ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

November 21, 2008

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

Submitted via email

RE: Docket No. R-1334, Reserve Requirements of Depository Institutions

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System (Board) Interim Final Rule amending Regulation D, Reserve Requirements of Depository Institutions, permitting Federal Reserve Banks to pay interest on required reserve and excess balances.

Background

The Financial Services Regulatory Relief Act of 2006, Public Law 109-351, granted Federal Reserve Banks the authority to pay interest on required reserves and excess balances commencing October 1, 2011. Section 128 of the Emergency Economic Stabilization Act of 2008, accelerated the effective date of this new authority to October 1, 2008.

On October 9, 2008, the Board published an interim final rule amending Regulation D, Reserve Requirements of Depository Institutions, to implement the accelerated payment of interest. On November 4, 2008, the Board published a

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

INDEPENDENT COMMUNITY BANKERS of AMERICA *The Nation's Voice for Community Banks®*
1615 L Street NW, Suite 900, Washington, DC 20036 ▪ (800)422-8439 ▪ FAX: (202)659-3604 ▪ Email: info@icba.org ▪ www.icba.org

revision to the interim final rule altering the formula for calculating interest payments on excess balances.

ICBA Position

ICBA recognizes the importance of the Federal Reserve System (System) having the necessary tools to implement effective monetary policy. We understand the payment of interest on required reserves and excess balances will further strengthen the System's ability to support financial stability while implementing appropriate monetary policy. We further recognize that the quick implementation of this rule coupled with the unprecedented turmoil and governmental programs implemented to address the turmoil will have negative unintended consequences for some depository institutions. ICBA strongly urges the Board to be mindful of the cumulative impact of the existing environment described above and to new and evolving Federal government programs and to quickly adopt policies to assist affected depository institutions.

Bankers' Banks

The nation's twenty bankers' banks[2] are an example of depository institutions suffering negative unintended consequences. Specifically, bankers' banks are uniquely affected by these developments as they primarily obtain the liquidity necessary to fund their operations from respondents' excess liquidity in the form of "due to" accounts and federal funds.

Bankers' banks are experiencing record outflows from their agency federal funds programs. Some respondents are moving funds to their accounts at Reserve Banks due to safety concerns and the ability to obtain a higher rate of return on their funds. Others are paying down Federal Home Loan Bank advances and/or investing in short-term U.S. Government Securities. Others are leaving excess funds in their bankers' bank "due from" accounts which is particularly problematic for bankers' banks since these accounts are on-balance sheet transactions requiring the appropriate levels of capital. Conversely, agency federal funds program transactions are off-balance sheet transactions and do not require supporting capital. For example, one bankers' bank reports that, over a three-week period of time, its respondents have shifted $200 million from its agency federal funds program to "due to accounts." This bank's agency federal funds program typically averages $700 million, equating to almost a 30 percent decline.

To address this negative unintended consequence, ICBA strongly urges the Board to establish a new type of account, an agency reserve account, that would permit bankers' banks and other correspondent banks to deposit overnight,

[2] The nation's 20 bankers' banks were organized and authorized solely to provide correspondent banking services to community banks, including savings and loan associations. Bankers' banks serve more than 6,000 respondents and are owned primarily by community banks and their holding companies. Unlike other correspondent banks, bankers' banks rely significantly on "due to" accounts and respondent overnight excess funds for liquidity since they have no retail demand deposit or savings accounts.

INDEPENDENT COMMUNITY BANKERS of AMERICA The Nation's Voice for Community Banks®
1615 L Street NW, Suite 900, Washington, DC 20036 • (800)422-8439 • FAX: (202)659-3604 • Email: info@icba.org • www.icba.org

aggregated respondent excess funds with Reserve Banks and pass back the proportional interest to their respondents. Such an account would be a win-win situation for bankers' banks and other correspondent banks, as well as, their respondents, the Federal Reserve Banks and the Board. Bankers' banks would maintain their source of liquidity and continue their valuable roles in providing correspondent services. Respondent banks would also reap the benefits of having an additional safe and interest-bearing investment option. Reserve Banks would avoid the challenges of gearing up their operational capabilities and customer service resources to support a significant increase in reserve accounts as depository institutions migrate from bankers' banks to Federal Reserve Banks. Finally, such an arrangement would complement the Board's execution of monetary policy by funneling these funds into accounts at Federal Reserve Banks.

Passing Back of Interest to Respondents

The Board is seeking comments on whether it should require, rather than permit, pass-through correspondents to pass back proportional interest earned to respondents. ICBA supports the Board requiring correspondents to pass back proportional interest earned to respondents beginning two years after adoption of the final rule as it would be unfair for correspondents not to share this income. A delayed effective date would provide correspondents the necessary time to modify accounting systems and business models.

Conclusion

Again, ICBA appreciates the opportunity to comment on this interim rule. We strongly urge the Board to expeditiously proceed with the vetting and implementation of the agency reserve account concept and any other potential changes necessary in response to the negative unintended consequence of the accelerated payment of interest on reserves coupled with the severe strains in the financial markets. ICBA also urges the Board to require correspondent banks to pass back interest to respondent banks within two years of the final rule's effective date.

If you have any questions or need additional information, please contact the undersigned by email at viveca.ware@icba.org or by telephone at (202) 659-8111. Thank you.

Sincerely,

/s/

Viveca Y. Ware
Senior Vice President
Payments and Technology Policy