From: United Bankers Bank, Chuck Hokans

Subject: Federal Reserve Bank Services Private Sector Adjustment Factor

---

Comments:

Date: May 29, 2009

Proposal: Federal Reserve Bank Services Private Sector Adjustment Factor
Document ID: OP-1354
Document Version: 1
Release Date: 03/31/2009
Name: Chuck Hokans
Affiliation: United Bankers'' Bank
Category of Affiliation:
Address:
Suite
City:
State:
Country: UNITED STATES
Zip: PostalCode:

Comments:

Part 1 May 29, 2009 Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve System 20th Street and Constitution Avenue NW Washington, DC 20551 Re: Private Sector Adjustment Factor: Docket No. OP-1354 Dear Ms. Johnson: We appreciate the opportunity to comment on the proposed changes to the Private Sector Adjustment Factor (PSAF). The PSAF is part of the Board's calculation that establishes the fees that the Reserve Banks charge for certain financial services provided to depository institutions. The PSAF was required by the Monetary Control Act of 1980. Our organization, United Bankers' Bank (UBB) is headquartered in Bloomington, Minnesota and provides a comprehensive suite of correspondent banking services to community banks in a 12 state market area primarily located in the upper Midwest. We were chartered in 1975 as the nation's first bankers' bank. We are concerned about the Federal Reserve Bank's proposal to significantly modify the formula upon which the PSAF is based and feel that the effect of such proposed changes will be to empower Reserve Banks' to arbitrarily price services to the detriment of private market competitors.
We would like to note that UBB is both a competitor and user of 9th District Federal Reserve Bank services. For many years UBB has been one the largest customers of the Minneapolis Fed. Our understanding of the Fed's current position is that a portion of its traditional business has moved to the private sector, Fed faces competition from a variety of market participants in electronic transaction processing and it has witnessed a decline in total dollars held on deposit in correspondent clearing account balances. A major source of "imputed" income for the Fed in the calculation of the PSAF comes from the investment value of those correspondent clearing balances. As those balances decline so does the investment income calculated by the Fed and used in the calculation of the PSAF. The overall effect of these changes (in the view of the Fed) has been to artificially maintain Fed prices at levels higher than other market participants limiting its ability to compete. Over time the Fed has found it more difficult to compete with private sector market participants and without the PSAF change feels that its decline as a market provider will continue and possibly at an accelerated rate. The Fed has proposed a new PSAF based on a formula known as "The Publicly Traded Firm Model." UBB has many questions about the formula itself as well as its

effective implementation. We feel that the following points are important in the evaluation of the Fed's proposed changes to the PSAF: 1. For market participants, the Fed is both the "rule-maker" and a "market competitor." In our private enterprise system the Fed occupies a unique position. It competes with the private sector and makes the rules under which all market participants compete. It is easy to make the assumption that if the Fed finds that the current PSAF is to its disadvantage, the only reason why it would wish to change it is to gain advantage. This is an option that those of us in the private sector do not have available to us. The Fed accurately notes that there has been a considerable migration of business away from Fed services. So, it would appear that since Fed cannot compete under the current PSAF it simply uses its authority to change the rules so it can compete. In addition, there is no discussion about the outcome of the proposed adoption to "The Publicly Traded Model" in regard to the current Fed fee structure. 2. The Fed controls the pricing on its own products: its earnings credit rate, the Fed Funds rate and interest paid on excess reserves. The Fed notes in its proposal that there has been a migration of funds from its "Clearing Balances" to Excess Reserves. It further notes that Fed customers receive a higher rate of return on Excess Reserves than they would receive for their earnings credit and speculates that "Clearing Balances" will continue to decline. In the private sector it is customary to define a strategy and adjust pricing (as one component) to implement that strategy. If "Clearing Balances" are important (unless trumped by monetary policy) the Fed should improve the rate it pays on its earnings credit that may encourage more financial institutions to utilize balances to support service usage. 3. The Fed's discussion of competitor "user-owned utilities" needs clarification. There was significant discussion of the competitive threat to the Fed posed by "user-owned utilities." CHIPS and EPN are specifically mentioned as cooperatives owned by their members that "do not hold overnight balances for their customers." However, the term of "user-owned utilities" is never fully defined. Nor is the level of competitive issues created by "user-owned utilities" ever fully developed. In addition, by defining "user-owned utilities" as holding overnight balances significant market participants such as bankers' banks are excluded. Our perspective is that competition is critical to our free enterprise system. If "user-owned utilities" have created some competitive issues for the Fed that should encourage Fed officials to identify strategies whereby it might compete at a higher level. The marketplace tends to vote with its "pocket-book." Innovation, speed to market with new ideas, operational efficiencies, need satisfying customer service and reasonable prices normally grows business and improves market share. 4. The proposed "Publicly Traded Model" raises many questions. a. It is very likely even under the most difficult scenarios that there will always continue to be balances left at the Fed. The new model would disregard imputed income gained from those balances.