Treasury Strategies.
The Power of Experience®

June 1, 2011

Hon. Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
Washington D.C. 20551

Dear Chairman Bernanke:

I am writing to you concerning a matter of systemic concern to the U.S. banking and financial system. On July 21, 2011, the long-standing federal policy that has prohibited banks from paying interest on business checking accounts — Regulation Q — will be repealed, as mandated by a misguided provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The abrupt repeal of Regulation Q will potentially destabilize the banking system, create disintermediation disruptive to the short-term money markets, and increase the cost of credit for businesses and consumers alike.

The Federal Reserve Board recently requested comment on the potential systemic effects of Regulation Q repeal. Appropriately 55 comment letters were filed in response. All but a handful of these letters opposed repeal of Regulation Q. Very few letters favored repeal without further study of the potential competitive and systemic impact. I am enclosing a summary highlighting some of the comment letters.

The Federal Reserve Board also requested comment on what actions it should take to minimize the systemic impact of Regulation Q repeal. A number of commenters urged the Board to encourage Congress to revoke the provision of the Dodd-Frank Act requiring repeal of Regulation Q. Other commenters suggested that the Board delay implementation of the repeal until the systemic effects can be studied. Other commenters suggested that the federal banking regulators take various supervisory actions, including the issuance of a joint policy statement, to minimize the impact on banking safety and soundness.

The most effective course of action would be for Congress to revoke Regulation Q repeal and then hold hearings on the systemic impact — something it should have done before enacting the repeal provision.

Absent legislative action, this matter is an appropriate one for the Financial Stability Oversight Council. The Council was created by Congress in the Dodd-Frank Act for the very purpose of assessing systemic risks such as this and making recommendations for action by the financial regulators. This could be the first significant systemic threat facing the financial system since the crisis of 2008-09 and a test of the Council's effectiveness in addressing systemic risks. It would be a major failing of the Council if it does not assume responsibility for addressing this threat to avert harm to U.S. banking and financial system and the economy as a whole.

Treasury Strategies, Inc.
309 W. Washington Street
13th Floor
Chicago, Illinois 60606
t 312.443.0840
f 312.443.0847

61 Broadway
Suite 905
New York, New York 10006
t 212.292.0856
f 212.292.0863

1 Northumberland Avenue
Trafalgar Square
London
WC2 N5BW
Great Britain
t +44 207 872 5551
f +44 207 872 5611

www.TreasuryStrategies.com

I am enclosing a comment letter filed by Treasury Strategies with the Federal Reserve Board addressing some of the systemic threats that we see arising from repeal of Regulation Q.

We urge your immediate attention to this matter as the scheduled date for repeal — July 21, 2011 — is fast approaching and there is no indication that banks and the financial system as a whole are prepared for the impact it likely will have.

Sincerely,

Anthony Carfang

Anthony Carfang

Copies to:

Larry Ingrassia
Business Editor
The New York Times
620 Eighth Avenue
New York, NY 10018

Gretchen Morgenson
Assistant Business and Financial Editor
The New York Times
620 Eighth Avenue
New York, NY 10018

Robert James Thomson
Managing Editor
The Wall Street Journal
200 Liberty Street
New York, NY 10281

Treasury Strategies.

The Power of Experience®

ATTACHMENT 1

May 6, 2011

By Electronic Mail

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

Re: Request For Comment: Prohibition Against Payment of Interest on Demand Deposits

(RIN No: 7100-AD72)

In response to your request for comment regarding the Repeal of Regulation Q, Treasury Strategies, Inc. (TSI) has prepared the following opinion. Treasury Strategies is the leading Treasury consulting firm working with corporations and financial institutions in the area of treasury, liquidity, and payments. Since the enactment of Dodd-Frank, Treasury Strategies has conducted regulatory response planning efforts with numerous financial institutions, which in aggregate, comprise over 40% of total U.S. banking deposits.

Enacted in 1933 as part of the Glass-Steagall Act, Regulation Q prohibits the payment of interest on corporate checking accounts and has been part of the commercial banking regulatory landscape for over 75 years. The bill to repeal Regulation Q was introduced by Rep. Scott Murphy in November 2009 under the title *The Business Checking Fairness Act*, but was eventually inserted as an amendment to the Dodd-Frank bill. In a statement issued by Rep. Murphy, he stated that he introduced the Business Checking Fairness Act to, "level the playing field for small businesses, giving them access to more capital and increasing their job creating potential."

Unlike prior attempts to repeal Regulation Q, the amendment that added Murphy's proposal to Dodd-Frank received relatively little debate. Neither the House nor the Senate contemplated the validity of Murphy's claims and there was no attempt to fully assess the economic impacts of fundamentally altering the commercial banking industry. According to the bill's sponsors, the intended benefits of repealing Regulation Q repeal are:

1. Increased small business growth due to the interest earnings on their cash assets.
2. Enhanced effectiveness for small depository institutions in competing for commercial balances.

The repeal of Regulation Q fails to meet its stated benefits of helping small businesses and community banks.

Treasury Strategies, Inc.

309 W. Washington Street
13th Floor
Chicago, Illinois 60606

t 312.443.0840
f 312.443.0847

61 Broadway
Suite 905
New York, New York 10006

t 212.292.0856
f 212.292.0863

1 Northumberland Avenue
Trafalgar Square
London
WC2 N5BW
Great Britain

t +44 207 872 5551
f +44 207 872 5611

www.TreasuryStrategies.com

Potential Negative Impact to Small Businesses

Treasury Strategies' research indicates that the typical small business holds less than $10,000 in its checking account. If a bank pays a 2% interest rate on these balances, a generous rate in today's environment, a typical small business would earn less than $200 per year in interest. Obviously, $200 in interest every year is hardly enough income for a small business to grow or add new jobs as suggested by Rep. Murphy.

Furthermore, banks are likely to increase the banking fees that they charge to business customers in order to make up for the added costs of paying interest on business checking accounts. If we assume a relatively low monthly service fee of $25, or $300 annually, the net result to the small business earning interest on its checking account would be a cost of $100 per year. Therefore it becomes clear that the repeal of Regulation Q will do nothing to improve the growth of small businesses.

Reduced Ability for Community Banks to Compete

Community banks often rely upon attractive interest rates in order to attract customers away from larger banks, which may offer a broader array of services. So, the thinking behind the repeal of Regulation Q was that by enabling community banks to pay interest on business checking accounts, they would be more effective in competing with larger financial institutions.

However, in reality, quite the opposite is true. Under the repeal of Regulation Q, community banks are handicapped in competing with larger financial institutions. By virtue of balance sheet size and geographic reach, community banks have less of an opportunity to deploy new funds than larger more geographically diverse competitors. As a result of these factors, the competitive position of small depository institutions declines.

Repeal of Regulation Q Harms All Businesses and Banks

Treasury Strategies' extensive research and analysis indicates that this legislation will also have detrimental impacts to businesses and financial institutions of all sizes. Some of the hidden macroeconomic dangers of the proposal include:

- Increased deposit volatility
- Increased concentration of financial assets in the banking sector
- Higher operating costs for both banks and businesses
- Contradictions with current and proposed banking regulations

The repeal Regulation Q will cause significant damage to businesses and banks of all sizes and the overall stability of the financial system as a whole.

Increased Deposit Volatility

The repeal of Regulation Q creates incentives for corporations to seek the most attractive interest rate, creating greater deposit volatility for financial institutions. In the current environment, businesses cannot receive interest on deposits, but they do receive notional earnings credits, which can be used to pay for bank services. This feature provides businesses with the benefit of being able to pay for bank services with deposit balances and provides the bank a more stable deposit portfolio. Businesses have an incentive to leave deposits with their service providers rather than actively seek rates, creating a more stable deposit portfolio for banks.

Interest-bearing balances are inherently more volatile than non-interest-bearing balances because the benefits (interest earnings) are unassociated with any stabilizing factors such as using balances to pay for services. The lack of stabilizing factors increases the level of "hot money" in the banking sector in instances where the competitive bidding up of interest rates results in offers above the equilibrium level. The artificial inflation of interest rates increases the risk that a bank will experience an exodus of deposits if it lowers its interest rates amidst one of these bidding wars. Prior to the enactment of Glass-Steagal, this was less of a risk due to the fact that moving deposits between banks was a very manual process. However, in today's electronic environment, this risk is enormous given that a business can quickly transfer funds between institutions with the click of a button.

Increased deposit volatility will also further exacerbate financial system risk by increasing the likelihood that a bank will suffer a liquidity crisis or fail to meet stable funding requirements. The increased risk is counterproductive to current regulatory agendas proposed and enacted by the Basel committee and the FDIC and does not meet the stated objective of the bill's sponsors of improving the competitive position of small banks. In fact, the bill makes it more likely that small banks will face increased liquidity risk and higher funding costs at a time when they are already suffering.

Treasury Strategies' research indicates that up to 60% of commercial clients consider an interest-bearing account to be an optimal solution, all else being equal. This indicates that the risk of increased deposit volatility is very real. Businesses view interest-bearing accounts as viable alternatives to their current deposit operating accounts.

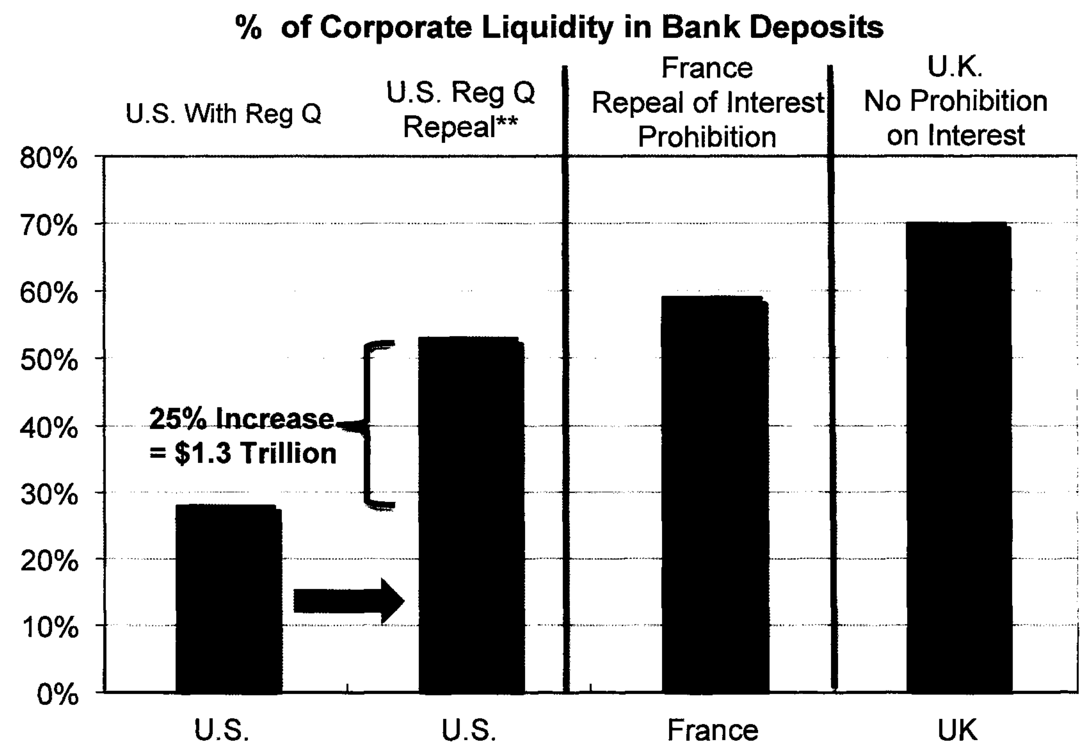
Increased Concentration of Financial Assets within the Banking Sector

Bank balance sheets are currently flush with deposits as evidenced by the $1.5 trillion in excess reserves currently held by banks with the Federal Reserve. Additionally, Treasury Strategies' Corporate Liquidity research indicates that corporate treasurers currently hold an all-time high of 28% of their liquid assets in bank deposits. If the repeal of Regulation Q proceeds as planned, corporations could increase their bank deposits by a significant amount, as evidenced by the experiences of other countries with similar laws.

For example, France recently repealed a similar prohibition on interest payments for corporate checking accounts in 2004 and corporations reacted by increasing their percentage of bank deposits from approximately 40% to 60% of their liquid assets in the following years. Banks have the advantage of being able to arbitrarily set interest rates, which allows them to effectively attract assets away from MMFs as investors seek to maximize yield. Assuming a similar increase in bank deposits for corporations in the U.S. would amount to approximately $1.3 trillion (**See Figure 1**) in new balances flowing onto bank balances sheets.

This significant increase in corporate bank deposits would increase the concentration of financial assets within the banking system. This further exacerbates the problem of too big to fail.

Figure 1



**Treasury Strategies estimate

Higher Operating Costs for Banks and Businesses

Banks typically use deposits to fund their lending activities. The introduction of interest-bearing deposits raises the cost of funding by changing some portion of non-interest-bearing deposits to interest-bearing deposits. This will lead to the following consequences:

Less Efficient Money Markets: As stated in the prior section, the concentration of financial assets in the banking sector will increase, resulting in non-bank money markets becoming substantially less liquid and less robust. Many corporations use a mix of money market instruments to meet their short-term funding needs such as meeting payroll, purchasing raw materials, etc. The primary purchasers of these securities are money market mutual funds (MMFs), which have a yield based on the return of their underlying assets. With less liquidity in the money markets, corporations will either have to pay higher yields on the securities that they issue or turn to banks to satisfy their short-term funding needs. It is highly unlikely that banks would be willing to satisfy even a portion of the $1.3 trillion of short-term liquidity at current spread levels. We would thus expect the spread levels on credit offerings to widen.

Higher Costs of Credit: Banks can adjust the cost of providing credit to commercial customers by charging higher rates on loans. The increases in credit costs to commercial customers will be significant if large portions of deposits are converted to interest-bearing accounts.

In order to attract investors and to offset the costs associated with interest-bearing deposits, some institutions might also resort to loosening their lending requirements. The high-cost funds and high-risk assets could create another perfect storm similar to the real-estate bubble of the mid 2000's.

More Expensive Products and Services: Banks are also likely to increase the cost of their products and services in order to offset the higher cost from paying interest on deposits. Currently many products and services are partially subsidized by the spread income the bank earns on the deposits that the services generate. To offset the lower spreads, banks will likely increase the costs of the products and services.

Contradictions with Other Active and Proposed Regulations

The repeal of Regulation Q is counterproductive to the Basel III proposals around liquidity coverage and stable funding, Basel III capital requirements. It also is at odds the new FDIC assessment methodology regulations deigned to improve the liquidity, funding sources, and capital holdings of the banking industry.

Liquidity: Under the Basel III International Framework for Liquidity Risk Measurement, Standards, and Monitoring proposal and the new FDIC assessment methodology, banks are penalized for holding volatile deposits. As demonstrated above, repeal of Reg Q results in higher deposit volatility. Therefore, these regulations will force banks to maintain significant levels of cash or high-quality liquid investments in reserves, which decreases their ability to provide loans to business of all sizes.

Stable Funding: The Basel Committee recently proposed the creation of a Stable Funding Ratio[2] that would require banks to evaluate the liquidity profiles of their assets and liabilities to better align assets to deposit duration. Interest-bearing deposits receive a short-term duration and are not considered stable funds. These deposits could not be used to fund long-term assets and similar to the liquidity rules, would decrease the availability of credit to businesses of all sizes.

Capital: As mentioned in prior sections, the potential flow of deposits into interest-bearing checking accounts could severely strain bank capital levels, forcing banks to maintain ever-increasing levels of capital, resulting is lower returns on that capital.

The combined impact of these regulations along with the disintermediation of secondary markets will further exacerbate the need for banks to increase lending costs. The costs of bank products and services will also increase, which ultimately harms the very customers that the repeal of Regulation Q was purported to help.

[2] **Source**: Basel III International Framework for Liquidity Risk Measurement, Standards, and Monitoring, December 2010

Conclusion

The repeal of Regulation Q fails to deliver its promised benefits of increased small business growth and improved competitive positioning for Small Depository Institutions.

Instead of promoting economic growth and providing stability for banks and businesses alike, the repeal of Regulation Q adds further risks and costs to the financial system by:

- Increasing deposit volatility
- Increasing concentration of financial assets in the banking sector
- Creating higher costs of doing business for both banks and businesses
- Contradicting current and proposed banking regulations

There is no such thing as a "free lunch" and the repeal of Regulation Q attempts to adjust the equilibrium of the commercial banking market without regard to the consequences for banks or businesses. **Treasury Strategies urges the Federal Reserve to work with Congress to remove the repeal of Regulation Q from the Dodd-Frank Act, not just for small depository institutions, but for banks of all sizes. Failure to do so could result in damage to the effective operation of the U.S. commercial banking sector and overall economy.**

Sincerely,

Anthony J. Carfang, Partner

Cathryn R. Gregg, Partner

Jacob Nygren, Manager

Jonathan Talbert, Consultant

Treasury Strategies, Inc.
309 W Washington Street, 13th Floor
Chicago, Illinois 60606

APPENDIX I — Background of Authors

Treasury Strategies, Inc. is the leading Treasury consulting firm working with corporations and financial institutions. Our experience and thought leadership in treasury management, working capital management, liquidity and payments, combined with our comprehensive view of the market, provides us a unique perspective and unparalleled insights into both the corporate and financial sectors. The fact that our clients include corporate investors, financial institutions, regulators, and fund companies is further evidence of our involvement within the money market fund industry. Anthony J. Carfang and Cathryn R. Gregg are Partners of Treasury Strategies. Jacob Nygren is a Manager at Treasury Strategies. Jonathan Talbert is a Consultant at Treasury Strategies.

ATTACHMENT 2

Highlights of Comment Letters Filed in Opposition to Regulation Q Repeal

"We strongly urge the Federal Reserve to indefinitely postpone the rescission of Regulation Q until the Federal Reserve can study the impact on community banks, their customers and communities, and to evaluate alternative solutions."

— *Illinois Bankers Association*

"If this 77 year-old prohibition expires, it will actually stifle credit availability to small businesses and increase the cost of credit."

— *Illinois Bankers Association*

"Regulation Q would have a devastating competitive effect on community banks. The prohibition was put into place for a reason...to provide a stable source of reliable funding for our nation's banks. Large too big to fail banks, who have largely funded themselves with off balance sheet sources to avoid FDIC insurance premiums, are likely to look at this as an opportunity to "buy" domestic deposits, robbing local communities of needed capital to fund important rural projects."

— *A community bank in Texas*

"On its surface, it might appear that the repeal of this 77 year old prohibition, scheduled for July 2011, is a positive for small businesses when, in fact, this repeal will stifle credit availability to small business and increase the cost of credit."

— *Independent Bankers Association of Texas*

"Regulation Q would have a devastating competitive effect on community banks."

— *Independent Bankers Association of Texas*

"The prohibition was put into place for a reason — to provide a stable source of reliable funding for our nation's banks. Too big to fail banks, which have largely funded themselves with off balance sheet sources to avoid FDIC insurance premiums, are likely to look at this as an opportunity to "buy" domestic deposits, robbing local communities of needed capital to fund important rural, suburban and urban projects."

— *Independent Bankers Association of Texas*

"The repeal of Regulation Q places additional competitive and profitability burdens on all banks. ...This new expense comes at what is potentially the worst time possible. The entire industry has been suffering since the downturn began in 2008, and is only now returning to profitability. The addition of this new expense will increase funding costs for all banking institutions, which may lead to an increase in lending rates and decreased loan demand, precisely at a point in time that loan demand had been expected to improve."

— *A large banking organization (Suntrust)*

"Among the primary drivers of the repeal of Regulation Q has been the desire to help spur small business growth by providing small businesses with an additional revenue stream. When one considers that the average small business maintains deposit balances of less than $10,000, poised to earn $200 annually in a 2.00% rate environment, it becomes clear that the repeal of Regulation Q is more of a detriment to the banking industry than it is a benefit to small businesses.

— *A large banking organization (Suntrust)*

"The repeal of Regulation Q adds complexities to the existing marketplace that need further consideration. The impact of these changes may lead to major shifts in deposits and sources of funding affecting liquidity measurements."

— *A large banking organization (Suntrust)*

"Since there is little or no demand for new loans — from applicants with the ability to repay — our loan-to-deposit ratio has declined to approximately 60%. Yes, the repeal of Regulation Q will increase 1st Bank's cost of funds, and without loan demand, that additional cost will decrease net income. Since big banks have branches in many locations and economies, big banks will not be tied to local community loan demands. Big banks will be able to bid up the rates paid and move these deposits, especially with remote deposit capabilities. Consequently, community banks may be "out-priced" or forced to match the big-bank rates, which will reduce income. The repeal of Regulation Q has the potential to be just another nail in the coffin of community banks."

— *1st Bank, Sidney, Montana*

"The demise of Regulation Q will greatly diminish the value and stability of core deposits. If the market necessitates interest on commercial checking, Junction National will be at a competitive disadvantage and additional interest rate risk will be prevalent on the balance sheet. Large retail institutions have the ability to price aggressively to attract additional deposits to be used for loan demand in lieu of borrowing funds. Loan demand in our community is relatively low and impedes the ability to offer higher rates on deposits, especially given the current interest rate environment. In an effort to maintain adequate earnings, evaluation of the bank's current fee structure for existing products and services will be warranted. A repercussion of the repeal of Regulation Q is unfortunately increased costs to the consumer."

— *Junction National Bank, Texas*

"Today's competitive model for demand deposits is a level playing field based on service and relationships, two things community banks excel at compared to "Too Big To Fail" (TBTF) banks. Once interest is paid on these deposits, the deposits are at risk of moving to the competitor with the biggest funding need, including TBTFs, which will be eager to offset community banks' service advantages through aggressive pricing, supported by costly ad campaigns smaller banks cannot match. More critically, the elimination of Regulation Q will likely move most community banks to a liability-sensitive position, exposing their net interest margins to losses from higher interest rates just as rates are poised to rise significantly from their historical lows. It does this by eliminating community banks' largest single source of long-term fixed-rate funding. The S&L crisis of the 1980s, one of the most expensive bailouts in our nation's history, was precipitated by a pervasive interest rate mismatch where individual institutions took on long-term, fixed rate exposure in the form of fixed-rate mortgage lending and funded it with interest-sensitive deposits during a protracted period of rising interest rates. The impact of funding changes means that community banks will have to have fewer fixed-rate loans, mortgages and municipal securities on their balance sheets. Unlike community banks, the TBTFs have multiple sources of long-term funding available, which will give them an advantage in lending and investing for longer maturities. Notwithstanding their flexibility in funding, recent changes to the Federal Deposit Insurance Corp. assessment base could lead TBTFs to be more aggressive in accumulating demand-deposit funding even with an interest rate component. With banks facing so many regulatory changes, it's understandable they have not focused on Regulation Q, particularly since historically low rates will understate the initial impact of this change in 2011. However, given that rates traditionally rise 400 basis points coming out of a recession, it's easy to see how the Regulation Q repeal could quickly have a multimillion-dollar impact on the typical community bank. Consider a community bank with $600 million in assets, 25% of which are in non-interest-bearing deposits, or $150 million. If $100 million of this is business deposits and subject to interest under the repeal of Regulation Q, and interest paid is 1%, the interest expense hit will be $1 million; at 2%, it's 2 million, and so on. As interest rates rise, that impact could be dramatic on a community bank. A well-run bank with a 1% ROA could see its profitability and market value decline by 10% for every 1% it pays in demand-deposit interest. To the extent the change blurs the line in the mind of depositors between time deposits such as money market deposit accounts and interest bearing demand deposits, the amount of funds in the banking system for lending or investing will be directly reduced. This is because every dollar that moves from an interest bearing time account into an interest bearing demand interest bearing demand deposit account will result in an immediate loss often cents in investible/loanable funds because ten percent of demand deposits are required to be kept in reserves at the Federal Reserve Bank while no reserves are required on time accounts. With regard to the issue that this is a quid pro quo for banks receiving interest on their reserves at the Fed, keep in mind that the interest paid on reserves is only about a tenth of the interest lost from the elimination of Regulation Q. As far as businesses receiving a benefit from the payment of interest on demand deposits, it will be offset by cash fees to pay for services which the demand deposit balances would have previously afforded them, and from higher loan rates from borrowing customers."

— *Cullen/Frost Bankers, Inc., Texas*

"In reality, this repeal will stifle credit availability to small business and increase the cost of credit. Such interest bearing accounts would be subject to a 10% reserve requirement by all institutions, freezing important capital that might otherwise be available for lending. Additionally, as rates begin to rise over time, financial institutions will find it necessary to pass along their increased costs in the overall cost of the credit to small business and commercial customers. Perhaps most importantly, we believe that a repeal of Regulation Q would have a devastating competitive effect on community banks. The prohibition was put into place for a reason — to provide a stable source of reliable funding for our nation's banks. Large too big to fail banks, who have largely funded themselves with off balance sheet sources to avoid FDIC insurance premiums, are likely to look at this as an opportunity to "buy" domestic deposits, robbing local communities of needed capital to fund important rural projects. I think you will agree that Congress should delay efforts to implement this long standing prohibition until such time as the Federal Reserve can study its real impact on the safety and soundness of our financial institutions and its impact on local economies."

— *A community bank*

"I strongly oppose the repeal of Regulation Q, which will have dire effects on community banking. This repeal alone is guaranteed to increase the cost of funds; couple that with the inevitable rise in rates and a bank's viability becomes a huge concern. Additionally, interest rate risk will be increased as banks largest source of stable, fixed rate deposits shift to variable rates. This shift has the potential to place many banks in a liability sensitive position at a time when rates have nowhere to go but up. The increase in costs of funds and increase in interest rate risk will negatively impact the small businesses and commercial customers that utilize community banks because banks will have to increase service fees and will provide less fixed rate financing options in an effort to minimize interest rate volatility. The elimination of Regulation Q will be a detriment to the nation's community banks."

— *Aimbank, Texas*

"Our demand deposit base is probably the most important aspect of our success so we have worked very hard to build it and our strategy and business plan project a continuation of that effort. Paying interest on demand deposits will increase the level of our expenses and negatively impact our profit margins. Finally, interest on checking will add interest rate risk to our balance sheet as more interest sensitive instruments will likely need to be used to offset the loss of demand deposits because we won't be able to compete with the big banks in this new arena. We small community banks are intimately familiar with the safety and soundness ramifications of all of the above. Surely you can appreciate the potential shock to the system that may be caused by this change. I urge you to repeal Section 627 of the Dodd-Frank Act."

— *Pacific Enterprise Bank, CA*

"To pay interest on commercial demand accounts would drive up the cost of business and place greater stress on the net interest margin. Personally, I can't see how or why this could benefit community banks. In addition, this would increase the interest rate risks to the Bank's balance sheet as we add more interest sensitive products to our current offerings. Please give consideration to repealing Section 627 of the Dodd-Frank Act."

— *Southern Bank & Trust, Georgia*

"I see this happening after Reg. Q becomes a reality. The small community bank's core deposits will become a target for the big banks, offering sophisticated marketing programs that will promise big returns, but after bringing in millions in deposits, I'm sure the banks will lower the rates in a pre-meditated manner. Our small bank still operates on the concept of the spread between our loan yields and cost of funds. Big banks already consider loans as "loss leaders", instead relying on ancillary services, like securitization, for their profitability. This disparity in the business models will only widen, in my opinion, after the implementation of Reg. Q. I truly believe Reg. O will give the big banks one more advantage over the community banks, whose survivability is already in question."

— *SCV Bank, California*

"Bank profits are weak enough; adding more interest expense will cause weaker profits, will cause more financial stress for banks, which could cause more Government bail-outs of the big banks that are still in financial trouble... Bankers are greedy — Banks will just try to cover the increased expense by increasing revenues in some other area."

— *Belle Glade Bank, Florida*

"The repeal of this long standing rule will create a highly uneven competitive playing field and is likely to yield severe unintended consequences. Personally, I believe in some small rural areas it may even lead to potential bank failures. ...Allowing banks to pay commercial businesses interest on demand deposits will create and foster an environment that will make it increasingly difficult for community banks across the country to serve the needs of small business."

— *A community bank in Michigan*

"Relationship banking is measured by the bank's level of non-interest bearing deposits compared to its total deposits. The payment of interest on business deposits is not only going to erode that measure, it is also going to cause increased liability sensitivity for all banks and increased fees for the bank's customers. Is that what you want?"

— *Bank of the Northwest, Washington*

"The repeal of Reg Q has very significant implications for the balance sheets and income of depository institutions. It is a game changer and should not be implemented without multiple years of study. The anticipated effect on bank profits is to drive them down substantially, leading to further bank failures nationwide. The anticipated effect on rates offered is that super-large institutions like Chase, Bank of America, Wells, etc. will offer enticing rates to large customers (business and consumer) and take away the customers from community banks. In order to compete, community banks would have no choice but to offer unsustainable interest rates and APYs on ordinary deposit accounts, particularly those with large balances, e.g. over $100,000. This will contribute to the undesirable growth of too-big-to-fail institutions. The repeal of Reg Q will result in a strong demand for interest bearing demand deposits; it will change the face of banking and contribute to bank failures. Banks that pay interest will suffer the income and profit consequences of doing so, and banks that fail to pay interest will lose their customers and fail. The repeal of Reg Q will have an unbearable effect on the competitive burden on smaller depository institutions such as community banks."

— *Anonymous Community Bank*

"I strongly oppose the above due to its additional cost and sensitivity on the balance sheet of our community bank. As it is currently, the bank cannot even cover its cost of FDIC insurance as it sells excess liquidity in the form of

Fed Funds and the inclusion of interest on demand accounts will only exacerbate an already negative situation."

— *First Community Bank*

"The elimination of Regulation Q, at this time, is a serious risk to the safety and soundness of substantial majority of America's "Main Street" institutions."

— *Cornerstone Bank, GA*

"ICBA Urges the Federal Reserve and the FDIC to Postpone the Rescission of Regulation Q Due to Safety and Soundness Concerns... excessive interest rate competition could be harmful to overall banking stability and the safety and soundness of banks.... The repeal of Regulation Q will have serious implications for the balance sheets and income statements of many community banks and the stability of the banking system. Business deposits will become so volatile that they may expose banks to potential liquidity problems. ...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. ...ICBA supports an indefinite postponement of the proposed rescission of Regulation Q and those FDIC regulations that prohibit the payment of interest on demand deposits until the agencies are able to study the safety and soundness consequences of allowing these regulations to expire. ...Besides having a detrimental effect on the balance sheets of community banks, ICBA is also concerned that the repeal of Regulation Q will result in increased deposit volatility."

— *Independent Community Bankers of America*

"During the month of April, 2011, ICBA conducted a survey of it members to determine the potential impact of the repeal of Regulation Q. Approximately 460 community bankers responded to the survey representing banks from almost every state. In response to a question about the impact of the repeal of Regulation Q, almost 64% of respondents said that it would have significant implications for their bank's income. Asked specifically about how the bank's income would be impacted, more than 55% said it would have up to a 10% adverse impact and more than 20% said it would have a greater than 10% adverse impact on earnings. Almost 80% of the community bankers who responded also said that the repeal of Regulation Q would make deposit liabilities more interest rate sensitive and therefore more volatile. An overwhelming majority of bankers concluded that community banks will have higher interest rate expense and would find it more difficult to attract deposits as a result of the repeal of Regulation Q."

— *Independent Community Bankers of America*

"These changes could dramatically alter the competitive landscape between banks and money market funds and potentially create large outflows from money market funds and into banks either immediately or during a future financial crisis, putting severe pressure on the money markets."

— *Investment Company Institute*

"These changes could dramatically alter the competitive landscape between banks and money market funds and potentially create large outflows from money market funds and into banks either immediately or during a future financial crisis, putting severe pressure on the money markets. Furthermore, the combination of these two changes will significantly increase moral hazard for the banking system, and potentially increase the costs of operating the deposit insurance program for the FDIC and ultimately the U.S. taxpayer. Indeed, the adoption of these two provisions likely will create systemic risks that did not previously exist.

— *Investment Company Institute*

"The increase in total bank deposits resulting from the payment of interest on business checking accounts will come largely from money market funds. These funds are highly liquid cash-management vehicles that invest in high-quality, short-term instruments and pay a market rate of return. Money market funds historically have served as an alternative to noninterest-bearing bank deposits and will remain an attractive cash-equivalent for amounts in excess of the FDIC insurance limit of $250,000. The outflow of funds from money market funds, however, will harm the commercial paper market, as occurred dramatically during the 2008-09 financial crisis. Mutual funds are the largest purchasers of commercial paper, holding nearly 40 percent of the commercial paper that businesses issue to finance payrolls, inventories, and other short-term operating needs. The liquidity of the commercial paper market is tied to the flow of funds in money market funds. Banks cannot substitute for money market funds as purchasers of commercial paper. They cannot purchase equivalent amounts because they are subject to a capital charge against such purchases — commercial paper is weighted at 100 percent under the risk-based capital system that applies to banks. Money market funds are not subject to capital requirements because, among other things, they are not leveraged like banks, are not federally insured like banks and, unlike banks, don't have access to the Federal Reserve discount window. Money market funds also are large purchasers of municipal securities, holding nearly two-thirds of the short-term debt that finances state and local governments and such public projects as roads, bridges, and hospitals. Municipal entities will find fewer purchasers for their debt as a result of Regulation Q repeal and the resulting outflow of funds from money market funds to banks. Bank capital requirements similarly impede bank purchases of municipal securities."

— *Federated Investors, Inc. (a money market fund sponsor)*