Promontory Interfinancial Network℠

Mark P. Jacobsen
President and CEO

Promontory Interfinancial Network, LLC
1515 North Courthouse Road
Suite 1200
Arlington, Virginia 22201
703-292-3400 F 703-528-5700

mjacaobsen@promnetwork.com

January 31, 2014

Office of the Comptroller of the Currency
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219
Attention: Legislative and Regulatory Activities Division
Docket ID OCC-2013-0016
RIN 1557 AD 74

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Robert de V. Frierson, Secretary
Docket No. R-1466
RIN 7100-AE03

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary
RIN 3064-AE04

Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Ladies and Gentlemen:

I am writing on behalf of Promontory Interfinancial Network, LLC ("*PIN*")[1] to comment on the notice of proposed rulemaking issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System (the "*Federal Reserve*") and the Federal Deposit Insurance Corporation (the "*FDIC*" and, together, with the Office of the Comptroller of the Currency and the Federal Reserve, the "*Agencies*"), entitled *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring* (the "*U.S. Proposal*").[2] In accordance with the international liquidity standards (the "*Basel LCR*") published by the Basel Committee on Banking Supervision (the "*Basel Committee*"),[3] the notice proposes rules (the "*Proposed Rules*") to implement the liquidity coverage ratio (the "*LCR*") in the United States for large, internationally active banking organizations, their respective consolidated subsidiary depository institutions with total assets of $10 billion or more, and nonbank

1 Founded in 2002, PIN provides funding, liquidity management and relationship-building solutions to the banking and brokerage industries.

2 78 Fed. Reg. 71818 (Nov. 29, 2013).

3 The Basel Committee published the international liquidity standards in December 2010 (*Basel III: International framework for liquidity risk measurement, standards and monitoring* (December 2010)) and revised the standards in January 2013 (*Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013)).

financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve that do not have substantial insurance activities (together, "*Covered Banks*").[4]

Our comments focus on a single component of the Proposed Rules – namely, their treatment of brokered deposits – and specifically on two specific aspects of this treatment:

- the distinction the Proposed Rules draw between fully-insured retail brokered sweep deposits from non-affiliates and fully-insured retail brokered sweep deposits from affiliates, and

- the outflow rate assigned to fully-insured wholesale reciprocal brokered deposits.[5]

We appreciate the Agencies' efforts in the Proposed Rules to address circumstances unique to U.S. banks and markets. Although the Basel LCR does not mention or refer to brokered deposits, brokered deposits (which under existing law are deemed to include sweep deposit and reciprocal deposit programs) are an important funding source for U.S. banks. We strongly believe that the proposed treatment of certain aspects of brokered deposits (particularly fully-insured retail brokered sweep deposits and fully-insured wholesale reciprocal brokered deposits) should be refined before the Agencies issue final LCR rules (the "*Final Rules*").

The Proposed Rules present three important threshold policy issues that must be addressed in order to avoid potentially significant unintended consequences:

(i) The treatment of fully-insured non-affiliated sweep deposits and fully-insured wholesale reciprocal deposits in the Proposed Rules would impair banks' access to these vital funding sources.[6] The fully-foreseeable consequence would be to divert a significant portion of the funds that these banks currently receive from these sources to money market mutual funds ("*MMMFs*")[7] and other investments outside the banking system. Such a regulation-induced

---

4 The U.S. Proposal also would include a modified LCR (the "*Modified LCR*") as an enhanced prudential standard for bank holding companies and savings and loan holding companies with at least $50 billion in total consolidated assets that are not internationally active and do not have substantial insurance activities. The term "*Covered Banks*" includes banking organizations subject to the Modified LCR.

5 Our Comments are responsive to Questions 47 and 48 posed by the Agencies in the preamble (the "*Preamble*") to the Proposed Rules. In Question 47, the Agencies seek comment on the proposed outflow rates for brokered deposits, and in Question 48 ask whether it is appropriate to assign different outflow rates to fully-insured brokered sweep deposits that originate with a consolidated subsidiary of a Covered Bank as compared to other fully-insured brokered deposits.

6 PIN offers the Insured Network Deposits® service ("*IND*"), which is a brokered sweep deposit service drawing funds from both non-affiliates and affiliates of receiving banks, the Certificate of Deposit Account Registry Service®, or ("*CDARS*"), which is a reciprocal brokered deposit service for time deposits, and the Insured Cash Sweep® service, or ("*ICS*"), which is a reciprocal brokered deposit service for non-time deposits. As of December 31, 2013, focusing only on these PIN services, sums flowing to banks through fully-insured retail brokered sweep deposits from non-affiliates were approximately $72 billion and from fully-insured wholesale reciprocal brokered deposits were approximately $24 billion. Industry-wide, the numbers are larger.

7 As a result of experience with MMMFs during the financial crisis (including the Reserve Fund's "breaking the buck"), the concerns of policy makers (including the Securities and Exchange Commission and Congress, as well as the Agencies) with the systemic risks posed by MMMFs have received substantial attention. Policy makers have not yet coalesced around a solution for addressing those concerns. Any regulatory action, by the Agencies or otherwise, that could have the consequence of pushing funds out of the banking system into MMMFs should be addressed with extraordinary care. Rules giving rise to that result are bad policy absent a

(continued...)

migration of funds out of the banking system and into MMMFs should not be brought about without significant additional consideration.

(ii) The Agencies have provided no data or empirical analysis to support the Proposed Rules' treatment of fully-insured non-affiliated sweep deposits and fully-insured wholesale reciprocal deposits. The disadvantaged treatment of these types of deposits as compared to affiliated sweep deposits and retail reciprocal deposits appears to rely on legacy assumptions about funding stability that are not supported by credible empirical analysis. The outflow rates proposed for fully-insured non-affiliated sweep deposits and for fully-insured wholesale reciprocal deposits are actually *contrary* to what the data shows to be the behavior of these deposits. Adoption of a requirement on the basis of assumptions that are contradicted by the available data would undermine the Final Rules and produce undesirable effects.

(iii) There are important consequences for community banks that need to be vetted before finalizing the Proposed Rules. Although the Proposed Rules do not directly apply to banks under $50 billion in consolidated assets, they introduce a new paradigm for all stakeholders to evaluate the implied liquidity risk associated with the various types of brokered deposits. Investors, creditors, depositors and customers will use the outflow assumptions in these Proposed Rules to draw conclusions about the stability of assets and liabilities regardless of bank size. For example, a community bank that offers fully-insured reciprocal brokered deposits to its commercial customers as a mechanism to keep deposit relationships in the local community is technically outside application of the Proposed Rules. However, a potential acquirer or institutional investor will look at the community bank's wholesale reciprocal brokered deposits and discount the value consistent with market "standards," irrespective of whether the Proposed Rules apply to any given institution. Said another way, it is only a matter of time before the liquidity risk implied in this new paradigm will become the standard across the industry. The Proposed Rules, by assigning excessive and unwarranted outflow rates to wholesale reciprocal deposits, would devalue precisely the type of relationship brokered deposits that strengthen community banks. In doing so, they would produce an immediate and unwelcome reduction in community bank franchise value.

Therefore, as the Agencies finalize the Proposed Rules, we encourage them to thoughtfully consider the ramifications – including those related to liquidity, capital, and credit availability – for banks of all sizes.

Based on PIN's experience with its own insured deposit placement services, PIN believes that the Agencies should refine their approach to brokered sweep and reciprocal deposits in two respects:

- <u>First</u>, fully-insured retail brokered sweep deposits from non-affiliates should be assigned an outflow rate that is not higher than the outflow rate assigned to fully-insured retail brokered sweep deposits from affiliates (a 10% outflow rate under the Proposed Rules),[8] at least if the decision maker for withdrawal of the deposits is only the retail customer and the additional

(...continued)

contravening valid and more important policy making such rules necessary. We do not believe any such other valid and more important policy exists in this case.

[8] Proposed Rules § 32(g)(5).

standards described in Part I, below, are satisfied. The Proposed Rules in their current form would apply a 25% outflow rate to retail brokered sweep deposits from non-affiliates.[9]

- Second, fully-insured wholesale reciprocal brokered deposits should be assigned the same outflow rate as fully-insured retail reciprocal brokered deposits (that is, 10% instead of the 40% outflow rate assigned by the Proposed Rules).[10] If the Agencies are reluctant to take that step because it would result in fully-insured wholesale reciprocal brokered deposits having a lower outflow rate than other fully-insured wholesale deposits, the Final Rules at the least should assign fully-insured wholesale reciprocal brokered deposits the same 20% outflow rate proposed for other fully-insured wholesale deposits.[11]

The Proposed Rules, like the Federal Deposit Insurance Act ("*FDIA*"),[12] use an exceedingly broad concept of brokered deposits, bringing within their scope any deposit "that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker" as defined in the FDIA. Although the FDIC has concluded that most sweep deposits, and all reciprocal deposits, are "brokered deposits" under that definition,[13] fully-insured retail brokered sweep deposits and fully-insured wholesale reciprocal brokered deposits (including deposits placed through PIN's IND, CDARS and ICS programs) behave like core deposits rather than typical brokered deposits, which are deposits raised from non-relationship customers by offering higher interest rates than are offered for core deposits to bricks-and-mortar customers. Moreover, PIN's own experience with its reciprocal deposit services (CDARS and ICS) shows that reciprocal deposits originating with wholesale customers are equally as stable as reciprocal deposits originating with retail customers.

Part I of this letter addresses our recommendations with respect to fully-insured retail brokered sweep deposits from non-affiliates; Part II addresses our recommendations with respect to fully-insured wholesale reciprocal brokered deposits; and Part III addresses an additional concern with respect to the Proposed Rules.

---

9 Proposed Rules § 32(g)(6).

10 Proposed Rules §§ 32(g)(3), 32(h)(1)(ii)(B).

11 Proposed Rules § 32(h)(i).

12 FDIA § 29(a), 12 U.S.C. § 1831f(a), provides that an insured depository institution that is not well capitalized "may not accept funds obtained, directly or indirectly, by or through any deposit broker." The Federal Deposit Insurance Corporation's ("*FDIC*") implementing regulations use a slightly expanded formulation that is identical to the definition of brokered deposit in Section 2 of the Proposed Rules. 12 C.F.R. § 337.6(a)(2).

13 Proposed Rules § 2. With limited exceptions, the FDIC has taken the view that a deposit broker includes any person engaged in the business of placing or facilitating the placement of deposits with FDIC-insured depository institutions. As a result, the existing category of brokered deposits encompasses virtually any deposit for which a third party has been involved with its placement, even if the deposit does not have the "fast money" characteristics that initially created concern with brokered deposits.

I. The Final Rules should assign the same outflow rate to fully-insured non-affiliated brokered sweep deposits of retail customers that the Proposed Rules assign to fully-insured affiliated brokered sweep deposits of retail customers, at least for arrangements in which (i) only the retail customer or counterparty may remove the bank from the sweep arrangements and (ii) the other standards described below are also met.

The Agencies note in the Preamble that the Proposed Rules "would assign brokered sweep deposits progressively higher outflow rates depending on . . . the affiliation of the broker sweeping the deposits." [14] The Preamble does not address, and does not cite any study or data supporting, the different treatment of non-affiliated and affiliated brokered sweep deposits.

The Agencies' more favorable treatment of affiliated as compared to non-affiliated sweep deposits appears to reflect an assumption that sweep deposits from affiliates are more stable than sweep deposits from non-affiliates. This assumption is not supported either by a consideration of the characteristics of non-affiliated sweep deposits of the kind swept by PIN's IND service or by any other available data. Moreover, non-affiliated sweep programs can be structured, as discussed below, to reduce even further any concern regarding their stability.[15]

First, experience shows that fully-insured non-affiliated brokered sweep deposits are just as stable as fully-insured affiliated brokered sweep deposits because they share four key characteristics:

- In non-affiliated sweep programs, as in affiliated sweep programs, *the customer funds swept to banks arise out of a relationship between a retail customer and a financial institution* – in this case, between an individual retail customer and a broker-dealer at which the customer maintains a brokerage account, likely to be a long-term relationship like the customer's relationship with its bank and, also like bank relationships, in many cases including other services.

- In non-affiliated sweep programs, as in affiliated sweep programs, *brokerage accounts are inherently "transactional*". There are typically multiple aspects to the brokerage account relationship, including not only the use of the account for securities transactions, but also transactions such as direct deposit, bill pay and checking.

- In non-affiliated sweep programs, as in affiliated sweep programs, *the customer chooses the broker*, and the broker-dealer sweeps the funds to banks with which it has contracted. In sweep programs such as IND, the broker identifies available banks and the customer approves banks that are acceptable to the customer. The broker is contractually obligated to fulfill the terms of its agreements with the banks.

- In non-affiliated sweep programs, as in affiliated sweep programs, *the average per-account cash balance that is swept is relatively modest* – on average during the years 2008 to 2012 for IND, approximately $11,000 (although recent market trends have increased customer holdings of cash and this average has modestly increased to approximately $14,000 at the end of 2013). The combination of small per account balances – which are fully-insured – and a large number of accounts and customers

[14] Preamble at 71840.

[15] Our comments in this Part I focus on, and address only, fully-insured retail brokered sweep deposits.

participating in each broker-dealer's program (totaling across all brokers approximately 7 million depositors with over 35 million individual bank accounts for IND at year-end 2013) contributes to the extraordinary stability of funds swept by a broker to individual banks across time periods, including during periods of stress.

- In non-affiliated sweep programs, as in affiliated sweep programs, and unlike typical brokered deposits, *customer funds are being swept to banks for convenience and FDIC insurance coverage, not to implement a retail customer's search for yield.* When customers are searching for yield, they use the same brokerage accounts involved to purchase securities.

Additionally, where the only decision maker on placements or withdrawals is the retail customer (and the broker, as intermediary, is not permitted to remove a particular bank from a customer's list of acceptable banks), the decision-making process that could lead to withdrawals if a bank became distressed is the same as the decision-making process for withdrawal of retail deposits.

Second, the Proposed Rules' distinction between affiliated and non-affiliated sweeps is not supported by the available data. While comprehensive, industry-wide data for brokered sweep deposits is not available, IND is both a non-affiliated and an affiliated sweep service and thus has a meaningful body of evidence from which conclusions can be drawn. We have included in **Annex 1** data addressing a variety of aspects of the performance of IND deposits from June 2007 through December 2013. It is important to note that the enclosed data concerning IND deposits reflects experience prior to PIN's enhancement of IND (not yet fully in place) to implement requirements that (i) the only decision maker on placements or withdrawals is the retail customer and (ii) the contractual arrangements governing the IND program are long-term (one-year or more). Even absent those enhancements, IND deposits have shown consistent stability. In particular, referring to Annex 1:

- As shown in Figure 1, IND balances by broker-dealer have steadily risen in value, without material decline.
- As shown in Figure 2, IND deposits of each participating broker-dealer's customers at the top 10 banks have shown month-over-month outflow of less than 10%.
- As shown in Figure 3, IND balances show very low day-over-day volatility.
- As shown in Figure 4, retail customer IND account balances remain stable over time, even as broker-dealer program balances increase.
- As shown in Figure 5, IND sweep deposits have actually increased, rather than having decreased, during crisis periods, reflecting customer perceptions of the safety of fully-insured sweep deposits as compared to alternatives.

PIN has also found that deposit balances at the non-affiliated banks have been at least as stable as those at affiliated banks. As illustrated in Figures 6 and 7 of Annex 1, this pattern is clearly seen in the behavior of sweep deposits that flow from the same broker to both an affiliated bank and non-affiliated banks. For more than five years, since the broker began sweeping funds through IND, month-over-month outflow has actually been even less for non-affiliated deposits than for affiliated deposits.

We recognize that PIN's experience with respect to IND may not be representative of every non-affiliated sweep program, and we understand the desire to have the Agencies' rules accommodate deposit categories (including non-affiliated sweep programs) broadly and not just individual programs or products. However, the IND program implements both affiliated and non-affiliated sweeps representing over $100 billion in combined balances and is the country's largest non-affiliated sweep deposit program. As Annex 1 shows, the available data, covering a period of more than seven years, makes clear that relevant outflow levels in IND have not exceeded the 10% outflow rate assigned to fully-insured affiliated brokered sweep deposits under the Proposed Rules, much less the 25% proposed outflow rate for fully-insured non-affiliated brokered sweep deposits.

Moreover, as discussed with the Agencies on prior occasions, PIN has given substantial thought to how it might enhance its IND program to provide further comfort to the Agencies as to the stability of IND deposits. We believe that the three criteria specified below, if required of non-affiliated sweep deposits, strongly support applying an outflow rate to those deposits that is no higher than the outflow rate applied to affiliated sweep deposits. These three criteria (the "*Qualifying Non-Affiliated Brokered Sweep Standards*"), which are sufficiently broad to be included in the Final Rules, are as follows:

(i) the only decision makers on placements or withdrawals are (A) the retail customer and (B) for the limited purpose of administering the program (as reflected in the language suggested below), the program's administrator;

(ii) the contractual arrangements governing the sweep deposit program are long-term (with a remaining term of one year or more); and

(iii) the funds swept to the receiving bank originated from a transactional account (generally a brokerage account).

Given PIN's experience with IND showing that, even without these standards, non-affiliated sweep deposits are just as stable as affiliated sweep deposits, the enhancement provided by the Qualifying Non-Affiliated Brokered Sweep Standards should make non-affiliated sweep deposits even less subject to outflow. Hence, where the entire amount is covered by deposit insurance and the Qualifying Non-Affiliated Brokered Sweep Standards are met, PIN strongly believes that non-affiliated sweep deposits should be assigned an outflow rate that is not higher than the proposed 10% outflow rate for fully-insured affiliated sweep deposits.

Accordingly, PIN urges the Agencies, in the Final Rules, to further refine the Proposed Rules treatment of brokered sweep deposits by revising paragraph (5) of Section 32(g) of the Proposed Rules to read as follows:

> "(5) 10 percent of all brokered sweep deposits at the [BANK] provided by a retail customer or counterparty:
>
> (i) That **either:**
>
> **(x)** are deposited in accordance with a contract between the retail customer or counterparty and the [BANK], a consolidated subsidiary of the [BANK], or a company that is a consolidated subsidiary of the same top-tier company of which the [BANK] is a consolidated subsidiary; **or**
>
> **(y) if the deposited funds originated in the retail customer's securities account at a broker or dealer registered with the SEC under Section 15 of the Securities Exchange Act, are deposited in accordance with contractual**

arrangements, as applied to the [BANK], to the deposit broker and to any fiduciary, agent, custodian or person administering the arrangement (an "administrator"), (A) that have, at the time of deposit, a remaining term of at least 12 months and that may be terminated before the end of those 12 months only for breach of contract or as may be required by law (including an order of a regulatory authority) and (B) under which no person other than the retail customer or counterparty has the power or authority to terminate the placement of such retail customer's or counterparty's funds in deposits with the [BANK], except for the administrator in exercise of its administrative authority (and expressly not because of any determination relating to a change in the [BANK'S] financial condition, including the levels of its regulatory capital, or results of operations) or as may be required by law (including an order of a regulatory agency); and

(ii) Where the entire amount of the deposits is covered by deposit insurance;

(6) 25 percent of all brokered sweep deposits at the [BANK] provided by a retail customer or counterparty **and not described in paragraph (5);**

(i) That are not deposited in accordance with a contract between the retail customer or counterparty and the [BANK], a consolidated subsidiary of the [BANK], or a company that is a consolidated subsidiary of the same top-tier company of which the [BANK] is a consolidated subsidiary; and

(ii) Where the entire amount of the deposits is covered by deposit insurance."[16]

II. The Final Rules should apply the same outflow rates to reciprocal brokered deposits of wholesale customers as they apply to reciprocal deposits of retail customers. Consideration of the characteristics of fully-insured reciprocal brokered deposits as well as available data shows that fully-insured reciprocal brokered deposits of wholesale customers are equally as stable as fully-insured reciprocal brokered deposits of retail customers.[17]

The Proposed Rules' definition of reciprocal brokered deposits rests on two specific criteria:

(1) For any deposit received, the [BANK] (as agent for the depositors) places the same amount with other depository institutions through the network; and

(2) Each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members.[18]

The Agencies note in the Preamble, without drawing a distinction between reciprocal brokered deposits that originate with retail as opposed to wholesale customers, that "[r]eciprocal brokered deposits

---

[16] Additional text as compared to the Proposed Rules is in bold face.

[17] Our comments in this Part II focus on, and address only, fully-insured reciprocal brokered deposits where, if they originate with a wholesale customer, the customer is not a regulated financial company or other entity of the type enumerated in the lead-in to Section 32(h)(1) of the Proposed Rules.

[18] Proposed Rules § 2.

generally have been observed to be more stable than typical brokered deposits because each institution within the deposit placement network typically has an established relationship with the retail customer or counterparty making the initial over-the-insurance-limit deposit that necessitates placing the deposit through the network."[19] The Proposed Rules' assignment of outflow rates to reciprocal brokered deposits that originate with retail customers reflects that conclusion, assigning a 10% outflow rate to such deposits that are fully-insured and a 25% outflow rate to retail reciprocal deposits that are not fully-insured.[20] The Proposed Rules' assignment of outflow rates to reciprocal brokered deposits that originate with wholesale customers does not reflect that conclusion, assigning a 40% outflow rate to all wholesale brokered deposits, irrespective of whether or not they are reciprocal brokered deposits and irrespective of whether or not they are fully-insured.

The same characteristics[21] that contribute to the stability of retail reciprocal deposits contribute to the stability of wholesale reciprocal deposits (in each case as compared to other brokered deposits). Most important (and discussed further below), for both retail and wholesale reciprocal deposits, (i) the deposits arise out of the relationship between the member of the network with which the deposits originate and its customer and (ii) that member sets the interest rate on the funds it places with other network members.[22]

Again, as noted in Part I's discussion of brokered sweep deposits, we appreciate that the Agencies' rules must address deposit categories, and not simply (and more narrowly) specific and limited programs or products. However, based on PIN's experience with the two reciprocal brokered deposit networks that it administers (CDARS and ICS), and as can be seen from the information included in

---

19 Preamble at 71840. It is notable that the FDIC 2011 Report, although focused on whether brokered deposits contribute to bank failures and not specifically on their liquidity characteristics, also draws no distinction between reciprocal brokered deposits that originate with retail as opposed to wholesale customers, observing that "[b]ecause of the lack of sufficient data, the analysis could not reach firm conclusions, but it suggests that reciprocal deposits based upon real customer relationships...appeared likely to pose fewer problems than other brokered deposits, although they should not be considered core deposits." FDIC 2011 Report at 4.

20 Proposed Rules §§ 32(g)(3) and (4).

21 Blinder and Shastri, in their study "*Estimated Effects of CDARS Reciprocal Deposits on the Likelihood of Bank Failure*," which was attached to PIN's comment letter to the FDIC, dated January 3, 2011, found that the use of CDARS reciprocal deposits is associated with, if anything, a lower risk of bank failure. This conclusion is consistent with the finding reported in the paper "*Data-Driven Deposit Insurance Assessments*," May 1, 2011, by Professor Mark Flannery, who finds that CDARS reciprocal deposits are <u>not</u> associated with increased failure risk and are associated with lower resolution costs.

22 In reciprocal deposit programs, that member is customarily referred to as the "*relationship bank*" because the relationship bank has the "relationship" with the depositor providing the funds. Banks that receive funds placed through such a program are referred to as "*issuing banks*" or "*destination banks*." Funds are placed at destination banks in amounts below the FDIC standard maximum deposit insurance amount (currently $250,000) so that they will be insured under the FDIC's flow-through deposit insurance rules.

Annex 2,[23] there is no discernible difference in measures of stability of reciprocal deposits across retail and wholesale customers. In particular[24]:

- The CDARS reciprocal deposit early withdrawal rate has historically been less than 1% on a quarterly basis, dating from Q1 2007 to Q4 2013. For 2013, average early withdrawal rates were 0.79% for individuals, 0.48% for businesses, 0.19% for public entities and 0.42% for non-profits.

- The CDARS reciprocal reinvestment rate averaged 80.5% on a quarterly basis from Q1 2007 to Q4 2013. For 2013, average reinvestment rates were 85.8% for individuals, 85.4% for businesses, 73.3% for public entities and 84.2% for non-profits.

- The average monthly ICS reciprocal account closure rate in 2013 was 1.6%. For 2013, average closure rates were 2.5% for individuals, 1.5% for businesses, 1.3% for public entities and 1.2% for non-profits.

The Preamble's discussion of reciprocal brokered deposits does not identify any basis for concluding that such deposits originating with retail as opposed to wholesale customers, in each case as compared to typical brokered deposits of such customers, behave differently. Nor does it assert that the increased stability of reciprocal brokered deposits is limited to such deposits that originate with retail customers. Additionally, the Agencies do not cite any data or analysis that supports the conclusion that the acknowledged increased stability of reciprocal deposits is limited to such deposits that originate with retail customers. In the absence of data supporting an expectation that the incremental stability observed for reciprocal deposits would be limited to such deposits that originate with retail customers, we strongly urge that the Final Rules reflect the stability characteristics of reciprocal brokered deposits originating with wholesale customers by assigning such deposits the same outflow rate that applies to reciprocal brokered deposits originating with retail customers (10% in the Proposed Rules). If the Agencies are reluctant to take that step because it would result in a category of wholesale deposits having an outflow rate that is the same as the outflow rate for the corresponding category of retail deposits, we urge the Agencies at the least to reflect in the Final Rules the stability characteristics of reciprocal brokered deposits originating with wholesale customers by assigning such deposits the same outflow rates that apply to non-brokered deposits – that is, in the Proposed Rules, 20% if fully-insured and 40% if not fully-insured.

Importantly, the resolution of this issue will have significant implications for community banks. The preponderance of CDARS and ICS reciprocal deposits are held by institutions with assets under $50 billion. Indeed, a majority of reciprocal deposits, approximately $25 billion, are held by institutions with assets under $10 billion. We currently estimate that as much as three-fourths of reciprocal balances would not be considered retail.[25] Although community banks are not directly covered by the LCR, the

---

[23] As in the case of brokered sweep deposits, comprehensive, industry-wide data for reciprocal brokered deposits is not available. However, PIN processes the large majority of reciprocal deposits, and PIN has a meaningful body of evidence to support its conclusions arising from its operation of CDARS and ICS, PIN's two reciprocal brokered deposit programs. We have included in Annex 2 information relating to the behavior of reciprocal deposits in CDARS and ICS.

[24] Banks are eligible to place their own funds through CDARS and ICS, but such deposits as a percentage of overall reciprocal deposits are *de minimis*.

[25] CDARS and ICS reciprocal deposits are distributed as follows: Individuals – 19%, Businesses – 32%, Public Entities – 34%, Non-Profits – 14%, Banks – 1%.

assignment of the proposed 40% outflow rate to "wholesale" reciprocal deposits threatens to cause a serious problem for community banks by disrupting their existing funding positions and sharply reducing their franchise value.

The franchise value of a community bank depends in significant part on the price that a potential acquirer might be willing to pay for it. In turn, the price that an acquirer is willing to pay depends in significant part on the value that the community bank's deposit base would have to the acquirer. One of the marks of a strong community bank is that its deposit base includes significant amounts of deposits by local businesses with which the bank has a relationship. Reciprocal deposit services enable community banks to retain these large-dollar relationship customers. But if a prospective acquirer is subject to the LCR or believes that it might one day become subject to the LCR, then the price that it would be willing to pay for a community bank would likely be substantially diminished by the prospect that, after the acquisition, reciprocal deposits from business customers would become subject to a 40% outflow rate.

Given the importance of community banks' reciprocal deposits from local businesses, and given the consistent empirical evidence that wholesale reciprocal deposits are equally as stable as retail reciprocal deposits, retaining the currently-proposed outflow rates in the Final Rules for these deposits would – with no offsetting benefits – needlessly devalues the deposits of community banks, with immediate effect, entirely on the basis of a regulatory classification that, as shown above is not supported by, and is actually contrary to, the data.

III. The Agencies' reservation of authority provisions should recognize that circumstances supporting a deviation from literal application of the Final Rules could support lower and less constraining, and not only greater and more constraining, HQLA and related net cash outflow requirements.

Techniques and technology for gathering deposits and identifying characteristics that support their stability are developing and inevitably will further evolve over time. The Agencies, in the Proposed Rules' reservation of authority provision,[26] specifically address the possibility of imposing on a bank a requirement to hold an amount of high-quality liquid assets "greater than otherwise required" under the Proposed Rules, and more broadly (in Section 2(b)) recite that nothing in the Proposed Rules limits the authority of the Agencies to take supervisory or enforcement actions. We think it important that the Final Rules recognize the possibility of improved stability characteristics as compared to the assumption that the only sensible deviation from the Final Rules would be more rigorous and constraining of a possible need for more rigorous treatment on which the Proposed Rules are premised. Specifically, we believe the Agencies should preserve within the Final Rules the power and authority, without the need for a formal rulemaking process, to permit a bank to apply a lower outflow rate than would otherwise apply to particular categories of liabilities if and when a bank or banks make a proper showing to the Agencies that are their primary regulators that such lower outflow rate is warranted.

* * *

---

[26] Proposed Rules § 2.

Thank you for your consideration of our comments. Should you wish to discuss them further, please contact the undersigned at (703) 292-3333 (mjacobsen@promnetwork.com).

Sincerely,

Mark P. Jacobsen
President and Chief Executive Officer

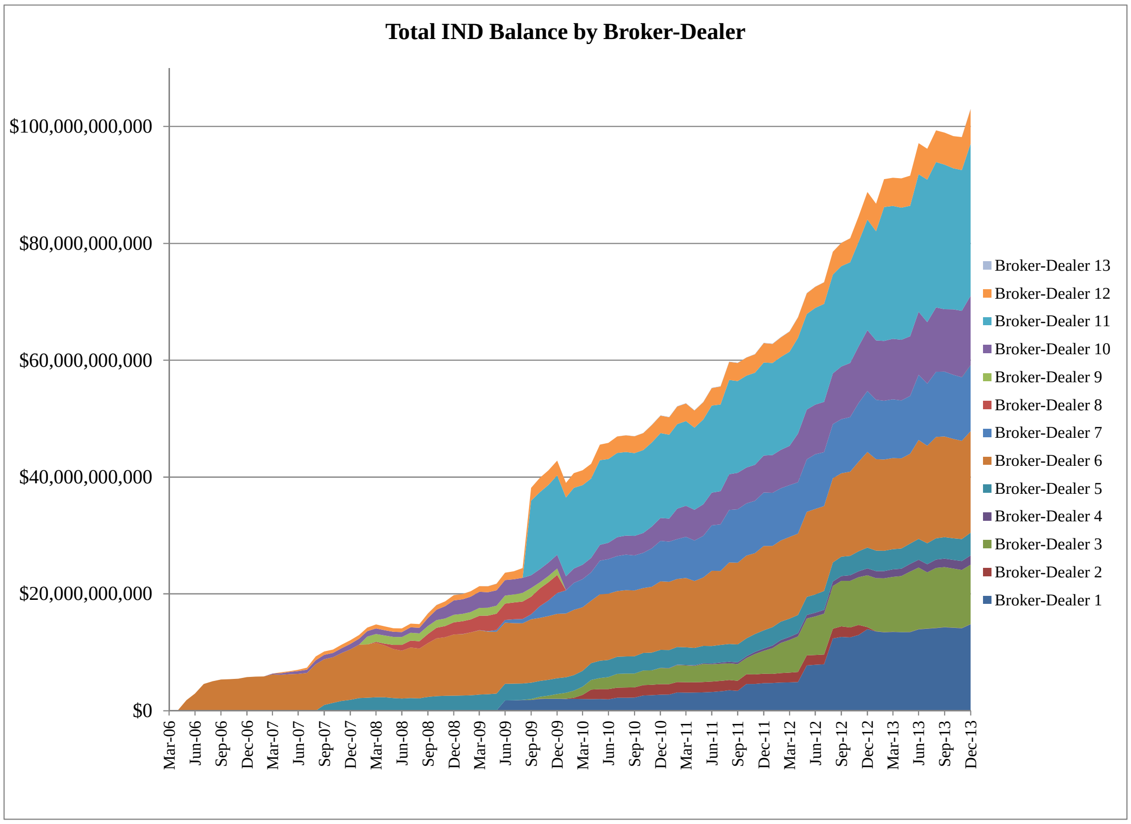
DATA AND STATISTICAL TABLES FOR PROMONTORY'S IND SERVICE

I. Stability of Sweep Deposits

A. IND balances by broker-dealer have steadily risen in value, without material decline.

Broker-dealer sweep deposits have provided a stable source of funding for decades. As shown in Figure 1, IND balances since inception have shown consistent and sustained growth. IND currently supports the sweeping of over $100 billion from broker-dealers into nearly 85 depository institutions.

Figure 1

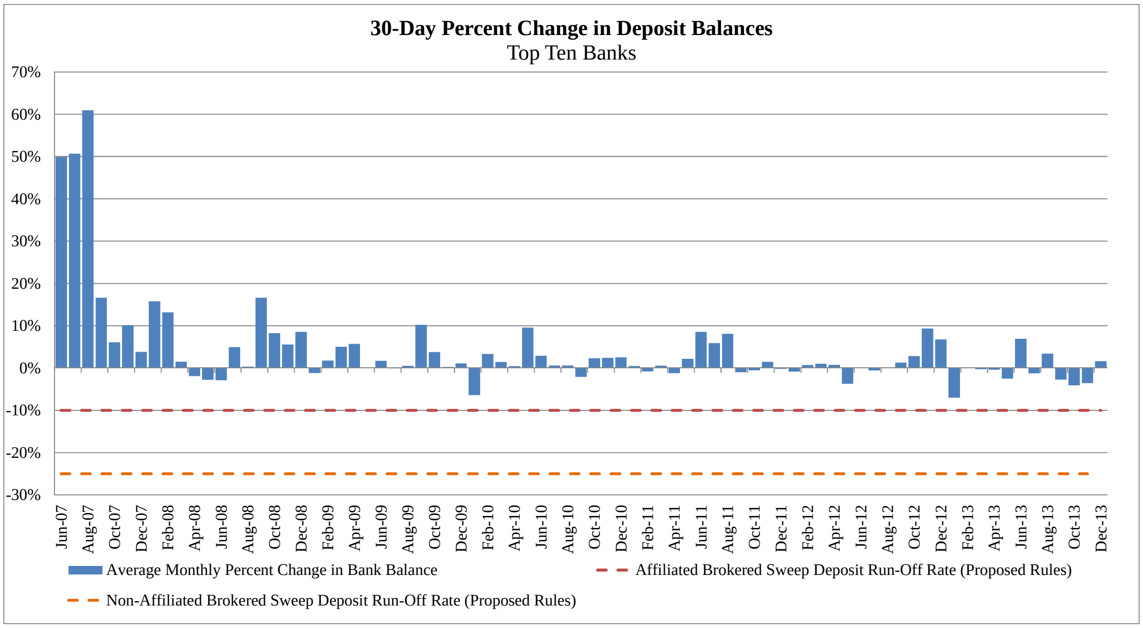


Source: Promontory Interfinancial Network

B. IND deposits of each participating broker-dealer's customers at the top 10 banks have shown month-over-month outflow of less than 10%.

Figure 2 below shows the results of a deposit outflow analysis examining the behavior of retail customers' IND deposits during 30-day periods, consistent with the Proposed Rules' LCR 30-day timeframe.[1] The sample included the top ten depository institutions with the largest IND balances. The outstanding balance of deposits decreased in 23 of the 79 months studied, and when the outstanding balance decreased at all, the decrease was minimal. In no circumstance did the decrease reach even the proposed outflow rate for affiliated sweep deposits.

Figure 2



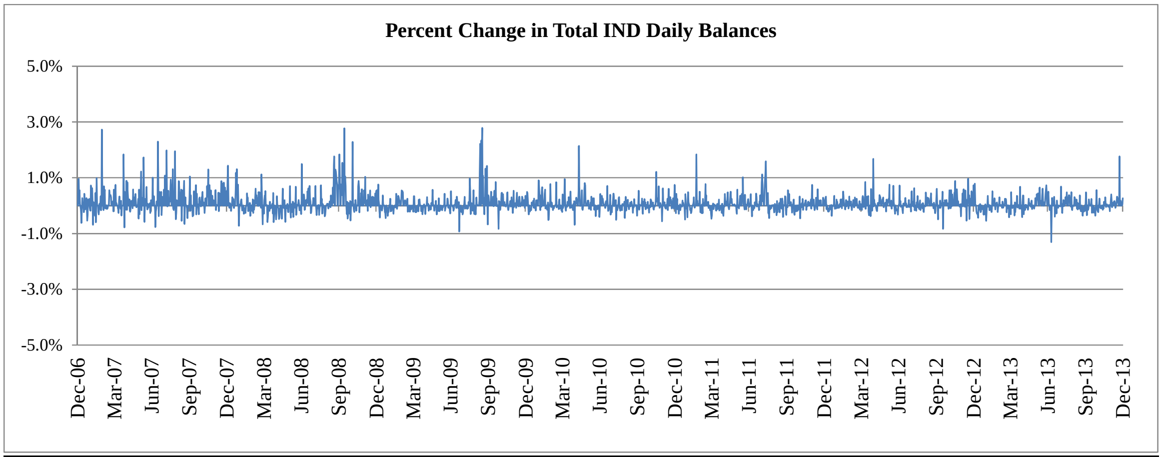
Source: Promontory Interfinancial Network

C. IND balances show very low day-over-day volatility.

As shown in Figure 3, since December 2006, the percent change in total daily IND deposits has remained largely within +/- 0.5% and has never exceeded 3.0%. The single largest daily outflow represented only 1.3% of outstanding IND program balances.

[1] The change in outstanding balance was calculated on the basis of total month-end deposits, including deposits from customer accounts that existed at the beginning of the month as well as new customer accounts that came into the bank over the course of the month.

Figure 3

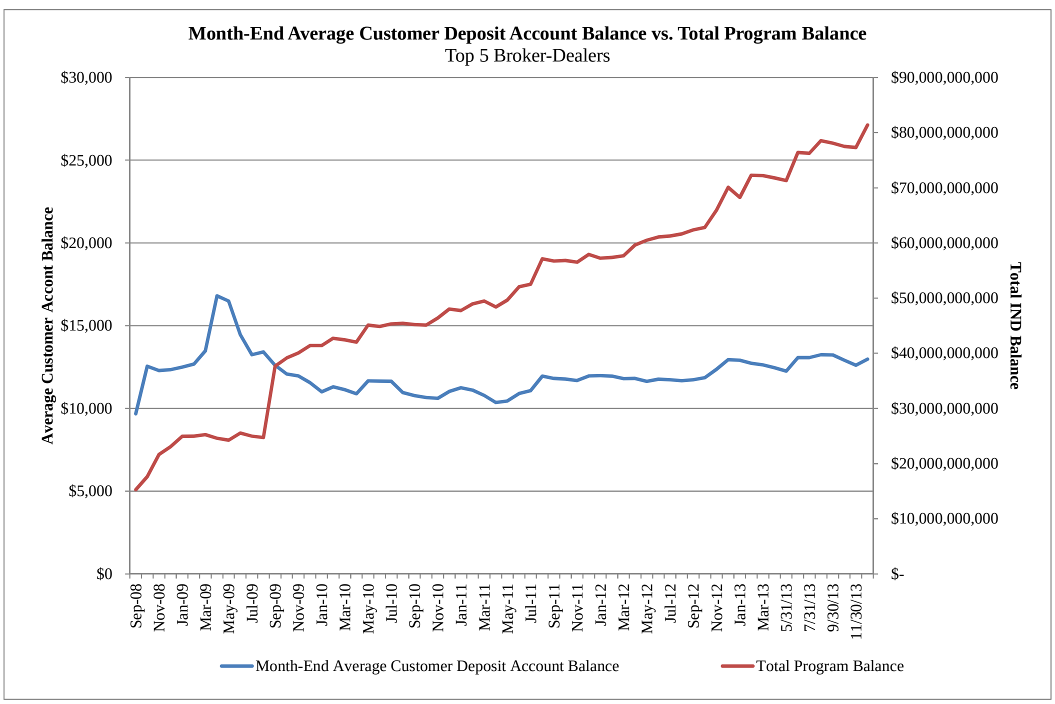


Source: Promontory Interfinancial Network

D. Retail customer IND account balances remain stable over time, even as broker-dealer program balances increase.

Figure 4 below shows average customer deposits and total IND deposits for the top five broker-dealers using IND, representing over $81 billion or 78% of total IND deposits. As total IND deposits for these five broker-dealers (red line) have increased during the time period, average customer deposits (blue line) have remained within a narrow, consistent range.

Figure 4

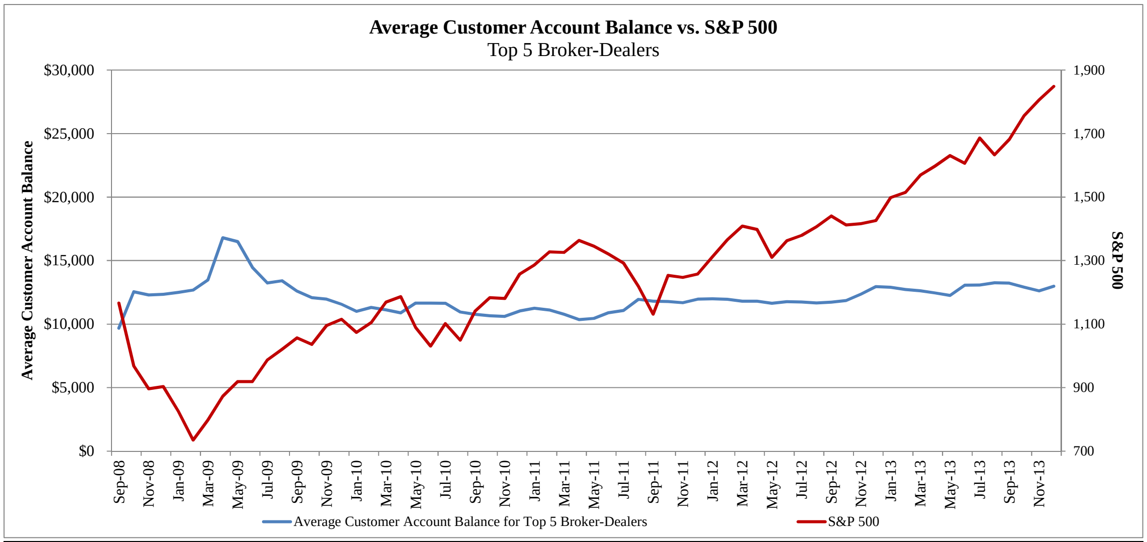


Source: Promontory Interfinancial Network

E. IND sweep deposits have actually increased, rather than having decreased, during crisis periods, reflecting customer perceptions of the safety of fully-insured sweep deposits as compared to alternatives.

Excess cash balance inflows from broker-dealers during crisis periods provide a key source of funding for banks because, when financial markets are under stress, brokerage customers typically increase their cash balances. PIN analyzed the relationship of customer deposits and market volatility and identified an inverse relationship. Figure 5 shows that average customer deposits for the five broker-dealers with the highest IND deposits rose as the S&P declined during the U.S. financial crisis in 2008-2009 and as Euro-region sovereign concern resurfaced in August – September 2011.

Figure 5

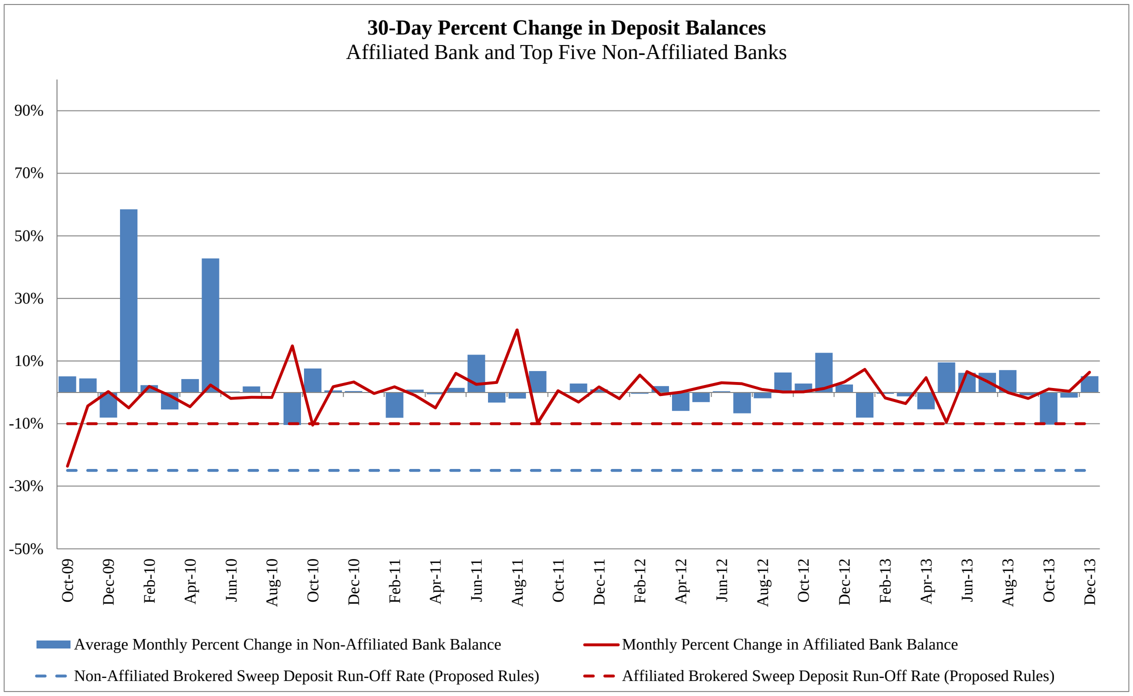


Source: Promontory Interfinancial Network

II. Affiliated and Non-Affiliated Sweep Deposits

PIN analyzed IND deposit stability for a broker-dealer that has one of the highest levels of IND deposits and sweeps funds both to an affiliated bank and to non-affiliated banks. First, PIN considered the month-over-month change in overall bank balances for the affiliated bank and the five non-affiliated banks that have received the largest amounts of funds from the broker. Second, PIN evaluated customer-level deposit data to determine whether there was any difference in stability between affiliated and non-affiliated banks. As shown in Figure 6, the data supports the conclusion that, since the broker began using IND in 2008, deposit balances at the non-affiliated banks have been at least as stable as those at the affiliated bank.

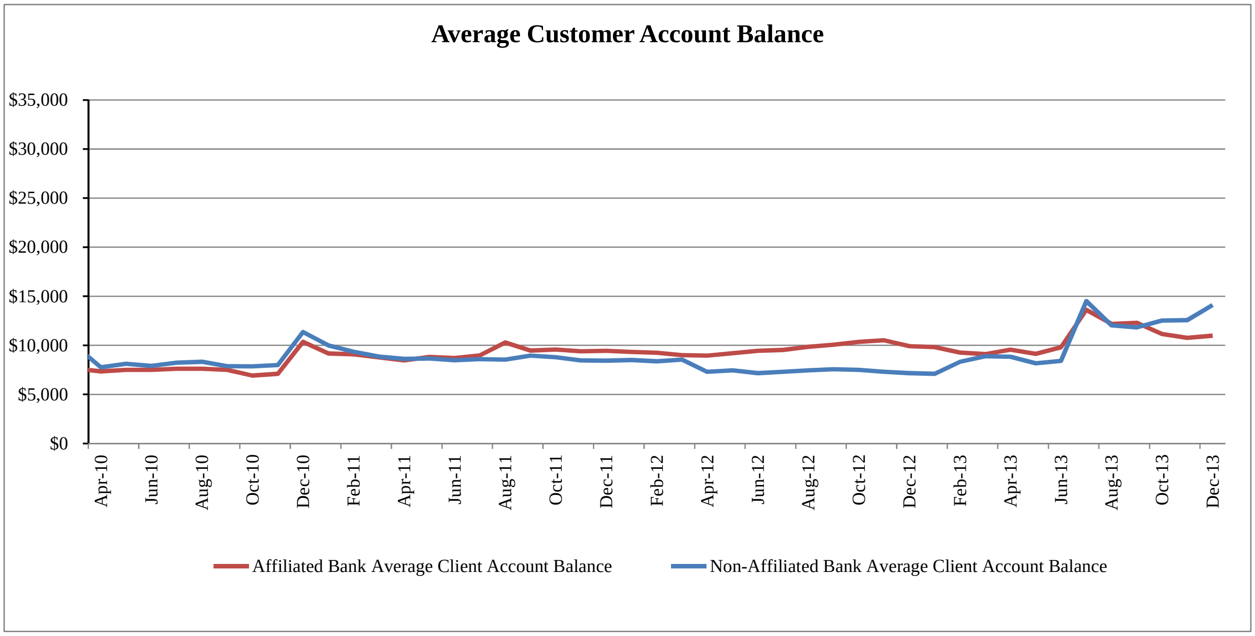
<u>Figure 6</u>



Source: Promontory Interfinancial Network

Figure 7 shows the average customer account levels of the affiliated bank and the non-affiliated banks for the large broker-dealer referred to above. As Figure 7 shows, average customer-level deposit balances and month-over-month changes in balances for affiliated and non-affiliated banks have remained consistent.

<u>Figure 7</u>



Source: Promontory Interfinancial Network

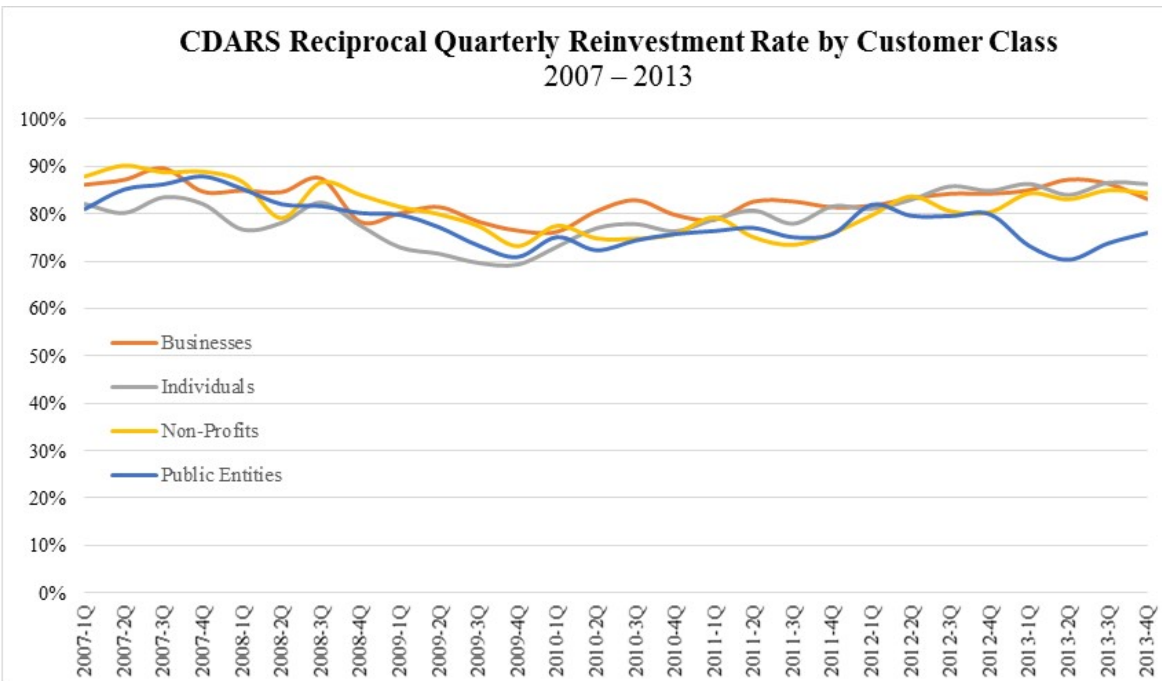
Annex 2

DATA AND STATISTICAL TABLES FOR PROMONTORY'S RECIPROCAL SERVICES (CDARS AND ICS)

A. Deposit stability as measured by CDARS reinvestment rates for reciprocal deposits is consistent across retail and wholesale customer classes.

Figure 1 shows reinvestment rates for CDARS reciprocal deposits on a quarterly basis from Q1 2007 to Q4 2013. As Figure 1 conveys, retail and wholesale customer classes were highly consistent in reinvestment rate throughout this period, which included the most recent financial crisis in its entirety. In 2013, the average quarterly reinvestment rates were as follows: Individuals – 85.8%, Businesses – 85.4%, Public Entities – 73.3%, and Non-Profits – 84.2%. As these uniformly high reinvestment rates reflect, deposit stability as exhibited by a high reinvestment rate is a characteristic of both retail and wholesale reciprocal deposits.[1]

Figure 1



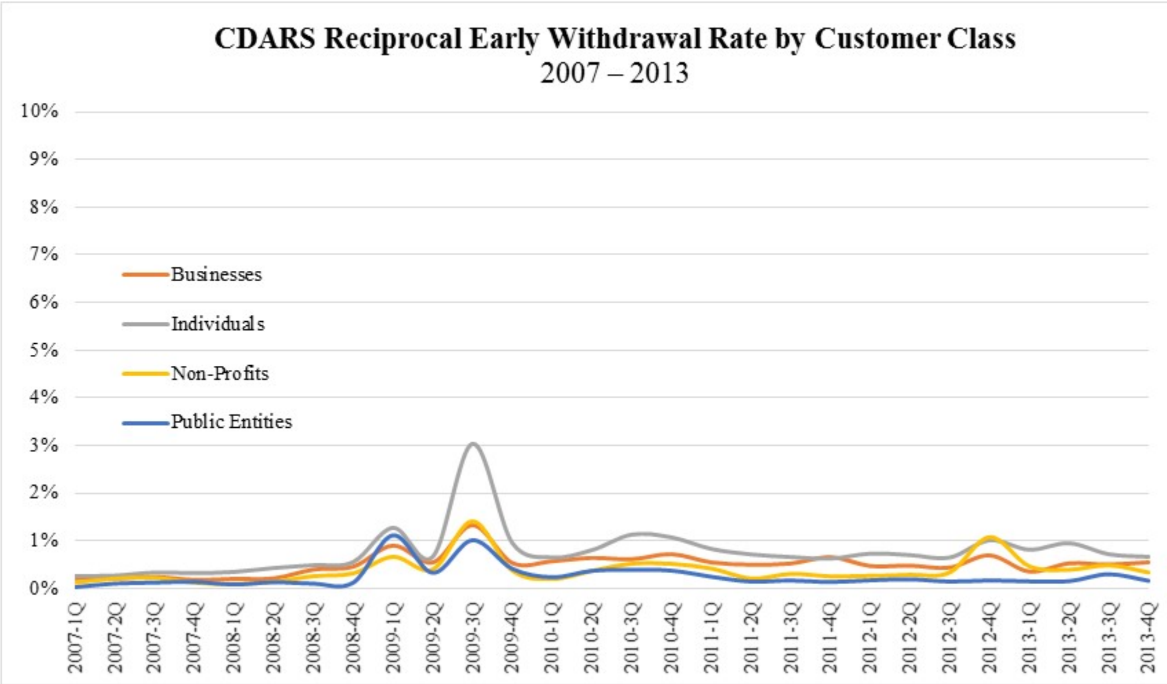
Source: Promontory Interfinancial Network

[1] CDARS reciprocal deposits are held by the following customer classes: Individuals – 19%, Businesses – 32%, Public Entities – 34%, and Non-Profits – 14%. Although banks can also place their own funds, their overall share of reciprocal deposits is *de minimis*.

B. Deposit stability as measured by CDARS early withdrawal rates for reciprocal deposits is consistent across retail and wholesale customer classes.

Figure 2 shows early withdrawal rates for CDARS reciprocal deposits on a quarterly basis from Q1 2007 to Q4 2013.[2] Figure 2 illustrates the exceptionally low early withdrawal rates across customer classes. In 2013, the average quarterly early withdrawal rates were as follows: Individuals – 0.79%, Businesses – 0.48%, Public Entities – 0.19%, and Non-Profits – 0.42%. As these rates show, customer classes that would be deemed wholesale by the Proposed Rules actually exhibited even lower early withdrawal rates than retail customers.

Figure 2



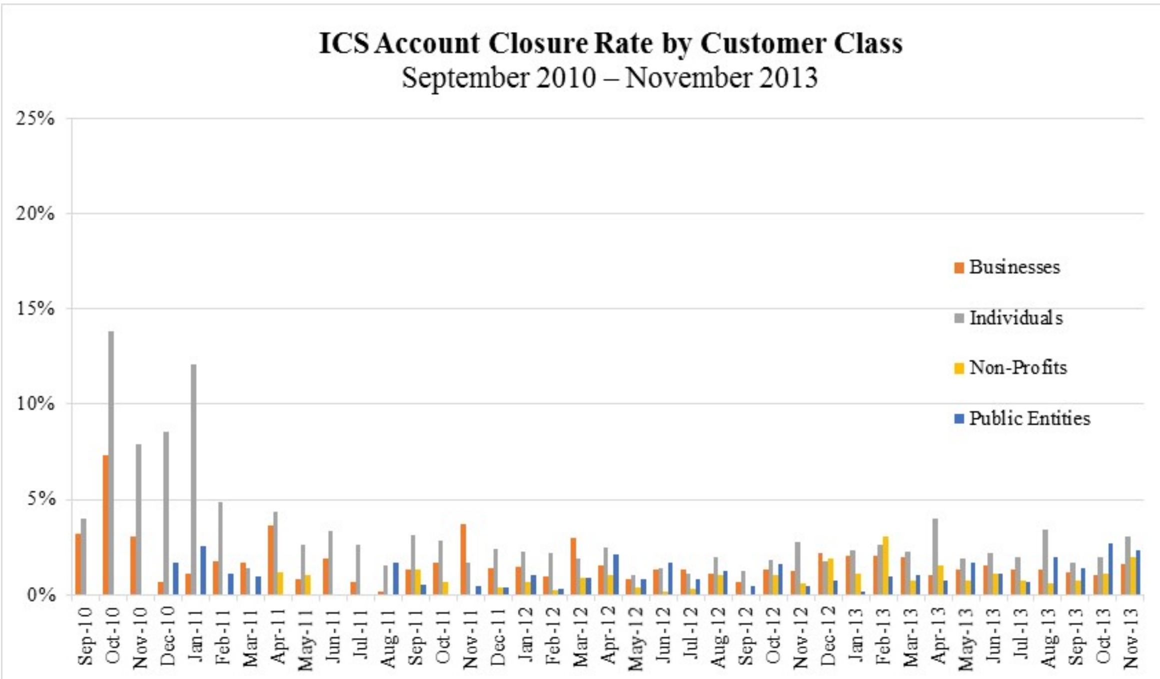
Source: Promontory Interfinancial Network

[2] CDARS reciprocal early withdrawal rate is defined as the sum of all early withdrawals made by customers of a given customer class in a given quarter divided by the beginning CDARS reciprocal balance for that class in the same quarter.

C. Deposit stability as measured by ICS account closure rates for reciprocal deposits is consistent across retail and wholesale customer classes.

Figure 3 shows ICS account closure rates since September 2010.[3] As can be seen, account closure rates for both retail and wholesale customer classes have been extremely low and getting even lower. In 2013, the average monthly ICS account closure rates were as follows: Individuals – 2.5%, Businesses – 1.5%, Public Entities – 1.3%, and Non-Profits – 1.2%. As these rates show, customer classes that would be deemed wholesale by the Proposed Rules actually exhibited even lower ICS account closure rates than retail customers.

Figure 3



Source: Promontory Interfinancial Network

[3] ICS account closure rate is defined as the total number of non-zero-balance accounts withdrawn to zero dollars in a given month, and never returned to a non-zero-balance account in any subsequent month, divided by the number of non-zero-balance accounts in a given month.