UNITED BANKERS' BANK

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October 26, 2009

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

Re: Proposed Guidance on Correspondent Concentration Risks (Docket No. OP-1369)

Dear Ms. Johnson:

We appreciate the opportunity to comment on the **Proposed Guidance on Correspondent Concentration Risks** (hereinafter "Proposed Guidance") set forth by the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision ("the Agencies").

Our organization, United Bankers' Bank, 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. Our history and experience in this area provide us with a unique perspective on correspondent banking.

Comments on the Proposed Guidance

1. **General Comments**
    a. **Regulation F Conflict:**
    Banks currently must comply with the requirements of Part 206 (Regulation F or "Reg F") when conducting business with other financial institutions. Part 206.3 addresses the prudential standards a bank should consider in preventing excessive exposure to any individual correspondent. Part 206.4 stipulates the limits on credit exposure (25% of a bank's capital) "…unless the bank can demonstrate that its correspondent is at least adequately capitalized, as defined in § 206.5(a) of this part." Therefore, under Reg F, banks have the ability to set internal concentration limits depending on the financial condition of the correspondent bank.

The Proposed Guidance, while stipulating a 25% of capital concentration limit, does not address any issues relating to the financial condition of the respondent bank or the correspondent bank. We request that any future guidance in this area at least mirror the requirements of Reg F, and in addition, allow for consideration of a higher concentration limit (i.e. 50% of capital) if the respondent bank and the correspondent bank are both "well capitalized." If the financial condition of a correspondent bank deteriorates, it has always been incumbent upon the respondent bank to reduce ongoing credit exposure and business dealings.

In addition, other considerations in setting concentration limits may include exempting certain transactions, such as loan participations. We feel another exemption that should be explicitly addressed is in Part 206.4 (d) (2). This section of Reg F states that "The proceeds of checks and other cash items deposited in an account at a correspondent that are not yet available for withdrawal" are excluded in the determination of credit exposure.

b. **Implicit Endorsement of Institutions Considered Too Big To Fail ("TBTF") or Government-Sponsored**

We have concerns the Proposed Guidance will result in implicitly endorsing institutions considered TBTF or those that are otherwise supported by some degree of government involvement. This implied endorsement would, in effect, create an unfair and unwarranted competitive advantage in the correspondent banking area if the Proposed Guidance does not also apply to the TBTF entities, the Federal Reserve Banks, the Federal Home Loan Banks, and state-owned banking institutions.

In addition to our concerns that the Proposed Guidance provides a competitive advantage to institutions considered TBTF, we also believe that perhaps more importantly, the Proposed Guidance may competitively favor the Federal Reserve Bank ("FRB"). The FRB offers a limited line of correspondent services primarily focused on transactional/settlement services. Lending services through the Fed Discount Window are available but under defined circumstances. In May 2009, the FRB requested comment on a proposal to revise the Private Sector Adjustment Factor (PSAF). The proposed revision of the PSAF would have provided the FRB greater latitude in determining the pricing of its services. While we are not aware of the final disposition of PSAF we are concerned that there is the potential of a "double-impact" to the market for correspondent services. The potential of FRB below market pricing for transactional services combined with the (presumed) exemption of the FRB from Guidance Letter restrictions could very well have a negative competitive effect on correspondent providers of all types but particularly bankers' banks who both use FRB services and compete with the FRB in the marketplace.

c. **Dis-economies of Scale**
We believe that both respondent and correspondent banks will incur significant cost as a result of the Proposed Guidance. New costs will result from additional new account relationships that respondent banks will be forced to pursue in order to meet new concentration limits. Many banks may find it challenging to find correspondent providers since fewer banks offer these kinds of services. In addition, since most banks will traditionally keep the majority of their business with one correspondent bank, correspondent banks may see many new requests for services, but without the inherent dollar volume for profitable business. Thus, prices for correspondent services may increase. From the respondent bank's perspective, additional costs would include the cost of keeping a minimum compensating balance in each correspondent bank account to offset service charges, additional reconciling responsibilities, and additional internal and external audit verifications and controls.

d. **Fed Fund Limitations**
Most respondent banks keep the majority of their business with one correspondent bank. The primary correspondent bank typically offers a Fed Fund borrowing capability to the respondent bank. However, in addition to creditworthiness, some correspondent banks base their Fed Funds lines on the business volume done by the respondent bank. Fracturing business relationships in order to meet concentration limits could limit Fed Fund availability since a reduction in business volume by the respondent bank at the primary correspondent bank may encourage the correspondent to limit the existing line. Also, a secondary correspondent bank may offer only a limited line (if any) to a respondent bank doing limited business with them. Smaller community banks are most likely to be affected by this since their correspondent business is limited by their size. We are aware of specific instances where TBTF banks have advised their respondent banks that if they were to move any of their business to a new provider, the result would be either the elimination or substantive reduction of their Fed Fund line at the TBTF correspondent bank.

e. **Market Distortion**
We respectfully request that more time be given to study the Proposed Guidance to better understand all potential consequences stemming from implementation. Consideration should be given to the vital nature of the respondent correspondent relationship in the operation of both the nation's banking system as well as the economy as a whole. While bank assets are highly concentrated in the TBTF banks, small community banks (<$1 billion in total assets) play a vital role in financing small business which provide the largest percentage of the nation's total employment. Unforeseen consequences resulting from fixing one perceived systemic risk problem (currently addressed by Reg F) could inadvertently create a dysfunctional

banking system which focuses more on meeting mandated concentration limits and potentially restricting the efficient flow of credit.

f. **Calculation Method for Determining Concentrations**
The Proposed Guidance does not provide any details on how the concentration limits should be calculated. Providing a detailed/specific example of the calculation of concentration based on a sample balance sheet would be helpful to understand the full impact of the Proposed Guidance. What are the exact components of the concentration calculation? In addition, should banks calculate these concentrations using actual daily balances (that may materially change due to many reasons), quarter-end balances, average balances, or some other method?

2. **The appropriateness of aggregating credit and funding exposures**
We do not support the concept of aggregating exposures for both credit and funding risks, since these are separate and distinct exposures. The type, term, and the nature help distinguish these risks.

A Fed Funds line from a correspondent bank to a respondent bank is, in most instances, discretionary and can be terminated on short notice. We do not understand the logic of combining these types of funding sources. If the funding "flows-through" a correspondent bank as opposed to being the direct responsibility of that correspondent bank (i.e. brokered CD's) that exposure should also be excluded.

Loan participations, by their nature, provide another example. Loan participations may be purchased from or sold to a correspondent bank. In many cases, the correspondent bank's role in a loan participation sold to a respondent bank is that of a servicing agent, not the loan obligor. There is minimal, if any, credit risk to the respondent bank in this example. FASB 140 provides specific accounting guidance for loan participations. Based on our understanding of FASB 140, loan participations which are not the direct obligation of the correspondent bank should be excluded from the Proposed Guidance.

The Proposed Guidance does not address transactions within a multi-bank holding company. These transactions may include sales of fed funds and loan participations among the subsidiary banks. Generally, these types of transactions have created efficiencies, reduced risk, and increased the potential for earnings.

The Agencies also do not specify how Federal Home Loan Bank advances would be viewed. We continue to believe that the Agencies should consider either increasing the proposed limits on exposure, identifying specific exclusions on either credit or funding or modifying Reg F through a focus on well-capitalized as opposed to the current adequately-capitalized.

3. **Types of factors institutions should use to assess correspondents' financial condition. (Ranges for each factor monitored are to be required)**

   As previously stated, it is our belief that the proper structure to manage correspondent relationships is already in place through Reg F. If new regulatory guidelines are proposed, then those changes should only go into effect upon the downgrading of a correspondent bank's capital status.

   Reg F requires correspondent banks to be at least "adequately capitalized." The Agencies may wish to consider changing Reg F to the extent that correspondent banks need to maintain a "well-capitalized" status.

4. **Types of actions to be considered for contingency planning and appropriate timeframes.**

   A respondent bank has the ability to control a significant amount of its business activity with its correspondent bank. However, the Agencies must give consideration to the actions by the respondent bank given a change in the financial condition of its correspondent bank. In this regard, one should be mindful of the type of "triggering events" that may require action by the respondent banks. Specifically, systemic risk could be created as a result of wholesale action by respondent banks that ultimately could significantly affect the liquidity of the correspondent bank. For example, if a specific asset quality measure such as the "Texas Ratio" was used to determine when respondent banks were required to reduce their exposure to their correspondent bank, an artificial crisis may be created. While the correspondent bank may indeed have some degree of asset quality issues that drove the "Texas Ratio" to the trigger level, the actual severity of the asset quality problem will only be known by the correspondent bank and their regulatory agency. All the respondent bank will know is that they must reduce their exposure quickly. It is not impossible to imagine a panic situation whereby the action of respondent banks could create immediate reputational issues for the correspondent bank that could move quickly into an unfortunate liquidity event.

   Specific actions that a respondent bank could take may include moving Fed Funds Sold as principal to agent, moving settlement and drawing down DDA balances to FDIC insured levels. Loan participations, stock investments in the correspondent bank, and loans to the correspondent bank would be relatively illiquid.

5. **Operational procedures that the Agencies should consider before finalizing the Proposed Guidance.**

   There is a significant level of reporting required by the Agencies within the Proposed Guidance. If a correspondent bank is "well-capitalized" the possibility of impairment/failure within a short timeframe is remote at best. Leveling new reporting requirements on top of an industry already laboring under significant reporting requirements (regulatory and audit) for very minor (if any gain) makes no sense. As stated earlier, we encourage the Agencies to simply modify Reg F by raising the acceptable capital standard from “adequately capitalized” to “well capitalized” or consider certain exclusions to the proposal.

Summary

We are concerned and very aware of the problems that exist in our nation’s financial services sector. We are also sympathetic with the concerns of regulators who are charged with preserving safety and soundness. It has always been our goal to be part of the solution and not the problem.

We believe that the Proposed Guidance as currently structured will not fully meet the Agencies ultimate goal of reducing the potential for systemic risk. The Proposed Guidance will raise costs for respondent banks and correspondent banks, potentially disrupt the efficient flow of credit in the marketplace, and force many banks to move at least a portion of their business to TBTF banks/government sponsored banks. The Proposed Guidance will also create another level of competitive inequality between correspondent banks and TBTF banks, FRB, and government sponsored banks.

To quote Sheila Bair’s October 19, 2009 interview with USA TODAY, “Too big to fail has become worse. It’s become explicit when it was implicit before. It creates competitive disparities between large and small institutions because everybody knows small institutions can fail. So it’s more expensive for them to raise capital and secure funding.”

The Proposed Guidance is a major change with major implications for our nation’s banking system. We urge the Agencies consider giving this matter more time, work specifically within the context of Reg F, and continue to seek additional industry input before publishing the final Guidance.

Sincerely,

William C. Rosacker
President