"Your Path To Success"

June 10, 2008

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

RE: Policy on Payments System Risk; Daylight Overdraft Posting Rules
Docket No. OP-1310

Dear Ms. Johnson:

On behalf of the Bankers' Bank Council, I would like to submit the following comments in response to the Board's request for comment on the proposed change in posting time for commercial and government ACH debit transfers that are processed by the Reserve Banks' FedACH service from 11:00 a.m. ET to 8:30 a.m. ET.

The bankers' bank council represents 21 bankers bank in the United States, representing approximately 6,000 customer community banks.

Our organization strongly opposes the proposed change due to the costs the change will impose upon our banks as well as the thousands of community banks we serve. The proposed change provides benefits to the few very large banks that originate the vast majority of ACH debit transactions at the expense of the thousands of community banks that are net receivers of those transactions. The additional cost and burden placed on the net receivers far outweighs the benefits to the large originators and the Federal Reserve Banks. If the Board does decide to implement the ACH posting rule change, it should not be made effective until Federal Reserve Banks begin to pay market rate interest on account balances held in Federal Reserve accounts.

While we understand the Federal Reserve Banks' desire to make the FedACH service more competitive with EPN, eliminating the minor competitive difference in the posting times would shift very significant costs onto the thousands of community banks and the bankers' banks many of those community banks settle through.

The Board's concerns in 1994 that the "receiver of ACH debit transactions cannot predict with certainty the value of transactions that they will receive on certain days" and that banks need time in the morning to determine funding needs are still very valid concerns. This issue has become even more critical since 1994 as the volume of checks converted to ACH debit transfers has grown exponentially. The fact that the Fedwire system is open at night does not change the circumstances for most banks. Even though Fedwire is open early in the morning, the primary source for funding accounts – particularly for bankers' banks – is the return of fed funds sold the previous day. Purchasers of fed funds are not in a position to return funds by 8:30 a.m. the next morning.

The proposed changes will impose significant costs and lost revenue on bankers' banks – costs which will be passed on to the thousands of community banks that own and are served by those bankers' banks. Using the Payments System Risk Policy Fee Calculator web site, it is estimated that individual bankers' banks could incur tens of thousands of dollars in daylight overdraft fees annually if the posting rule change is implemented. Beyond the fees, the Federal Reserve Banks have strongly discouraged banks from incurring any daylight overdrafts and have reprimanded banks that incur multiple daylight overdrafts.

Because bankers' banks and community banks are usually net payors of ACH debit transfers, they will have three basic options for funding their intra-day position at the Fed and avoiding daylight overdraft fees, each of which has significant costs to bankers' banks:

1) Leave excess balances in their fed account each night to fund the 8:30 a.m. posting of ACH debits

   To take one example, Midwest Independent Bank, Jefferson City, Mo. estimates this option would cost MIB about $2 million annually in lost interest at a 2.00% fed funds rate, based on the average daily net difference for debit transfers that would start posting at 8:30 a.m. instead of 11:00, MIB

2) Try to get fed funds trades settled earlier in the day

   Bankers' banks are usually net sellers of funds and rely heavily on the return of those funds each morning from purchasers to fund their Federal Reserve accounts. Our experience has found that most purchasers of fed funds are not willing or able to return funds by 8:30 a.m. ET because fed funds trades normally have a 24-hour term. Those few purchasers that may agree to meet an earlier deadline would normally deduct several basis points off the interest rate paid to accommodate the request. This costs bankers' banks and their customers a significant amount of lost interest income and puts bankers' banks at a disadvantage when competing for fed funds business.

3) Pledge additional collateral (under the proposed policy)

   The cost of this option will vary greatly based on the amount and types of collateral kept, but for most bankers' banks this will impose additional costs. One of the key lines of business for many bankers' banks is loan participations (or overlines) as opposed to the direct lending that most commercial banks engage in. Because overlines are not eligible to be pledged as collateral for Federal Reserve Bank borrowings, bankers' banks will be forced to use the few loans they do make directly, such as bank stock loans, or purchase additional securities for collateral to cover daylight overdrafts. Pledging the few direct loans it has would limit the bankers' bank's flexibility in managing its loan portfolio because pledged loans would not be eligible to be participated out to other banks. Furthermore, these loans, once pledged to the Federal Reserve Bank will no longer be available for pledging as collateral to the Federal Home Loan Bank affecting liquidity strategies already in place. Finally, purchasing additional securities would lower the yield on the bank's portfolio by replacing higher-yielding loans with lower-yielding securities.

Response to Proposal Questions

The following are responses to the seven questions posed by the Board in the request for comment:

1) To what extent do institutions that originate debit transfers through FedACH incur competitive disparities because of the difference in settlement times between operators? To what extent would adopting the proposal alter this situation?

   Bankers' banks are sending points for community banks that originate debit transfers. Our experience with these originators is that the posting time does not present any competitive disparities between the operators. Therefore, adopting the proposal would not alter the situation.

2) To what extent are there competitive disparities between ACH operators because of the difference in settlement times? To what extent would adopting the proposal alter this situation?

   While the difference in posting times between EPN and FedACH appears to create a competitive disparity, we believe that large-volume originators of debit transactions consider price and service levels to be the deciding factors when choosing an ACH operator. Bankers' banks, for the most part, use the Fed for all of their ACH origination activity, even though EPN offers an earlier posting time, because the Fed offers the best price and service levels to meet the needs of our customers.

3) Would the proposed change have an effect on the availability of funds to customers of depository institutions?

   The proposed change should not have any effect on the availability of funds to commercial and retail customers of depository institutions. The change will have a significant effect on the availability of funds between financial institutions as they work to adjust their intra-day funding position between 8:30 a.m. and 11:00 a.m. Banks that are net payors of ACH debit transactions will see a significant reduction in the availability of funds between 8:30 a.m. and 11:00 a.m.

4) To what extent would the proposed broader PSR policy changes mitigate the liquidity concerns of originating institutions if the Board did not adopt the proposed change to the posting rules?

   If the Board did not adopt the posting rule change, the proposed broader PSR policy changes should be adequate to alleviate most liquidity issues for originating institutions.

5) To what extent would the proposed broader PSR policy changes mitigate the liquidity concerns of receiving institutions if the proposed change to the posting rules was adopted?

While the proposed broader PSR policy changes would mitigate some of the liquidity concerns, those changes would not be enough to offset all of the daylight overdrafts that would be incurred.

6) Under the current and the proposed PSR policy, what costs would institutions expect to incur to fund their Federal Reserve accounts by 8:30 a.m., particularly if the institutions did not want or were ineligible to incur daylight overdrafts?

   Again using Midwest Independent Bank as an example, the only way to reliably fund its Fed account by 8:30 a.m. and avoid daylight overdrafts, would be to leave an average of $100 million per day in additional funds in its Federal Reserve account. At the current fed funds rate of 2.00%, this would cost $2 million per year in lost interest income. Even though the Fedwire system is open in the overnight hours, there would be no place for to wire in additional funds from during that time. The Bankers' banks work to effectively manage their money and their customers' money by selling all excess funds in the fed funds market. Those proceeds from those fed funds trades are not normally available from the purchasing banks until closer to the current 11:00 a.m.posting time. Our experience has shown that when purchasing banks are asked to return fed funds trades earlier in the day, many will not (or can not) and those that do agree to return the funds earlier normally will reduce the interest rate paid by several basis points.

7) Is six months sufficient lead time to implement the change in posting times? Alternatively, should the Board implement the change to the posting rules at the same time as the proposed broader PSR policy changes?

   While we strongly oppose implementation of the posting rule change, if it is implemented, it should not be done until the broader PSR policy changes are implemented and Federal Reserve Banks begin paying market rate interest on accounts held by banks. This will allow banks time to find ways to mitigate the daylight overdrafts that will be incurred.

<u>Conclusion</u>

The bankers' banks are strong supporters of the FedACH service and wants to see it remain competitive. The proposed posting rule change, however, would improve FedACH's competitive position, relative to EPN, only slightly while imposing significant and unnecessary costs on thousands of community banks as well as the bankers' banks that provide settlement services. This proposal clearly benefits the few very large volume originators of ACH debit transfers that normally have better access to other intra-day funding sources while imposing significant costs on thousands of institutions that are net receivers of those debit transfers.

If the proposed rule change is adopted as proposed, it will adversely impact not only the twenty-one bankers' banks, but thousands of community banks that rely on them for settlement, clearing and other correspondent banking services.

Thank you for the opportunity to comment on this proposal. If you have any questions about these comments or our position on this proposal, please feel free to contact me, or any noted member

Sincerely,

L.D. McDonald
President /CEO
Midwest Independent Bancshares, Inc.
Chairman Bankers' Bank Council 2008 -2009

On behalf of:

Bruce Schriefer, President/CEO Banker's Bank of Kansas, N.A.	Wichita, Kansas
Charlotte Martin, President Great Lakes Bankers' Bank	Gahanna, Ohio
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