Reference: Docket No. OP-1310

I am writing on behalf of Bankers' Bank Northeast ("BBN") relative to the proposed change to the daylight overdraft posting rules under the Payments Systems Risk (PSR) policy that would align the posting times for ACH credit and debit transfers in the payments system. BBN is one of 21 bankers' banks nationally, which occupy a unique and very important place in the nation's banking system. The change as proposed would create significant liquidity challenges, negatively impact earnings and potentially affect the overall competitiveness of BBN and other bankers' banks, to the detriment of the national banking system.

BBN, like other bankers' banks, was organized solely to do business with other financial institutions. Further the Bank is owned exclusively by forty-five financial institutions located throughout New England. As a correspondent bank for financial institutions, BBN offers a variety of settlement services through respondent relationships tied to BBN's master account at the Federal Reserve Bank of Boston. BBN has a third-party agent relationship with client banks at the Fed that allows us to originate, receive and settle client bank ACH activity. In May 2008 BBN settled approximately $1.1 billion in ACH debits and credits.

Relative to the questions contained in the request for comment Section III the following information is provided:

1. Relative to debit originations, BBN feels that process as presently structured is more advantageous than the proposal.

2. BBN feels that settlement as presently structured is more advantageous than the proposal.

3. The proposed change would adversely impact availability of funds to BBN client banks. The change would force us to require client banks to keep funds on deposit to provide liquidity to fill the early morning void created by posting debits and credits simultaneously at 8:30 AM since BBN can not retrieve invested overnight funds that early in the morning. The funds kept by our client banks (for protection against daylight overdrafts) reduce availability to them; they in turn would have fewer funds available to their customers. BBN in turn would maintain a non-interest bearing account at the Fed that both inflates BBN's balance sheet (requiring additional capital) and depresses its profitability.

   BBN is also concerned with liquidity issues that may occur with client bank demands to draw down funds earlier in the day to meet their obligations. BBN settles approximately $3 billion in transit activity for its client banks monthly. In addition, BBN operates an as agent fed funds program with daily activity of approximately $800 million per day. An increase in client bank requests for funds to cover their ACH debits would put further pressure on BBN to increase its clearing balance in order to accommodate the proposed change. Although BBN would earn additional earnings credits, based on current usage of Fed services these credits would not be fully utilized and the credits are earned at a rate substantially lower than other investments available to BBN. This would further negatively impact earnings and liquidity.

4. No comment.

5. No comment.

6. In accordance with the Monetary Control Act of 1980, BBN is not required to maintain cash reserves at the Fed; accordingly BBN is not permitted to incur a daylight overdraft at any time. For years, this has not been an issue as the daylight overdraft posting rules employed by the Fed has posted overnight credits in advance of debits. Under the proposed change, the simultaneous posting of ACH debits and credits is likely to create daylight overdrafts unless the Bank's clearing balance is substantially increased or BBN chooses to maintain reserves to be eligible for a net debit cap. Each of these options will negatively impact the Bank's liquidity and earnings, and is inconsistent with the Fed's regulations not requiring cash reserves of bankers' banks.

   At present, BBN invests its excess liquidity into higher yielding assets as compared to maintaining deposits in its correspondent or Federal Reserve Bank of Boston ("FRBB") accounts that have significantly lower earnings allowance rates as well as other deductions to collected balances. Based on recent ACH volume, BBN would have to increase its clearing balance significantly at the FRBB to avoid any daylight overdraft activity. BBN currently has a clearing balance of $1 million. During May 2008 ACH debits exceeded credits 64% of the time. While the daily average of debits exceeding credits was approximately $1.1 million for the month, the variance on one day was in excess of <u>$15.5 million</u>. There is no way to predict a net debit position. Increasing clearing balances to avoid any daylight overdraft would cost BBN approximately $150,000 per year in lost revenue.

   There are several concerns with choosing to maintain reserves. Unlike a typical financial institution, BBN does not have a mix of interest and non interest bearing deposits; all of BBN's deposits are in transaction accounts. BBN does not have any vault cash. It is estimated that BBN would be required to maintain approximately $6.7 million in reserves or 6% of total assets. Since there is no interest paid on reserves, in today's rate environment, lost earnings to BBN would exceed $300,000 per year.

   It should also be noted that BBN's capital is approximately $9.4 million. With a de minimis cap applied against that capital level, the allowable daylight overdraft capacity is $3.76 million, which is significantly lower than our highest single day difference between ACH debits and credits.

   If BBN maintains reserves, client bank account balances and associated earnings credits would be negatively impacted, since our banks would be assessed a 10% reduction on incremental collected balances. This action would reduce availability of funds to our client banks.

   The economics of the change would force us to pass through to our client banks the additional funding requirements (i.e. funding that the Federal Reserve is not required to maintain). Additionally, collateralization contains an innate cost. Collateral kept at the Fed is not available for use at alternative competitively priced funding sources such as the Federal Home Loan Banks. Even if the Federal Reserve were to allow use of the collateral at its Discount Window the pricing is often disadvantageous.

7. Six months is not sufficient to make plans for additional funding. It has taken 10 years to perfect our current operating procedures and to secure external funding. We built our business model based on Fed published operating procedures to include ACH posting routines. We point to the fact that we have had only a handful of actual daylight

overdrafts over our ten year history. However, our role as an aggregator for community banks requires significant levels of liquidity to guard against daylight overdraft exposures. Although our average net ACH debit exposure is in the realm of only $1,000,000, recent history indicates on any given day the daylight OD potential can exceed $15,000,000. That number is growing as we take on additional business on behalf of small community banks.

Finally BBN believes that the proposed rule would create a *competitive advantage* for Reserve Banks. Due to the unique nature of bankers' banks, which the Federal Reserve System has recognized in its regulations, BBN and other bankers' bank's balance sheets do not reflect the volume of settlement activity processed by them on a daily basis. Implementation of the proposed rule would greatly and negatively affect the competitive position of bankers' banks like BBN and its ability to expand its product offering in the ACH area. This may result in a discontinuation of the service, causing client banks to pursue less desirable choices. In effect, the proposed rule would put BBN and all bankers' banks at a competitive disadvantage to the "central bank".

Thank you for your consideration and review of the Bank's comments. Please call me with any questions or concerns.