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May 10, 2019

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Regulation D: Reserve Requirements of Depository Institutions (Docket Number R-1652;
RIN 7100-AF-40)

Dear Ms. Misback:

The Independent Community Bankers of America (ICBA)¹ appreciates the opportunity to comment on the advance notice of proposed rulemaking (ANPR) concerning *Regulation D: Reserve Requirements of Depository Institutions*. As the ANPR points out, the Federal Reserve is considering proposing amendments to its Regulation D to lower the rate of interest paid on excess balances (IOER) maintained at the Federal Reserve Banks (Reserve Banks) by eligible institutions that hold a very large proportion of their assets in the form of balances at Reserve Banks.

Section 19 of the Federal Reserve Act grants the Reserve Banks the authority to prescribe regulations concerning the payment of interest on balances at a Reserve Bank. Regulation D specifies the types of balances on which interest may be paid, the interest rates applicable to those balances, and the method for calculating interest. Currently, the Reserve Banks pay an interest on balances that are maintained to satisfy an institution's required reserve balance (IORR) as well as interest on balances that are in excess of required reserves (IOER). Both the IORR and the IOER rates were 2.4% when the ANPR was issued in March.

ICBA's Comments

As the ANPR explains, some financial firms are seeking to establish special state charters for depository institutions with narrowly focused business models that involve taking deposits from

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

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institutional investors and investing all or substantially all of the proceeds in balances at Reserve Banks. These Pass-Through Investment Entities or PTIEs would not be subject to federal prudential regulation and would not be subject to the same set of capital and other prudential requirements as other federally regulated banks. Their business purpose appears to be to attract a large amount of deposits from institutional investors and pass through the interest obtained at the IOER rate from a Reserve Bank to their depositors, less a small spread.

Unfortunately, under the current provisions of Regulation D, PTIEs can earn interest on their balances at a Reserve Bank at the IORR and IOER rate while at the same time avoiding the costs borne by other institutions authorized to maintain balances at Reserve Banks, such as the costs of capital requirements and other elements of federal regulation and supervision, because of the limited scope of their product offerings and asset types. **ICBA agrees with the Federal Reserve that this is not what Congress intended when it amended the Federal Reserve Act to authorize Reserve Banks to pay interest.** Paying interest to PTIEs would allow institutional investors that are not authorized to maintain balances at Reserve Banks to earn interest at the IOER rate. **We believe Congress's intent was to allow the payment of interest on balances at the IOER rate to a limited class of institutions, i.e., insured depository institutions.** Paying interest to PTIEs would theoretically allow any institution or person to reap the benefits of receiving interest from a Reserve Bank at the IOER rate just by being an investor in the PTIE.

Furthermore, ICBA believes that PTIEs could diminish the availability of funding for commercial banks generally at a time when attracting deposits is very difficult. If deposits at PTIEs become more attractive investments for cash investors than holding cash in commercial banks, this will raise overall funding costs for banks and ultimately raise the cost of credit provided by banks to households and businesses. ICBA also has some concerns that lenders in the overnight general collateral repo market could find PTIE deposits more attractive. If the rise of PTIEs were to reduce demand for the general collateral repo market making it more costly for securities dealers to finance their inventories of Treasury securities, this could have all sorts of consequences to commercial banks that depend heavily on the overnight repo market to meet their funding and liquidity needs.

In short, ICBA would support an amendment to Regulation D that would provide a lower IOER rate for PTIEs than for other insured depository institutions. PTIEs could be identified as any eligible institution that holds a very large share of its assets in the form of balances at a Reserve Bank.

ICBA appreciates the opportunity to comment on this ANPR. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 821-4431 or Chris.Cole@icba.org.

Sincerely,
/s/ Christopher Cole

Christopher Cole
Executive Vice President and Senior Regulatory Counsel