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September 13, 1999

Ms. Cynthia L. Johnson  
Director  
Cash Management and Policy Planning Division  
Financial Management Service, Room 420  
401 14<sup>th</sup> Street, SW  
Washington, DC 20227

Re: Docket No. 99-19564 - Proposed Revision of Regulations Governing the Treasury Tax and Loan program - Federal Register: July 30, 1999 (Volume 64, Number 146)

Dear Ms. Johnson:

On behalf of the member bank subsidiaries of Fleet Financial Group ("Fleet"), I am pleased to comment on the Department of Treasury ("Treasury") proposal to revise regulations governing the Treasury Tax and Loan Program ("TT&L").<sup>1</sup> Treasury is proposing a revision of its regulations governing the TT&L program and specifically a change to the interest rate Treasury charges on TT&L note balances. Under the current rule, the TT&L rate of interest is the Federal funds rate published weekly by the Board of Governors of the Federal Reserve System less 25 basis points. Treasury is proposing to change the basis for computing the TT&L rate of interest to an overnight repurchase agreement rate in order to better approximate the market interest rate for collateralized lending.

Fleet participates in the investment component of the TT&L Program; thereby, borrowing excess operating funds from Treasury. If the proposed revision were adopted, it is unlikely that Fleet would continue to participate in the investment component of the program, because the proposed revision would substantially eliminate the compensation Fleet receives for its exposure to market risk. Participants in the TT&L investment component are exposed to market risk because of the uncertainties participants face in determining the amount of TT&L funds that may be held. Specifically, all investment balances held by participants are subject to call on same day's notice. In addition, depositaries may participate in either the next day or same day direct investment program. In all cases, Treasury provides notification of calls and direct investments to participants at approximately 11:00 A.M. (EST). Participants can not be certain of the actual TT&L note balances held until after the notification. Exposure to market

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<sup>1</sup> The member bank subsidiaries of Fleet Financial Group are Fleet National Bank, Fleet Bank, N.A., Fleet Bank-NH and Fleet Bank of Maine.

risk arises when the current market interest rates deviate from the rate paid to Treasury. Market interest rates may vary greatly. For example, for the past year the range of trading for Federal funds published by the Federal Reserve has averaged 189 basis points. In addition, participants are exposed to market risk because the base rate is published weekly and applied to balances held in arrears. The current rate for TT&L note balances provides participants with reasonable compensation for their exposure to interest rate risk.

The Treasury proposal states that the current rate was put into place when the repurchase agreement market was not mature and a published rate was not available. Thus, the TT&L rate was set as an approximation of a repurchase agreement rate. Treasury proposes changing the rate to an explicit repurchase agreement rate. This change is intended to allow Treasury to receive the actual interest rate, rather than a proxy rate for an economically similar transaction. Given that TT&L participants are exposed to interest rate risk that would not otherwise be present in repurchase agreement transactions, holding TT&L funds is not economically similar to transacting in repurchase agreements.

The Treasury proposal further states that the proposed change is intended to provide depositaries with an easily understandable rate which will be publicly available; however, the proposed rate is not currently compiled or published. The Fed funds effective has been published and available to depositaries since 1954. The proposed rate would be less understandable due to the lack of historical data and expose participants to additional risk since the compilation methodology is not defined in the Treasury proposal. In addition, because TT&L participants are banks that are likely to be more active in the Fed funds market than the repurchase agreement market, the Fed effective rate is likely to be more understandable than the repurchase agreement rate. The most active participants in the repurchase agreement market are broker/dealers.

The proposed change, if adopted, will result in depositaries holding less TT&L funds; consequently, the capacity of the TT&L system will be significantly reduced. This will have greater implications for implementation of monetary policy and the liquidity of the banking system. Implementation of monetary policy will be complicated by the proposed change, because as the capacity of the TT&L system is reduced, Treasury balances held at the Fed will increase and become more volatile, particularly, at times of peak Treasury payment flows. When Treasury balances at the Fed increase the Fed will have to offset the reserve drain with open market operations. It is possible that at times that the Fed will have difficulty attracting enough proposals in its operations to fully offset the reserve need causing the market Fed funds rate to increase significantly above the rate intended by the FOMC.<sup>2</sup> Even the possibility that the Fed may have difficulty managing bank reserves may impact a wide range of market interest rates; thereby, impacting monetary policy. The Fed funds market will also become more volatile as a result of the increase in volatility of Treasury balances held at the Fed. The overall liquidity of the banking system will be reduced as a result of increased Treasury balances held at the Fed because funds that would otherwise be directly maintained by depositaries would now be controlled by Treasury and the Fed.

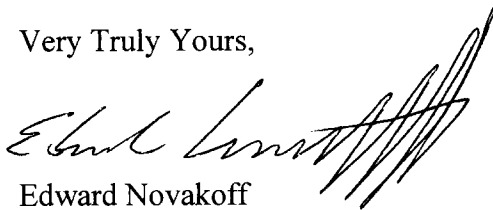
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<sup>2</sup> This problem would be compounded by the ongoing reduction in the supply of Treasury securities.

We do not believe that the proposed changes will achieve the stated goals of Treasury. Since TT&L funds and repurchase agreements are not economically similar, applying the repurchase agreement rate to TT&L funds will not achieve an alignment of economically similar transactions. Moreover, most depositaries will view the repurchase agreement rate as less easily understandable. Reduced participation in the TT&L program will adversely impact interest rate markets and increase systemic liquidity risk in the financial system. While the proposed rate of interest is likely to be higher than the current rate, Treasury will not realize higher returns on its excess operating cash because TT&L capacity will be reduced. The public interest is not served in any way by the proposed change; therefore, we strongly recommend that Treasury rescind the proposal.

If you have any question or would like additional information related to Fleet's comment on the Treasury proposal, please feel free to contact me at 617-346-5280.

Very Truly Yours,

A handwritten signature in black ink, appearing to read "Edward Novakoff", with a stylized flourish at the end.

Edward Novakoff  
Senior Vice President  
Treasury Funding