

# **The Rate Corridor Under Pressure: IOR, ON RRP, and the GENIUS Act**

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## **Abstract**

The Federal Reserve manages interest rates through a corridor system bounded by the Interest Rate on Reserve Balances above and the Overnight Reverse Repurchase Agreement facility below. The GENIUS Act does not eliminate either rate. It constructs a statutory layer that terminates the transmission of both before they reach the consumer economy. This paper disaggregates the mechanism. The IORB channel between the Federal Reserve and the banking sector remains technically intact under the GENIUS Act's architecture; the severing occurs at the boundary between the banking layer and the consumer, where the Act's prohibition on stablecoin yield creates a rate-insensitive transaction medium by law. The ON RRP floor is damaged through three compounding mechanisms: the reduction of money market fund counterparty depth as consumers migrate to stablecoins; the distortion of short-duration Treasury yields by captive, price-inelastic reserve demand that renders market signals less coherent; and the structural immobility of mandatory stablecoin reserves, which cannot be cycled through the overnight drain operations the facility requires. The combined effect is a rate corridor that continues to function at the institutional level while progressively losing its grip on the consumer economy in proportion to stablecoin adoption. The degradation is continuous and proportional rather than episodic, making it difficult to detect through standard monetary metrics until the divergence becomes too large to attribute to measurement error. The Federal Reserve retains its instruments. It loses its economy.

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## How the Fed Controls Interest Rates: The Corridor System

The Federal Reserve does not set interest rates by decree. It manages them through a corridor system, two boundary rates between which the federal funds rate trades.

The ceiling is the Interest Rate on Reserve Balances (IORB). The Fed pays this rate to depository institutions on reserves they hold at the Fed. Because banks can always earn IORB risk-free, they will not lend reserves in the private market at rates below it. IORB puts an effective upper bound on where overnight rates trade.

The floor is the Overnight Reverse Repurchase Agreement rate (ON RRP). Through this facility, the Fed sells Treasuries to eligible counterparties, primarily money market funds (MMFs), government-sponsored enterprises, and primary dealers, overnight, and repurchases them the next day. The rate paid sets a floor: counterparties will not lend elsewhere at rates below what the Fed will pay them risk-free. ON RRP extends rate control to non-bank institutions that cannot earn IORB.

The two rates working together form a functional corridor. The fed funds rate trades within it. This is Powell's warning made concrete: lose IORB, and the ceiling disappears. Lose effective ON RRP, and the floor disappears. Either way, the Fed loses precision control over the marginal price of money.

GENIUS does not eliminate either rate. What it does is structurally undermine the transmission of both, at the consumer layer and at the market depth level simultaneously.

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## The IOR Argument: Correctly Located

The common formulation of the Powell/IOR argument, that GENIUS causes reserves to migrate off the Fed's balance sheet, destroying the IOR channel, is mechanically incorrect. It points at the right conclusion by the wrong route.

Under GENIUS, reserves backing stablecoins remain on the Fed's balance sheet. Banks holding those reserves still earn IORB. The IOR channel between the Fed and the banking sector remains technically intact.

The transmission break occurs one step downstream.

The reserve sits at the Fed earning IORB. The bank intermediates it into a stablecoin. The stablecoin holder earns nothing; GENIUS prohibits yield payment to holders by statute. The consumer transacts in an instrument whose return is fixed at zero regardless of the policy rate.

This means the IOR channel between the Fed and banks continues to function normally at the institutional layer while being severed by law before it reaches consumers. The policy rate signal travels from the Fed to the bank and stops. It does not reach the person making spending decisions.

This is Powell's warning; the cable is cut, not the lever. And the cut is legislated, not accidental. At scale, consumer spending behavior becomes entirely rate-inelastic. The Fed tightens. Banks earn more on reserves. Stablecoin holders notice nothing. Consumption patterns do not respond. Inflation management through rate adjustment requires that higher rates reduce consumer spending; that mechanism depends on consumers holding rate-sensitive instruments. If consumers hold stablecoins, they do not.

The more precise version of the argument: GENIUS does not destroy the IOR mechanism. It creates a statutory structure that terminates rate transmission before it reaches the economy's transaction layer. The lever works. The cable ends at the bank. The wall is between the bank and the consumer, built by law, and called consumer protection.

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## The ON RRP Floor: Three Compounding Vulnerabilities

The ON RRP damage is distinct from the IOR argument and operates through three separate mechanisms that compound each other.

First: Money Market Fund Disintermediation

The ON RRP floor works because MMFs are large, active counterparties. MMFs compete with stablecoins for the same consumer and institutional cash. Both offer dollar-denominated, low-risk instruments for cash parking. The difference is that MMFs pass through the policy rate to their holders. When the Fed raises rates, MMF yields rise. Stablecoins do not. In a rising rate environment, rational cash holders should prefer MMFs. But in the adoption phase described in this series, stablecoin reward structures over-incentivize conversion; consumers are paid to hold stablecoins even when MMFs would yield more in dollar terms.

As consumer and institutional cash migrates from MMFs to stablecoins, MMF assets shrink. Smaller MMFs mean reduced ON RRP counterparty depth. A facility whose floor-setting power depends on active participation from large counterparties becomes less effective as those counterparties shrink. The floor does not disappear immediately; it thins. Rate control at the lower bound becomes less precise.

#### Second: T-Bill Yield Compression Distorts the Floor Signal

GENIUS permits stablecoin reserves to be backed by short-duration Treasury instruments in addition to Fed reserves. This creates a captive, price-inelastic T-bill buyer. Stablecoin issuers must hold T-bills as a reserve requirement; they are not yield-seeking investors making discretionary allocation decisions. They buy T-bills because the law requires it, at any yield.

ON RRP functions in part as a rate floor because it offers a guaranteed return that sets a minimum for what market participants will accept on short-duration instruments. When T-bill yields are market-determined, they trade close to the ON RRP rate, and the relationship is coherent. When stablecoin reserve requirements create artificial, inelastic demand for T-bills, yields on those instruments become administratively suppressed rather than market-determined. T-bill yields no longer reliably reflect the marginal cost of short-duration money. The ON RRP rate, calibrated against a market that is now partially non-market, loses its signal integrity.

#### Third: Structural Reserve Lock-Up Removes the Facility's Flexibility

The ON RRP is a temporary drain instrument. It absorbs excess reserves overnight and returns them the next day. Its operational value lies in flexibility: the ability to cycle reserves through the facility in response to liquidity conditions, preventing rates from falling through the floor during periods of excess cash.

Stablecoin reserve requirements create permanent, mandatory reserve and T-bill holdings. These reserves cannot be cycled through ON RRP operations without disrupting the stablecoin's backing requirements. They are structurally immobile. As stablecoin adoption scales, an increasing share of the reserve base becomes ineligible for ON RRP drainage. The facility retains its form but loses its operational flexibility; it can drain what is cyclable, not what is structurally locked.

This matters acutely given the current state of the facility. ON RRP balances have declined from a peak of \$2.55 trillion in late 2022 to near-zero as of 2025, a collapse that analysts describe as removing a systemic stabilizer rather than confirming normalization. The buffer that protected the financial system against liquidity shocks has already been depleted. Stablecoin architecture would prevent any future rebuilding of ON RRP buffers by redirecting excess cash into stablecoin structures rather than the facility. The system enters the next liquidity stress event with both its existing buffer exhausted and the mechanism for rebuilding it structurally obstructed.

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## The Combined Effect on Rate Control

Taking the IOR and ON RRP arguments together:

The IORB ceiling continues to function at the institutional level; banks respond to rate signals normally. The ON RRP floor continues to exist at the nominal level; the offering rate is still set and operations still occur. But:

Consumer spending behavior is insulated from the ceiling by statute: rate hikes do not reach the transaction layer. The floor's counterparty base, the money market fund complex, is systematically reduced through stablecoin adoption incentives. The floor's signal integrity is degraded by captive T-bill demand that distorts short-duration yields. The floor's operational flexibility is reduced by structural reserve lock-up.

The corridor exists on paper. Its ability to govern the actual economy degrades in proportion to stablecoin adoption. There is no discrete moment of failure. The degradation is continuous, proportional, and largely invisible; the Fed's metrics continue to show rates trading within the corridor while the corridor's grip on consumer behavior and market dynamics progressively loosens.

This is a more dangerous failure mode than a visible breakdown. Institutional actors respond to formal rate signals. Consumer economic behavior does not. Inflation models calibrated to rate-sensitive consumer behavior generate incorrect forecasts. Policy tightening that appears adequate by institutional measures proves inadequate for the real economy. The error is not detected until the divergence between institutional conditions and consumer conditions becomes too large to ignore, at which point stablecoin adoption is mature, entrenched, and politically protected.

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## Summary: What GENIUS Builds Into the Monetary Architecture

GENIUS does not abolish the Federal Reserve's tools. It constructs a parallel monetary layer that those tools cannot reach.

The IOR channel between the Fed and banks remains intact. The ON RRP facility continues to operate. The federal funds rate continues to trade within the corridor. All of this is true and all of it is increasingly irrelevant as the share of consumer transactions denominated in stablecoins grows.

What GENIUS builds into law, permanently and by design, is a consumer-facing monetary layer that is rate-insensitive by statute, backed by instruments whose yields are distorted by captive mandatory demand, administered by private issuers with no monetary policy mandate, and growing through incentive structures designed to accelerate adoption.

The Fed sets the price of money for banks. Stablecoin supply and adoption dynamics set the price of money for everyone else. As the consumer layer grows relative to the

institutional layer, the Fed's price-setting function covers a shrinking share of actual economic activity.

Powell's warning was about losing IOR. The more precise concern is this: GENIUS constructs a system where IOR is preserved but contained, functional within the institutional perimeter and irrelevant beyond it. The Fed retains its instruments and loses its economy.

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## Conclusion

The rate corridor does not break. It persists at the institutional layer while losing its grip on the consumer economy in proportion to stablecoin adoption. That distinction is what makes the failure mode difficult to detect and difficult to address. Monetary metrics continue to show the corridor functioning normally. Consumer behavior decouples from it invisibly, proportionally, in a way that inflation models calibrated to rate-sensitive populations are not equipped to measure.

There is no discrete moment at which the Federal Reserve's instruments become vestigial. There is a continuous process of scope reduction: the institutional layer they reach remains intact; the consumer layer they need to reach to control inflation shrinks as a share of actual economic activity. The tools remain. The economy they were built to govern moves into a different monetary layer, governed by different rules, administered by different entities, and reachable by none of the instruments the Federal Reserve's statute contemplates.

The subsequent paper in this series maps the credit creation consequences of this architecture: what happens to the money supply and the banking system when reserve absorption at scale is conducted by entities with no credit creation mandate.

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## References

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