INDEPENDENT COMMUNITY
BANKERS of AMERICA

October 26, 2009

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Ms. Jennifer J. Johnson
Secretary
Board of Governors
of the Federal Reserve System
20th Street & Constitution Av NW
Washington, DC 20551

Office of the Comptroller
of the Currency
250 E Street SW
Mail Stop 2-3
Washington, DC 20219

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Submitted via email

Re: Correspondent Concentration Risks
Federal Reserve System Docket No. OP-1369, Office of the Comptroller of the Currency Docket ID OCC-2009-0013, Office of Thrift Supervision Docket ID OTS-2009--20016

Dear Sirs or Madams:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the proposed correspondent concentration risk guidance issued by the Federal Deposit Insurance Corporation, Federal Reserve Board of Governors, Office of the Comptroller of the Currency and the Office of Thrift Supervision (collectively, the Agencies).

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[1] *The Independent Community Bankers of America represents nearly 5,000 community financial institutions of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community financial institutions compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 300,000 Americans, ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

The proposed interagency guidance requires financial institutions to implement policies and procedures for identifying, monitoring, and managing correspondent concentration risk exposures and to perform appropriate due diligence on all interbank credit exposures and funding transactions.

The proposed guidance compliments or builds upon the Federal Reserve's Regulation F (Limitation on Interbank Liabilities) which mandates respondent banks have policies and procedures for limiting correspondent bank exposure, conduct periodic reviews of a correspondent bank's financial condition, and take appropriate steps when there is deterioration in the correspondent's financial condition.

If adopted, examiners will review bank policies and procedures during examinations to ascertain compliance with this guidance and Regulation F.

ICBA Position

ICBA supports financial institutions having appropriate risk management policies and procedures in place for all types of risk, including correspondent concentration risks; however, it is important for the Agencies to tailor risk management requirements to an institution's size and complexity.

We are deeply concerned regarding the proposal's complexity and the addition of new regulatory burden this proposal creates for community banks and their correspondents. Additionally, ICBA is concerned that this well-intentioned proposal has the potential to alter successful and long-standing correspondent banking relationships mutually benefiting community banks and their smaller correspondent banks, particularly the nation's twenty bankers' banks.

We urge the Agencies to carefully consider comments from ICBA and others and not to proceed with quick implementation of the guidance proposal until the implications are well understood. Such an approach would lessen the likelihood of negative unintended consequences resulting from implementation of the guidance.

ICBA's comments on the specific aspects of the proposed guidance are discussed below.

Credit Exposure Instruments

Under the proposed guidance, credit exposures include, but are not limited to:
- due from accounts (demand deposits and certificates of deposits);
- principal federal funds sold;
- over-collateralized amount on repurchase agreements;
- under-collateralized amount of reverse repurchase agreements;
- current positive fair value on derivatives contracts;
- unrealized gains on unsettled securities transactions;
- direct or indirect loans for benefit of the correspondent or its holding company or affiliate; and
- Investments (such as trust preferred securities, subordinated debt, and stock purchases in the correspondent, its holding company or affiliate).

*Due From Account*s

ICBA strongly urges the Agencies to exclude items in the process of collection consistent with Regulation F Section 206.4(d) (2) from the due from account balance. We believe that Regulation F's exclusion recognizes the burden and limited materiality of including items in the process of collection which vary on a daily basis. ICBA encourages extending this exemption to the proposed guidance.

Loan Participations

The proposal's treatment of loan participations and syndications has created considerable uncertainty and angst among community bank respondents and correspondents. The commentary's background notes that "credit exposures may include direct or indirect loans (including participations and syndications)," however, the actual text of the proposed guidance does not specifically include participations and syndications.

ICBA questions the potential inclusion of loan participations in the credit exposure calculation. Loan participations must be sold without recourse in order to meet the definition of a sold loan. The bank purchasing the loan participation must independently analyze the credit of the underlying borrower(s) and guarantor(s) in order to make an independent credit decision. The bank purchasing the loan participation will want to also be comfortable with the originating bank's underwriting and credit administration process, but that does not equate to the credit quality of the selling bank. The only case that could be made for underwriting the seller is in making the determination whether or not the seller will remain in business for the period of time the loan is outstanding. If a bank is buying a 5- or 10-year loan participation, that would be nearly impossible to do. Worst case, the lead bank goes into receivership and the FDIC appoints a conservator who has the obligation to service the loan. We urge the Agencies to exclude loan participations and syndications from the credit exposure calculation and monitoring requirements if the credit exposure is to the borrower and not the correspondent bank.

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Moreover, it is common for correspondent banks to acquire a large participation in a loan originated by another bank which is then divided and sold to numerous respondents. In this scenario, credit risk lies with the originating bank, but not with the correspondent bank selling the participations. We further urge the Agencies to permit the exclusion of credit risk in this scenario as well.

We do agree that any direct or indirect loans from the respondent bank to the correspondent bank should be included in the credit exposure calculation.

In summary, ICBA encourages the Agencies to clarify the treatment of loan participations and syndications recognizing that the credit risk exposure varies based on the origination and sale of loan participations and syndications.

Unrealized Gains on Unsettled Securities Transactions

Most securities are purchased on a T+3 settlement basis wherein there is a three-day lag between the buyer's purchase commitment and actual delivery and settlement of the security. To try and estimate the credit risk associated with the transaction for a 3-day period is extreme. How would the market price be calculated? The community bank buyer would have to complete a transaction, and then go to an independent broker for independent pricing and valuation. This would be an extremely time-consuming and unnecessary process for quantifying 3-days' risk that is likely nominal. ICBA urges the Agencies to exclude unrealized gains on unsettled securities transactions given the burden far outweighs any benefit associated with attempting to quantify this credit exposure.

Over-Collateralized Amount on Repurchase Agreements

ICBA recommends the Agencies exclude the over-collateralized amount on repurchase agreements from the credit exposure calculation as the calculation would be onerous and yield little if any additional exposure. For example, if a bank is required to pledge 110 percent of a security's market value against a repurchase agreement, the worse-case scenario would be a collapsed bank and a liquidated security to settle the repo. A third party trustee would be involved with liquidating the collateral, and the owner of the repurchase agreement would be made whole to the extent the market value of the security collateral equaled or exceeded the amount of the repo. Any extra would be returned to the collapsed bank. The value of determining the credit risk of the over-collateralized security is nil.

Concentration Calculations

The proposed guidance requires respondents to implement procedures for identifying correspondent concentrations (aggregate credit and funding exposures) on a stand alone basis, as well as taking into account exposures to the correspondent's affiliates. Respondent banks must also consider the exposures of its affiliates and calculate both the gross and net (less any pledged collateral) credit exposures for each correspondent relationship.

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ICBA is deeply concerned that the proposed guidance would impose excessive burden on respondents by requiring numerous concentration calculations. Based on ICBA's interpretation of the proposed guidance, respondents may need to compute up to sixteen exposure calculations for each correspondent relationship as noted below:

- respondent-only exposures to a correspondent only;
- respondent-only exposures to a correspondent and correspondent's affiliates;
- aggregate exposures of the respondent and its affiliates to a correspondent only;
- aggregate exposures of the respondent and its affiliates to a correspondent and its affiliates;
- exposures for both funding and credit exposures; and
- credit exposures on both a gross and net basis.

ICBA requests the Agencies to clarify whether our interpretation above is accurate and, if so, to lessen this inordinate burden.

Concentration Thresholds

The proposed guidance notes that regulators generally consider credit exposures greater than 25% of a bank's Tier 1 capital as a concentration. On the liability side, there is no established concentration threshold, however, a funding exposure as low as 5% of a bank's total liabilities could pose elevated liquidity risk.

ICBA appreciates the Agencies' decision to direct banks to establish "prudent correspondent concentration limits, as well as ranges or tolerances for each factor being monitored," rather than treating the referenced thresholds as caps. However, ICBA is concerned that bankers and examiners will view these thresholds, as caps to the detriment of numerous successful correspondent relationships. ICBA urges the Agencies to clarify in the final guidance and applicable examination procedures that these thresholds are indicators of increased risks rather than bright line caps on risks.

Effective Date

ICBA recommends the Agencies adopt an effective date for the final guidance ranging from 90 to 120 days to provide respondents and their correspondents sufficient time to develop and implement policies and procedures consistent with the guidance. Moreover, this time frame would permit correspondents time to develop tools and resources designed to assist their respondents in complying with the guidance and in reducing some of the compliance burden.

<u>Excess Balance Accounts</u>

The Agencies are seeking comments regarding any potential operational issues resulting from the Federal Reserve Board's policy of limiting financial institutions to one eligible excess balance account (EBA). ICBA's March 2, 2009 comment letter regarding EBAs recommended the Federal Reserve Board permit an EBA Participant (a respondent bank) to designate more than one EBA Agent (a correspondent bank) if they so desire. ICBA continues to support respondent banks having the flexibility to maintain more than one EBA.

The implementation of the proposed guidance will further pressure respondents to diversify correspondent relationships and without the ability to maintain more than one EBA, many respondents will likely move their relationships to Federal Reserve Banks to lessen compliance burdens and ensure safety. A continued cap on the number of EBAs would provide Federal Reserve Banks with a competitive advantage over private-sector correspondents contrary to the Federal Reserve Board's longstanding posture of prescribing polices supporting a balanced and competitive marketplace between the Federal Reserve Banks and private-sector competitors. ICBA urges the Federal Reserve Board to remove this limitation on the number of EBAs a financial institution may maintain.

<u>Affiliate Clarification</u>

ICBA seeks clarification regarding the applicability of the proposed guidance to interbank exposures within a bank holding company. For example, a bank holding company with a 51% ownership in an affiliate bank sells loan participations to the affiliate bank equaling approximately 50% of the affiliate bank's Tier 1 capital. From time to time, the affiliate bank also sells a small amount of federal funds to the bank holding company. ICBA believes that affiliates should be excluded from the guidance since there is common management and ownership. Additionally, inclusion of affiliates would impair downstream banks' ability to purchase and profit from loan participations.

Conclusion

Again, ICBA appreciates the opportunity to comment on this proposed guidance. We strongly urge the Agencies to thoroughly vet comments from ICBA and others to lessen the likelihood of negative unintended consequences to the correspondent marketplace.

Additionally, ICBA encourages the Agencies to:

- exclude or clarify the referenced credit exposure instruments
- clarify the number of exposure calculations required and lessen the excessive burden associated with these calculations;

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- clarify in the final guidance and applicable examination procedures that the referenced credit and liquidity thresholds are indicators of increased risks rather than bright line risks caps; and,
- adopt an effective date for the final guidance ranging from 90 to 120 days.

We also urge the Federal Reserve Board to permit respondents to maintain more than one Excess Balance Account.

If you have any questions or need additional information, please contact the undersigned by email at viveca.ware@icba.org or telephone at (202) 659-8111. Thank you.

Sincerely,
/s/
Viveca Y. Ware
Senior Vice President
Payments & Technology Policy