Deutsche Bank

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June 2, 2008

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: **Policy on Payments System Risk** Docket No. OP-1309

Dear Ms. Johnson,

Deutsche Bank, AG ("Deutsche Bank") appreciates the opportunity to comment on the consultation paper issued by the Federal Reserve Board ("Board") on intraday liquidity management and payments system risk policy (the "Paper").

Deutsche Bank through its New York branch and its wholly-owned subsidiary Deutsche Bank Trust Company Americas ("DBTCA") is one of the largest U.S. dollar clearing banks. Accordingly, Deutsche Bank takes an interest in and supports the Board's efforts to reduce risks, while improving efficiency in the payments system.

Deutsche Bank would like to commend the Board on its proposal to amend the Payments System Risk policy ("PSR") to adopt a new strategy for providing intraday balances and credit to healthy depository institutions predominantly through explicitly collateralized daylight overdrafts at a zero fee. The revised PSR would replace the present fee structure of 36 basis points with a deductible equal to ten percent of the depository institution's capital that is considered in calculating the depository institution's debit cap. Deutsche Bank believes that the proposed changes to the PSR will improve the present system by providing depository institutions with greater flexibility in managing daylight overdraft fees. Deutsche Bank recognizes that the proposed changes to the PSR are just one aspect of the Board's efforts to reduce the risk in the payments system, specifically the risk of late day payments. We look forward to the discussion of these efforts as they develop.

Deutsche Bank also supports the Board's proposal to give well rated Foreign Banking Organizations ("FBOs") increased flexibility with regard to the overall size of their debit caps by providing a max cap up to the FBOs' worldwide capital without having to demonstrate a business case. This change will facilitate the management of payment capacity as well as the management of the day light overdraft expense. In addition, we applaud the Board's decision to take a significant step forward in leveling the playing field between well rated FBOs and U.S. depository institutions. We encourage the Board to consider allowing well rated FBOs to use a greater percentage of their worldwide capital when calculating the uncollateralized debit cap. Recognition of a greater percentage of worldwide capital would provide well rated FBOs with additional flexibility in managing their daylight overdraft fees and debit cap capacity.

As noted, Deutsche Bank strongly supports the provision of central bank balances against collateral, however, we urge the Board to act quickly to improve the systems and procedures for the management of collateral pledged to the discount window. The explicit fee on Federal Reserve intraday credit is being replaced by the implicit cost of collateral and the amount of this implicit cost is driven by the level of efficiency at which the collateral is managed. Depository institutions that have variability in the amount of daylight overdraft capacity that is required from day to day will want to increase and decrease collateral as needed. Daily movement of collateral will also give depository institutions the ability to offer their clients similar choices in pricing and would encourage depository institutions to require collateral from clients that utilize their daylight overdraft capacity.

The proposed changes to the PSR recognize pricing as a driver of behaviors among market participants when managing the daylight overdraft. The removal of the two week average debit cap partially addresses the behavior of market participants in managing to their respective debit cap limits. Not addressed in this proposal is the impact of managing to the single day debit cap. We encourage the Board to consider permitting well rated FBOs to utilize a greater percentage of worldwide capital in the calculation of their uncollateralized debit caps. We believe that not allowing well rated and well managed FBO's to use a greater percentage of worldwide capital puts these FBO's at an economic disadvantage to their domestically headquartered peers as domestically headquartered depository institutions have a greater degree of flexibility in choosing between collateralized and uncollateralized daylight overdrafts..

Deutsche Bank supports the Board's proposed changes to the PSR and encourages the Board to continue to explore the expanded use of discount window collateral with regard to managing payments system risk.

Deutsche Bank

Deutsche Bank appreciates the Board's consideration of our comments and recommendations. Enclosed please find our responses to the Board's questions regarding the proposed changes to the PSR. Please do not hesitate to contact the undersigned at (212) 250-2428 should you have any questions about this letter.

Very truly yours,

Joseph J. Rice
Director
Treasury

Enclosure

cc: Richard Ferguson
Russell Fitzgibbons
Kim Olson
Joshua Kaplan, Esq.
Jane Wakefield, FRBNY

Responses to Section V of the Federal Reserve's Consultation Paper on Intraday Liquidity Management and Payments System Risk Policy
Docket No. OP-1309

General

1) Does your institution believe that the introduction of a zero fee for collateralized daylight overdrafts will contribute to an overall reduction in liquidity, operational, and credit risks in the payments system? Would it reduce these risks for depository institutions, their customers, or financial utilities?

> *We believe that the zero fee for collateralized daylight overdrafts alone will not have a significant impact on the liquidity and operational risks in the payments system. The credit risk to the Federal Reserve will be mitigated to the extent that depository institutions place additional collateral at the Discount Window. We do not believe that depository institutions will place additional collateral at the Discount Window exclusively for intraday debit cap purposes unless the depository institution expects prolonged daylight overdraft exposure as the cost of additional collateral is likely to exceed the cost of the pro-rated 50 basis points charged by the Federal Reserve Bank.*

2) What procedural or systems changes do you expect to make as a result of this proposed policy change?

> *We currently place available collateral at the Discount Window and do not anticipate making any major changes to the management of Discount Window collateral. We believe that member depository institutions and the Federal Reserve Banks will need to make improvements in the systems and procedures used to move collateral to and from the Discount Window. At the current time, collateral would need to be in place for at least one overnight period to be useful in collateralizing daylight overdrafts. In many cases, the collateral may need to be in place for two overnight periods to cover the entire day. Operations staff at the Reserve Banks and the member depository institutions will need to improve their capacity to efficiently pledge and return collateral throughout the Fedwire day (21.5 hours).*

Collateral

3) Does your institution regularly use Federal Reserve daylight credit, and does your institution currently have sufficient unencumbered eligible collateral to pledge to the Reserve Banks to take advantage of a zero fee for collateralized overdrafts? By your estimate, what proportion of your expected average and peak overdraft would you intend to collateralize?

> *We regularly use daylight credit at the Federal Reserve. The collateral that we currently maintain at the Discount Window is there primarily to provide for overnight contingency borrowing from the Discount Window and the Term Auction*

Facility Program. Other than the loans pledged to the Borrower in Custody program ("BIC"), we source eligible collateral from the market or place collateral that would otherwise be financed in the repo markets and fund that collateral on an unsecured basis. The zero fee benefit of collateral will certainly outweigh the current deductible that is applied to daylight overdraft pricing. We have historically maintained collateral that is 160% of our average daylight overdraft and 32% of our average daily peak overdraft in Deutsche Bank AG, New York Branch ("DBNY"). Over the past 6 months, we have maintained elevated levels of collateral for end of day contingency funding purposes at the Discount Window. DBTCA typically runs lower daylight overdraft balances as compared to Deutsche Bank AG. Consequently, DBTCA maintains collateral that is 626% of the average daylight overdraft and 69% of the average peak overdraft.

4) Would your institution's intraday credit use increase or decrease from current levels? Do you expect the intraday credit usage of depository institutions as a group to increase or decrease from current levels?

We do not expect our intraday credit usage to change significantly as a result of this policy change.

5) While the proposal envisages no fee for collateralized overdrafts, institutions will face an opportunity cost to pledge collateral. How difficult or costly would it be to collateralize daylight overdrafts? What opportunity costs would your institution face in pledging (additional) eligible assets to the Reserve Bank to collateralize daylight overdrafts? What are the costs of entering into the Reserve Banks' borrowing documents?

Sourcing collateral is not difficult. The cost of sourcing collateral (outside of loans pledged via the BIC program or other eligible, unencumbered assets already on a depository institution's balance sheet) for pledging to the Discount Window will vary based on the type of collateral and the term for which it is financed. Streamlined processes and systems for the pledging and returning of collateral will be essential in managing the cost of collateral for depository institutions. The documentation costs are not a factor as we have always maintained some level of collateral at the Discount Window.

6) How would the adoption of this new PSR strategy, which explicitly links collateral to daylight overdrafts and pricing of daylight overdrafts, affect the availability of collateral for other financial market activity? How might it affect other creditors and other payments system participants?

To the extent that depository institutions source assets externally to pledge to the Discount Window to support intraday liquidity, there would be additional demand for eligible collateral which may drive up prices. The highest quality collateral is the easiest to move and presents the least credit risk. It is possible that the new policy *may create additional demand for quality collateral and drive up the net cost of carry for these assets as securing collateral for payments system risk management would now compete with other collateral uses such as posting margin at exchanges and counterparties.*

7) What (additional) collateral management capabilities would your institution expect of its Reserve Bank (such as changes to the frequency or means of obtaining collateral reports, the ability to move directly and quickly collateral in and out of pledge accounts, and so on)?

We would expect that the Federal Reserve Bank will have to improve its systems and processes to accelerate its ability to receive and return collateral. Automated databases of acceptable collateral using CUSIP and ISIN numbers need to be available to depository institutions.

8) If you do not currently have a borrowing agreement or pledge any collateral, would you expect to do so? If so, would the rationale rest on the use of daylight overdrafts or overnight extensions of credit?

Not applicable.

Pricing

9) To what extent would your institution make payments earlier in the day as a result of the proposed pricing changes? If your institution holds payments in a liquidity queue, would your institution continue to hold payments, particularly large-value payments, in a liquidity queue under the proposed policy changes? If so, under what circumstances would your institution continue to queue payments? What further steps would encourage queue reductions?

The proposed changes to the policy will only impact payments held for liquidity. Payments held for credit or debit cap capacity reasons will not be affected. The Federal Reserve Bank's earlier request for comments asked depository institutions and other interested parties if time of day pricing would encourage earlier repayment. Time of day pricing for daylight overdraft may have the desired effect of moving the return of federal funds settlements earlier in the day. It would also reinforce the concept of pricing timed payments.

10) Does your institution believe that the introduction of a zero fee for collateralized daylight overdrafts could lead to changes in practices for returning early securities used in repurchase agreements? What changes might institutions expect?

We do not expect changes to the current payment practices for payments related to secured financing transactions or for securities settlement. For most asset classes, the return of securities is tied to the DTC settlement cycle. DTC requires that we make progress payments to them via Fedwire if the net settlement is an outflow. In *the case of new commercial paper that we purchase, DTC does not release the new securities until late in the day. We cannot place those new securities into tripartite repo until they are delivered to us. In some cases, Deutsche Bank must fund the release of maturing commercial paper from tripartite repo early in the day but cannot place new issue commercial paper until later in the day. This causes us to use our daylight overdraft capacity at the Reserve Bank to cover the timing mismatch. We do not believe that the zero fee for collateralized daylight overdrafts will have any impact on this settlement cycle.*

11) Does your institution believe that the introduction of a zero fee for collateralized daylight overdrafts and the higher (50 basis point) fee for uncollateralized daylight overdrafts could lead to changes in practices for the early return of fed funds loans? What changes might institutions expect?

To the extent that some depository institutions are not relying on tripartite repo and DTC settlements for incoming cash flows, return cash from maturing fed fund loans might be accelerated if the collateral held by these depository institutions provided greater relief from daylight overdraft fees than the current deductible does. Depository institutions with significant funding flows from tripartite repo or DTC settlements will not have sufficient incentive to return the cash from fed funds loans earlier.

12) If your institution would face potentially higher fees on its daylight overdrafts, how will your institution adjust its collateral position or payments activities in response to the Board's proposed fees?

The decision to increase the level of collateral for daylight overdraft purposes will be an economic decision based on the least cost option between paying to the Federal Reserve Bank the 50 basis point risk premium and the cost of maintaining additional collateral at the Discount Window solely for intraday settlement purposes. Depository institutions will maintain collateral at the Discount Window principally to support contingency overnight borrowing from the Discount Window resulting from end of day funding volatility.