposit franchise associated with deposits created mechanically by QE, not all deposits. If aggregate reserves were to decline through policy action, banks' demand for safe assets would likely shift into Treasuries and MBS. Because those assets can be held by anyone, the subsidy for commercial banks that Ample Reserves bestows disappears.

Hughes and Younger, "The Price of the Floor," 17–21, 26–28; Alyssa G. Anderson et al., "A User's Guide to Reducing the Federal Reserve's Balance Sheet," Finance and Economics Discussion Series 2026-019 (March 2026).

²³ The Federal Home Loan Banks' accounts at the Fed earn no interest by law, so the FHLBs lend idle cash overnight, a few basis points below IORB, overwhelmingly to the American branches of foreign banks, which escape the FDIC assessment and park the proceeds at the Fed at IORB. This trade is now most of what remains of the federal funds market.

the same FDIC assessment fees that make the trade unprofitable for the domestic banks that do have to pay them. That arbitrage for foreign banks, while small in absolute terms, made possible about \$54 million of gain in 2023.²⁴

In addition to these subsidies, the balance sheet that Ample Reserves requires quietly shifts debt management and credit allocation decisions away from the Treasury and toward the Federal Reserve. The Treasury, as the fiscal agent for the United States government, decides the term distribution of debt issuance. In any given auction, it may decide to issue a 28-day bill, or a 30-year bond, or any term in between. But when the Fed buys a 30-year Treasury, for example, and finances it with reserves, the consolidated government balance sheet replaces a fixed-rate, long-term obligation with a floating-rate, short-term one. The effective maturity of the privately held federal debt shortens without the Treasury deciding. Recent estimates of the Fed's Treasury holdings indicate that they carry a weighted average maturity of 8.8 years, against 5.9 for the market they were drawn from.²⁵

Treasury could offset the Fed's purchases by issuing more long-term debt, but it has chosen to pursue its own debt management objectives rather than systematically neutralizing the Fed's portfolio choices. Treasury's borrowing advisers say they analyze how Fed holdings change the maturity and interest rate exposure of the consolidated public debt, but they explicitly say they have not shifted their debt issuance decisions as a result.²⁶ Ample Reserves thus shifts some measure of discretion over the maturity structure of privately held government debt to the central bank.

One could argue that these effects are more a function of the Fed's chosen SOMA portfolio composition than they are of Ample Reserves per se. After all, one could in principle back reserves with Treasuries of any maturity—for example, a portfolio that exactly matched the maturity structure of current private Treasury holdings, or one that is more weighted to short maturities. But while this is true

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Gara Afonso, Alex Entz, and Eric LeSueur, "Who's Lending in the Fed Funds Market?," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, December 2, 2013; Gara Afonso, Gonzalo Cisternas, Brian Gowen, Jason Miu, and Joshua Younger, "Who's Borrowing and Lending in the Fed Funds Market Today?," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, October 10, 2023; Ayelen Banegas and Manjola Tase, "Reserve Balances, the Federal Funds Market and Arbitrage in the New Regulatory Framework," *Journal of Banking & Finance* 118 (September 2020): 105893.

²⁴ Author's calculation from Federal Reserve data. Average daily federal-funds volume in 2023 (\$106.4 billion) × an assumed foreign-bank share of borrowing (90%) × the estimated share of borrowed funds retained as reserve balances (80%) × the average IORB–EFFR spread (7.07 basis points) yields \$54.2 million.

In 2017, Thomas Keating and Marco Macchiavelli estimated that FDIC-exempt foreign banks retained roughly 78–80 cents of each additional federal-funds dollar as reserves.

Thomas Keating and Marco Macchiavelli, "Interest on Reserves and Arbitrage in Post-Crisis Money Markets," Finance and Economics Discussion Series 2017-124 (Washington, DC: Board of Governors of the Federal Reserve System, 2017), 23–24.

²⁵ Federal Reserve Bank of New York, *Open Market Operations During 2025*, 25; U.S. Government Accountability Office, *Federal Debt Management: Treasury Is Meeting Borrowing Needs but the Deteriorating Fiscal Outlook Poses Risks*, GAO-26-107529 (Washington, DC: Government Accountability Office, March 2026), 24.

²⁶ In 2010, Treasury's Assistant Secretary for Financial Markets Mary J. Miller indicated that Fed purchases would not change Treasury's debt management strategy, and the Treasury Borrowing Advisory Committee (TBAC) subsequently recommended preserving regular, predictable issuance regardless of Fed monetary policy. October 5, 2010, <https://home.treasury.gov/news/press-releases/tg890>; Treasury Borrowing Advisory Committee, minutes of November 2, 2010, <https://home.treasury.gov/news/press-releases/tg942>.

Assistant Secretary for Financial Markets Joshua Frost reaffirmed the focus on structural demand and long-term borrowing costs in July 2024. Frost, "Principles of U.S. Debt Management Policy," July 11, 2024, <https://home.treasury.gov/news/press-releases/jy2460>.

In 2026, the TBAC again reaffirmed the stance previously taken, although it acknowledged that it might take into account the Fed's portfolio when deciding its issuance mix. Treasury Borrowing Advisory Committee, "Bill Purchases and the Consolidated Balance Sheet," February 3, 2026, 3, 11, 18, <https://home.treasury.gov/system/files/221/TBACCharge1Q12026.pdf>. The report examines duration and interest-rate-reset exposure, which differ from the weighted-average-maturity figures cited above.

in principle, it is also the case that, in actual practice, the Fed has chosen not to transition the SOMA to such a portfolio and has no imminent plans to do so.

Beyond its effect on debt maturity, the Fed also allocates private credit through its enduring holdings of \$2 trillion of mortgage-backed securities. In choosing to allocate credit to housing over other sectors like student loans, municipal debt, or auto credit, the Fed makes a political decision outside of its mandate.²⁷

The Fed's footprint in markets and politics

The large balance sheet required by ample reserves also expands the Fed's footprint across financial markets, interfering with the price signal, particularly for long-term Treasuries. The central bank is such a large buyer in some Treasury issuances that its appetite for purchases shifts market prices. Today the Fed is the largest single holder in the two most important bond markets in the financial system, the market for federal government debt and for agency mortgage securities. At the March 2022 peak, it held nearly 30% of all outstanding Treasury bonds and more than 40% of the agency mortgage securities market.²⁸ Over the years since, that share has fallen modestly. The median share of a typical Treasury issue that the Fed owns has fallen to roughly 13%, but the legacy concentration remains. In 39 separate issues, nearly all of them long bonds and some not maturing until 2047, the Fed owns more than half of everything outstanding. The average across those 39 issues is 65%, and in nearly half of them, the Fed owns a full 70%. Those majority stakes add up to \$868 billion, nearly a quarter of the Fed's entire portfolio of Treasury notes and bonds. In these issues, the Treasury issued a total of \$1.3 trillion, which means the Fed's holdings leave less than \$470 billion for every other investor in the world combined.²⁹

A footprint of this scale moves prices through expectations alone. When the Fed announced its first mortgage-purchase program in November 2008, mortgage rates fell about 85 basis points in five weeks before a single bond had been bought.³⁰ At the end of 2016, Board economists estimated that the Fed's securities portfolio was holding the ten-year Treasury term premium roughly 100 basis points below where it otherwise would have been.³¹ Evidence that QT announcements raise longer-term government-bond yields reinforces the importance of the expected path of central-bank holdings.³² Markets can continue to trade smoothly and incorporate new information, but the prices they discover reflect the persistent effect of Fed asset purchases on the supply of securities. Peer central banks also caution against

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²⁷ Board of Governors of the Federal Reserve System, "Factors Affecting Reserve Balances (H.4.1)," statistical release, July 23, 2026, table 1.

²⁸ Andrew T. Levin, Brian L. Lu, and William R. Nelson, "Quantifying the Costs and Benefits of Quantitative Easing," NBER Working Paper 30749 (Cambridge, MA: National Bureau of Economic Research, December 2022).

²⁹ Share calculations follow the issue-level method of Levin, Lu, and Nelson, applied to CUSIP-level holdings and each issue's share outstanding as reported in Federal Reserve Bank of New York, "System Open Market Account Holdings of Domestic Securities," as of August 5, 2026; author's calculations.

³⁰ Diana Hancock and Wayne Passmore, "Did the Federal Reserve's MBS Purchase Program Lower Mortgage Rates?," Finance and Economics Discussion Series 2011-01 (Washington, DC: Board of Governors of the Federal Reserve System, 2011).

³¹ Brian Bonis, Jane Ihrig, and Min Wei, "The Effect of the Federal Reserve's Securities Holdings on Longer-Term Interest Rates," FEDS Notes (Washington, DC: Board of Governors of the Federal Reserve System, April 20, 2017).

³² The stock effect concerns securities withheld from private portfolios and expectations of future holdings, rather than disruption on each transaction date. Stefania D'Amico and Thomas B. King, "Flow and Stock Effects of Large-Scale Treasury Purchases: Evidence on the Importance of Local Supply," Finance and Economics Discussion Series 2012-44, <https://www.federalreserve.gov/pubs/feds/2012/201244/>; Wenxin Du, Kristin Forbes, and Matthew N. Luzzetti, "Quantitative Tightening Around the Globe: What Have We Learned?," NBER Working Paper 32321, April 2024, <https://doi.org/10.3386/w32321>.

an excessive market presence. The ECB instructs itself to avoid “an over-proportional market footprint,” and the Reserve Bank of Australia prices operations to avoid “an overly large presence in the repo market.” The Bank of Canada warns against “an unhealthy over-reliance” on central bank balances.³³ The Bank for International Settlements laid out a north star in 2023 when it said “[t]he balance sheet needs to be elastic, not large.”³⁴

Finally, Ample Reserves introduces meaningful political costs. A structurally large balance sheet makes the Fed a standing target for political critics. It invites accusations that the central bank subsidizes commercial banks, finances the government’s debt, allocates credit, and inappropriately interferes with price signaling in financial markets. Each claim contains enough truth to stick. It also invites political voices to imagine expanding the central bank’s role. If the Fed can hold \$2 trillion of mortgages in ordinary times, why not municipal bonds, subsidized small business credit, a green investment portfolio? Why might it not purchase Treasury notes directly to help with debt management?³⁵ Each idea has attracted serious consideration in the past decade. Even if the political vulnerability could be managed, Ample Reserves also contributed to a more subtle internal corrosion, because the standing cushion of reserves makes hard reforms optional. Payment modernization can wait because reserves cover timing gaps, and liquidity rules need not be fixed because another layer of reserves can manage short-term distress.

What a successor system should do

A successor framework should embrace the advances of Ample Reserves but mitigate its operational failures and meaningful side effects. Reliable rate control should continue through the use of administered rates, avoiding a return to the pre-2008 Scarce Reserves system that depended on daily forecasts of reserve demand. But the overall level of reserves should be minimal in size, only enough to facilitate payment settlement and regulatory compliance. That would result in a significantly smaller permanent balance sheet, with outright securities holdings limited to short-dated Treasuries. The central bank should begin to provide liquidity elastically. The quantity of reserves should expand and contract with demand, revealed through central bank borrowing at published terms. Finally, we need clear separation of routine liquidity provision from emergency assistance, so that use of ordinary standing facilities signals nothing about the health of a financial institution.³⁶

Assets held to supply reserves should have stable values, trade in deep markets, and leave as little imprint as possible on the prices private investors face. Short-dated Treasuries best meet those tests: They expose the Fed to little duration risk and interfere less with the Treasury’s chosen maturity structure than long-term bonds. A smaller portfolio would also reduce the risk that Fed holdings dominate particular

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³³ The statements are collected in Bill Nelson, “The Fed vs. the World: Our Central Bank’s Unique Distrust of Private Markets,” Bank Policy Institute, June 20, 2025.

³⁴ Bank for International Settlements, *Annual Economic Report 2023* (Basel: Bank for International Settlements, June 2023), 69.

³⁵ Robert Menendez et al. to Steven T. Mnuchin and Jerome H. Powell, letter, May 14, 2020; Congressional Oversight Commission, hearing on the Main Street Lending Program, August 7, 2020; Robert C. Hockett, *Financing the Green New Deal: A Plan of Action and Renewal* (Cham: Palgrave Macmillan, 2020); Stephanie Kelton, *The Deficit Myth: Modern Monetary Theory and the Birth of the People’s Economy* (New York: PublicAffairs, 2020).

³⁶ For a historical overview of how to construct reliable standing facilities in lieu of ongoing open market operations, see Ulrich Bindseil, *Monetary Policy Operations and the Financial System* (Oxford: Oxford University Press, 2014), 70–71.

issues.³⁷ The Fed could still buy longer-term Treasuries for quantitative easing when needed, with those holdings sold as recovery took hold.

This paper argues for what I will call an “Elastic Reserves” system, built on the use of three standing facilities and paired with a program to reduce reserve demand. The Fed sets a SOFR target rate and uses the administered rates of multiple facilities to guide market rates toward it. A rebuilt SRF would lend overnight at 10 basis points above IORB, in any amount eligible collateral supports, limiting upward pressure on rates through marginal reserve provision. A new Term Liquidity Facility (TLF) auctions four-month reserves weekly against a tiered schedule of collateral, so that longer-term liquidity needs can be met in an orderly and reliable fashion. The discount window endures to facilitate emergency borrowing when necessary. These standing facilities enable a significant reduction in the baseline level of aggregate reserves. The report proposes several major reforms to reduce structural reserve demand, including reform of liquidity regulation, improving dealer intermediation, a modernized payment system, and a Treasury account at the Fed backed by bills.

The Elastic Reserves system differs from the current Ample Reserves system in two important ways. It makes reducing reserve demand a central objective, and it lets banks’ demand determine the quantity supplied. This is preferable to merely working toward a smaller balance sheet under the current Ample Reserves system because, under the latter, the Fed would still have to supply the reserve stock its operating system requires. Elastic Reserves would instead let private payment needs and prudent buffers determine that stock, with standing facilities preserving rate control as demand changes.

Section II develops the architecture for standing facilities, and Section III outlines the agenda for reserve demand reduction. Section IV considers potential objections. Finally, Section V imagines a path toward implementation.

II. The New Elastic Reserves System

What reserves should be for

At their core, reserve balances are the money banks use to settle payments with one another. When money moves from one bank to another—for a salary or the purchase of a financial asset or home—the banks generally settle up by shifting reserve balances at the Fed. This means a bank needs reserves to facilitate its ongoing flow of payments and to serve as a buffer given the uncertainty in the timing and size of outflows. The banking system’s base need for payment facilitation serves as the genuine lower bound on the total amount of reserves, although that lower bound depends on the availability of intraday credit, the design of the payment system, and the speed with which banks can borrow needed reserves.³⁸

After 2008, reserves acquired a second function: satisfying regulatory demand. In the Great Financial Crisis, the interbank lending market dried up, and reliable sources of short-term financing were no longer

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³⁷ An alternative would match the long-lived demand for currency with longer-term Treasuries while backing reserves with short-term assets: Hugo De Vere, Srinivas Ramaswamy, and Sam Schulhofer-Wohl, “Accounting for Interest Rate Risk: Matching Fed Assets to Liabilities,” Federal Reserve Bank of Dallas, August 7, 2025, <https://www.dallasfed.org/research/economics/2025/0807>.

³⁸ Darrell Duffie, “The Payment System Puts a Floor on the Fed’s Balance Sheet,” *Brookings Papers on Economic Activity*, Spring 2026; Ricardo Reis, “Payment Needs and the Size of the Federal Reserve’s Balance Sheet” (comments prepared for the *Brookings Papers on Economic Activity* spring conference, March 2026).

available. In response, regulators created a raft of new frameworks to ensure banks would have easier access to funds, particularly requiring minimum levels of high-quality liquid assets to satisfy internal stress tests, resolution-planning assumptions, and supervisory expectations. These rules frequently treat a reserve held in advance as more reliable than capacity to borrow reserves against collateral, even when the latter is legally available and operationally sound.³⁹ The Basel liquidity framework was expressly designed to discourage central banks from becoming lenders of first resort and to favor self-insurance by banks.⁴⁰ Covered U.S. banks now hold approximately \$4.1 trillion of high-quality liquid assets, but the headline stock does not establish how much liquidity can be used without violating a requirement or prompting supervisory concern.⁴¹ In addition to the imposition of liquidity requirements, banks' preference for reserves increased post-crisis, because of a strong desire to avoid the discount window.⁴²

Liquidity regulation made reserves the proof of a bank's supposed resiliency without making the banking system more resilient. A buffer that must remain above a regulatory minimum can absorb losses only to the extent that an institution is willing and permitted to cross that minimum. Charles Goodhart's pre-crisis analogy still rings true. A traveler steps off the train at a deserted station and finds a single taxi outside. But the driver cannot take him to his destination, because a town ordinance requires that one cab always be waiting there.⁴³ The mandatory reserve buffer may be a lovely idea, but unless it can be used, it serves no purpose. Fed research on the March 2020 dash for cash illustrates the problem. Higher liquidity ratios did not stem a run. Banks with buffers *above* their required liquidity coverage ratios supplied necessary credit. Only the excess above the regulatory minimum predicted liquidity provision, and the effect was selective and temporary.⁴⁴ Similarly, Credit Suisse's reported liquidity coverage ratio remained far above 100% days before its forced sale in March 2023.⁴⁵

The Elastic Reserves framework proposes returning reserves to their core utility as the means of payment settlement in the financial system. It does away with the charade that larger stocks of reserves enhance financial stability. By providing access to abundant liquidity on an ongoing basis, an Elastic Reserves operating framework minimizes the need for liquidity hoarding, enabling banks to hold the balances they need to settle payments plus whatever buffer each judges prudent. The banking system's insurance against liquidity shocks should take the form of contingent capacity to create reserves rather than furnishing an enduring but idle stock.

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³⁹ Alyssa G. Anderson, Alessandro Barbarino, Anthony M. Diercks, and Stephen Miran, "A User's Guide to Reducing the Federal Reserve's Balance Sheet," Finance and Economics Discussion Series 2026-019 (Washington, DC: Board of Governors of the Federal Reserve System, March 2026).

⁴⁰ Stefan Ingves, quoted in Bill Nelson, "Liquidity Regulations, Prepositioned Discount Window Collateral and the Central Bank Balance Sheet," Bank Policy Institute, May 28, 2026.

⁴¹ Anderson et al., "A User's Guide."

⁴² For a full accounting of the shift in the financial system, see Hughes, *Plumbing and Power*, forthcoming.

⁴³ C. A. E. Goodhart, "Liquidity Risk Management," LSE Financial Markets Group Special Paper 175, October 2007.

⁴⁴ R. Matthew Darst, Lucia Gurrieri, Arazi Lubis, and Alexandros P. Vardoulakis, "The Last Taxi: LCR Buffers and Bank Liquidity Provision," Finance and Economics Discussion Series 2026-051 (Washington, DC: Board of Governors of the Federal Reserve System, July 2026), <https://doi.org/10.17016/FEDS.2026.051>.

⁴⁵ Swiss Financial Market Supervisory Authority and Swiss National Bank, "FINMA and the SNB Issue Statement on Market Uncertainty," joint press release, March 15, 2023; Credit Suisse Group AG, "Credit Suisse Group Takes Decisive Action to Pre-emptively Strengthen Liquidity and Announces Public Tender Offers for Debt Securities," media release, March 16, 2023.

The central principle: Supply set by demand

Ample Reserves, by design, assumes that there is a minimum, evolving quantity of reserves below which reserves develop a convenience yield and that the central bank can estimate it. In reality, reserve demand varies with payment flows, tax dates, settlement cycles, and seasons, making a fixed quantity always skewed in one direction or the other. Today's focus on reserve supply forces the Fed to keep guessing the system's minimum comfortable level, a nearly impossible task given the dynamism of the financial system. By contrast, an Elastic Reserves system automatically injects and drains reserves in response to bank demand. The Fed discloses the terms on which it will lend, accepts good collateral, and lets banks' bidding for reserves determine the quantity of reserves in the system. The Bank of England has been running an operating system along these lines for nearly two years and with significant success.⁴⁶ Reserves expand when the system needs them and contract on their own when the loan is repaid. Elasticity runs in both directions without a committee deciding either leg.

The Fed's founders would recognize the idea, because it is in line with the institution's original design. The first promise in the Federal Reserve Act's title is "to furnish an elastic currency."⁴⁷ The Senate Banking Committee, reporting the bill in November 1913, recorded what unaccommodated swings in money demand had meant in practice. In 1907, the rate for call money ranged from 2% to 45% in January and from 5% to 125% in October.⁴⁸ The remedy Congress chose was not to warehouse idle cash but to empower a central bank to expand the supply of currency and reserves by lending to member banks against the short-term commercial and agricultural loans on their books, then to contract that supply as the loans matured. Before the Fed learned to use open market operations as an instrument of monetary policy in the 1920s, the discount window did most of that work. As former ECB official Ulrich Bindseil observes, "The history of central banking in the nineteenth century is largely the history of its liquidity-providing standing facility."⁴⁹ Demand for money in today's economy follows its own seasonal variations distinct from the agricultural swings of the last century. The operating framework should embrace that variability rather than merely tolerate it.

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⁴⁶ Bank of England, *Transitioning to a Repo-Led Operating Framework*, discussion paper (London: Bank of England, December 2024). Over the year to February 2026, Short-Term Repo drawings rose from £50.3 billion to £97.0 billion and Indexed Long-Term Repo drawings from £9.5 billion to £69.9 billion across 79 firms, while reserves fell from £706.7 billion to £643.5 billion and "sterling short-term repo rates remained closely anchored to Bank Rate." Bank of England, *Report on the Bank's Official Market Operations March 2025–February 2026* (London: Bank of England, June 2026).

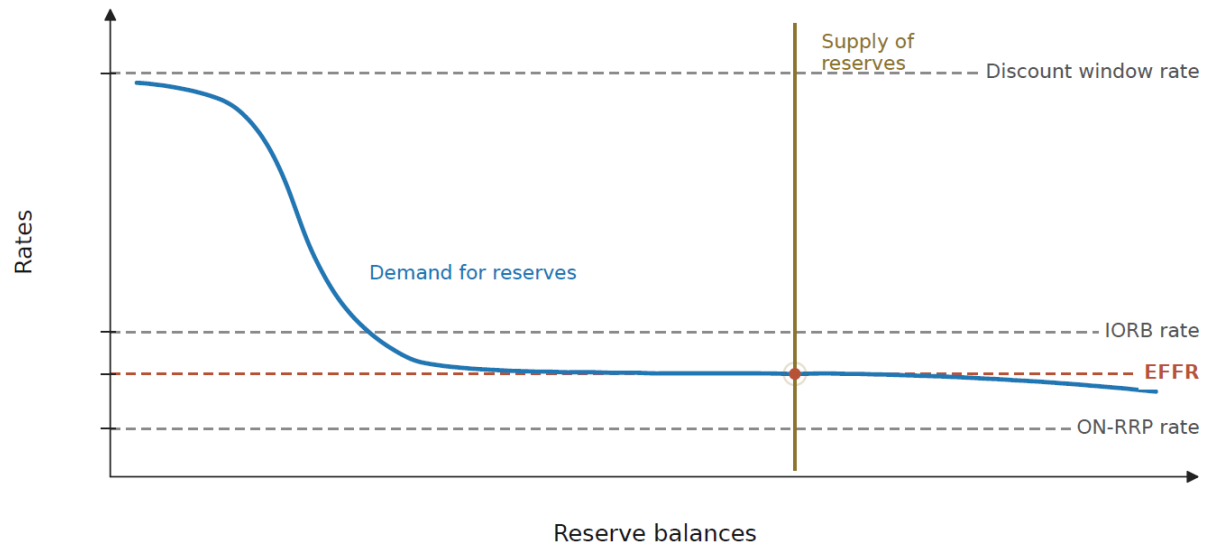
⁴⁷ Federal Reserve Act, Pub. L. No. 63-43, 38 Stat. 251 (1913).

⁴⁸ Senate Committee on Banking and Currency, November 1913, quoted in Bindseil, *Monetary Policy Operations and the Financial System*, 72.

⁴⁹ Bindseil, *Monetary Policy Operations and the Financial System*, 73.

Figure 3

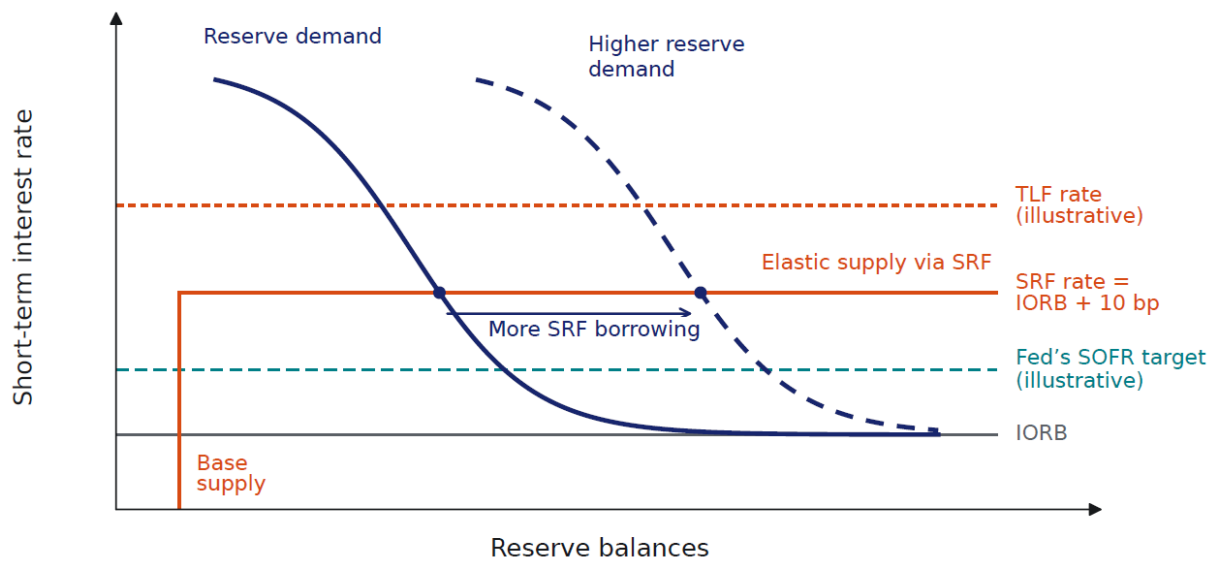
Price elasticity of reserve demand today



Schematic of today's reserve-demand curve, drawing on Poole (1968) and Afonso et al. (2020).

Figure 4

Reserve demand and elastic supply in a demand-driven system



IORB, SRF and TLF rates guide SOFR toward the Fed's target.

Target and TLF positions are illustrative; TLF pricing varies by collateral class.

Market rates may differ because of intermediation and timing.

Let private wholesale markets allocate liquidity first

In an Elastic Reserves system, the first source of overnight financing would be the private money market, as it is today. Private wholesale lending is efficient at reallocating cash from institutions with temporary surpluses to those with deficits. That shrinks the aggregate quantity of reserves the system must hold. It also informs. Private rates aggregate dispersed knowledge about funding conditions and institutional position. A rise in private borrowing can send a signal to policymakers that reserve demand is tightening before any shortage emerges. Institutions that consistently require higher rates to borrow might need additional supervisory attention, depending on the context.

In an Elastic Reserves system, some institutions would *need* to borrow from the Fed whenever aggregate reserve demand exceeded the available stock. Other banks could obtain those newly created reserves through private markets. The SRF would apply collateral requirements and haircuts in line with comparable market transactions. Its rate, 10 basis points above IORB, would encourage banks to seek private financing first and turn to the SRF when needed. Private trades can redistribute existing reserves, but only Fed lending can close any remaining aggregate reserve shortfall within this framework. Banks would continue to borrow and lend to one another regularly in the secured interbank market; non-bank financial institutions, including money-market funds, foreign banking organizations, and hedge funds, would continue to transact in repo and adjacent markets. The federal funds market, which the adoption of Ample Reserves obliterated, would likely not return, because unsecured financing has become significantly more difficult under post-crisis regulation.⁵⁰

A redesigned Standing Repo Facility

Today's Standing Repurchase Agreement Operations should be rebuilt to become the core monetary policy tool of the Elastic Reserves system.⁵¹ The current facility is intended to limit how high market rates can rise. The Fed prices it at the top of its target range for the short-term interest rate—currently at 10 basis points above IORB and a few more basis points above SOFR. Most commercial banks only use it when something has gone wrong. The Elastic Reserves system would retain its full allotment format and price lending at 10 basis points above IORB. Collateral requirements and haircuts would be in line with comparable market transactions. The rate premium would encourage banks to borrow in private markets first, while keeping the SRF available when private financing could not meet their needs. With a smaller underlying reserve stock, some banks would be forced to use the facility in ordinary business whenever an overnight shortfall remained after private redistribution and TLF lending.

Here's how that works. As the Fed drains reserves and balances become less abundant, banks would first seek cash in private markets. As aggregate reserve demand begins to exceed available supply, SOFR would rise above IORB. If an overnight shortfall remains after private redistribution and TLF lending,

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⁵⁰ The FDIC assessment, implemented in 2011, now uses a base of total assets rather than domestic deposits, which means every dollar borrowed comes with a few basis points of cost. In addition, Dodd-Frank leverage ratios mean that unsecured lending uses the same balance sheet capacity as a risky loan with a much higher yield. This means that unsecured interbank lending is gone and will stay gone; leaner reserves will revive redistribution, but in the collateralized repo market.

⁵¹ The Fed renamed the Standing Repo Facility "Standing Repurchase Agreement Operations" in December 2025 when it also adopted full allotment. Currently, the operations occur during two daily windows. This report makes the case for a standing facility, thus it purposefully retains the earlier name.

Reserve Bank of New York, "Statement Regarding Standing Overnight Repurchase Agreement Operations," December 10, 2025, https://www.newyorkfed.org/markets/opolicy/operating_policy_251210.

some eligible institutions have to turn to the SRF for marginal financing. Any eligible institution can borrow reserves from the SRF against Treasury and agency collateral, at any amount the collateral supports, at a rate above IORB from a standing facility accessible during published operating hours. Borrowing at the SRF creates new reserve balances, easing the shortage and helping guide SOFR toward the Fed's target. When reserve demand recedes, loans mature, and the corresponding reserves are extinguished. The facility therefore provides adequate reserves with a supply curve that is horizontal at an elevated rate above IORB for eligible collateral (see Figure 4).

The SRF should initially be priced at 10 basis points above IORB. With collateral requirements and haircuts aligned with private markets, this premium would give banks an incentive to seek cheaper private funding. Yet private transactions can only redistribute existing reserves. Because the framework deliberately maintains a lean underlying reserve supply, some banks will still have to borrow from the SRF to meet the remaining aggregate shortfall. Consider three banks that each want \$10 billion in reserves. Bank A holds \$20 billion, while B and C hold none. A can lend \$10 billion to B, but the system is still \$10 billion short. C must borrow from the Fed, or another bank must borrow and pass the funds to C. B and C both need financing, but neither is individually required to use a Fed facility. Some borrowing from the Fed is unavoidable if all three banks are to meet their reserve demand.

A modest premium would accommodate that routine borrowing and help to keep market rates from spiking above the Fed's target. A larger spread, perhaps of 25 basis points, would offer stronger incentives for private trading, but it would sacrifice tighter rate control without eliminating the system's need to borrow from the SRF.

With a repo facility as its core monetary policy tool, it would be most appropriate for the FOMC to shift its principal target rate for monetary policy implementation to a secured borrowing rate—such as the SOFR—rather than the federal funds rate.⁵² This shift would make sense not only because it would align the target rate with the core monetary policy tool, but also because it would allow the Fed to focus on the most relevant and robust money markets. The federal funds market is now thin and dominated by lending from Federal Home Loan Banks to foreign bank branches, making its rate less informative about wider funding conditions.⁵³ Federal Home Loan Banks (FHLBs) shift cash between overnight investments and advances to member banks, so their liquidity needs can move federal funds lending and rates even when

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⁵² SOFR is the broadest measure of the cost of overnight secured financing, as it includes all transactions included in the Broad General Collateral Rate (BGCR) as well as bilateral general collateral Treasury repo transactions executed through the Fixed Income Clearing Corporation's (FICC) delivery-versus-payment service. And the BGCR itself encompasses all trades in Triparty General Collateral repo as well as FICC's GCF Repo transactions. See <https://www.newyorkfed.org/markets/reference-rates/sofr> and <https://www.newyorkfed.org/markets/reference-rates/bgcr>.

The Fed could choose a rate based on a narrower portion of the market, such as the BGCR or the Triparty General Collateral Rate (TGCR). The main advantages of using SOFR are that it gives a more complete picture of secured overnight borrowing dynamics, and it will be less sensitive to idiosyncratic shocks in particular market segments. For the case for TGCR, see Lorie Logan, "Ample Liquidity for a Safe and Efficient Banking System," October 31, 2025, <https://www.dallasfed.org/news/speeches/logan/2025/10/31/251031>.

SOFR's broader coverage does not make it immune to regulatory or institutional change. See also Federal Reserve Bank of New York, "Additional Information about Reference Rates Administered by the New York Fed," updated April 6, 2026, <https://www.newyorkfed.org/markets/reference-rates/additional-information-about-reference-rates>.

⁵³ Afonso et al., "Who's Borrowing and Lending in the Fed Funds Market Today?" While lending by nonbank entities like FHLBs makes up around 90% of fed funds activity, the fed funds market can still be a significant source of liquidity for some regional and community banks. See Sriya Anbil, Alyssa Anderson, and Benjamin Eyal, "Bankers' Banks and Their Role in the Federal Funds Market," FEDS Notes, Board of Governors of the Federal Reserve System, January 30, 2026, <https://www.federalreserve.gov/econres/notes/feds-notes/bankers-banks-and-their-role-in-the-federal-funds-market-20260130.html>.

aggregate reserves remain abundant.⁵⁴ In September 2019, for instance, the EFFR moved only after repo rates had increased much more sharply. SOFR revealed the pressure earlier and more directly.⁵⁵

Under Elastic Reserves, the FOMC would announce a SOFR target rate, and the Fed would calibrate IORB, the SRF rate, and TLF pricing to guide SOFR toward it. IORB would help limit how low overnight rates might fall, because eligible banks could earn that rate by holding reserves. The SRF, priced 10 basis points above IORB, would help limit how high rates might climb, while TLF pricing would be used for longer-term supply of reserves, easing pressure on overnight funding. These pricing tools would help achieve the target, rather than define it. Daily SOFR could still move around the target as demand, intermediation costs, and auction timing changed. Modest movements would convey information about funding conditions rather than automatically signal an operational error.

The overnight reverse repurchase facility would become unnecessary in the new framework. That facility exists to absorb nonbank cash when reserve abundance pushes market rates too far below today's target range. In a demand-driven system, reserves supplied through lending facilities are extinguished as loans are repaid, limiting persistent excess supply. Temporary QE purchases would create reserves that would only drain when the Fed sold the assets or runoff occurred. The Fed could retain a reserve absorption tool like the Overnight Reverse Repurchase Agreement Facility (ON-RRP) to be used in those periods until it could unwind QE purchases.

A new Term Liquidity Facility (TLF)

The SRF's primary role in the Elastic Reserves framework is to supply marginal overnight reserves. It is not intended to meet medium-term liquidity needs or to monetize the broader assets held by commercial banks. A second facility, the Term Liquidity Facility (TLF), meets medium-term liquidity needs to ensure that daily rate movements are modest in size. Its role is to convert a very broad range of assets into reserves for a defined term without forcing banks to liquidate assets or use an emergency facility. In the Elastic Reserves system, the central bank's TLF would be the standing facility providing ongoing, longer-term liquidity, through the use of pre-positioned collateral valued with pre-published, standardized haircuts.⁵⁶

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⁵⁴ FHLBs cannot earn IORB and invest liquidity in federal funds, repo, deposits, and Treasuries; higher repo returns can draw their cash out of federal funds without any fall in aggregate reserves. Roberto Perli, "Balance Sheet Normalization: Monitoring Reserve Conditions and Understanding Repo Market Pressures," September 26, 2024, <https://www.newyorkfed.org/newsevents/speeches/2024/per240926>.

⁵⁵ On September 17, 2019, SOFR rose 315 basis points above IORB and EFFR rose 20 basis points above it. An SRF lending at 10 basis points above IORB would have supplied marginal reserves at its scheduled operations, although market intermediation costs and auction timing could still create rate gaps. Sriya Anbil, Alyssa Anderson, and Zeynep Senyuz, "What Happened in Money Markets in September 2019?," FEDS Notes, Board of Governors of the Federal Reserve System, February 27, 2020.

⁵⁶ Bill Nelson has similarly proposed regular auctions of term primary credit to make central-bank borrowing an ordinary part of liquidity management. Nelson proposes weekly auctions of one- and three-month primary credit; the TLF proposed here uses four-month funding and a separate facility identity.

Bill Nelson, "Forward Guidance: Remodeling the House after Tearing Up the Floor: Suggestions for the Fed's Implementation Framework," January 23, 2025, <https://www.linkedin.com/pulse/forward-guidance-remodeling-house-after-tearing-up-floor-bill-nelson-u0omc>.

Each week, the Fed would auction four-month reserves against three published classes of collateral, ranked by how readily the central bank could liquidate them if a borrower failed.⁵⁷ Class A would include Treasuries, agency debt, and agency mortgage-backed securities—the sovereign core already eligible at the SRF. Class B would include high-quality assets without federal backing, such as investment-grade state and municipal bonds, foreign sovereign debt meeting published standards, and investment-grade corporate bonds. Class C would include eligible commercial and industrial loans, residential and commercial mortgages, agricultural loans, small-business loans, and consumer credit of the types traditionally accepted at the discount window.

The breadth of the three classes of collateral improves institutional access. The SRF’s sovereign collateral requirement naturally favors large dealer banks and firms with substantial securities inventories. Smaller and regional institutions hold larger shares of their assets in business, agricultural, mortgage, and consumer loans. The TLF allows those institutions to obtain routine liquidity without first transforming their portfolios into Treasuries or relying exclusively on the Federal Home Loan Banks.⁵⁸ Minimum bid sizes and the auction system’s pricing would be designed to embrace meaningful participation by institutions outside the globally systemic banks. Each collateral class should have a published minimum spread and haircut schedule. Spreads and haircuts would rise with credit risk, duration, valuation uncertainty, and liquidation cost.⁵⁹ The governing principle is equal treatment of collateral within transparent risk categories.

The TLF would operate as a weekly, uniform-price auction in which the Fed furnishes a variable supply of reserves lent against all three classes of collateral. The Fed would privately construct supply curves for each class, reflecting how much it would be willing to lend at different spreads to IORB at or above the applicable minimum spread, as well as its preferences for total lending across the auction. It would calibrate those schedules alongside IORB and the SRF rate to guide SOFR toward the target while accommodating term liquidity needs. Bidders would submit bids specifying their desired borrowing amount, the rate they would be willing to pay (expressed as a spread to IORB), and the class of collateral they would use as security. Within each collateral class, the Fed would rank bids from highest spread to lowest and determine a “stop-out” price—i.e. the clearing spread at which the submitted bids are reconciled with the Fed’s rate preferences. All successful bids would pay that class’s stop-out spread. Bids above the stop-out spread would receive their full requested amounts, while bids at the stop-out spread could be pro-rated if necessary. Stress would require no separate decision to enlarge the operation, because heavier bidding simply travels up a supply schedule set in advance. This is broadly the procedure used by the Bank of England’s Indexed Long-Term Repo (ILTR) facility.

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⁵⁷ Four months is the longest term the Fed’s standard lending authority currently allows. Section 10B of the Federal Reserve Act, codified at 12 U.S.C. § 347b, permits a Reserve Bank to “make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank.”

Congress would ideally extend the maximum maturity to six months or a year, but it is not a requirement for the TLF to function.

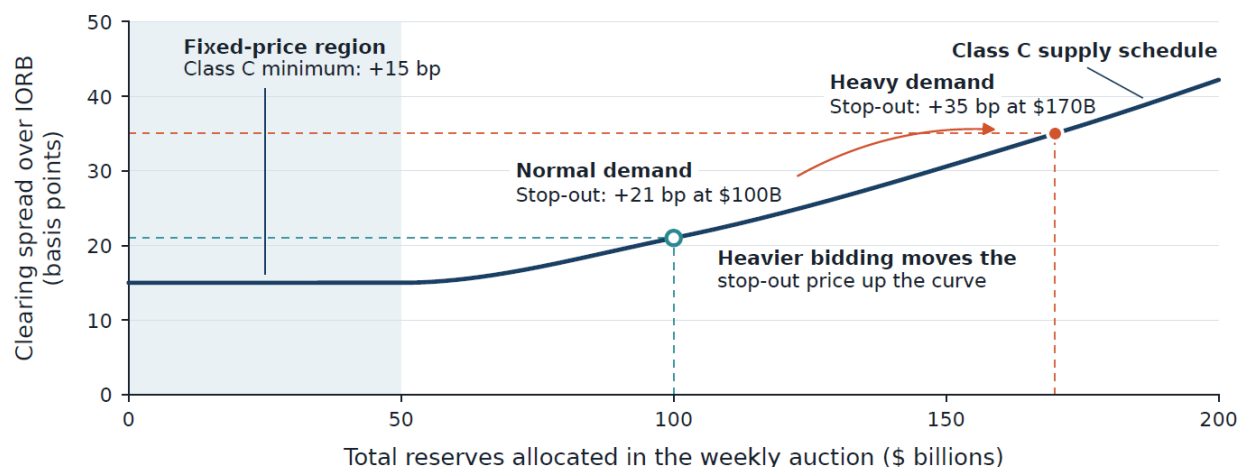
⁵⁸ Lorie Logan and Sam Schulhofer-Wohl, “Options for Reducing the Size of the Fed’s Balance Sheet,” Federal Reserve Bank of Dallas, April 2, 2026.

⁵⁹ The Bank of England uses 3 basis points over the policy rate for the sovereign class, 5 for its second class, and 15 for the broadest set of collateral. Bank of England, “Recalibration of the Indexed Long-Term Repo Operation,” market notice, June 11, 2025; Bank of England, Transitioning to a Repo-Led Operating Framework.

Figure 5

A demand-responsive supply curve for Class C collateral

Illustrative weekly auction under the proposed Term Liquidity Facility



Note: Illustrative Class C calibration; other collateral classes would have lower minimum spreads and flatter schedules. The \$200B auction limit applies to the total auction across all collateral classes, not separately to each class. At a four-month tenor, that limit permits up to roughly \$3.4 trillion outstanding.

Source: Author's illustration.

Weekly auctions are useful because they force banks to anticipate their upcoming liquidity needs, but their downside is that they may cause banks to create a reserve cushion which could be unnecessarily large. To mitigate this and to provide additional agility in the financial system, the Fed could offer a scheduled daily TLF backstop auction between weekly auctions to allow banks to cover unexpected needs. This could be a useful vehicle for smaller banks that encounter unexpected shortfalls, since they are less likely to have abundant SRF-eligible collateral. An eligible institution could borrow against the same collateral schedule at the most recent auction clearing spread plus a small, fixed markup. Indexing the daily price to the auction rate plus a small penalty prevents firms from gaming the system while providing access between weekly auctions.⁶⁰ Use of the daily backstop is a contingency option within routine operations, not a substitute for emergency assistance.

The Board of Governors, in conjunction with the FOMC and the Reserve Banks, can implement the TLF using existing congressional authorization. Reserve Banks would extend advances under Section 10B, governed by Regulation A, and documented under Operating Circular 10, which already supplies the contractual architecture for advances, including valuation, repayment, and enforcement terms.⁶¹ The TLF would be term central bank lending, not a Section 14 open market repo.

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⁶⁰ A robust auction each week with many participants provides important information about liquidity demand. The daily price will reflect conditions that held when the original auction was held in order to prevent institutions from gaming the system should market conditions shift between the auction and the draw from the daily facility.

⁶¹ Federal Reserve Banks, Operating Circular No. 10: Lending, effective August 28, 2023, <https://www.frb-services.org/binaries/content/assets/crsocms/resources/rules-regulations/082823-operating-circular-10.pdf>; Board of Governors of the Federal Reserve System, "Term Auction Facility," noting that TAF was created under the Federal Reserve's standard Section 10B discount-window authority, <https://www.federalreserve.gov/regreform/reform-taf.htm>.

To be clear, that legal characterization does not change the facility's economic place in a repo-led operating framework. The transaction is temporary, collateralized funding in which the Federal Reserve creates reserves against haircut-adjusted assets and extinguishes those reserves when the borrower repays the advance. "Term Liquidity Facility" accurately identifies the legal and policy function while preserving the central economic point that reserves are supplied elastically against collateral rather than through outright securities purchases.

Implementing the TLF requires the coordination of different arms of the Fed, which would require explicit division of authority. The Board should authorize and oversee the facility under Regulation A. The FOMC should be in charge of integrating the facility into the overall operating framework and managing its ongoing operations, including the policies that govern the auction supply schedule and minimum spreads. The Reserve Banks should hold the necessary collateral and extend and administer the advances that result from the auction. The New York Fed compiles the bids across the System and computes the stop-out rate, but Reserve Banks handle settlement. That's a complex set-up, but the Fed has operated this exact institutional configuration before.

The Term Auction Facility precedent

In December 2007, the Fed could see the storm clouds of the coming crisis on the horizon. Anxious to ensure institutions had access to ready liquidity without having to turn to the discount window, the Fed launched the Term Auction Facility (TAF). Depository institutions unable to find market liquidity easily could participate in a group auction that the Fed conducted every two weeks. The auction framework removed the stigma that borrowing from the discount window would have brought while providing liquidity to institutions in need.⁶² The reframing was the point. "You could actually criticize a bank for not participating in this," Bill Dudley told the FOMC as the design was debated. "They are somehow leaving money on the table."⁶³ Ironically, the concept had been developed before the crisis in a Fed study of alternative operating procedures.⁶⁴ TAF used the same broad collateral and eligible institutions as the discount window but set the price competitively. It began with 28-day credit and later added 84-day terms, and all successful bidders paid a common rate subject to a pre-announced, published minimum rate.⁶⁵

The banks came at once: The first auction drew more than \$60 billion of bids from 93 banks for the \$20 billion on offer, and every auction until October 2008 was oversubscribed.⁶⁶ Across 60 auctions between December 2007 and March 2010, 416 institutions borrowed.⁶⁷ Outstanding credit peaked at

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⁶² Corey N. Runkel and Anshu Chen, "United States: Term Auction Facility," *Journal of Financial Crises* 4, no. 2 (2022): 1375–76.

⁶³ Transcript of the meeting of the Federal Open Market Committee, September 18, 2007, 141.

⁶⁴ The concept came from the 2002 System study *Alternative Instruments for Open Market and Discount Window Operations*, which the FOMC commissioned in January 2001 when surpluses threatened to eliminate Treasury debt. Federal Reserve System Study Group on Alternative Instruments for System Operations, *Alternative Instruments for Open Market and Discount Window Operations* (Washington, DC: Board of Governors of the Federal Reserve System, December 2002), <https://www.federalreserve.gov/monetarypolicy/files/fomc20021201memo01.pdf>.

⁶⁵ Runkel and Chen, "Term Auction Facility," 1376, 1389–90. TAF auctions were run as "single-price" auctions with all bidders paying the stop-out rate, subject to the minimum bid rate.

⁶⁶ Board of Governors of the Federal Reserve System and Corey N. Runkel, "TAF Operations Data," *Yale Program on Financial Stability Documents* 13072 (2010); Runkel and Chen, "Term Auction Facility," 1389.

⁶⁷ Roughly two-thirds of the lending flowed through the American branches of foreign banks caught in the global dollar squeeze. Runkel and Chen, "Term Auction Facility," 1377, 1387.

\$493 billion, cumulative lending reached \$3.8 trillion, and the Fed lost nothing.⁶⁸ The high take-up of TAF funds suggested that its design had successfully insulated it from stigma. Evidence from bidding behavior reinforced that conclusion: In TAF auctions, banks often bid above the rate they would have paid for the same collateralized credit at the discount window, a way to see the economic value of avoiding the window's stigma.⁶⁹

As the TAF program developed and financial markets experienced increasing strain, the TAF began to increasingly take on the form proposed for the new TLF.⁷⁰ As financial strains intensified after Lehman Brothers failed, the Federal Reserve sharply increased the amount offered in each TAF auction. The larger amounts offered soon exceeded the aggregate bids received, which meant that all qualifying bids were accepted and the stop-out rate fell to the minimum bid rate. TAF therefore produced de facto full-allotment outcomes, although it remained a fixed-quantity auction rather than an uncapped full-allotment facility.⁷¹ In the years after the crisis, abundant liquidity meant banks did not need to use TAF as often. Staff recommended extending the facility.⁷² At least one FOMC participant proposed keeping it as a standing backstop priced outside ordinary market channels.⁷³

Although the TLF is functionally similar to TAF, it serves a different purpose. TAF was introduced as a temporary crisis program and withdrawn when the crisis ended, whereas the TLF would operate in normal times. Ongoing borrowing with pre-positioned collateral would make additional usage in times of stress easier. Auctions in normal market environments would create the operational experience that would be particularly valuable in crisis moments when liquidity is hard to come by.

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⁶⁸ Runkel and Chen, "Term Auction Facility," 1377; U.S. Government Accountability Office, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, GAO-11-696 (Washington, DC: Government Accountability Office, 2011).

⁶⁹ Olivier Armantier, Eric Ghysels, Asani Sarkar, and Jeffrey Shrader, "Discount Window Stigma during the 2007–2008 Financial Crisis," *Journal of Financial Economics* 118, no. 2 (2015): 317–35.

⁷⁰ The December 2007 announcement itself held open the possibility of a permanent facility: "Experience gained under this temporary program will be helpful in assessing the potential usefulness of augmenting the Federal Reserve's current monetary policy tools . . . with a permanent facility for auctioning term discount window credit," and the Board anticipated seeking public comment on any such proposal. Board of Governors of the Federal Reserve System, "Federal Reserve and Other Central Banks Announce Measures Designed to Address Elevated Pressures in Short-Term Funding Markets," press release, December 12, 2007.

⁷¹ Runkel and Chen, "Term Auction Facility," 1377, 1389. The allotment for the auction just after Lehman's failure was set at \$150 billion, double the size of the largest allotment up to that point. The allotments remained at that level through the end of June 2009. In July 2009, the FOMC began lowering the allotment gradually, with the allotment for the final auction in March 2010 set at \$25 billion.

⁷² In June 2009, Brian Madigan, the director of the Board's Division of Monetary Affairs, reported that the staff leaned toward maintaining the TAF in the steady state at a low level, ready for future periods of stress. That September, he told the committee the staff recommended "initiating soon the process of seeking public comment on a proposal for a permanent TAF." Transcript of the meeting of the Federal Open Market Committee, June 23–24, 2009, 24; Transcript of the meeting of the Federal Open Market Committee, September 22–23, 2009, 27.

By November, the recommendation had given way to deferral, because winding the auctions down to zero would leave the TAF authorized in Regulation A, available whenever needed. As the Board economist Bill Nelson put it in January 2010: "Whether to have a permanent TAF and, if so, in what form is an issue that could be addressed further in the future, when the Federal Reserve's post-financial-crisis monetary policy framework becomes clearer." Transcript of the meeting of the Federal Open Market Committee, November 3–4, 2009, 13; Transcript of the meeting of the Federal Open Market Committee, January 26–27, 2010, 24.

⁷³ Bullard did float this at the April 2009 meeting: "One idea I would have going forward for the lender-of-last-resort programs, one thing the Committee and the Board could consider, is trying to price those programs so that they are all backstops. This means that especially the TAF, the CPFF, and the swaps would all continue to exist, but we would arrange the pricing to make them just outside what would be available through market channels. I am not sure exactly how this could be done, but I think it could be done." Transcript of the meeting of the Federal Open Market Committee, April 28–29, 2009, 67.

The discount window, retained as the emergency tier

A fully operational TLF overlaps with much of what the discount window now does, and it is tempting to conclude the window should be retired. But it shouldn't be, primarily because the stigma now attached to the window could migrate to whatever facility remained functionally closest to it. Discount window stigma has proven remarkably durable, partially because it was a result of Fed policy decisions. Beginning in 1920, Reserve Banks charged penalty rates that climbed with the size of a bank's borrowings. In the decades afterward they kept the discount rate cheaper than market borrowing and instead used restrictions and stigma to pressure banks not to use the facility in normal times.⁷⁴ A 2003 redesign split lending into "no questions asked" primary credit and secondary credit for weaker institutions, but stigma endured.⁷⁵ Since those changes, Fed officials have repeatedly called window use "acceptable and beneficial" in guidance and speeches with little progress to show for it.⁷⁶ There is an entire literature of proposed patches, but few authors expect those solutions to dispel it altogether.⁷⁷ The stigma is strong enough that banks suffer abnormal negative stock returns merely from disclosing that they pre-positioned collateral,⁷⁸ and the weekly balance sheet release still lets markets triangulate who borrowed.⁷⁹

The Elastic Reserves system stops trying to engineer the stigma away and instead moves primary credit provision into standing facilities. Banks would first cover payments and unexpected outflows through private markets, with the scheduled SRF and TLF operations supplying reserves on a regular basis. When aggregate reserve demand exceeds the available stock, some institutions would be forced to borrow from these facilities in ordinary business, while others could obtain those newly created reserves through private markets. The extraordinary case of tapping discount-window credit, however, would come with greater supervisory involvement and potentially bespoke collateral treatment. The discount window would purposefully preserve the discretion the statute grants to lend against collateral a bank never pre-positioned or assets that fail a schedule's terms. The window could assess lendable value beyond what any published table would offer, if examiners believe the bank to be solvent. This

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⁷⁴ Even today the Fed's website proclaims that "it has never lost a cent on its discount window loans to banks." Board of Governors of the Federal Reserve System, "Why Does the Federal Reserve Lend Money to Banks?," last updated June 17, 2011.

For more on the discount window's early stigma, see Olivier Armantier et al., "History of Discount Window Stigma," Liberty Street Economics (blog), Federal Reserve Bank of New York, August 10, 2015; Allan H. Meltzer, *A History of the Federal Reserve*, vol. 1, 1913–1951 (Chicago: University of Chicago Press, 2002).

⁷⁵ Susan McLaughlin, "Discount Window Stigma: What's Design Got to Do with It?," Yale Program on Financial Stability, April 2, 2024.

⁷⁶ Michael S. Barr, "The Importance of Effective Liquidity Risk Management" (speech, ECB Forum on Banking Supervision, Frankfurt, December 1, 2023); Barr, "Supporting Market Resilience and Financial Stability" (speech, 2024 U.S. Treasury Market Conference, Federal Reserve Bank of New York, September 26, 2024); Board of Governors of the Federal Reserve System et al., "Addendum to the Interagency Policy Statement on Funding and Liquidity Risk Management: Importance of Contingency Funding Plans," July 28, 2023; Board of Governors of the Federal Reserve System, Regulation YY frequently asked questions, updated August 13, 2024.

⁷⁷ Michael Hsu would carve out a stigma-free tranche of window lending for ultra-short outflows; Susan McLaughlin would decouple primary from secondary credit; others would grant window capacity credit in the liquidity coverage ratio or in internal stress tests. The Fed's own request for information conceded that the window's collateral systems are antiquated.

Michael J. Hsu, "Building Better Brakes for a Faster Financial World" (speech, Columbia Law School, New York, January 18, 2024); Susan McLaughlin, "Lessons for the Discount Window from the March 2023 Bank Failures," *Journal of Financial Crises* 6, no. 2 (2024): 72–84; Board of Governors of the Federal Reserve System, request for information on discount window and intraday credit operations, September 2024.

⁷⁸ Gary B. Gorton, Chase P. Ross, and Sharon Y. Ross, "Where Collateral Sleeps," NBER Working Paper 34266 (Cambridge, MA: National Bureau of Economic Research, September 2025).

⁷⁹ Steven Kelly, "Weekly Fed Report Still Drives Discount Window Stigma," Yale Program on Financial Stability, April 3, 2024.

configuration ensures that commercial-bank-initiated standing facilities and central-bank-controlled emergency assistance remain distinct.⁸⁰

The package, not a menu

The three facilities are complements. The SRF helps guide SOFR toward the Fed’s target, alongside IORB and TLF pricing, but reaches only short maturities and the sovereign collateral core. Without the TLF, liquidity provision would only be possible for the system’s largest banks, and with too narrow a collateral set to ensure adequate supply. The TLF can remain routine only if the discount window stands apart as the emergency tier, and the discount window can be reserved for exceptional cases only if healthy institutions have dependable access to the SRF and TLF.

The architecture also serves the banking system’s breadth and diversity rather than just relying on globally systemically important banks to intermediate liquidity. The SRF’s clean-collateral design naturally favors the large dealer banks that hold Treasuries at scale, but the TLF’s broader schedules and small minimum bids are what extend the framework to the regional and community banks whose assets are disproportionately more likely to be loans.⁸¹ The facilities should therefore be developed and launched as a package, with clear access and valuation arrangements, and pre-positioning required for the TLF.

Elastic Reserves governance should broadly mirror how it works today. Because the SRF and TLF manage the elastic supply of reserves, the FOMC should coordinate their usage. The SRF functions as ordinary open market business under Section 14 of the Federal Reserve Act, while the TLF functions under the Section 10B lending authority whose use at scale the TAF established.⁸² The discount window would remain administered by the twelve Reserve Banks under the Board’s rules.

Precedents: The Bank of England, the ECB, and Australia

The Bank of England and the European Central Bank are both shifting their operating systems to need lower levels of aggregate reserves, but they have contrasting approaches. The Bank of England prices its short-term repo operations at Bank Rate—the equivalent of pricing at IORB—because borrowing is meant to be a normal source of reserve supply, just slightly cheaper than market financing to compensate for the collateral and compliance costs. Its leaders have said publicly that routine use is expected and needed to ensure adequate reserve provision. By early 2026, reserves had fallen from a peak of £979 billion to £644 billion, short-term repo was providing roughly 15% of all reserves, and about thirty firms were bidding in a typical weekly operation.⁸³

The ECB has taken a different approach, pricing its weekly liquidity facility 15 basis points above the deposit rate with a comparatively broad collateral set. Its leaders want the facility to be a fallback rather

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⁸⁰ Bindseil, *Monetary Policy Operations and the Financial System*, 70–71.

⁸¹ Lorie Logan and Sam Schulhofer-Wohl, “Options for Reducing the Size of the Fed’s Balance Sheet,” Federal Reserve Bank of Dallas, April 2, 2026.

⁸² 12 U.S.C. § 347b; Federal Reserve Banks, Operating Circular No. 10 (Lending).

⁸³ Bank of England, *Report on the Bank’s Official Market Operations March 2025–February 2026*; Bank of England, *Transitioning to a Repo-Led Operating Framework*; Prudential Regulation Authority, statement on the Short-Term Repo facility, August 2022; Vicky Saporta, “Resilience and Readiness across the Sterling Monetary Framework,” Bank of England, March 27, 2026.

than an ongoing resource.⁸⁴ Euro-area liquidity remains excessive, so ECB borrowing remains trivial. As reserves drain, it remains an open question whether banks will turn to borrow at that premium or whether the ECB will shift its framework.⁸⁵

The Reserve Bank of Australia (RBA) borrows features from the BOE and ECB. Its weekly full-allotment repo auctions let banks determine reserve supply at a published price of 10 basis points above its target rate and 20bp above the rate paid on reserves. A separate overnight facility covers needs between auctions. Despite the pricing, the RBA and its prudential regulator have encouraged routine facility use, helping banks become more comfortable holding fewer reserves. Australia follows much of the logic proposed here, although its regular repos run for seven or 28 days, and it has no equivalent of the four-month, broad-collateral TLF.⁸⁶

The architecture proposed here for the United States draws heavily on the Bank of England's facility structure, but with important differences. The SRF would lend at 10 basis points above IORB, rather than at the rate paid on reserves as in the Bank of England's short-term operation. With market-aligned collateral requirements and haircuts, that premium would encourage private transactions while leaving some banks dependent on the SRF to meet an aggregate reserve shortfall. The SRF would hold scheduled daily auctions, while the Bank of England's short-term repo operation is weekly. The TLF follows the Bank of England's weekly auction structure but adds a scheduled daily auction, priced at the most recent auction clearing spread plus a small markup. The framework also retains the existing discount window as a distinct emergency tier for institutions requiring supervisory involvement or bespoke collateral treatment.

III. Reducing Structural Demand for Reserves

The Elastic Reserves facilities outlined above on their own will not reduce reserve demand, but they pave the way for the Fed to aggressively pursue policies that enable overall reserve demand to fall. An elastic supply of reserves without demand reduction would mean the balance sheet stays larger than the payment system requires. The costs catalogued in Section I would persist, just with a more responsive demand-driven operating system. Conversely, reducing reserve demand without establishing a dependable elastic supply would bring its own problems. It would perpetuate the need to forecast reserve demand, at a lower aggregate reserve level, and foster unnecessary fragility in moments of market stress. The two must be paired.

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⁸⁴ European Central Bank, "Changes to the Operational Framework for Implementing Monetary Policy," press release, March 13, 2024; Isabel Schnabel, "Towards a New Eurosystem Balance Sheet" (speech, ECB Conference on Money Markets, Frankfurt, November 6, 2025).

⁸⁵ European Central Bank, "Liquidity Conditions and Monetary Policy Operations from 11 February to 5 May 2026," *Economic Bulletin*, no. 4/2026.

⁸⁶ David Beckworth, "An Aussie Way Forward for the Fed," *Macroeconomic Policy Nexus*, September 14, 2026, <https://macroeconomicpolicynexus.substack.com/p/an-aussie-way-forward-for-the-fed>; Christopher Kent, "The RBA's Monetary Policy Implementation System—Some Important Updates," April 2, 2025, <https://www.rba.gov.au/speeches/2025/sp-ag-2025-04-02.html>; David Jacobs, "The Road to Ample—Towards a Demand-driven Liquidity Regime," August 25, 2026, <https://www.rba.gov.au/speeches/2026/sp-so-2026-08-25.html>.

In a set of 2026 papers, Lorie Logan, Stephen Miran, Darrell Duffie, and others identified an array of potential reforms aimed at reducing the structural demand for reserves.⁸⁷ The proposal here organizes many of those ideas around a single operating principle: Banks should only hold the reserves needed for settlement and a prudent private buffer. At the center of the reserve demand reduction agenda is a trade. Banks pre-position collateral at the Fed and are released, in exchange, from liquidity requirements that build unusable and wasteful buffers. Liquidity requirements should not compel banks to hold balances in excess of payment needs, because reliable, collateralized borrowing capacity can perform the same liquidity function. Warehousing of abundant liquidity should end.

The proposed policy changes to reduce reserve demand are not prerequisites for the roll-out of the elastic facilities. The two should be developed in tandem. As the facilities demonstrate reliability and market participants gain experience, the FOMC can more aggressively pursue the policies that allow for structural reserve stock to decline. Data gathered from usage of the facilities can help the FOMC to calibrate the facilities' parameters, ensuring that the pace of reserve reduction is gradual and unlikely to lead to disorderly markets.

First, pre-position collateral

The Elastic Reserves system's promise is that any solvent bank can convert good collateral into reserves quickly, in good times and bad. Even today, pre-positioning is correlated with willingness to use liquidity facilities. Fed research finds that banks with collateral already pledged to the discount window are materially more likely to borrow when needed.⁸⁸ In an Elastic Reserves system, every depository institution would maintain pre-positioned collateral for TLF access. SRF counterparties could instead deliver eligible securities at settlement.⁸⁹ Reserve Banks hold collateral for the TLF to make borrowing from the facility easy.⁹⁰ Banks should execute periodic test transactions through the facilities, not merely confirm that documents exist. Operational readiness reduces the friction of internal approvals that make central-bank credit provision slower than private alternatives. It also lets the Federal Reserve assess collateral in advance, when there is time to inspect and document.

Carefully developed, published haircuts are central to making the structure work. A haircut determines how much credit the Federal Reserve will extend against an asset and therefore functions as both an insurance premium and risk constraint. Rates that are out of line with market benchmarks risk inadvertently steering credit. If haircuts are too low, the facility provides unusually favorable funding to risky or illiquid assets. If they are too high, institutions will be less likely to pre-position or use the facility.⁹¹ Schedules should be conservative enough to protect the Reserve Banks through a borrower default and collateral liquidation, and stable enough that firms can plan their funding.

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⁸⁷ Logan and Schulhofer-Wohl, "Options for Reducing the Size of the Fed's Balance Sheet"; Anderson et al., "A User's Guide"; Duffie, "The Payment System Puts a Floor."

⁸⁸ Mark Carlson and Mary-Frances Styczynski, "Pre-Pledged Collateral and Likelihood of Discount Window Use," FEDS Notes, Board of Governors of the Federal Reserve System, August 29, 2025.

⁸⁹ Eligible counterparties borrowing from the SRF could choose to pre-position eligible collateral to permit immediate settlement, but advance pre-positioning would not be required. The counterparty could deliver eligible securities at the time of borrowing. Because the SRF would accept only standardized, readily priced securities, its eligibility checks and pre-positioning arrangements could be substantially lighter than those of the TLF.

⁹⁰ Collateral could also be positioned to meet SRF liquidity demands, or banks may conduct ordinary repo operations as current standing repo facilities work.

⁹¹ Logan and Schulhofer-Wohl, "Options for Reducing the Size of the Fed's Balance Sheet."

That means that the haircut schedule should be governed by clear rules widely agreed upon by market actors and Fed officials alike. Assets should be placed into categories by observable characteristics such as obligor type, credit quality, duration, seniority, market depth, and valuation confidence. Haircuts should be reviewed on a fixed calendar in a collaborative fashion with meaningful input from banks. The Fed should retain authority to demand additional collateral or reject an asset that fails documentation standards, but it should not adjust ordinary terms borrower by borrower as an instrument of credit policy. Pre-positioning requires banks to use unencumbered assets and to develop clear legal rights and custody arrangements for use, but those costs are more modest than requiring every bank to hold the same form of central-bank money in advance.

One major obstacle stands in the way of this arrangement. Much of the collateral banks could pre-position, particularly loan books, is already pledged to the Federal Home Loan Banks (FHLBs), the government-sponsored cooperatives that have evolved into an ongoing source of medium-term lending for the banking system.⁹² A bank may appear to have substantial Federal Reserve borrowing capacity even though an FHLB holds the first lien. Banks currently park collateral at the FHLBs because they are a cheap and reliable source of advances that lack meaningful stigma. But the relatively low cost of FHLB advances is a result of public policy. Investors treat FHLB debt as federally guaranteed and lend to the FHLB System at rates only modestly above the Treasury's.⁹³ That enables the FHLBs to lend onward at that subsidized cost plus overhead.⁹⁴ FHLB advances consequently price below the Fed's primary credit rate, which keeps solvent banks away from the central bank and deepens the window's stigma.⁹⁵ In the spring of 2023, several failing banks drew on FHLB advances aggressively. Silicon Valley Bank increased its outstanding FHLB advances from \$20 billion to \$30 billion in the week before its failure, but it was closed before it could transfer collateral from its FHLB to the Federal Reserve and obtain additional discount-window funding.⁹⁶

Banks need to stop turning to FHLBs for liquidity and instead turn to the Federal Reserve. The remedy for the FHLB disintermediation requires no legislation. Steven Kelly, Susan McLaughlin, and Andrew Metrick have proposed codifying a rule that the Federal Housing Finance Agency could issue to establish that the all-in cost of an FHLB advance may not fall below the Fed's primary credit rate unless the lending directly serves the housing mission.⁹⁷ The Government Accountability Office picked up the idea in December 2025 as an option for enhancing financial stability.⁹⁸ With the artificial discount gone, banks

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⁹² Adam B. Ashcraft, Morten L. Bech, and W. Scott Frame, "The Federal Home Loan Bank System: The Lender of Next-to-Last Resort?," *Journal of Money, Credit and Banking* 42, no. 4 (June 2010): 551–83.

⁹³ The Congressional Budget Office put the System's annual subsidy at \$6.9 billion in fiscal year 2024. Congressional Budget Office, *The Role of Federal Home Loan Banks in the Financial System* (Washington, DC: Congressional Budget Office, March 2024).

⁹⁴ Because the borrowers own the FHLB as a cooperative, dividends return part of every interest payment back to borrowers, enhancing the subsidy.

⁹⁵ Steven Kelly, Susan McLaughlin, and Andrew Metrick, "FHLB Dividends: Low-Hanging Fruit for Reconfiguring FHLB Lending," *Journal of Financial Crises* 6, no. 2 (2024): 85–104; Joshua A. Jacobs and Rajdeep Sengupta, "Bank Funding and FHLB Advances," Federal Reserve Bank of Kansas City, *Economic Bulletin*, October 16, 2025.

⁹⁶ The three banks at the center of that season's failures were among the System's heaviest borrowers, and each drew advances harder as its depositors fled. Silicon Valley Bank failed before its FHLB could coordinate with the Federal Reserve Bank of San Francisco. U.S. Government Accountability Office, *Federal Home Loan Banks: Actions Related to the Spring 2023 Bank Failures*, GAO-24-106957 (Washington, DC: Government Accountability Office, March 2024).

⁹⁷ Kelly, McLaughlin, and Metrick, "FHLB Dividends."

⁹⁸ U.S. Government Accountability Office, *Federal Home Loan Banks: Role During Financial Stress and Members' Borrowing Trends and Outcomes*, GAO-26-107373 (Washington, DC: Government Accountability Office, December 2025).

would position collateral where the liquidity insurance actually is, and the FHLBs could return to funding housing at term.⁹⁹

Second, replace stockpiling requirements with usable liquidity

Bank surveys consistently identify regulation and supervision as major determinants of reserve demand. When the Bank Policy Institute surveyed member banks in January 2026, treasurers listed among the most important drivers of their reserve demand Regulation YY's monthly internal liquidity stress tests, the imperative of never needing the discount window or a daylight overdraft, resolution planning requirements, and examiner expectations. The highest ranking factor was banks' own internal liquidity standards, but even these were not entirely separate from considerations related to the Fed; several banks indicated that their internal standards were designed partly to ensure they never have to borrow from the Fed at all.¹⁰⁰ The Fed's own survey of senior financial officers found much the same in 2019.¹⁰¹ Research by Fed staff suggests current regulations cause banks to need hundreds of billions of dollars more reserves than they would otherwise.¹⁰²

Today's liquidity requirements use a perverse logic in which the funds supposedly held in case of emergency cannot be used in case of emergency. Because banks are required to sustain a liquidity coverage ratio that is above a particular threshold, a bank that exhausts its buffer to cover the outflows that the rule envisages would be in breach of the regulation.¹⁰³ Remaining compliant through a 25% run requires starting at 175% of the requirement, and 197% for the stickiest retail funding, because the rule taxes stability hardest. A compliant bank caught mid-run must meet withdrawals not by spending liquid assets but by selling illiquid ones, precisely the fire sale the rule was invented to prevent.¹⁰⁴

The most effective improvement is to abandon the stockpiling requirement and adopt a usable liquidity requirement, which is based on the borrowing potential of the central bank. Mervyn King, former Governor of the Bank of England, advocates for a similar idea, where the central bank functions as a "pawnbroker for all seasons." In this case, all of a bank's runnable liabilities would be covered by collateral, thereby eliminating the need for a central bank to act as the lender of last resort.¹⁰⁵ The

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⁹⁹ Aaron Klein and Chris Hughes, "Reform the Federal Home Loan Banks to Finance the Housing America Needs," Brookings Institution, April 27, 2026.

¹⁰⁰ Bill Nelson, Laurence Bristow, and Brett Waxman, "What Determines Banks' Demand for Reserve Balances?," Bank Policy Institute, January 14, 2026.

¹⁰¹ Board of Governors of the Federal Reserve System, Senior Financial Officer Survey, August 2019.

¹⁰² Ryan Bush, Adam Kirk, Antoine Martin, Philip Weed, and Patricia Zobel, "Stressed Outflows and the Supply of Central Bank Reserves," *Liberty Street Economics* (blog), Federal Reserve Bank of New York, February 20, 2019.

¹⁰³ The liquidity coverage ratio generally requires covered banks to hold enough high-quality liquid assets to meet projected net cash outflows over 30 days of stress. The 2019 tailoring rule eased these requirements for some smaller banks and exempted others. See Board of Governors of the Federal Reserve System, "Federal Reserve Board Finalizes Rules That Tailor Its Regulations for Domestic and Foreign Banks to More Closely Match Their Risk Profiles," press release, October 10, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm>.

¹⁰⁴ Take a bank funded by \$100 of deposits to which the rule assigns a 25% runoff rate. The bank must hold \$25 of high-quality liquid assets. If a 25% run arrives and the bank spends that \$25 meeting it, the rule still demands coverage of the \$75 of deposits that remain—another \$18.75—so surviving the run in compliance means having started with \$43.75, or 175% of the requirement. The examples follow Marco Macchiavelli, "The Upside-Down World of the Liquidity Coverage Ratio: Some Unpleasant Arithmetic," Bank Policy Institute, February 11, 2026.

¹⁰⁵ Mervyn King, *The End of Alchemy: Money, Banking, and the Future of the Global Economy* (New York: W. W. Norton, 2016), chap. 7.

proposal outlined here is narrower. Banks would maintain sound collateral, pre-positioned at a Reserve Bank and valued under published haircuts, and would be able to convert it into reserves within a day. Capital requirements address solvency concerns. The new liquidity paradigm simply ensures that a wide range of assets are quickly convertible to cash should the need arise.

This approach would not provide unlimited public insurance. Reserve provision is limited by the collateral a bank has pledged and by the haircut the Federal Reserve publishes against it. Any bank that wants more reserves must offer up the assets to secure them.

It would, however, give supervisors real-time visibility into a bank's liquidity position. A bank that funds itself with highly runnable liabilities while holding assets with a sizable haircut could be a problem. But because pre-positioned collateral is continuously visible to the Federal Reserve, supervisors could watch a bank's lendable value against its runnable funding in real time rather than reconstructing it from a monthly filing. In the case where a firm has outrun its capacity to borrow, the facilities would require it to pledge more. The discipline moves from the form in which liquidity is stored to the quality and availability of assets supporting it.¹⁰⁶

The Fed could make this change within its existing legal authority. Dodd-Frank's Section 165 obliges the Board to impose enhanced liquidity standards on the largest holding companies, but it does not prescribe that banks must warehouse the assets themselves. The Fed could interpret that to mean that full allotment liquidity facilities with considered haircuts satisfy the requirement. If outright replacement of the existing liquidity regulations proves too ambitious, fallback measures exist. First, the Fed could allow reliable SRF and TLF borrowing capacity to count toward the liquidity coverage ratio and internal stress tests.¹⁰⁷ Second, recovery and resolution plans could recognize the liquidity from the SRF and TLF facilities as available to a solvent institution. Third, minimum liquidity ratios could be set to decline automatically or cease to bind during defined system-wide stress, so that use of a buffer is compliance rather than a violation.¹⁰⁸

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¹⁰⁶ Silicon Valley Bank (SVB) is a useful case study. SVB was not subject to the liquidity coverage ratio, and the Bank Policy Institute has reconstructed that it would have reported a ratio near 150% had the rule applied. Today's existing LCR requirements would have certified the bank as liquid. But SVB "did not test its capacity to borrow at the discount window in 2022 and did not have appropriate collateral and operational arrangements in place to obtain liquidity," according to the Federal Reserve's own review.

Pre-positioning would not have made SVB solvent. Roughly \$15 billion of unrealized losses in its held-to-maturity portfolio stood against roughly \$16 billion of equity, and central bank lending against haircut-adjusted market value supplies liquidity, not capital. It would, however, have bought time, perhaps making a fire sale possible rather than outright failure.

Bill Nelson, "Silicon Valley Bank Would Have Passed the Liquidity Coverage Ratio Requirement," Bank Policy Institute, March 14, 2023, <https://bpi.com/silicon-valley-bank-would-have-passed-the-liquidity-coverage-ratio-requirement/>; Board of Governors of the Federal Reserve System, Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (Washington, DC: Board of Governors, April 2023), 4; SVB Financial Group, Form 10-K for the fiscal year ended December 31, 2022, filed February 24, 2023.

¹⁰⁷ Brett Waxman, "Unlocking the Discount Window," Bank Policy Institute, October 3, 2025; Anderson et al., "A User's Guide."

¹⁰⁸ Macchiavelli, "The Upside-Down World of the Liquidity Coverage Ratio."

Third, enable primary dealers to intermediate

In some periods, liquidity may be abundant, but dealers are unable to provide it to those who need it. Insurers, hedge funds, and other levered holders of Treasuries have no access to the Fed's facilities. They rely on dealers to borrow and lend onward, and every dollar of that intermediation grosses up both sides of the dealer's balance sheet. Ordinary advances become prohibitively expensive, particularly in moments of duress. A dealer that borrows \$1 billion from the current SRF and on-lends it at a five basis point markup earns about \$500,000 a year. Under the leverage-ratio standards finalized in late 2025, the holding company must hold Tier 1 capital of roughly 4% against the added \$1 billion of assets—\$40 million—which, at a 10% cost of equity, costs \$4 million a year to carry. The trade must earn roughly forty basis points, eight times the markup, before the dealer breaks even.¹⁰⁹ In ordinary times private repo markets mitigate this problem through central clearing and balance sheet netting. A dealer's borrowing and lending positions with the same central counterparty can offset for accounting and leverage purposes. A loan from the Federal Reserve does not get that treatment, because the Fed only lends. Without an offsetting position to net it against, the money the dealer borrows sits on the balance sheet at full size.¹¹⁰

The simplest repair is to bring the Fed's facility transactions into central clearing so that a dealer's matched positions net, shrinking the balance-sheet exposure of passing central-bank money onward. Nonbanks would still borrow from dealers, not from the Federal Reserve. But when a dealer's SRF borrowing and matched onward loan have the same maturity and settlement terms, routing both through the central counterparty allows the two legs to net. In October 2025, Federal Reserve staff presented the FOMC with the benefits and costs of centrally clearing SRF transactions. Almost all participants who commented said that clearing could improve the facility's effectiveness, and participants generally supported further study.¹¹¹ Some officials expressed concern that clearing could make leveraged nonbank trades cheaper to fund. In particular, central clearing's balance sheet relief might help a wide range of financial system actors, because the same netting makes levered basis trades cheaper to fund. With central clearing, a dealer who now needs roughly 40 basis points to justify passing SRF cash onward would need only a few basis points once the two trades offset. It would still, however, be the dealer's responsibility to assess counterparties and set the haircuts on the collateral. If the problem is excessive nonbank leverage, then margin requirements, counterparty limits, or revised stress tests should address those risks.

There are riskier alternative solutions: excluding reserves and Treasuries from the supplementary leverage ratio or providing Fed facility access to nonbanks to reduce dealer costs. The Fed need not go

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¹⁰⁹ The calculation applies the roughly 10% gross return on equity that dealers target when allocating balance sheet internally. A narrower measure of the cost, the wedge between what a dealer pays for equity and for debt, would imply a breakeven closer to 25 basis points. For the framework, see Darrell Duffie, "Financial Regulatory Reform After the Crisis: An Assessment," *Management Science* 64, no. 10 (2018): 4835–57.

¹¹⁰ Logan and Schulhofer-Wohl, "Options for Reducing the Size of the Fed's Balance Sheet"; Logan, "Ample Liquidity for a Safe and Efficient Banking System"; Duffie, "The Payment System Puts a Floor"; Securities and Exchange Commission, final rule on central clearing of U.S. Treasury securities, adopted December 13, 2023.

¹¹¹ Board of Governors of the Federal Reserve System, "Minutes of the Federal Open Market Committee, October 28–29, 2025," November 19, 2025, <https://www.federalreserve.gov/monetarypolicy/fomcminutes20251029.htm>.

that far. Central clearing of facility transactions, with access confined to banks and primary dealers, buys the most intermediation capacity for the least structural change.¹¹²

Fourth, modernize the payment system

Given reserves' base function as payment settlement, the technology used for settlement has outsized importance in determining how many aggregate reserves are required. At the end of 2025, Fedwire, the world's largest payments system, and its companion securities settlement system handled over \$7 trillion of payments on an average day.¹¹³ Fedwire settles payments through real-time gross settlement (RTGS), in which payments are immediately, individually, and finally settled. In an RTGS system, unlike in a netting system, credit risk is eliminated because funds are settled immediately. However, in an RTGS system, a bank is required to have the full payment amount on hand when paying the beneficiary.¹¹⁴ For most of Fedwire's history, banks bridged liquidity needs by using intraday credit. In the first half of 2007, the ten largest banks ran daylight overdrafts averaging \$120 billion a day in a system whose entire overnight reserve stock was under \$10 billion.¹¹⁵ Since 2020, peak overdrafts for the system have averaged less than \$5 billion, a result of a shift in bank behavior because of policy and supervisory preferences.¹¹⁶ No bank CEO wants to be required to testify in front of Congress that they rely on intraday credit for routine payment facilitation. As a result, today banks hold overnight reserves to cover intraday timing gaps that could otherwise be financed or netted.

Other major central banks have taken a different approach to address this problem. Rather than create a separate liquidity-providing mechanism outside the RTGS system, they integrated a liquidity saving mechanism to search for cancelling payments. Large value payments in these systems are arranged in a centralized queue in which the system searches for sets of payments that cancel one another. When A owes B \$30 million and B owes A \$20 million, both settle at once, and \$10 million of reserves changes hands. In effect, payment loops would be automatically shortened. All payments would be finally settled in the central bank. The systems of the Bank of England, the Bank of Japan, the Bank of Canada, and the ECB employ this mechanism.¹¹⁷ American banks know the technology works because they built a private

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¹¹² The most serious objection is that the savings are small. David Bowman, Yesol Huh, and Sebastian Infante estimate that if every private repo trade were run through a clearinghouse, dealers could clear only about \$104 billion of the \$1.6 trillion now sitting on their books, barely enough to register in the capital ratios of the largest banks. But that counts the trades dealers already do, and dealers already arrange their private business to cancel out wherever the rules allow. The one counterparty they cannot arrange that way is the Fed. What matters is whether a dealer lends out the next billion in a week of crisis, and that turns on what the trade costs at that moment.

David Bowman, Yesol Huh, and Sebastian Infante, "Balance-Sheet Netting in U.S. Treasury Markets and Central Clearing," Finance and Economics Discussion Series 2024-057 (Washington, DC: Board of Governors of the Federal Reserve System, July 2024).

¹¹³ Duffie, "The Payment System Puts a Floor."

¹¹⁴ The alternative is deferred net settlement, the method of the automated clearinghouse that carries most of America's routine payments called ACH. Hold payments in a batch, cancel offsetting obligations against one another, and settle only the difference hours or a day later. Netting is thrifty, because a bank needs cash only for the net, but the thrift comes with the cost of credit risk. Until settlement arrives, every recipient is in effect an unsecured creditor of every payer, and a failure in the interim can claw back money the recipient thought it had. That is why every major economy moved its high-value payments to real-time gross settlement, and why the newer instant payment systems, the Fed's FedNow among them, settle gross as well. Duffie, "The Payment System Puts a Floor."

¹¹⁵ Badev et al., "Fedwire Funds Service"; Duffie, "The Payment System Puts a Floor."

¹¹⁶ Badev et al., "Fedwire Funds Service"; Duffie, "The Payment System Puts a Floor."

¹¹⁷ Duffie, "The Payment System Puts a Floor"; Bank of Japan, "Information Disclosure Based on the Principles for Financial Market Infrastructures: The BOJ-NET Funds Transfer System," June 2019.

system called CHIPS, which combines netting with a liquidity-saving algorithm and moves about \$2 trillion a day.¹¹⁸ Recent changes in the Bank of England's funding mechanism cut its banks' intraday liquidity needs by approximately 20%. Changes to the mechanisms of the Bank of Japan and the Bank of Korea achieved similar results. Banks in Canada, which has a high-value payment system called Lynx, settle over 99% of payments via the system using a queuing mechanism. Prompt payment settlement can occur even with much smaller opening balances, as demonstrated through simulations by Duffie, Srisht Fateh Singh, and Chaojun Wang.¹¹⁹ Federal Reserve estimates place the potential reserve demand reduction at approximately \$125 billion.¹²⁰

The implementation of a liquidity-savings mechanism would be technologically and operationally demanding—a multi-year phased project, to be sure. It would also require behavioral changes as banks adjust their processes for payment releases, liquidity planning, and contingency systems. In the interim, the Fed should reassess the stigma and pricing of daylight credit so that banks are not required to substitute permanent overnight balances for temporary intraday needs.

Fifth, insulate reserves from the Treasury's account

The largest single source of variance in reserve supply is the government's own checking account. Every dollar that moves into the federal government's transaction account at the Federal Reserve, the Treasury General Account (TGA), is a dollar drained from bank reserves. Every dollar the Treasury spends flows back out, becoming a reserve. Before the financial crisis, Treasury generally maintained a small Treasury General Account (TGA) and placed much of its operating cash at commercial banks, limiting the reserve effect.¹²¹ That arrangement required management of hundreds of deposit accounts and involved its own credit and operational risks.¹²²

The modern TGA is much larger and more volatile, and all of the funds are deposited at the Fed. Treasury seeks a cash balance sufficient to cover substantial outflows, and debt limit episodes can cause the account to decline and rebuild by hundreds of billions of dollars.¹²³ In the summer of 2025, rebuilding the account after resolution of the debt limit reduced reserves by approximately \$350 billion in ten weeks. By autumn, repo-market indicators were signaling the pressure that preceded the December interventions.¹²⁴ The volatility itself raises reserve demand, because banks hold a standing buffer against the possibility that the government's cash management will drain the system without warning.

Annette Vissing-Jorgensen, now an economist at the Federal Reserve Board, has proposed a clean fix. The Fed should back the TGA with Treasury bills and adjust the level as the TGA level fluctuates. When

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¹¹⁸ Duffie, "The Payment System Puts a Floor."

¹¹⁹ Darrell Duffie, Srisht Fateh Singh, and Chaojun Wang, "An Efficient Liquidity Savings Mechanism" (working paper, Stanford University, 2026).

¹²⁰ Anderson et al., "A User's Guide."

¹²¹ Bill Nelson, "Two Little-Noticed and Self-Inflicted Causes of the Fed's Current Monetary Policy Implementation Predicament," Bank Policy Institute, October 1, 2019.

¹²² U.S. Government Accountability Office, Debt Management: Treasury Has Improved Short-Term Investment Programs, but Should Broaden Investments to Reduce Risks and Increase Return, GAO-07-1105 (Washington, DC: Government Accountability Office, September 2007), 13, table 2, <https://www.gao.gov/products/gao-07-1105>.

¹²³ Annette Vissing-Jorgensen, "Fluctuations in the Treasury General Account and Their Effect on the Fed's Balance Sheet" (FEDS Notes, Board of Governors of the Federal Reserve System, August 6, 2025).

¹²⁴ Perli, "Money Market Conditions and the Federal Reserve's Balance Sheet."

the account swells, the Fed would undertake offsetting open market operations (either repo, or outright purchases or sales) in matching size—recreating the drained reserves in the banking system—and when it drains, the Fed would sell securities, allow them to mature, or engage in reserve draining repo operations.¹²⁵ Had the arrangement been in place in 2025, the Fed would have bought roughly \$350 billion of bills as the account refilled, and the banking system would never have felt the variance in aggregate reserves. Bill purchases (or repos) would be automatic and matched to realized TGA changes. The alternative is to place more Treasury operating balances at commercial banks, updating the pre-crisis Treasury Tax and Loan arrangement.¹²⁶ Either way, when the government moves its own money, the banks should not feel it.

What the program yields

With these changes, how much smaller could the balance sheet be? Consider a range of scenarios. The most careful official arithmetic to date, from a Federal Reserve staff team that included former Governor Stephen Miran, catalogued fifteen options—most of them versions of the reforms above—and estimated that the full menu would remove \$1.2 to \$2.1 trillion from a balance sheet of \$6.7 trillion, taking reserves from \$3 trillion to roughly \$1.7 trillion at the midpoint. The authors note that their arithmetic assumes the Ample Reserves framework remains in place, and that deeper reductions would require leaving it.¹²⁷

Under an elastic system, reserves could decline below the minimum consistent with Ample Reserves because banks would rely on the SRF and TLF for marginal and term liquidity. With the payment queue and a steadied Treasury account no longer wasting the cash that remains, banks would hold the reserves they need to settle the day's payments plus whatever buffer each judges prudent—plausibly on the order of \$1 trillion. The balance sheet would settle around \$4.5 trillion, and most of that would be the currency the public holds. It would be backed by short-dated Treasuries and short-term collateralized loans, rather than \$2 trillion of mortgage bonds and the long end of the Treasury market. The Fed's footprint as a share of GDP would be smaller than at any point since 2008, and the interest paid to banks would fall by roughly two-thirds, commensurate with the decrease in the stock of reserves on which interest is paid.

These are purposefully approximate estimates. The Elastic Reserves framework does not prescribe a fixed minimum stock of reserves, but a promise that the quantity of reserves, whatever it proves to be, is discovered by demand rather than estimated by committee.

IV. Objections, Tradeoffs, and Safeguards

Why not repair Ample Reserves?

The easiest route to reform is to keep the existing Ample Reserves framework, but make tweaks to its operations. That would be a mistake.

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¹²⁵ Vissing-Jorgensen, "Fluctuations in the Treasury General Account."

¹²⁶ Nelson, "Two Little-Noticed and Self-Inflicted Causes."

¹²⁷ Anderson et al., "A User's Guide."

Ample Reserves reform efforts often point to proposals that focus on changes to the Fed's portfolio, specifically shifting to a system where the Fed only holds short-dated Treasuries.¹²⁸ A portfolio of short-dated Treasuries would eliminate direct housing credit allocation and reduce the Fed's Treasury duration exposure. It would also reduce the risk of the Fed booking accounting losses ("deferred assets"), since overnight reserves would be backed by similarly short-term securities.

Those would be substantial improvements, but they would still leave important problems unaddressed. Large purchases of short-term Treasuries could reduce the supply available to investors, affecting yields and collateral availability. Perhaps more importantly, changing the portfolio would not address the problems on the liability side of the balance sheet. Banks would still hold a large stock of interest-bearing reserves, preserving the benefits they receive from financing those balances with lower-cost deposits. The Fed would also still have to estimate how many reserves count as "ample," adjusting for market shocks and seasonal fluctuations. Banks' reluctance to draw down their liquidity buffers and the costs dealers face in borrowing and lending onward could still leave funding markets under strain even when aggregate reserves appeared sufficient.

A second set of ideas focuses on tiered remuneration of reserves.¹²⁹ In this scenario, the Fed would pay IORB on a baseline amount of reserves and a lower rate above it. That approach could reduce gross interest expense, but it would require the Federal Reserve to assign or forecast each institution's remunerated tier. The deposit-related subsidy to banks would be more modest, but it would still retain the previously described issues of the large size of the balance sheet.¹³⁰ At a fundamental level, why accept a bloated amount of reserves when policies exist to reduce aggregate reserves, making tiering unnecessary?

A set of regulatory reforms within Ample Reserves could also be valuable. Counting Fed borrowing capacity toward LCR requirements, improving the usability of the liquidity buffer, and improving payments efficiency by encouraging daylight overdrafts could all reduce the minimum reserve stock. But if the Federal Reserve retains a supply-driven approach, it will still need to estimate the point at which the demand curve steepens. Demand reduction alone moves that point lower, but it does not make aggregate reserve demand observable or provide marginal reserves automatically. Periods of money market stress—as experienced in September 2019, March 2020, March 2023, and late 2025—would become a recurring and unnecessary phenomenon.

Finally, an alternative to repairing Ample Reserves would be to return to a Scarce Reserves system. This would achieve a small balance sheet and private rate discovery, but it would restore daily Desk forecasting and expose the system to abrupt rate movements when forecasts of autonomous factors are wrong. The pre-2008 framework depended on estimating Treasury flows, currency demand, payment disturbances, and reserve requirements each day.¹³¹ The Elastic Reserves system achieves the goal of a smaller footprint while allowing full-allotment lending to replace discretionary fine-tuning.

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¹²⁸ Christopher J. Waller, "Thoughts on Quantitative Tightening, Including Remarks on the Paper 'Quantitative Tightening around the Globe: What Have We Learned?'" (remarks at the 2024 U.S. Monetary Policy Forum, New York, March 1, 2024), <https://www.federalreserve.gov/newsevents/speech/waller20240301a.htm>; Charles I. Plosser, "A Limited Central Bank," *Cato Journal* 34, no. 2 (Spring/Summer 2014): 201–11.

¹²⁹ Anderson et al., "A User's Guide"; European Central Bank, "ECB Introduces Two-Tier System for Remunerating Excess Liquidity Holdings," press release, September 12, 2019, https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190912_2~a0b47cd62a.en.html.

¹³⁰ Hughes and Younger, "The Price of the Floor."

¹³¹ Bindseil, *Monetary Policy Operations and the Financial System*, 57–60.

Will routine facilities displace private markets?

Some may be concerned that routine facilities could extend the problem of a large Fed footprint in markets, just in a new form. A central bank willing to lend too cheaply against too broad a collateral set could become the preferred counterparty of banks and dealers. Private lenders might lose business, and market prices would carry less information.

In the Elastic Reserves system, use of the central bank facilities is necessary to dynamically accommodate reserve demand. But central bank facilities are not designed to be the first source of market financing or to influence medium- or long-term interest rates. In short-term markets, private money markets would be the major source for overnight financing, with the Fed offering marginal funding to ensure rate stability. Private repo could clear below the SRF's rate of 10 basis points above IORB. With collateral requirements and haircuts in line with comparable market transactions, the rate premium would encourage banks and dealers to keep lending to one another first.¹³² SRF lending would remain limited to eligible banks and primary dealers against Treasury and agency collateral. Nonbanks would continue to borrow through dealers. In the longer-term money markets, the TLF's auction and rising spread structure across collateral classes allows market demand to determine the price of liquidity. Because of this structure, private markets would remain the primary source of financing across the term schedule. The central bank stands behind them, lending at the margin to provide adequate liquidity to the banking system. Private redistribution cannot create reserves, so some banks would still be forced to use the SRF whenever an overnight shortfall remained after TLF lending.

The Bank of England's experience indicates that routine central bank repo facilities can play a supporting role to active private markets even when the facilities supply a meaningful share of reserves. As of early August 2026, the Bank's short-term and indexed long-term repo operations together supplied about a third of outstanding reserves, up by twenty-fold in two years. Private gilt repo grew over the same period; daily average outstanding positions reached £935 billion in the first quarter of 2025, about 50% above their 2018 level. The price signal endures. Sterling repo has generally settled five to ten basis points above Bank Rate, which, according to the BOE, is roughly the all-in cost of using the short-term facility.¹³³

If Fed facilities persistently displace otherwise viable private financing, the Fed can always adjust the facilities' spreads, the frequency of availability, or policies around pre-positioned collateral. To ensure the system is working as designed, the Federal Reserve should publish an annual footprint assessment covering facility shares of relevant markets and disclose any particularly concentrated use in certain collateral classes or by certain kinds of institutions.

Collateral and credit risk

The shift toward collateralized loans of an Elastic Reserves system moves the Federal Reserve's exposure from a portfolio of marketable securities it owns toward claims on borrowing institutions secured by

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¹³² Roberto Perli, "Reserve Management and the Fed's System Open Market Account: Recent Experience and Insights from Surveys" (remarks at the 2026 Financial Markets Conference, Federal Reserve Bank of Atlanta, Fernandina Beach, Florida, May 19, 2026), <https://www.newyorkfed.org/newsevents/speeches/2026/per260519>.

¹³³ Bank of England, *Weekly Report*, 5 August 2026 (reserve balances of £637.1 billion, short-term repo of £123.9 billion, and indexed long-term repo of £78.2 billion); Victoria Saporta, "The Evolving Liquidity Landscape" (speech, European Central Bank Conference on Money Markets, Frankfurt, November 7, 2025); Bank of England, *Enhancing the Resilience of the Gilt Repo Market*, Discussion Paper (London: Bank of England, September 2025); Bank of England, *Report on the Bank's Official Market Operations March 2025–February 2026* (London: Bank of England, 2026).

pledged assets. The Fed's collateral pool would grow significantly, and valuation and liquidation capacity would become more important—a real shift in the type of risk associated with the Fed's asset portfolio.

Any new risks stemming from the collateralized loans of the Elastic Reserves system must be measured against the risks of Ample Reserves. A long-duration Treasury portfolio carries interest rate risk, and mortgage-backed security (MBS) holdings carry both interest rate and prepayment risk. The Ample Reserves system still requires emergency lending with credit risk when stress occurs. The elastic system substitutes short-duration, collateralized credit exposure for part of today's duration exposure. The Reserve Banks have longstanding systems for valuing discount-window collateral, and TAF demonstrated that broad-collateral term lending can operate at large scale without credit loss.¹³⁴ Those results do not guarantee that losses would not occur in the Elastic Reserves system, but they provide an empirical basis for expecting losses to be minimal.

Moreover, risk protection in the Elastic Reserves system would be multi-faceted and broadly manageable. The TLF would separate liquidity risk from solvency risk. Collateral would be pre-positioned, regularly valued, and reliant on conservative haircuts. The Federal Reserve would have rights to demand substitution or additional collateral and liquidate collateral after default. It would only lend to solvent institutions whose viable repayment path does not depend on continued Fed credit provision. When supervisory information raises a material solvency concern, access should move from the rule-based TLF to the discount window or resolution process, where the central bank can impose bespoke terms and coordinate with the relevant insurer and supervisor.

Haircuts and the temptation to steer credit

Another legitimate concern is the inevitable human judgment required to value collateral and assess risk. The Federal Reserve must decide which assets qualify, how categories are defined, and how much protection it needs to lend. Those choices affect the relative funding value of loans and securities.¹³⁵ For instance, if Class C treatment is too favorable, the TLF could encourage origination of assets tailored to Federal Reserve eligibility. If it is too punitive, smaller and loan-focused banks would remain dependent on the FHLBs or the discount window.

To ensure that parameters are set properly, implementing institutions at the Fed should work with private sector actors to assess risk and determine valuation discounts for each category. An external technical panel could review the methodology annually, and material changes should receive public notice and a transition period. The schedule should be neutral among sectors to the extent possible. Credit quality, duration, seniority, and liquidation cost should determine treatment, not the policy demands of activists interested in a central bank more engaged in credit allocation.

Moral hazard

Reliable liquidity insurance might encourage banks to hold fewer liquid assets and could support greater maturity transformation. That is partly by design. Individual self-insurance is costly, and central banks

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¹³⁴ Runkel and Chen, "Term Auction Facility."

¹³⁵ Marvin Goodfriend, "Why We Need an 'Accord' for Federal Reserve Credit Policy: A Note," *Journal of Money, Credit and Banking* 26, no. 3 (August 1994): 572–80.

exist in part because pooled liquidity insurance is more efficient.¹³⁶ Reliance on the central bank should be properly managed so that institutions are not using public subsidy for private risk.

Preventing that subsidy requires a rigorous and defensible set of policies around haircuts, collateral maintenance, and pre-positioning costs. Those decisions can be thought of as the insurance premiums for liquidity needs. Meanwhile, capital requirements and resolution rules remain the protection against insolvency.¹³⁷ Shareholders and unsecured creditors will remain exposed to loss, as they should be. Supervisors will need to learn that banks' dependence on liquidity facilities is necessary and desirable, but also be able to assess when banks approach the limits of tapping normal funding available to them.

There is an additional concern that decreasing the costs of intermediation for banks and dealers—through establishing full allotment facilities like the SRF and centrally clearing the transactions—could increase funding for risky leveraged trading strategies by hedge funds and other nonbank financial institutions, as previously discussed in the section on central clearing.¹³⁸ The SEC, Federal Reserve, and relevant central counterparties should respond through a reconsideration of margin and counterparty exposure limits and stress testing. But denying dealers the ability to move liquidity efficiently is an imprecise and costly way to regulate nonbank leverage because it also impairs rate control and Treasury market functioning.

Stigma, disclosure, and the bailout narrative

Routine use of Elastic Reserves facilities is the principal defense against stigma. TAF reached 416 institutions because auctions made borrowing a common funding choice rather than a bilateral request associated with weakness. The TLF should begin operations before reserves become scarce, with test participation by large, regional, community, domestic, and foreign banking organizations. A facility used by dozens of institutions in ordinary weeks conveys less information about any one borrower.

Disclosure of Fed facilities will be necessary. The Dodd-Frank Act requires the Federal Reserve to publish transaction-level information on discount window advances and open market operations with an approximately two-year lag, including borrower or counterparty identity, amount, rate, and collateral information.¹³⁹ The SRF and TLF should be designed with the knowledge that institutional usage patterns will eventually become public. With routine participation across the banking system, disclosure should become run-of-the-mill compliance rather than a signal of weakness.

Some will inevitably call these facilities “bailouts” for the banks, seeing in the public liquidity provision an uncompensated gift to the private sector. But it is hard to find the gift in a loan made at a published price to a solvent institution, secured by collateral worth more than the advance, and repaid with interest. The real gifts arrive when a run meets a banking system with no orderly way to borrow. In March 2023, Silicon Valley Bank failed faster than it could move collateral to the discount window. Over the ensuing weekend, the government guaranteed every uninsured deposit at two failed banks and stood up an

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¹³⁶ Douglas W. Diamond and Philip H. Dybvig, “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy* 91, no. 3 (June 1983): 401–19.

¹³⁷ King, *The End of Alchemy*, chap. 7.

¹³⁸ Anil K. Kashyap, Jeremy C. Stein, Jonathan L. Wallen, and Joshua Younger, “Treasury Market Dysfunction and the Role of the Central Bank,” *Brookings Papers on Economic Activity*, Spring 2025.

¹³⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, § 1103, adding Federal Reserve Act § 11(s), 12 U.S.C. § 248(s); Board of Governors of the Federal Reserve System, “Quarterly Transaction Data,” last updated September 29, 2017, <https://www.federalreserve.gov/regreform/reform-quarterly-transaction.htm>.

emergency facility that valued underwater bonds at par.¹⁴⁰ Nothing in this framework offers terms half as generous. Routine, collateralized lending at a price is how actual bailouts become unnecessary.

V. From Review to Implementation

The path of least resistance for the Fed’s Balance Sheet Policy Task Force is to offer a menu of potential reforms. But a menu of discrete options invites piecemeal choices, allowing the FOMC to postpone comprehensive reform of its operating framework indefinitely. Opportunities to reset Fed operating systems do not come often. This moment should not be wasted. The task force should deliver a concrete blueprint that specifies how Elastic Reserves facilities and meaningful reserve demand reduction go hand in hand. It should recommend a new operating system, outlining the objectives, operating principles, facility architecture, risk controls, transition parameters, and a comparative assessment of alternatives. There will of course be details to iron out, but the task force can confidently recommend a new direction even if it doesn’t answer every implementation question.

Leadership from the Chair is critical, given the overlapping mandates and interlocking tools required to update the operating system. Consider the disparate parts of the Fed and United States government that would need to be organized. The FOMC selects the implementation regime and sets the terms of open market operations. The Board is responsible for implementing Regulation A, which specifies discount window lending standards, liquidity regulation, and much of supervision. Reserve Banks lend and hold collateral under Section 10B. The New York Fed implements and oversees the System’s day-to-day operations. The FDIC and OCC shape supervisory treatment, and the SEC and FICC govern key elements of Treasury clearing. The FHFA governs the Federal Home Loan Banks, and the Treasury controls the TGA. Only a clear mandate and leadership from the top can ensure that this large network of interlocking institutions works together.

The Federal Reserve can implement the core architecture of an Elastic Reserves system without new legislation. But members of Congress already are asking important questions about Ample Reserves, showing particular interest in the fiscal and distributional consequences of IORB. There are legislative proposals to eliminate the ability to pay interest on reserves entirely.¹⁴¹ That would be a mistake. Eliminating IORB would unnecessarily impair monetary policy implementation.

By contrast, Congress could move to direct the Federal Reserve to achieve a smaller balance sheet through elastic collateralized supply while preserving the administered rate. If legislators are genuinely concerned about the negative effects of Ample Reserves and the balance sheet, they could amend the Federal Reserve Act to require the Board and FOMC to provide facilities that supply reserves elastically, directing the Fed to hold the minimum assets necessary for effective monetary policy implementation. The legislation could outline a period for the Fed to develop a transition plan and a system of ongoing testimony and public reporting to detail its efforts at reducing reserve demand and providing elastic

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¹⁴⁰ Board of Governors of the Federal Reserve System, Review of the Federal Reserve’s Supervision and Regulation of Silicon Valley Bank (April 2023).

¹⁴¹ In July 2025, Sens. Ted Cruz and Rick Scott introduced the Fiscal Accountability for Interest on Reserves Act, which would strip the Fed’s authority to pay interest on reserves outright, on the grounds that the policy “rewards big banks—including large foreign banks—at the expense of all Americans.” Office of Senator Ted Cruz, “Sens. Cruz, Scott Lead Bill to Stop Federal Reserve from Paying Interest on Bank Reserves,” press release, July 30, 2025, <https://www.cruz.senate.gov/newsroom/press-releases/sens-cruz-scott-lead-bill-to-stop-federal-reserve-from-paying-interest-on-bank-reserves>.

facilities. If Congress chose to take this route, it would be wise to adjust the maximum term for Section 10B maturities beyond four months, enabling the Fed to develop a TLF that might lend at maturities of six months or longer.

Some may see this as a threat to Fed independence. Unlike recent threats from the executive branch which are cause for deep concern, Congress has a responsibility to manage and direct the Fed's activity. Over the course of its history, Congress has adjusted the collateral the Fed is authorized to lend against and even specified the operating objectives of monetary policy. The 1977 Federal Reserve Reform Act and the 1978 Humphrey–Hawkins Act, for instance, required the Fed to monitor and disclose the monetary aggregates, helping institutionalize the monetary-targeting framework that Fed Chair Paul Volcker would make the basis of his dramatic shift in operating procedures in 1979.¹⁴² No one wants politicians meddling in the implementation details of monetary policy, but should legislators feel that the central bank has erroneously chosen a path that requires a bloated balance sheet, it has the ability to set a clear objective of monetary policy implementation with the minimum number of reserves required and demand an implementation plan from the Board.

Ample Reserves only works with a balance sheet at historically unprecedented size. Even then, its operators are repeatedly stuck enlarging the stock of reserves when market disruptions occur. The framework may have produced reliable rate control in ordinary times, but it has also required a new form of ongoing reserve supply management, sustained a large transfer to bank shareholders, altered the maturity structure of privately held public debt, allocated credit, displaced markets, and increased the Federal Reserve's political exposure.

An Elastic Reserves system preserves the advances of the Ample Reserves framework but shifts to a market-determined or demand-driven reserve system. The Fed sets a SOFR target rate and uses IORB and the SRF and TLF rates to guide market rates toward it. Private markets allocate liquidity first, and the SRF supplies marginal overnight reserves. The TLF provides regular four-month liquidity against a broad, pre-positioned collateral set. The discount window remains a standing facility in case of emergency. These changes make it possible for the Fed to update liquidity regulation, payments infrastructure, and the backing of the TGA so that banks require significantly fewer reserves and no longer need to warehouse them for operational reasons. The Elastic Reserves system holds the potential to ensure rate control and financial stability with a significantly smaller balance sheet.

Fortunately, the Fed need not build from scratch. The success of functionally similar existing facilities provides a track record that suggests that Elastic Reserves facilities can run at scale. The SRF exists and needs reform rather than invention. A term auction facility ran for twenty-eight months, through the worst of a financial crisis, with hundreds of counterparties and no losses. In addition to those successes, contemporary international experience confirms the workability of the system sketched out here. The Bank of England today operates a repo-led framework, using it to meaningfully shrink the balance sheet.

The task force should embrace the Fed's original mandate to prize elasticity in reserve provision and recommend reimagined standing facilities alongside reforms to reduce reserve demand. That kind of bold move would dramatically reduce the Fed's footprint in money markets and strengthen the standing of the institution for years to come.

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¹⁴² Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, 91 Stat. 1387 (1977); Full Employment and Balanced Growth Act of 1978, Pub. L. No. 95-523, 92 Stat. 1887 (1978); Meltzer, *A History of the Federal Reserve*, vol. 2, bk. 2, 1970-1986, 985–91.



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