MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
Washington, DC 20515

PATRICK McHENRY, NC
RANKING MEMBER

December 16, 2022

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

The Honorable Janet Yellen
Secretary
Department of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

Dear Chairman Powell and Secretary Yellen:

We write to highlight the global uncertainty surrounding certain segments of domestic and global financial markets. As the Federal Reserve continues to use its tools to rein in inflation, it continues to draw U.S. Dollar-liquidity out of the domestic and global financial system. While this is necessary to restore price-stability, it comes with related risks. The Federal Reserve and the Department of the Treasury must be cognizant of the potential financial stability issues that may result from these efforts.

Economists at the Bank for International Settlements (BIS) recently highlighted the $80 trillion-plus in outstanding obligations to pay U.S. Dollars in connection with currency-swap and foreign exchange-swap borrowings.[1] Given the sheer magnitude of the aggregate amounts in question, the estimated $5 trillion of daily turnover in U.S. Dollar-denominated swaps,[2] and the centrality of U.S. Dollar-financing to global trade and financial markets, this issue deserves close attention.

Although a majority of these U.S. Dollar swaps are protected by risk mitigation measures,[3] an estimated 31% of U.S. Dollar-denominated swaps do not have such protections.[4] This means that a likely $24 trillion-plus of outstanding U.S. Dollar swap-arrangements and a BIS-estimated $2.2 trillion in daily turnover is subject to unmitigated risk.[5]

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[1] Claudio Borio, Robert McCauley, & Patrick McGuire, Dollar Debt in FX Swaps and Forwards: Huge, Missing, and Growing, BIS Quarterly Review, Dec. 2022, at 67–73.
[2] *Id*. at 67.
[3] Such measures include pre-settlement netting that reduces total outstanding dollar-values or payment-versus-payment arrangements that only allow settlement if both sides of a transaction fulfill their obligations.
[4] Marc Glowka & Thomas Nilsson, FX Settlement Risk: An Unsettled Issue, BIS Quarterly Review, Dec. 2022, at 75–81.
[5] *Id*. at 76.

Currency- and foreign exchange-swap arrangements that seemed manageable to market actors even one year ago may no longer be manageable today. While many of these swap-contracts have been either closed or rolled-over since the Federal Reserve began tightening operations, it does not mean that hidden risks are not still present.

It is critical that the Federal Reserve and Department of the Treasury assess the likelihood for and effects of potential impacts on U.S. financial institutions and markets and the U.S. financial system as a whole from negative spillbacks if a significant portion of these swap-arrangements were to turn sour.

We appreciate your attention to this critical issue and stand ready to work with you to ensure you have the tools you need to ensure the safety and soundness of the domestic and global financial system.

Sincerely,

Patrick McHenry
Ranking Member

Warren Davidson
Member of Congress