PACIFIC COAST BANKERS' BANK

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
VIA EMAIL: comments@fdic.gov

October 26, 2009

RE: Proposed Correspondent
Concentration Risk Guidance

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
VIA EMAIL: regs.comments@federalreserve.gov

RE: Docket No. OP-1369

Office of the Comptroller of the Currency
250 East Street, S., Mail Stop 2-3
Washington, DC 20219
VIA EMAIL: regs.comments@occ.treas.gov

RE: Docket ID OCC-2009-0013

Pacific Coast Bankers' Bank ("PCBB") respectfully submits the following comments to the Interagency proposal dealing with correspondent concentration risks ("Interagency Proposal"). This submission has been approved by the Board of Directors of PCBB which is comprised of the CEO's of various community banks and is after discussion with various community bank clients of PCBB that operate throughout the United States. PCBB is also a member of The Bankers' Bank Council and is in support of the comment letter that was sent by such entity but believes that additional modification and clarification is necessary related to the Interagency Proposal. In addition to those outlined below, PCBB is not in support of allowing multiple correspondents for pass through of Excess Balance Accounts ("EBA"). We believe this adds little value to the risk concentration associated with a correspondent and further complicates an already complex and potentially costly infrastructure to support this new guidance.

**Introduction and Foundation**

To provide a basis for the comments, PCBB is a bankers' bank headquartered in San Francisco, California and serves community banks primarily in the western United States and Middle Atlantic States. PCBB is owned by Pacific Coast Bankers' Bancshares ("Bancshares"), a registered bank holding company. Bancshares is primarily owned by financial entities and as of September 30, 2009 had 219 shareholders, with the vast majority owning significantly less than 1% of the outstanding shares of Bancshares. PCBB has always maintained high liquidity levels and the deposits of PCBB are primarily demand deposit accounts tied to several hundred community banks that use PCBB for settlement and cash management services**.** PCBB does not compete with the Federal Reserve Bank and as such the majority of its clients have established relationships with the Federal Reserve Bank system.

PCBB recognizes the Interagency Proposal is related to the ongoing banking crisis and a desire by regulatory agencies to provide guidance to insured depository institutions as to the proper management of risks associated with credit and funding concentrations in correspondent bank relationships. However, it is important to note that the Interagency Proposal could have the unintended consequence of driving correspondent relationships away from bankers' banks that are specifically established for the benefit of community banks and do not compete with community banks. Certain aspects of this guidance could have unintended consequences that will serve to drive community banks to the money center banks that are by law "too big to fail." These larger entities have historically shown repeatedly that they are not interested in serving the needs of the community banks, but are rather significantly fee and income driven. The proposed changes will negatively impact community banks and their clients, the consumer and the small business customer. In addition, unlike bankers' banks, these major correspondent banks have also shown historically they are not interested in being a financial partner with the Federal Reserve Bank, which adds additional systemic risk into the system.

**Comments**

In reviewing the Interagency Proposal we have the following specific comments:

**CREDIT CONCENTRATIONS THRESHOLD**

PCBB does not have issue with the credit concentration guidance of 25% of Tier 1 capital and believes that is an acceptable guidance threshold. However, what is included in the grouping should be reconsidered. The guidance on identifying credits associated with correspondent banks should be clarified as not to include loan participations as these are not credit extensions/exposures to either party but the credit exposure of the underlying borrower. A bankers' bank will purchase and/or sell loan participations, but typically does not lead these same credits. In the normal environment of loan participations bought and sold, the only underlying credit exposure to the banker's bank is that of payments passing through the correspondent during or in the event of failure. This is only a temporary exposure, as payments would eventually be settled in receivership. Each party must be held to credit standards outside of exposure, and the attempt of the Interagency Proposal to control buying or selling participations under this guidance as a credit exposure is misplaced.

There should be a distinction between loan participations that are generated directly by a correspondent bank and those participations that are purchased by a correspondent bank from a respondent bank, or purchased by the respondent form the correspondent. It is understood that credit concentration risks may be elevated by certain types of loan participations purchased from correspondent banks, and these should be governed under the agency guidelines of credit concentration, not through agency guidelines of correspondent concentration. Inclusion of any direct extension of credit to the correspondent/respondent bank (and/or affiliated entity). Recommended language for the Interagency Proposal is as follows:

***1.)Credit concentrations in a correspondent <u>do not include:</u> 1) loan participations originated by an entity apart from the correspondent or its affiliated entities, where controlling ownership of the participation is maintained by participants other than the correspondent, and where there is no extension of credit directly to the correspondent or affiliated entity; 2) loan participations where the correspondent is the initiating lead bank and/or retains a controlling interest in the participation AND there is clear participation certificate documentation which would pass the control aspects of the loan to the remaining participants in the event of regulatory closure of the bank; or 3)Shared National Credits or syndicated loan pools that do not carry any direct exposure to or from the correspondent bank.***

Also stock ownership in a bankers' bank by a respondent bank should not be considered a correspondent credit concentration, since community banks do not own stock in other non bankers' bank entities or "other correspondents," this would be considered unfair to bankers' bank charter. In addition, stock owned in bankers' banks are treated the same as stock owned in the Federal Reserve Bank or the Federal Home Loan Bank, per FFIEC guidelines. As such, these are long term in nature. In addition, other than the ultimate failure of the entity, an investment in a bankers' bank by a respondent bank should not be considered as a credit exposure. It is recommended that stock ownership in a bankers' bank be expressly excluded as a credit for purposes of determining a credit concentration in a correspondent relationship.

## LIABILITY CONCENTRATIONS THRESHOLD

The liability concentration threshold illustration misses a primary support mechanism bankers' banks provide to thousands of community banks across the country. By definition and structure, bankers' bank liabilities are tied to relations with its client community banks. The illustration of a 5 percent exposure as posing an elevated risk does not easily apply to the business model for PCBB or other bankers' banks where the liability concentrations are deposits of hundreds of community banks. While the aggregate relationship of several hundred banks represents almost 100% of PCBB's total liabilities, the excess liquidity that PCBB maintains shows under stress analysis that even if the largest deposit relations withdrew their funds in close proximity to one another, there would be very little funding risk. One of the critical elements of dealing with funding volatility is having a diversified and large deposit customer base. There should not be a funding exposure if the liabilities are diversified into several hundred community banks.

Also included in the proposed guidance is the elevated concern – "the financial institutions that rely on correspondent bank for account clearing services may find it difficult to quickly transfer processing services to another provider." In relation to PCBB this comment is unwarranted, since PCBB requires all of its clients to have accounts with the Federal Reserve Bank. By design, this structure ensures that in the event of a dire circumstance, transferring processing services quickly to the Federal Reserve would not be an issue. The Interagency Proposal should provide in the guidance an exception for funding concentrations of a "well diversified" bankers' bank provided its respondent banks also have a separate account the Federal Reserve Bank. This process would significantly reduce any potential systemic risk.

**FEDERAL FUNDS SOLD AS PRINCIPAL**

The guidance specifically identifies inclusion of federal funds sold as principal to a correspondent bank. This specifically limits and targets bankers' banks more so than other correspondents as bankers' banks do not have branches or compete with their respondent bank customers, unlike major correspondent banks. We would suggest that if the guidance wishes to limit federal funds sold to any one institution it should be so stated and applied industry-wide.

**MANAGING CORREPSONDENT CONCENTRATIONS –CONTINGENCY FUNDING**

The Interagency Proposal contains the following language related to Managing Correspondent Concentrations -Contingency Funding:

*"Contingency plans should not rely on temporary deposit insurance programs for mitigating concentration risk."*

While that statement may be true for the long term, the FDIC under its current regulations that have been extended to June 30, 2010 provides for unlimited insurance coverage on non interest bearing accounts. While the FDIC has not stated that it will be extending the unlimited coverage of non interest bearing accounts beyond June 30, 2010, it has not stated that the program will terminate either**.** As such, we believe the inclusion of this comment at this time is not warranted and should be stricken from the Interagency Proposal, to the extent that current law or regulations permit such mitigation. However, for contingency planning purposes, we would agree that temporary programs will need to be replaced by alternative funding sources. The Interagency proposal guidance should allow for deduction of funds that are in fact insured to the maximum level permissible.

**Conclusion and Request For Additional Dialogue**

PCBB believes that risk management practices for each community bank should include an evaluation of its correspondent relationships. However, to limit systemic risk, the Interagency Proposal and the guidance contained should be the basis of dialogue and discussion among the regulators and banks to formulate a cohesive and thoughtful solution over time. The guidance should provide for a sufficient transition period, to allow community banks to prepare proper policies, procedures, controls and reporting as to be required under the guidance.

PCBB, its Board and Management have had a long and meaningful relationship with all of the regulatory agencies. PCBB believes that it has been a leader for community banks and partner with the regulatory agencies. PCBB has been a facilitator of meaningful and productive risk management practices for community banks operating throughout the United States. PCBB recognizes the difficult time that exists for banks and regulators and it is in this time that we must all come together to set meaningful guidance for all banks that is well thought out and limits unintended consequences. Community banking within the United States is critically important to the overall economy as it serves as the primary backbone of lending to small businesses – the largest single creator of jobs in the country. PCBB and other correspondents are a critical component of support to the endeavors of community banks and their customers.

The Board and Management appreciate the opportunity to comment on the Interagency Proposal and are available to discuss this letter and have additional dialogue and discussion as may be requested or warranted.

Respectfully,
Steve Brown
President and CEO