Bankers' Bank Northeast
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Re: Docket No. R-1381

I am writing on behalf of Bankers' Bank Northeast, a state chartered, FDIC insured and Federal Reserve member bankers' bank located in Glastonbury, Connecticut. Bankers' Bank Northeast provides correspondent services to over 200 federally insured depository institutions in New England and New York State. Nearly 50 of our client banks are also investors in their Bankers' Bank.

The Board of the Federal Reserve has requested comments on proposed amendments to Regulation D, Reserve Requirements of Depository Institutions, which would allow the Federal Reserve to establish Term Deposits Accounts. As a correspondent bank we are extremely concerned about unintended consequences of the proposed amendments because in our opinion they will:

1) Create a competitive offering that private sector correspondent banks cannot duplicate.

2) Not attain the desired attributes of an effective monetary control tool

3) Cause community banks to once again fail to be included in an efficient manner in a program that will likely be primarily to the benefit of the country's largest depository institutions.

Thank you for the opportunity to comment on a significant event for the Federal Reserve, correspondent banks and respondent banks. The proposed program is new to me and as such we may not yet fully understand the structure and the likely results. The following comments are accordingly provided with the expectation that with your help we will learn more as a result of the comments letter process:

I. DISSOLUTION OF PRIVATE SECTOR ABILITY TO COMPETE.

While the stated purpose of the amendments is to facilitate the conduct of monetary policy, the proposed program exhibits product-like characteristics that are in direct competition with the private sector Federal Funds market. For many decades the network of private sector banks which comprise the Federal Funds market has effectively facilitated the investment of excess liquidity within the marketplace. Generally speaking community banks are net sellers of funds and the upstream banks are net users of such funds. The net users tend to be the larger financial institutions. The existence of this marketplace thereby enables community banks to sell their excess funds to upstream banks at a competitive rate of interest.

It should be noted that term deposit accounts offered by the Central Bank will be extremely attractive to all banks since these investments will carry a zero risk rating as well as offer higher rates than overnight funds (during normal yield curve periods). Furthermore those same funds can be used as collateral at the Discount Window should the bank decide to retrieve cash to meet unforeseen liquidity needs. The proposed product incorporates:

1) zero risk
2) higher [than overnight] rates
3) the ability to quickly "liquefy" using the Discount Window
4) the unlimited availability of funding by the Central Bank

The result of the above combination is the creation of a product that will likely destroy the private sector Fed Funds market. No private sector correspondent bank would have anywhere near the capacity to take billions of such funds while assuring every depositor immediate access to their term funds through use of the Discount Window. (To do so would be a violation of prudent Asset Liability Management for a private sector participant).

The proposed changes to Reg D along with the existing Excess Balance Account [EBA] program will compete directly with the private sector network. The offering of term deposits should accordingly be recognized not only as an intended monetary tool but also as a new product introduction to the marketplace. The new product should be priced in such a way that implications to the private sector are fully considered. **As such the PSAF rules should be applied.**

The placement of excess liquidity in the form of overnight investments and/or demand deposits is a vital source of funding for correspondent banks and a valuable service to respondent banks. If this relationship is usurped by the Central Bank it is likely that the private sector correspondent banking market will experience extreme stress since its business plan would have to change dramatically.

The fact that the proposed amendments do not provide for the use of the term deposit as collateral for borrowings by respondent banks from private sector correspondent banks precludes competition regarding this attractive aspect of the service.

We respectfully suggest that for the new monetary tool to be effective and valuable to community banks the program must include the participation of private sector correspondents. It should be noted that the private sector correspondent bank aggregation activities currently integral to the EBA program introduce in 2009 have proven to be valuable to our client banks and to the Federal Reserve. The high and growing level of participation in that program by community banks through the bankers' bank network indicates the success of that cooperatively offered product.

Correspondent banks should be allowed to act "as agent" for respondents to enable the aggregation and placement of funds in term deposits at the Central Bank for the following reasons:

a. Many community banks do not actively manage an account with their local Federal Reserve Bank and therefore lack the ability to easily participate in the program or to borrow at the discount window.
b. Allowing correspondents to aggregate funds will ensure that all banks, big and small, will have an opportunity to participate effectively and efficiently.
c. **Regulation D currently allows for correspondent banks to act "as agent" in the placement of funds into EBA. Allowing correspondent banks to act in a similar capacity with term deposits would add consistency to the proposed changes**
d. Considering that the term deposit: may only be used as collateral at the discount window; carries a zero percent risk weighting (as do EBA deposits), combined with the potential inability of correspondent banks to act as agent negatively impacts the competitiveness of the correspondent banking industry relative to the Federal Reserve.

II. ISSUES PREVENTING THE INITIATIVE TO WORK EFFECTIVELY AS A MONETARY CONTROL TOOL

The use of Term Deposit Accounts at the Central Bank would introduce an unproven activity in competition to the private sector financial markets. We expect that the amount of funds placed in such a program would be massive because of the strong appeal to banks. In fact, to operate as an effective monetary control tool the amounts would in fact need to be extremely large. In our long experience as correspondent bankers, we have learned that community banks are consistent contributors to the banking system's liquidity pools because they operate very conservative balance sheets; i.e. they maintain relatively high levels of liquidity. In fact they are required to do so by their regulators.

However, smaller banks have not been able to directly participate effectively in the traditional Fed Funds market and over time have turned to their correspondent banks as a means to aggregate their collective liquidity in order to maximize their returns in the Fed Funds market. A typical community bank sells to Bankers' Bank Northeast $2,000,000 (the median amount invested) into the overnight Federal Funds market. It is expected that community banks will take at least a portion of their overnight funds to place in the term facility offered by the Central Bank since they will benefit from the expected higher rate associated with longer term investments. If a community bank elects to move 50% of its overnight funds into a term deposit the transaction would amount to $1,000,000. **Such relatively small amounts are unlikely to carry any weight within a nationwide program that is likely to handle huge sums of money.**

Of note, if all 8,000 community banks participate at the level of $1,000,000 the total amount invested in term deposits would amount to $8,000,000,000. Certainly a miniscule amount relative to what's needed for effective monetary control purposes. Accordingly the program is likely to respond to the needs of large banks as opposed to community banks and credit unions.

Setting a minimum term deposit amount at $5,000,000; allowing correspondents access to term deposits to provide collateral for borrowing lines; combined with a process that would allow correspondent banks to act as agent for downstream banks (just like the existing EBA program) would address this negative aspect of the proposal because it would enable the correspondent to apply the leverage of its ability to aggregate funds.

III. PROPOSED PROGRAM WILL BENEFIT THE LARGEST BANKS

As noted above the anticipated aggregate amount that community banks will place in term deposits is small at $8,000,000,000 and the amount expected to be invested by a singular community bank is small at $1,000,000. However, large banks are likely to place monumental amounts in such a relatively risk free investment. Their propensity to operate with small margins and low equity to assets levels (as opposed to typical community bank propensities) will ensure that the rates they would accept are lower than the rates accepted by the nation's smaller depository institutions. It would be a case of the rich getting richer, once again.

Additionally, since community banks would not be involved in the new market every day (because their small investments would not warrant daily participation, they are unlikely to be able to submit winning bids as effectively as the large banks). Likewise, if the program is operated on an offered rate basis the largest banks again would be more aggressive and would likely take the entire amount offered. Such a happenstance would leave community banks without access to the higher interest rates of term deposits.

We can also anticipate that the largest banks would use the proposed program as another opportunity to arbitrage by taking advantage of the higher term deposit rates and by inflating their balance sheets. Once again because they are able to work with smaller margins and lower capital rations, such activity would become prevalent.

The Federal Reserve should provide a process so that community banks and credit unions are able to participate is a program that offers high rates and zero risk.

In response to the question posed in the request for comment, we note that the shorter the term of the deposit offering the more dollars that will be placed. We suggest that since the product addresses the need to place excess liquidity the bank investor will want to keep the maturities short. The Fed may want to offer maturities in the range of 12 weeks roughly twice the duration of the FOMC meeting schedule because most bankers feel confident projecting Fed interest rate moves within that timeframe.

In summary, as a bankers' bank dedicated to enabling community banks compete, we must be allowed to participate in the proposed program. We recognize the benefit for our client banks as primarily in the form of improved earnings attributed to a new ability to invest their liquidity at higher rates with little market rate risk and with virtually no credit risk. Although we perceive the proposed program to be more beneficial to the largest banks, we would ***support the program if we as correspondents would be allowed to participate as aggregators. We can assure that the proposed program could be beneficial to community banks if we can assist their participation****. Otherwise, we predict that the proposal would result in the long-term elimination of private sector correspondents and the demise of the private sector Fed Funds market.*

Thank you for consideration of our comments. If you have any questions, please contact me at 860 633-5690 or pjs@bankersbanknortheast.com.