TheBankersBank

YOUR CORRESPONDENT BANK

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October 23, 2009

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

RE: Docket No. OP-1369: Comment on Proposed Interagency Guidance – Correspondent Concentration Risks

Dear Ms. Johnson:

The Bankers Bank, a state banking association ("TBB"), provides a wide range of correspondent services to over 270 state and national community banks located in Arkansas, Missouri, Oklahoma, Tennessee and Texas. We appreciate this opportunity to comment on the recently-proposed interagency guidance, joined by Board of Governors of the Federal Reserve System ("the Board"), on correspondent concentration risks.

TBB wholly embraces the wisdom of the proposal's central theme, that being to promote constant vigilance in recognizing, monitoring and managing the total risk of correspondent concentrations. Nevertheless, there are elements in the proposal for which request your reconsideration, modification and clarification, as follows.

1. Friction Between Reg. F and Proposed Guidance as to Credit Exposure.

Regulation F requires institutions to reduce credit exposure to below 25 percent of total capital within 120 days after the date when the first Report of Condition or other relevant report becomes available showing that the correspondent is no longer at least Adequately Capitalized. By contrast, the proposal tacitly encourages regulators to view as suspect a respondent's credit exposure near, at or above 25% of Tier 1 capital to any correspondent, regardless of the correspondent's level of capitalization. Since the proposal currently suggests no distinction for treating potentially vast differences in the capitalization of correspondents banks, despite the practical reality that this is an obvious, crucial factor in a respondent's decision of how much total exposure should be maintained with a correspondent, TBB is concerned that this guidance will evolve into an absolute, and its cautionary urgings will be interpreted as prohibitions, when applied in the examination context. In that event, the present iteration of the proposal would tend not to assist the respondent in mindfully managing its concentration risk as much as it would force the respondent to forego its own considered judgment of correspondents' relative soundness, and mechanically scatter that risk.

We respectfully submit that the proposal be modified to expressly acknowledge that 25% of Tier 1 capital should not be understood as a blanket ceiling on a respondent's credit exposure to a correspondent that is least Adequately Capitalized, provided that such respondent demonstrates its continued awareness, appreciation and management of this risk. In the alternative, the proposal should be modified to reflect graduated ceilings higher than 25% of Tier 1 capital, for correspondents that are Well Capitalized and Very Well Capitalized.

2. Loan Participation Considerations.

The proposal instructs respondents to include loan participations purchased from a correspondent as an element in determining the respondent's credit exposure to that correspondent. Used in this connection, "credit exposure" is a misnomer unless the respondent is participating in a loan TO the correspondent. The true "credit exposure" is to the borrower, and a participation transaction must be analyzed by the purchasing institution as if it were evaluating a direct loan.

That said, TBB certainly appreciates the special risk posed by loan participation: the originating bank has the historic relationship with the borrower and responsibility for leading the credit, so if that institution fails, the participants may not have sufficient rapport with the borrower, or adequate resources and expertise to understand the borrower's business, to successfully realize on the loan. It follows, then, that the more participations a respondent may have in loans originated by one correspondent, the more the respondent's loan portfolio will be disrupted if that correspondent fails.

By contrast, a bankers bank such as TBB often acquires a large participation in a loan originated by another bank, and then sells off portions of that interest to numerous respondents. Under those circumstances, a respondent's exposure to disrupted loan management does not lie in the risk that TBB might fail, but that the originating bank might fail. However, the proposal does not distinguish between a respondent's participation in loans originated by a correspondent, and those which were purchased from a correspondent but originated by another bank. Because it guides the respondent to compute its participation concentration according to the correspondent from which it purchased its interest, the proposal actually misdirects the respondent's attention away from the true risk.

We therefore urge that the proposal be modified to reflect that a respondent should calculate its loan participation concentrations by aggregating the participation interests it owns in loans originated by any one bank, and not the participations that a respondent purchased from any one correspondent.

3. Proposed Funding Concentration Guidance.

While it does not set a threshold *per se*, the instant proposal plainly insinuates that funding concentrations as low 5% of an institution's total liabilities should be perceived as red flags signaling excessive risk. Given the significant hardship that would be caused to smaller institutions by requiring them to manage a 5% liquidity concentration threshold on a daily basis, the proposed guidance falls remarkably short of the agencies' customarily thorough level of explanation, discernment and analysis. The proposed guidance ignores, for example, the obvious differences between funding from large depositors vs. long-term secured advances from the Federal Home Loan Bank system, as well as how each institution's framing circumstances affect its risk/benefit analysis of potential funding sources.

TBB respectfully suggests that funding concentration issues are not sufficiently illuminated here, and would be better left for mature consideration in more appropriate guidance measures. See in particular, Docket No. OP-1362: Proposed Interagency Guidance – Funding and Liquidity Management. In the alternative, TBB recommends the proposal be modified to expressly acknowledge that it does not endorse blanket application of a 5%-of-liabilities threshold, or indeed any fixed threshold, but merely counsels banks to remain mindful of the risk posed by funding concentrations, to establish thresholds as each judges appropriate to its respective circumstances, and to provide for regular reconsideration and adjustment as necessary.

4. Friction Between Proposed Guidance and FRB Practice as to Excess Balance Accounts.

TBB has endorsed the proposal by Board of Governors of the Federal Reserve System (the Board) proposal to amend Regulation D, authorizing establishment of limited purpose accounts referred to in the proposed rule as "Excess Balance Accounts" (EBAs). See Docket No. R-1350. However, in preparation for effecting the amendment, the Federal Reserve Bank ("FRB") has required respondents to designate a single correspondent under which it may hold an EBA. Even without reference to the impact of the instant proposed guidance, but especially in light of that impact, the FRB's requirement (for which no rationale was given or is apparent) promotes unnecessary and inefficient movement of respondent funds, thus imposing undue hardship on smaller institutions. Simply put, encouraging banks to diversify their correspondent risk while simultaneously restricting them to one EBA through one correspondent is counter-productive at best.

Naturally, TBB is pleased to hold all or as much of our respondents' idle funds as they choose. While the agency-inflicted restriction may advance our own purely selfish economic interest in holding as much of our respondents' idle funds as possible, it does not serve our respondents' interest to deny them the flexibility and benefit of having EBA relationships with as many correspondents as they wish.

TBB therefore requests clarification, in the proposed guidance or elsewhere, expressly granting respondent banks the flexibility to have multiple EBA's, so they may have the benefit of these pass-through vehicles under multiple correspondents.

5. Unclear Implementation Timeframe; Disproportionate Burden on Smaller Institutions.

The proposal directs the respondent to identify (i) credit concentrations, and (ii) funding concentrations represented by the asset accounts listed below, (iii) on a gross basis and (iv) net basis, by aggregating all exposures to a correspondent, (iii) on a gross basis, and (iv) a net basis[1], including (but not limited to) the following:

- Due from accounts;
- Fed funds sold on an "as principal" basis;
- The over-collateralized amount on repurchase agreements;
- The under-collateralized portion of reverse repurchase agreements;
- The current positive fair value on derivatives contracts;
- Unrealized gains on unsettled securities transactions;
- Loans to (or for the benefit of) the correspondent, its holding company, and its affiliates; and
- Investments (i.e., trust preferred securities, subordinated debt, stock purchases) in the correspondent, its holding company, and its affiliates.

In other words, the proposed guidance instructs a respondent to make as many as 16 different, specific calculations for any one correspondent relationship. However, the proposal is silent as to the target date for implementing the calculation requirement, or the frequency with which a respondent must recompute its exposures.

Bankers banks must be afforded a meaningful opportunity to prepare their respondents to satisfy the new computation requirements, and the many other burdens of the guidance now proposed. Absent that grace, the proposal's numerous demands on respondents to "justify" their correspondent relationships may seem daunting to smaller institutions, which are bankers banks' primary customer base. Community banks may feel impelled to minimize the operational burdens and interpretational vagaries in this draft by making FRB their primary correspondent. It must be presumed that no such consequence is intended, given FRB's unequivocal brief as the bank of last resort.

[1] An exposure may be netted to the extent secured by the net realizable proceeds from readily marketable collateral.

TBB therefore requests that the proposal be clarified to set forth an implementation date sufficiently in the future to allow for responsible development and testing of services to aid respondents' performance under this guidance. We suggest, at bare minimum, a 90-day period between adoption of the guidance in final form and the target implementation date.

6. The Proposal Necessarily Exacerbates "Too-Big-to-Fail" Debacle.

Because the substantive essence of the proposal drives banks to guide their operations with the risk of correspondent failure constantly before their eyes, the government perhaps unintentionally, but certainly unfairly, puts its thumb on the scale in favor of those institutions deemed too big to fail.

Through its regulatory scheme, the government encourages respondents to limit their business, all other things being equal, to those correspondents with the best capitalization. Simultaneously through its treasury powers, the government sees to it that a favored handful of correspondents, which are privately owned and operated for private profit, have open access to capital from public sources. The interplay between the government's tacit "too big to fail" policy and its formal regulatory scheme manifestly induces respondents to direct ever more business to these privileged few, making those already "too big to fail" ever bigger. Setting aside for now the doubtful morality of shifting public wealth to select private hands, TBB notes that the path marked by force of these implicit and express policies inexorably leads to marginalization of smaller, community-based institutions, reduced diversity in the banking industry, and fewer sources available to finance small business development and innovation, all to the detriment of the nation's economic well-being as a whole.

The insalubrious effects of governmental scale-tipping may be neutralized by logical counter-measures. For example, a bank that is too big to fail might be nationalized in the same proportion that the public monies it received and has not yet repaid with interest bears to its current capital. Or, the capital of such banks, for purposes of Reg. F and correspondent exposure analyses, might be discounted by the component that was appropriated from taxpayers. Either measure would increase the business that respondents may have with correspondents other than those whose spectacular miscalculation of risk necessitated massive, publicly-funded recapitalizations.

TBB therefore requests that the proposed guidance on correspondent concentration risk be modified as necessary to purge its inherent, unwarranted bias in favor of institutions receiving taxpayer-funded capital support.

7. Request for Extension of Comment Period.

The 30-day comment period for the instant proposal is set to expire on October 26, 2009. Given the subject matter, the allotted time for respondents and correspondents to receive, digest and to confer on the proposal amongst themselves, and with their industry groups and compliance professionals, is insufficient for preparation of a complete and thoughtful response. The hardship is compounded during this particular 30-day period, as the attention of banks' management is necessarily directed to timely completion of 3rd quarter call reports.

Accordingly, TBB urges that an additional 30 days be granted, through and including November 25, 2009, for banks and other interested parties to submit further comments on the proposal.

Thank you for your attention.

Sincerely,

/s/ Don R. Abernathy, Jr.

Don R. Abernathy, Jr.
President