Liquidity Flows to Bank-Affiliated Broker Dealers

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Q: Why do bank-affiliated dealers borrow internally rather than from MMFs?

A substantial share of tri-party Treasury repo is between affiliates of the same BHC.

- Affiliated trades price **4–5 bps above** comparable unaffiliated trades.
- Premium widens when spreads across markets rise and during the SLR exemption.

Interpretation: an "affiliation premium" — bargaining over consolidated SLR rents.

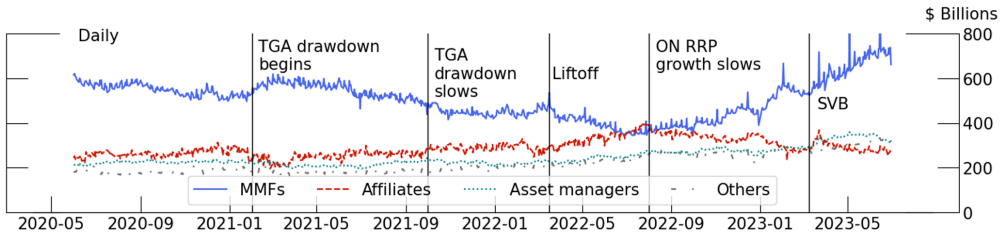
- Internal funding lets the BHC economize on consolidated balance sheet.
- Surplus split between bank affiliate and dealer.

Show $\sim$0.55 pass-through from internal repo borrowing to external reverse-repo lending.

Note: *affiliate repo is main way bank liquidity reaches repo market—****criminally understudied!***

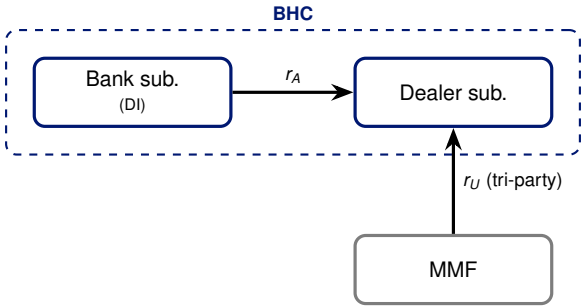
Inter-affiliate repo is at times the majority of tri-party repo

Hempel, Isley, Kahn and McCabe (2023): affiliate buildup as MMFs retreated to ON RRP.



What drives these volumes?

The obvious answer would be that the bank is charging a lower rate



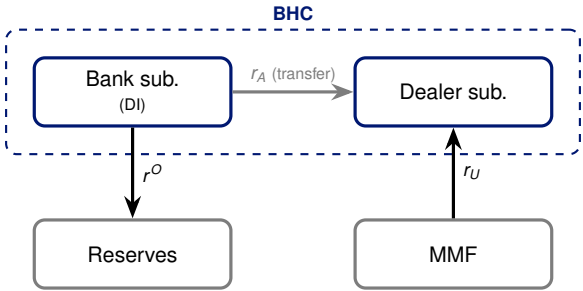
Naive story: the dealer takes the cheaper cash.

- Borrow internally if $r_A < r_U$; tri-party otherwise.

But the paper documents $r_A - r_U \approx +4$–5 bps.

$\Rightarrow$ **The dealer pays *more* internally. Cheap-cash story can't be it.**

But r_A is a transfer price: does not matter to the consolidated BHC.

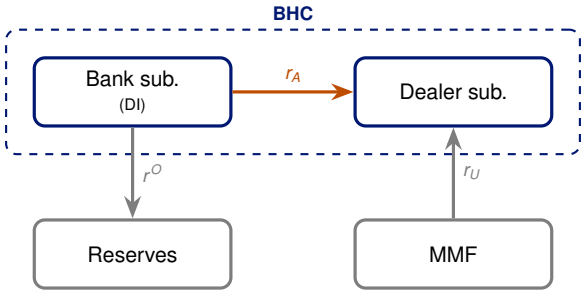


r_A: internal accounting, BHC pays itself.

- Bank sub's outside option: reserves at r^O (IORB).
- Internal funding relaxes consolidated balance sheet at shadow cost C'.

BHC-level surplus per dollar: $S = (r_U - r^O) + C'$.

Why does the paper care about r_A? Bargaining over S.



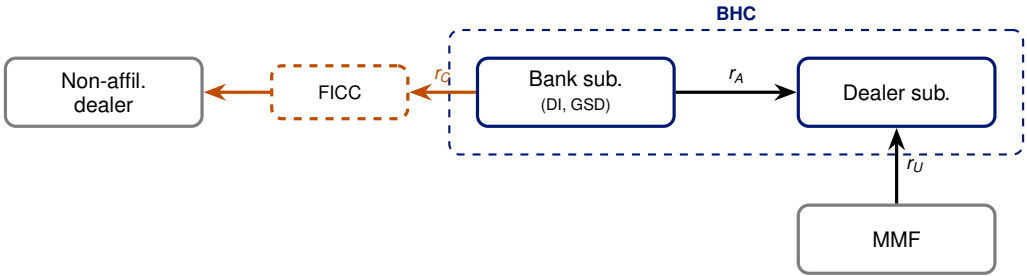
The paper documents that r_A moves systematically with:

- Cross-market spreads (proxies for C').
- The 2020–21 SLR exemption (a cut to C').

Paper's interpretation: r_A reflects bargaining between bank and dealer over $S = (r_U - r^O) + C'$.

An alternative interpretation: Regulation W 23B governs these rates

§23B (12 U.S.C. §371c-1): member-bank transactions with affiliates must be on terms "... **at least as favorable to such bank or its subsidiary**, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies."



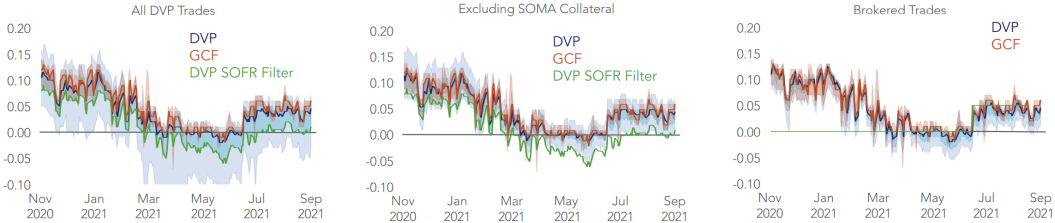
Comparable transaction = bank lending to non-affiliated dealer, likely **blind-brokered FICC** or similar.

- **All sample bank subsidiaries are direct clearing members.**

Why 23B fits the data:

Blind-brokered FICC transactions trade at a time-varying premium to tri-party with MMFs.

- This would then be generating the affiliation premium.
- Rate for brokered FICC transactions is *highly correlated* with CMTR or GCF-TGCR.



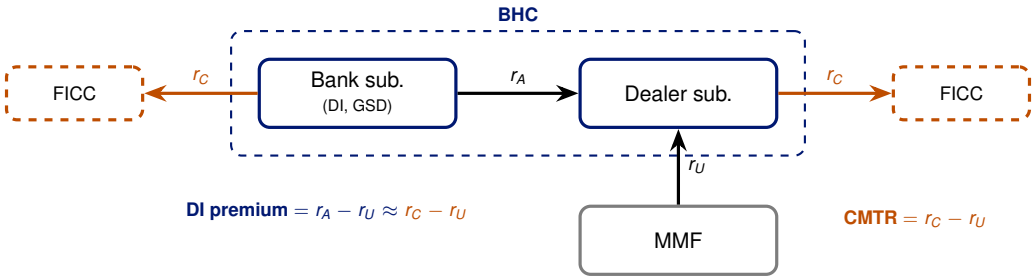
(Hempel and Kahn, 2021)

In this reading, GCF-TGCR, CMTR, DI affiliate premium **all measure essentially the same wedge.**

- GCF: thin overnight GC market. CMTR: some specials mixed in.

So expect to see a high correlation with these series + non-classical measurement error.

This isn't just about time series

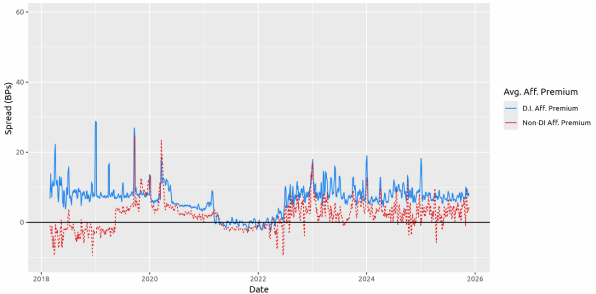


This $r_C - r_U$ wedge is *only partly* balance-sheet costs:

- Also reflects dealer bargaining power vs. MMFs (Senyuz et al. 2023, Huber 2023), differences in timing (Paddrik et al. 2023).

What would convince me: looking at non-member banks

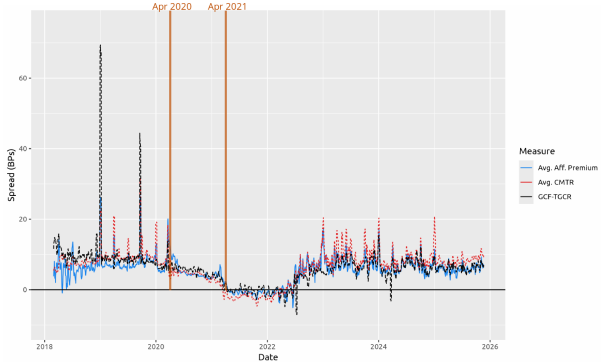
23B is asymmetric: only when a *member bank* lends to an affiliate.



Clear tests:

1. Do results carry through with only non-DI affiliates?
2. Do results carry through with only foreign branches, other non-member DIs?

Why *doesn't* the SLR exemption convince me?



Strongest evidence, but exemption window not a clean experiment.

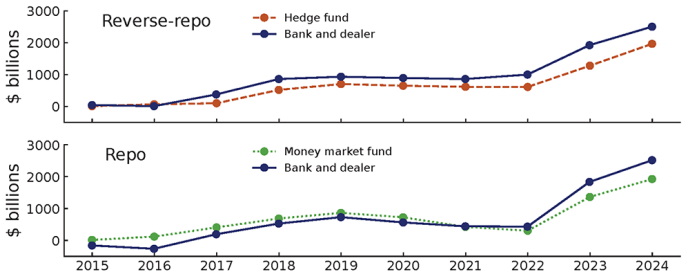
- Starts during COVID dislocation, ends right before ON RRP pins short rates.
- Most of the decoupling seems to sit in 2020, right in the aftermath of COVID.

Interesting to look at recent eSLR reform, went into effect in January.

In the end, does the paper need to focus on r_A?

The premium itself does not have a policy lever.

Policy implications really about surplus: Would lower C' increase repo supply (e.g. to basis traders) via DI affiliate lending?



Some reason to be skeptical (Hempel, Kahn and Shephard, 2025):

- Most variation in aggregate repo driven by dealer matched-book intermediation between hedge funds and MMFs rather than internal.
- Matched-book pass through ***does not*** differ between SLR dealers and non-SLR dealers.

This paper looks into a crucial part of the repo market

Pushes a criminally understudied topic forward.

While I differ on my interpretation of the spread, **I fundamentally agree on drivers of surplus.**

Surplus is where the focus should be, and looking at quantities may help nail that down.

Looking forward to seeing this agenda develop on the volumes side.