BARNEY FRANK, MA, CHAIRMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

SPENCER BACHUS, AL, RANKING MEMBER

December 12, 2008

VIA FACSIMILE

The Honorable Ben S. Bernanke
Chairman
The Federal Reserve Board
20th and C Street, NW
Washington, DC 20551

Dear Chairman Bernanke:

In recent weeks, bank loan terms have tightened and the nation's broader economic fundamentals have deteriorated. Although I am mindful that correlation does not necessarily suggest causation, I am writing to share my concern that the statutory provision authorizing the Federal Reserve to pay interest on member banks' required reserves and excess balances might also be discouraging these institutions from lending.

As you know, the Financial Services Regulatory Relief Act of 2006 that I co-authored originally allowed the Federal Reserve to begin paying interest on balances held by or on behalf of depository institutions beginning in 2011, but the Emergency Economic Stabilization Act (EESA) accelerated the effective date to October 1, 2008.

In normal economic circumstances I understand how paying interest on balances might help the Fed direct monetary policy. But it does not appear that this power has helped the Fed put a floor under interest rates. And it also seems to have given banks an incentive not to lend. I am concerned that this policy might be discouraging risk-averse institutions from lending money to consumers or other banks because they can instead deposit money at the Fed and collect interest at a rate of 1.0 percent. If that is the case, it would seem to undermine another Federal Reserve policy objective identified by Fed Vice Chairman Donald Kohn in a recent speech – "to create an environment in which, in the short run, banks can step up to fill as much of the gap as possible that has been left by still-dysfunctional markets, consistent with a strong, stable banking system."

When Congress passed EESA and authorized the expenditure of $700 billion, we did so because we wanted banks to deploy capital and liquidity, albeit prudently and responsibly. I would appreciate the Board's explanations as to (1) whether this new rule has had a counter-productive effect by limiting the efficacy of EESA; and (2) whether the matter requires modification, either by regulation or legislation.

Thank you for your consideration.

Sincerely,

Spencer Bachus

SPENCER BACHUS
Ranking Member