



TT&L  
033

September 27, 1999

Dear Ms. Cynthia L. Johnson:

Bank One Corporation appreciates the opportunity to comment on the proposed rule change that will affect the rate of interest paid by TT&L depositories for the use of Treasury funds. The Corporation is an active participant as a Treasury Tax & Loan Note Option Depository. We are a participant in both the direct investment program and the special direct investment program. Our affiliated banks have capacity of \$1.85 billion in the direct investment program and \$1.3 billion in the special direct investment program.

The proposal to change the rate of interest that is paid for these deposits would have a significant impact on our short-term funding strategies. The current pricing of these deposits enables the Corporation to adequately assume the costs and risks involved in being a participant in the programs. The Corporation's continued participation in the program would be jeopardized if the pricing were to change to the proposed overnight repurchase agreement rate.

There are three economic factors that we looked at in developing this response:

1. The operational cost of our participation has an annual cost of approximately five basis points when applied to our average balance experience. Operating costs include the posting of the collateral at the Federal Reserve Bank, time devoted by support staff to monitor balance levels, and system cost for collateral management.
2. Bank One's required return on risk based capital. In order to quantify the cost, certain assumptions were made. Due to the volatile nature of these balances, we estimate that the \$1 billion in average balances can be incorporated into our normal funding requirements only half the time. The other half of the time, short-term assets, generally 20% risk weighted (such as Fed Funds), need to be created. In order to meet internal ROE targets, the Corporation needs to earn 14.4 basis points per annum on these assets.
3. The Corporation's affiliated banks are able to generate large amounts of short-term funds in the inter-bank market that averages 8 basis points below the Fed Funds average (computed on a weighted average effective basis by the Federal Reserve Bank of New York). This would enable us to replace the TT&L deposits at a lower cost from sources that are potentially more stable.

We also have serious reservations about the new rate index. The current charge of the Federal Funds average less 25 basis points is based on a very well defined index. This index follows the seasonal changes directly related to the affiliated bank's changes in funding requirements. We are unsure of how this new repurchase agreement average would correlate to our cost structures in the funds market. There is also a certain amount of concern relative to source of the repurchase agreement average. The primary dealers that are currently surveyed by the Federal Reserve Bank of New York may be less willing to provide this information if it were to become public. Their reluctance could result in a skewed average that would not be a valid market rate.

We also believe the Treasury is protected at the current rate structure. Through these investment programs, the Treasury has a theoretical option. If the Federal Funds average less 25 basis points is greater than the prevailing three month Treasury Bill rate, the Treasury could withdraw funds from the investment accounts to satisfy their liquidity requirements without issuing additional debt. Conversely, when your financing alternatives cost less than the yield earned (Fed Funds average minus 25 basis points), balances can be kept at a positive spread. We have calculated this theoretical option to be worth 16 basis points per annum to the Treasury.

It is for these reasons that the Corporation would oppose the change regarding the rate of interest paid by TT&L Depositories for the use of Treasury funds. Further, we would be inclined to relinquish our role as a Depository if these changes were to take effect.

Lastly, our interest in obtaining note balances for a guaranteed term would depend on the pricing structure. We welcome the opportunity to examine the proposal in greater detail once specifics become available.

Again, thank you for the opportunity to respond. If you have any questions, please feel free to call me at 312-732-8301.

Sincerely,

Jeffrey P. Clennon  
Managing Director