INDEPENDENT COMMUNITY
BANKERS of AMERICA

February 1, 2010

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: Regulation D, Docket No. R-1381

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the Federal Reserve Board (Board) proposal to establish term deposits and facilitate transactions associated with term deposits. The proposal amends Regulation D (Reserve Requirements of Depository Institutions) and posting rules set forth in the Board's Policy on Payment System Risk.

The Board is using authority granted in Section 19(b) (12) of the Federal Reserve Act (Act) to establish term deposits. This section of the Act authorizes the Board to prescribe regulations regarding the payment of earnings on balances maintained at Reserve Banks. The Board anticipates using term deposits as an additional monetary policy tool for managing the aggregate quantity of reserves by removing liquidity from the system. Under the proposal, financial institutions would

[1] *The Independent Community Bankers of America represents nearly 5,000 community financial institutions 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 financial institutions 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.

have the option of investing excess funds in term deposits at a rate not exceeding the general level of short-term interest rates.[2]

ICBA Position

ICBA appreciates the Federal Reserve's ongoing consideration of tools that would allow for the execution of successful monetary policy; however, it is important for the Federal Reserve to be mindful of the unintended consequences these tools may have on certain segments of the financial services industry and on economic recovery efforts.

Term deposits would provide financial institutions with an attractive alternative to private-sector investment offerings such as Federal funds, brokered deposits, interbank deposits and commercial paper, and to deploying excess funds into the economy in the form of loans to small businesses and consumers. The zero risk rating and an incentive interest rate coupled with a regulatory environment where intense scrutiny of community bank commercial loan portfolios, liquidity and risk management is at unprecedented levels make the use of term deposits quite compelling.

ICBA is concerned that this proposal has the potential to alter successful and long-standing correspondent banking relationships mutually benefiting community banks and their smaller correspondent banks, particularly the nation's bankers' banks. We urge the Board to permit correspondent banks to serve as agents for term deposits comparable to their agent roles for excess balance accounts (EBAs).

Currently, a term deposit offering could be viewed as contradictory to President Obama's strategy of fueling economic growth and job creation by increasing banks' lending to small businesses. The Board must carefully balance the use of term deposits.

The economic recession, historically-low interest rates and Administration and Congressional efforts to jumpstart the economy certainly make it more difficult to analyze the long-term impact of this proposal on various stakeholders in the marketplace. There will certainly be intended and unintended consequences for various segments. We urge the Federal Reserve to carefully consider comments from ICBA and others and not to proceed with quick implementation of this proposal until the implications are well understood.

ICBA's comments on the specific aspects of the proposal follow.

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[2] The primary credit rate and rates on obligations with maturities of up to one year in which eligible institutions may invest, such as rates on term Federal funds, term repurchase agreements, commercial paper, term Eurodollar deposits, and other similar rates.

Term Deposit Characteristics, Structure and Operations

According to the proposal, term deposits would:

- likely have maturities ranging between one and six months but not exceeding one year;
- be distinct from other financial institution balances held at Reserve Banks;
- not be available for withdrawal prior to maturity;
- not satisfy reserve and contractual clearing balance requirements;
- not be available to clear payments or cover overdrafts(daylight and overnight);
- have a zero risk-weight for risk-based capital purposes;
- be available to collateralize daylight overdrafts and discount window borrowings with no haircut; and
- not be available to collateralize other borrowings.

Investment Limitations

The Board seeks comment on whether it is necessary to place limitations on the amount a financial institution may hold or the portion of a single offering that an institution may win at auction. From a safety and soundness perspective, ICBA does not believe it is necessary to impose limitations on an institution's total term deposit holdings given the zero risk-weight.

However, an auction process that does not impose limitations on the portion a single institution may win at auction would create an environment ripe for larger institutions to monopolize the process to the detriment of smaller financial institutions. ICBA recommends the Board establish single offering limitations for the twenty largest financial institutions to ensure that financial institutions of all sizes have the opportunity to win bids.

Collateralization

ICBA encourages the Federal Reserve not to preclude term deposits from collateralizing interbank borrowings and Federal Home Loan Bank Advances. Such action would afford financial institutions the flexibility to meet unanticipated liquidity needs through mechanisms other than the discount window.

Structure and Operations

The proposal does not provide for a defined term deposit structure, instead, the Board would have the flexibility to offer one maturity or several maturities and to establish interest rates through an auction mechanism, administratively, or by a formula. It is unclear if and when the Board would vary term deposit structure and/or operations.

ICBA encourages the Board to adopt a process for ensuring changes to term deposit structure and/or operations are transparent and provide the opportunity for public comment prior to adoption. For example, if the Board desires to use methodologies other than a competitive auction for establishing interest rates, the Board should seek public comment to provide all stakeholders the opportunity to weigh in on the proposed methodology.

Term Deposit Auction

As described in the proposal, a routine auction process held shortly before the end of each two-week reserve maintenance period would offer a fixed quantity of term deposits with relatively short maturities. An advance announcement would specify maximum and minimum bid amounts and a maximum-allowable bid rate. Bid amounts and the maximum-allowable bid rate could vary for each auction. Settlement would occur on the first day of the subsequent maintenance period.

Financial institutions desiring to purchase term deposits would submit competitive bids reflecting the interest rate they are willing to earn and the quantity they wish to purchase at the bid rate. All bids would be final at the submission deadline and not subject to modification or withdrawal.

Starting with the lowest bid, the Federal Reserve would accept as many bids as necessary to achieve the announced quantity of term deposits. According to the proposal, "all winning bids would receive the highest accepted rate; bids at lower rates would be accepted in full while bids at the highest accepted rate would be prorated as necessary. Settlement would occur at least one day after winning bidders receive notification."

To settle the auction, the Federal Reserve would transfer balances from winning bidders' master account or their correspondent master account to a term deposit. The term deposit principal plus accrued interest would be transferred to the institution's master account or correspondent's master account upon the deposit's maturity.

A single Reserve Bank, designated by the Board, would serve as the "Term Deposit Offering Administrator" and would be responsible for auction administration such as posting applicable announcements and auction results.

Auction Settlement Notification

ICBA recommends that correspondent banks should be notified at least twenty-four hours in advance of the term deposit settlement amount that will be debited from their account to avoid the occurrence of daylight overdrafts.

Bid Amounts

The proposal is silent regarding the range of minimum and maximum term deposit bid amounts. ICBA urges the Federal Reserve to establish minimum bid amounts to afford the smallest financial institutions the opportunity to participate in the auction program if they so desire. Alternatively, if the Board determines that such minimum bid amounts are not feasible, the Board should permit correspondent banks to serve as term deposit agents on behalf of smaller respondents as discussed below.

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Role for Correspondent Banks

Under the proposal, the role of correspondent banks is limited to facilitating the transfer of funds for the settlement of purchased and matured deposits. The competition between the Federal Reserve and private-sector correspondent banks has substantially increased since Section 128 of the Emergency Economic Stabilization Act of 2008 accelerated the effective date of the Federal Reserve's authority to pay interest on required reserves commencing October 1, 2008. ICBA continues to applaud the Board's decision to mitigate the Reserve Banks' competitive advantage over private-sector correspondent banks by establishing a capability for correspondent banks to act as agent and aggregator of EBAs.

ICBA urges the Board to allow correspondent banks to serve as term deposit agents similar to their roles as EBA Agents. Term deposit agent responsibilities would include: 1) submitting bids on behalf of aggregated respondents; 2) determining the amount to invest in term deposits; 3) maintaining adequate records reflecting each participant's term deposits; 4) calculating the amount of interest earned by each respondent or term deposit participant; and 5) depositing and withdrawing term deposits.

Funds management services are the linchpin service for correspondent banking. Under the close scrutiny and oversight of respondent banks' management, correspondent banks execute daily investment decisions on respondents' behalf. This service is successful, as many respondents do not have the resources to actively manage their funds. The reliance of community banks on this service is evidenced by the increasing number using EBA Agents. Allowing correspondent banks to serve as term deposit agents would preserve established correspondent/respondent relationships, permit smaller institutions to reap the benefits of term deposits without assuming additional burden, and lessen Reserve Bank operational burdens associated with accommodating smaller financial institution participation.

Conclusion

Again, ICBA appreciates the opportunity to comment on this proposal. We believe that financial institutions of all sizes would likely find term deposits a compelling investment alternative. To facilitate broad financial institution participation, ICBA recommends the Board establish: 1) single offering limitations for the twenty largest financial institutions to eliminate the possibility of these institutions monopolizing auctions; and 2) minimum bid amount ranges to afford the smallest financial institutions the opportunity to participate in the auction program. Alternatively, if the Board determines that such minimum bid amounts are not feasible, the Board should permit correspondent banks to serve as term deposit agents on behalf of smaller respondents.

We urge the Board to allow correspondent banks to serve as term deposit agents similar to their roles as EBA Agents to preserve established correspondent/relationships, permit smaller institutions to reap the benefits of term deposits without assuming additional burden, and lessen Reserve Bank operational burdens associated with accommodating smaller financial institution participation. ICBA encourages the Federal Reserve to notify correspondent banks at least twenty-four hours in advance of respondent banks' term deposit settlement amounts that will be debited from their account to avoid the occurrence of daylight overdrafts.

We also recommend that the Board not preclude term deposits from collateralizing interbank borrowings and Federal Home Loan Bank Advances.

ICBA urges the Federal Reserve to adopt a process for ensuring changes to the program are transparent and provide the opportunity for public comment prior to adoption. Finally, we strongly urge the Federal Reserve to thoroughly vet comments from ICBA and others to fully understand the intended and unintended consequences for various marketplace stakeholders.

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

Sincerely,
/s/
Viveca Y. Ware
Senior Vice President
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