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Ms. Cynthia L. Johnson
Director
Cash Management Policy
And Planning Division
Financial Management Service
Room 420
401 14th Street, S. W.
Washington, D.C. 20227

Re: Proposed Change to Interest Rate on TT&L Note Balances (RIN 1510-AA79)

September 27, 1999

Dear Ms. Johnson:

Thank you for presenting us with the opportunity to respond to your proposed changes in the Treasury Tax and Loan (TT&L) Program. Specifically, we would like to comment on whether depositories are likely to alter their participation in the investment component of the program.

HSBC Bank USA has participated in the TT&L Note program since its inception, originally as Marine Midland Bank. This gives us a reasonable perspective from which to view this issue. Banks that enter the program weigh many factors before committing to the investment portion of TT&L. This includes, current balance sheet size, availability of eligible collateral, its impact on various bank liquidity ratios, alternative sources of overnight funds, and most importantly, the price. We believe that if the Treasury increases the cost of the TT&L deposits to a new composite of the overnight repo rate, it would lead to a significant reduction in the number of banks participating in the program and the level of borrowings.

This statement is based on:

- Banks have access to a greater volume of funding products than the primary dealers, both domestic and overseas, and therefore their funding tends to be less expensive when viewed overall. In addition, the rate differential between secured financing and unsecured Federal Funds lending is much wider than two basis points. This spread would need to be reflected more equitably in this program in order to meet Treasury's desired volume levels.

- The proposed TT&L rate of Federal Funds minus two basis points, is an expensive rate for funds that are not guaranteed to be rolled over, and notification may not occur until 11:00 AM. This level of uncertainty takes the banks out of the early funding market, and could result in higher funding costs were the Treasury to withdraw its funds and the overnight interest rate moved up. In addition, the institutions that are creating a TT&L position by reversing in collateral for pledging purposes will withdraw from the market, since the higher cost and the uncertainty of balances would eliminate any marginal income benefits.

- The Federal Funds effective rate is the base rate for all overnight and short date trading in the interbank market. It is well understood by the banking community and is a good base from which to price the TT&L deposits. Conversely, the primary dealers set the Repo rate in the securities market. It can trade at levels that are substantially under or over the Federal Funds effective rate, especially during tax payment periods. Banks will always evaluate this pricing difference before choosing a source of funds and will not access the Repo market if the rate is higher than the Federal Funds rate. By tying the cost of deposits to the Repo composite, the Treasury would be adding an additional layer of uncertainty to the cost of TT&L. This will most likely further reduce bank participation. It is important that any price be related to the Federal Funds effective rate to facilitate the comparison of actual cost of funds to banks.

- Any Treasuries or Agencies securities pledged at TT&L can not be used for regular Repo activities and thus are not eligible for netting in the Government Securities Clearing Corporation (GSCC) system. This benefit has become a significant means to reduce overall balance sheet footings. If the TT&L is priced at the overnight Repo composite rate, banks will not have an incentive to turn to the TT&L facility, but rather will enter into Repos with other GSCC eligible members. This alternative can potentially reduce their balance sheets, a significant benefit when analysts review return on assets performance.

- Furthermore, if the processing costs of moving collateral to the TT&L account is combined with the adverse effect on the borrowing institutions liquidity ratios, the proposed TT&L facility offers only limited benefits to major banking institutions.

As is evident, the proposed pricing formula for TT&L balances, while intended to increase earnings for the Treasury, will discourage banks from utilizing this borrowing facility. Eventually, this could lead to reduced earnings for the Treasury and more complicated cash management activities. I believe that this runs contrary to Treasury's interest in view of the projected Federal budget surplus over the next decade.

If you have any questions, or would like to discuss these points further, please feel free to call me at 212-658-5786.

Sincerely:

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