From: jechtermeyer -11/11/2008 07:15:06 AM

Subject: Reserve Requirements of Depository Institutions

Subject: DOCKET No. R-1334 - Federal Reserve interim rule to pay interest on balances held at the Reserve Banks.

Bankers Bank of the West (BBW) appreciates the opportunity to comment on the Federal Reserves (Fed) program to pay interest on reserves. BBW is one of 20 commercial bankers banks and provides a wide range of correspondent banking services to nearly 400 community banks. We support the Feds efforts to enhance tools for conducting monetary policy and establish confidence in the banking industry. However, there are numerous issues with the program and technical clarifications needed in order to ensure the program works as intended and does not put community banks at a disadvantage.

Bankers Bank of the West acts as a fed funds agent for roughly 300 community banks. On average, 140 community banks sell excess funds to our agent fed funds pool. By aggregating the excess funds of our respondent bank customers, we gain efficiencies and obtain better rates for our respondent banks. From this large pool of funds, we can also diversify sales of fed funds to large upstream banks and reduce credit risk. The support of bankers banks also allows community banks to compete with the large complex banking organizations. Finally, by charter bankers banks are not allowed to attract traditional deposits and instead rely on their agent fed funds pool as a source of funding to support thousands of community banks. A significant change or reduction in such a valuable funding source will greatly restrict bankers banks ability to support community banks and will diminish healthy competition within the industry.

Until the fed funds market is trading at or above the floor rate established by the Feds interest on reserve program, bankers banks will be at a significant disadvantage. The Feds program will drain excess funds from the fed funds market and reduce inter-bank funding, greatly hamper bankers banks ability to provide needed services to thousands of community banks, and create an unfair playing field for large banking organizations. In addition, implementation of the program nearly three years earlier than expected has created tremendous confusion and deprived the industry of the necessary time to prepare. Bankers banks earnings will also be negatively affected.

The Feds program to pay interest on reserves reduces the funds available within the fed funds market for inter-bank lending and in todays environment is in direct conflict with the FDICs TLGP. A goal of the TLGP is to encourage inter-bank lending (i.e. fed funds). However, paying interest on reserves encourages banks to remove excess funds from the fed funds market and reduces fed funds available to thousands of community banks. The Fed has done a lot to increase liquidity, but this program is taking that same liquidity out of the market place.

The current rate to be paid on excess reserves is too high. The fed funds target minus 35bps, and now only 10bps, does not work in a dysfunctional market that is trading well below the target 65bps. Large banks are already taking advantage of the community banks and it is anticipated that because of their control over the fed funds market they will opt out of the TLGP, avoid the 75bps fee and still pay rates below the Feds floor rate.

To compete with the Fed in a dysfunctional fed funds market, recover the cost of the TLGP, and attract funds necessary to support community banks, bankers banks will in effect have to pay a rate 75bps more than what the market place or Fed are paying on excess reserves. Banks selling fed funds will not accept a rate 75bps below the market rate to guarantee their funds when they can simply deposit the excess funds at Fed. And, bankers banks will not be able to charge banks needing to purchase fed funds a rate 75bps above the market rate or Feds discount rate to recover the 75bps.

The Fed has created an unfair playing field by paying interest on transaction accounts and not allowing correspondent banks to do the same for the same types of accounts held with them. Correspondent banks are at an even greater disadvantage when the Feds program is coupled with the 75bps penalty/fee banks must pay to participate in the TLGP.

In addition, premature implementation has created numerous operational problems. Bankers banks (and other correspondent banks) have not had an opportunity to establish programs to facilitate sweeping respondent banks excess balances to the Fed or other accounts, or to set up an equivalent program to support the Feds goals. Also, the Fed is providing a poor service by simply passing on lump-sum amounts of interest earned on pass-through balances and requiring correspondents to determine how much interest to pay each respondent bank.

There are also opportunities to enhance the program. For one, the new rule should provide a mechanism for bankers banks and other correspondent banks to designate and deposit excess funds at the Fed on behalf of their customer banks. This would work similar to the current pass-through accounts held by state non-member banks to meet reserve requirements. However, because of the size of the balances, correspondent banks must be able to report these as off-balance sheet items and allow the respondent bank to report the balances as deposits held at Fed. Furthermore, a determination needs to be made on how these balances will be handled under the FDIC TLGP. This will provide an efficient means for respondent banks to settle their payments at the correspondent and pass through excess reserves to the Fed.

Another possible solution the Fed should consider is buying funds directly from the bankers banks at the intended rate. This would be much more efficient and effective in forcing the market to pay a competitive rate.

We support the Feds efforts to enhance the tools for conducting monetary policy. However, we also believe that bankers banks can help strengthen this monetary tool further, and at the same time support community banks, by being allowed to pass through excess reserves and not being restricted in how much unsecured debt we can purchase under the FDIC.

Sincerely,
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