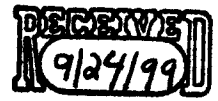


Crestar



Please delete any previous message from me regarding this, if received. This is the revised commentary:

TT&L
042

"Haircuts"

While newly instituted collateral values are generous for International Agency, Student Loan, Municipal Bonds, Corporate Bonds, and Money Market Instruments, they are quite low for Treasuries, Agencies, and all types of Mortgage Backed Securities. It is particularly of note that the Treasury will not take its own paper at 100% of market value, a practice normally followed by the repo market.

If repo customers demand more margin than market, the rate is sometimes adjusted to reflect that fact. The same should be true of TT&L deposits, particularly since both the existing and proposed arrangements require banks to keep excess collateral to allow for deposits coming in on any given day as well as the collateral margin.

Rate of Interest

Calculation of Overnight Repurchase Agreement Rate

It would be important to include the portion of the repo market that consists of transactions of \$1 million and less in the rate calculation, since a fairly large portion of TT&L payments are in this category. Typically, those transactions earn a rate at least 25 to 50 basis points less than that paid to competitively traded investments. If the repo rate calculation used by the Federal Reserve Bank of New York mirrors the Fed funds calculation, none of the small, low rate transactions will be included in the calculation. The dealers that I surveyed in preparing this do not want a daily repo rate published by the Federal Reserve Bank because they think their customers receiving 25 to 50 basis points under the market will want to know why they're not being paid Fed New York's repo rate.

In fairness to the banks, the size of an average TT&L transaction more closely mirrors the size of the smaller, direct repo trades, which is one reason to ensure that they are included in the average. Whether or not these smaller transactions are included would have an impact on the rate and on the willingness of banks to continue in the program.

Other Rate Considerations

If this change is instituted as proposed and the rate calculation is as indicated, there will be no reason for large institutions currently using Treasuries, agencies or mortgage-backed securities as collateral to continue keeping TT&L balances, since banks could finance these securities more cheaply in the repo or Fed funds markets. This is particularly true if the institution has good traders; pegging funding to an average cost is less attractive to institutions whose traders can beat the average. The additional haircut, excess collateral required for TT&L balances, and operational inefficiencies involved in maintaining collateral pledged to a ceiling level plus daily float will ensure that any reasonable institution will no longer accept substantial Treasury deposits.

Other Solutions

If the Treasury wants the advantage of the higher rate, it should hire traders to invest the majority

of the Treasury's funds in the repo market and eliminate a large portion of the existing TT&L arrangement. Banks and dealers could deliver securities to the U.S. Treasury's account at Fed New York. Standard market haircuts could be used. This process would pass on not just the higher rate to the Treasury, but also the cost of doing the transaction, which is currently borne by the banks, and any fail and credit risk. The practice of refusing to take securities that were reversed in by the counterparty should disappear, as well. A small portion of the existing TT&L program, that for "A" and "B" banks and up to a limited ceiling for "C" banks, might be left intact.

Conclusion

This institution is currently a note option bank with a ceiling of \$650,000,000 and ranks in the top 10 banks in its Fed district for accepting TT&L deposits. We would drop the ceiling to \$25,000,000 under the new proposal. Under current conditions, we have little interest in the fixed maturity proposal. That aspect of the proposal might be viewed slightly more favorably under different market conditions.