June 17, 2011

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Dear Chairman Bernanke:

On behalf of the nearly 5,000 members of the Independent Community Bankers of America (ICBA) as well as the undersigned state community banking associations, we respectfully ask that the Federal Reserve postpone indefinitely the proposed rescission of Regulation Q that prohibits the payment of interest on demand deposits and work with the banking agencies to fully study the safety and soundness consequences of allowing the regulation to expire.

We acknowledge that the U.S. House of Representatives has favorably voted on the repeal of Regulation Q many times in recent years prior to the passage of the Dodd-Frank Act; however the country's economic circumstances were vastly different than conditions today.

As you are aware, the Federal Reserve Board issued Regulation Q in 1933 as part of implementing the Glass-Steagall Act. The bill to repeal Regulation Q, the Business Checking Fairness Act, was introduced in 2009 and was eventually inserted as an amendment to the Dodd-Frank Act. Neither the House nor the Senate debated at length the provision that eventually became Section 627 of the Dodd-Frank Act and there never was a serious attempt to assess its impact on the banking industry. Section 627 repeals Section 19(i) of the Federal Reserve Act, effective one year from the date of enactment. Accordingly, the Federal Reserve Board will no longer have statutory authority to promulgate Regulation Q effective July 21, 2011.

We believe that the repeal of Regulation Q will have serious implications for the balance sheets and income statements of many community banks. Most importantly, it will significantly increase community bank funding costs, and ultimately increase the cost of borrowing to small business customers and further slow economic recovery and job creation. Competition from large banks will also force community banks to pay interest on business accounts, which will disqualify those accounts from temporary unlimited FDIC coverage for non-interest bearing transaction accounts. This will undermine a program intended to offset the funding advantage of the too-big-to-fail banks, which has been heightened due to the financial crisis.

Besides having a detrimental effect on the balance sheets of community banks, ICBA and the undersigned state community banking associations are also concerned that the repeal of Regulation Q will result in increased deposit volatility. Businesses will be under great pressure to seek the highest return on their deposits resulting in bidding wars for business deposits among banks. They will be less willing to leave money in a no or low interest demand deposit account just for the benefit of receiving a discounted or free banking service. Business deposits may become so volatile that they may expose banks to potential liquidity problems.

The repeal of Regulation Q will also have broader economic consequences. Large corporations that are now flush with cash will significantly increase their bank deposits as evidenced by the experiences of other countries. Funds will shift from money market mutual funds to banks. The undersigned anticipate that the major beneficiaries of this increase in commercial deposits from large corporations and the transfer of money from mutual funds will be the megabanks and that this will further increase the concentration of bank assets and exacerbate the problem of too-big-to-fail.

Furthermore, banks will be forced to offset their higher funding costs with higher service fees and loan rates. Currently, many commercial products and services are partially subsidized by the spread income the bank earns on the deposits that the service generates. To offset the lower spreads, banks will increase the costs of the products and services or eliminate them altogether. Business customers that currently enjoy free checking, lockbox, and other services will be charged for such services. Consumers also will see new charges for bank services as banks seek to cover their increased funding costs.

To that end, ICBA and the undersigned state community banking associations urge the Federal Reserve to indefinitely postpone the rescission of Regulation Q until the agencies can further study the implications for community banks' balance sheets and income statements of repealing Regulation Q. Otherwise, we fear that the sudden repeal of Regulation Q on July 21st will significantly impair the ability of community banks to attract commercial deposits and make loans to their communities. We are also concerned that excessive interest rate competition could be harmful to overall banking stability and the safety and soundness of banks.

Sincerely,

The Independent Community Bankers of America
Community Bankers Association of Alabama
Arkansas Community Bankers
California Independent Bankers
Independent Bankers of Colorado
Florida Bankers Association
Community Bankers Association of Georgia
Community Bankers of Iowa
Community Bankers Association of Illinois
Indiana Bankers Association
Community Bankers Association of Kansas
Community Bankers of Michigan
Independent Community Bankers of Minnesota
Missouri Independent Bankers Association
Montana Independent Bankers
Nebraska Independent Community Bankers
Community Bankers Association of New Hampshire
New Jersey Community Bankers Association
Independent Community Bankers Association of New Mexico
Independent Bankers Association of New York State
Independent Community Banks of North Dakota
Community Bankers Association of Ohio

Community Bankers Association of Oklahoma
Pennsylvania Association of Community Bankers
Independent Community Bankers of South Dakota
Independent Bankers Association of Texas
Virginia Association of Community Banks
Community Bankers of Washington
Community Bankers of West Virginia
Community Bankers of Wisconsin