SUNTRUST

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

Dear Ms. Johnson

On behalf of SunTrust Bank, I would like to take this opportunity to provide comments to the following four questions raised in the notice of proposed rulemaking issued by the Board of Governors of the Federal Reserve System to repeal Regulation Q, Prohibition Against Payment of Interest on Demand Deposits, published April 14, 2011.

1. Does the repeal of Regulation Q have significant implications for the balance sheets and income of depository institutions? What are the anticipated effects on bank profits, on the allocation of deposit liabilities among product offerings, and on the rates offered and fees assessed on demand deposits, sweep accounts, and compensating balance arrangements?

The repeal of Regulation Q has the potential to have significant implications for the balance sheets and income of depository institutions, allocation of liabilities among product offerings, and rates offered.

Balance Sheet and Deposit Shifts – Currently, banks maintain a large class of business deposits that have been non-interest bearing and a source of low-cost funding. With the repeal of Regulation Q, most banks will look to offer interest on these deposits as a way to remain competitive. Businesses will then have three options for earning interest – through traditional money market and savings accounts, sweep and demand deposits. Given the withdrawal limitations on money market and savings, businesses may find the access of DDA more appealing and opt to keep more cash in an interest bearing DDA. Sweep accounts usually involve a monthly fee that, in a low rate environment, often negates any financial benefit to the business; rate-seeking balances would have a new alternative available in an interest bearing DDA. Given these two alternatives, banks will likely see a shift in their liabilities towards the interest bearing DDA.

Income and Profitability Impacts – Bank profitability will be reduced as a result of the repeal of Regulation Q, with three key areas being affected: the value of the deposits to the bank, introduction of a new expense, and a reduction in fee income. Balances that are rate-seeking afford less of a financial benefit as banks manage their balance sheets. Obviously, the introduction of interest on DDA balances will generate a new expense for banks. In the current rate environment (together with the effects of the FDIC's temporary unlimited insurance on noninterest bearing transaction account deposits), the effects of the additional expense may have less of an impact at first, but this impact will become more significant as rates start to rise (and the temporary unlimited insurance expires). Another contributing factor to the impact of this new interest expense will be the extent to which banks look to compete for business balances, using interest rates as an acquisition tool. Lastly, as balances migrate from sweep and money market to DDA, compensating balances will increase, resulting in less fee income being recognized on banks' income statements.

2. Does the repeal of Regulation Q have any implications for short-term funding markets such as the overnight federal funds market and Eurodollar markets, or for institutions such as institution-only money market mutual funds that are active investors in short-term funding markets?

In light of the current low interest rate environment, the impact of the Repeal of Regulation Q to the overnight Fed Funds/Eurodollar market may be muted. Over time and in a changing rate environment, the repeal of Regulation Q may result in periods of increased volatility and displaced liquidity between deposits and the overnight Fed Funds/Eurodollar markets. The Federal Reserve and the FDIC should consider the competing effects between the rate paid on reserves, the ability to pay interest on deposits, and the rate paid in the overnight Fed Funds/Eurodollar market. As mentioned previously, corporate clients, including large cash movers, will have another option in which to optimize yields. As a result, balances may shift between deposits and other interest bearing overnight liabilities such as Eurodollars and/or pre-arranged sweep agreements which may add to the volatility in those products.

This new environment may widen the bid/ask spread in the overnight markets. In a higher rate environment, we believe that the rate paid for balances held at the Federal Reserve will establish a floor in the Fed Funds/Eurodollar markets while creating a ceiling to the rate paid on short term interest bearing deposits. Therefore as the rate paid at the Federal Reserve is managed down from the Fed Funds target rate, the rate required to attract funds to the Fed Funds/Eurodollar market could increase, causing the bid/ask spread to widen.

Additionally, banks will need to consider the impact of reserve requirements on both themselves and the typical correspondent bank client. For money transitioning from the overnight market to deposits, banks will be faced with holding additional required reserves. Community banks in a correspondent/respondent relationship that sell Fed Funds and have required reserves could benefit from transitioning their Fed Funds Sold to an interest bearing deposit. Funds would be classified as a "due to" account and could be counted toward meeting required reserves.

The Federal Reserve and the FDIC should also consider implications of this repeal to pre-arranged sweep agreements. We suspect we could see the same increased volatility in these products. Sweep arrangements were created because banks could not pay interest on business demand deposit accounts. At some point, certain investment options may no longer be needed. Other products will continue to exist, but whether they are used will depend on the clients' risk/return profile or desire for a diversification alternative for deposit balances greater than $250,000 (especially when the temporary unlimited insurance expires). In low rate environments, pre-arranged sweep agreements typically shift to deposits. However during periods of rate changes, increased volatility between deposits and sweeps may result.

The adoption of Basel III may also add another layer of complexity and may introduce some inconsistencies that will need to be addressed.

3. Is the repeal of Regulation Q likely to result in strong demand for interest-bearing demand deposits?

The demand for interest bearing demand deposits will initially depend largely on the competitive positioning of the product by banks (and effects of temporary unlimited insurance protection). Should one or more banks choose to use the rate offered on a DDA as an acquisition tool, then demand could increase as businesses look to capitalize on the ability to earn higher rates of interest on their operating cash. The actions of one or more banks could drive the remaining banks to also increase rates as a means to mitigate attrition, thereby fueling further the demand for interest-bearing DDA.

4. Does the repeal of Regulation Q have any implications for competitive burden on smaller depository institutions?

The repeal of Regulation Q places additional competitive and profitability burdens on all banks. Although the repeal does not require any bank to pay interest to its checking customers, the competitive landscape would indicate that all banks, large and small, will be forced to pay interest in order to remain market competitive. 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.

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.

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. We hope the effects of these changes are understood and attempts will be made to limit potential unintended consequences.

Regards

J. Griffin Foster