



1120 Connecticut Avenue, NW  
Washington, DC 20036

1-800-BANKERS  
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Keith Leggett  
Senior Economist  
Tel: 202-663-5506  
Fax: 202-828-4547  
Email: [kleggett@aba.com](mailto:kleggett@aba.com)

February 24, 2009

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

Re: Federal Reserve System; 12 CFR Part 204 Reserve Requirements of  
Depository Institutions; 74 Federal Register 5628, January 30, 2009

Dear Ms. Johnson:

The Board of Governors (Board) has proposed authorizing the establishment of limited-purpose accounts at Federal Reserve Banks (Reserve Banks) for the maintenance of excess balances of eligible institutions. These excess balance accounts (EBAs) would allow eligible institutions to earn interest without disrupting established business relationships with their correspondents. The American Bankers Association (ABA) supports the Board's proposal and appreciates its willingness to work with banks to minimize the disruption in the business relationship between respondent and correspondent banks arising from the payment of interest on reserves.

ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2.2 million men and women.

### **Background**

Section 128 of the Emergency Economic Stabilization Act of 2008 (the Act), enacted on October 3, 2008, accelerated the effective date granting the Reserve Banks authority to pay interest on balances maintained at the Reserve Banks by or on behalf of depository institutions. The Act made this authority effective on October 1, 2008. This authority was originally enacted in Title II of the Financial Services Regulatory Relief Act of 2006 with an effective date of October 1, 2011.<sup>1</sup>

Section 201(a)(12)(A) of the Financial Services Regulatory Relief Act of 2006 (FSRRA) amended the Federal Reserve Act by adding that "balances maintained at a Federal Reserve Bank by or on behalf of a depository institution may receive earnings to be paid by the Federal Reserve Bank at least once each calendar quarter, at a rate or rates not to exceed the general level of short-term interest rates."

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<sup>1</sup> Pub. L. 109-351, 120 Stat. 1966 (Oct. 13, 2006).

In our November 21, 2008, letter on the interim final rule authorizing the payment of interest on reserve balances, ABA supported the payment of interest on reserve balances but encouraged the Board to take every possible action to limit the adverse impact of its actions on the business relationships between respondent and correspondent banks.

### **ABA's Comment**

ABA supports the creation of EBAs. An EBA means an account at a Reserve Bank pursuant to §204.10(e) that is established by one or more eligible institutions and in which only excess balances of the participating eligible institutions may at any time be maintained. An excess balance account is not a pass-through account, rather it is considered to be the property solely of the EBA participant.

Currently under Regulation D, the balance in a pass-through account at a Reserve Bank of a banking firm with correspondent banking relationship with other banks is deemed to be the property of the pass-through correspondent exclusively; the account balance represents a liability of the Reserve Bank solely to the pass-through correspondent, regardless of whether the funds represent the required reserve balances of another institution that have been passed through the correspondent. As a result, the pass-through correspondent must show the entire balance in its Reserve Bank account on its own balance sheet as an asset, even if the balance consists, in whole or in part, of amounts that are passed through on behalf of respondents.

When a correspondent's respondents want to earn interest on excess balances by leaving them with the correspondent (which in turn passes those balances through to the Reserve Bank), the correspondent has a larger balance at the Reserve Bank. This causes the correspondent to hold more assets on its balance sheet, which lowers its leverage ratio for capital adequacy purposes.

Since the commencement of interest payments on excess balances in October 2008, the actual federal funds rate has generally averaged significantly below the interest rate paid by the Reserve Banks on excess balances. With the market federal funds rate below the rate paid by the Reserve Banks on excess balances, respondent banks have an incentive to shift the investment of their surplus funds away from sales of federal funds (through their correspondents acting as agents) and toward holding funds directly as excess balances with the Reserve Banks. This potentially disrupts established correspondent-respondent relationships, because it imposes a greater capital cost on correspondent banks.

The establishment of EBAs should reduce disruptions in established relationships between correspondents and their respondents that would result from a shift by respondents away from federal funds sales and toward holding excess balances in individual accounts at the Reserve Banks.

With EBA authority, all EBA balances would be deemed to be the property solely of the EBA participants, and to represent a liability of the Reserve Bank to the EBA participants alone and not to the EBA agent. Because the excess balances of EBA

participants in EBAs would be the Reserve Bank's direct liability to the EBA participants, the adverse leverage capital impact of such arrangements on correspondents would be mitigated.

ABA would recommend that the Board clarify in its final rule that the account may be structured whereby a single Excess Balance Account (EBA) is maintained by an EBA agent on behalf of all EBA participants for the maintenance overnight of the participants' aggregate excess balances. The EBA agent would be responsible for maintaining adequate records to demonstrate the level of excess balances in the EBA of each EBA participant. Such a clarification would reduce operational and regulatory burdens for correspondent banks.

In conclusion, ABA supports the Board's proposed amendment to Regulation D permitting the creation of Excess Balance Accounts.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Leggett". The signature is written in a cursive, flowing style.

Keith Leggett