K&L GATES

K&L GATES LLP
1601 K STREET, N.W.
WASHINGTON, DC 20006
T +1 202 778 9000 F +1 202 778 9100 klgates.com

January 31, 2014

Rebecca H Laird
rebecca.laird@klgates.com

T +1 202 778 9038

By Email

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
regs.comments@occ.treas.gov
Docket ID OCC-2013-0016
RIN 1557 AD 74

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov
Docket No. R-1466
RIN 7100 AE-03

Robert E. Feldman
Executive Secretary
Attn: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@fdic.gov
RIN 3064-AE04

Re: Comments on Proposed Liquidity Coverage Ratio

Dear Sir or Madam:

We appreciate the opportunity to comment on the recent proposal titled Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring[1] (the "Proposal") issued by the Office of the Comptroller of the Currency ("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), and Federal Deposit Insurance Corporation ("FDIC," and together with the OCC and Federal Reserve, the "Agencies"). Our comments focus primarily on problems raised by the Proposal's treatment of brokered deposits, although we also raise certain other concerns at the end of this letter.

I. Problems Relating to the Proposal's Treatment of Brokered Deposits

A. Incorporating the Existing Definition of "Brokered Deposit" is Counterproductive

We appreciate that when looking to implement the international standards on which the Proposal is based, the Agencies naturally look to existing means of classifying deposits under U.S. law. With

[1] 78 Fed. Reg. 71818 (Nov. 29, 2013).

brokered deposits, however, this effort will have consequences that we assume are unintended. To our knowledge, the brokered deposits concept is unique to U.S. law and, as explained below, is not designed for use as a measure of liquidity.

The Proposal's definition of "brokered deposit" mirrors an existing definition in FDIC regulations by capturing any deposit obtained, directly or indirectly, from or through the mediation or assistance of a "deposit broker," as that term is defined in the Federal Deposit Insurance Act ("FDI Act").[2] By doing so, the Agencies also import a body of administrative guidance interpreting that term, including a number of staff advisory opinions.[3] The FDI Act's definition of "deposit broker" was developed many years ago and for very different purposes than measuring liquidity. When first adopted and when the bulk of the FDIC's advisory opinions were issued, the FDI Act required all deposit brokers to register with the FDIC. The FDIC's advisory opinions were thus focused on the degree to which a third party was involved in facilitating the placement of a deposit--not on the relative stability of the deposits themselves.

Efforts to distinguish between different types of brokered deposits, in the FDIC's assessment regulations[4] and in the Proposal, show that not all brokered deposits present the same liquidity risk as the deposits referred by brokers at the time the deposit broker provisions were added to the FDI Act. In a recent study, the FDIC reviewed its treatment of brokered deposits ("FDIC Study")[5] and acknowledged that the brokered deposit regime under the FDI Act does not precisely fit for measuring the relative stability of deposits. Specifically, the FDIC Study concluded that certain classes of brokered deposits "appeared likely to pose fewer problems than other brokered deposits."[6] Importantly, the FDIC emphasized that it "could not reach firm conclusions" because of "the absence of sufficient data."[7] In the FDIC Study, the FDIC recommended not changing the brokered deposits regime under the FDI Act because the definition of deposit broker in the FDI Act was still somewhat useful predicting the probability that a bank would fail and the FDIC would use its discretion to offer administrative relief as necessary under that regime.[8]

Despite the FDIC's admission that it lacks sufficient data to reach firm conclusions about the relative stability of different types of brokered deposits, the Proposal incorporates the classifications discussed in the FDIC Study, without reference to any new sources of data.

To illustrate some of the possible unintended consequences of incorporating the FDI Act's definition of deposit broker, consider that deposits raised online through a listing service are not brokered deposits under current interpretations[9] and could be retail deposits under the Proposal, meriting a favorable assumed outflow rate of 10 percent. If a deposit raised through a listing service is a transaction account or if the depositor has a second account at the same institution, it might be given an even more favorable assumed outflow of 3 percent. Furthermore, consider the breadth of the definition of "deposit broker" in the FDI Act. A bank employee paid in any way other than "primarily in the form of a salary," *e.g.*, commissions, bonuses, or perhaps even hourly wages, to bring in deposits

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[2] *Compare* 78 Fed. Reg. 71818, 71857 (Nov. 29, 2013) (proposing § __.3) *with* 12 C.F.R. 337.6(a)(2); 12 U.S.C. § 1831f(g).
[3] Many of the staff advisory opinions are available on the FDIC's website at http://www.fdic.gov/regulations/laws/rules/4000-100.html.
[4] 12 C.F.R. § 327.8(q), Appendix A to Subpart A of Part 327, text below Table A.1.
[5] FDIC, Study on Core Deposits and Brokered Deposits (Jul. 8, 2011), *available at this link*.
[6] FDIC Study at 4.
[7] FDIC Study at 4.
[8] FDIC Study at 3.
[9] *E.g.*, FDIC Advisory Opinion 04-04 (Jul. 28, 2004); FDIC Advisory Opinion 02-04 (Nov. 13, 2002).

is a "deposit broker," and all deposits raised by the bank employee would be brokered deposits.[10] It seems like a curious result that a deposit raised through a listing service would get the more favorable outflow rate than a deposit with the same terms raised by a bank employee. Similarly, deposits referred by affiliates or a dual employee also would be brokered deposits and disfavored under the liquidity measures.[11] The number of additional relationships and the nature of the deposit (*i.e.*, checking, savings, etc.) have no bearing on whether it is a brokered deposit.

More significantly, the relative stability of a deposit has no bearing on whether it is a brokered deposit under the FDI Act. Treatment turns on whether a third party has received compensation for its role in referring a deposit to the bank. Even when a bank establishes a long term, direct relationship with the customer, the deposit will still be considered brokered if a third party received a commission or a referral fee of any sort. The FDIC Study identified certain characteristics that were "most useful" in evaluating deposit stability, including relative interest rates, whether deposits are gathered quickly or in bulk, and, to a certain extent, the existence of multiple customer relationships.[12] Concerning multiple customer relationships, the FDIC's study notes that "deposits that are based upon a customer relationship are likely to contribute to franchise value because they are more stable and they allow the bank to acquire long-standing relationships."[13] The Proposal accounts for this in the context of determining whether a retail deposit qualifies for the most favorable runoff rate, but ignores it in the context of brokered deposits, even though some brokered deposits may represent direct, long standing relationships with customers.

Another example of a likely unintended consequence is that deposits in certain sweep programs are not "brokered deposits,"[14] so they arguably would not be "brokered sweep deposits" under the Proposal. Inconsistencies like this, which appear to run counter to common sense, lead us to conclude that the brokered deposit regime under the FDI Act should not be incorporated into the final liquidity rule.

The international agreement on which the Proposal is based does not include a brokered deposits concept, and for the reasons explained above, the U.S.-specific brokered deposits concept should not be incorporated into the final liquidity rule. The Agencies should look to other, better suited measures of deposit stability when establishing assumed outflow rates.

B. <u>The Proposal Does Not Account for All Categories of Brokered Deposits</u>

In addition, the Proposal's categories of assumed outflow do not account for all types of brokered deposits. The Proposal has categories for brokered deposits that "mature" (presumably time deposits), brokered sweep deposits, and brokered reciprocal deposits, but there is no category for other retail brokered deposits. Other types of brokered deposits include brokered checking accounts, brokered savings accounts, and deposits referred by affinity groups, affiliates, or third party marketers.

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[10] *See* 12 U.S.C. § 1831f(g)(4)(B); FDIC Advisory Opinion 93-50 (Jul. 27, 1993), *available at this link*; FDIC Advisory Opinion 92-75 (Nov. 3, 1992), *available at this link*. The proposed definition of "retail deposit" expressly excludes all brokered deposits.
[11] *See* 12 U.S.C. § 1831f(g)(4)(A).
[12] *See* FDIC Study at 49.
[13] *Id.* at 51.
[14] FDIC Advisory Opinion 05-02 (Feb. 3, 2005).

C. The Proposal Does Not Contemplate Contractual Commitments in Brokered Sweep Programs

Especially troubling is the fact that the Proposal does not contemplate contractual requirements that exist in many brokered sweep programs. In these programs, brokers generally commit to maintain an aggregate deposit balance over a period of time. As with a time deposit, significant penalties apply if the broker reduces the balance below that minimum amount. The Proposal does not explain how these contractual commitments should be categorized or what outflow rate would apply. Because the Proposal refers to brokered deposits that "mature" within 30 days, it could be argued that brokered sweep deposits that are subject to a contractual period would not "mature" within 30 days and would be entitled to a more favorable runoff rate. It is not clear what the Agencies intend.

D. The Proposal Does Not Explain the Degree of Certainty Banks Must Have in Determining Full Insurance Coverage

Under the Proposal, the assumed outflow of a brokered sweep deposit appears to depend on whether the deposit is fully insured, but depository institutions participating in sweep programs might not be able to determine with certainty whether a deposit is fully insured. In sweep programs, brokers monitor account balances to ensure that the balance of each customer's funds in the sweep program does not exceed the deposit insurance limit, but brokers depend on customers to tell them if they have other funds with a particular institution outside of the sweep program. If a customer fails to notify the broker, the customer's total deposits with that institution could exceed the insurance limit. Similarly, depository institutions do not know the identity of the individual sweep customers so they cannot determine, with certainty, whether the insurance limit has been exceeded. This is also true for many brokered time deposits. The Proposal does not explain the degree of certainty the Agencies expect depository institutions to have when determining whether a brokered deposit is fully insured.

E. The Proposal Does Not Explain How Future Administrative Guidance Interpreting the Brokered Deposit Provisions of the FDI Act Will Affect the Proposed Liquidity Rules

Finally, the three Agencies have developed the Proposal jointly, but the FDIC has historically interpreted the FDI Act, including the brokered deposits provisions, independently. What procedures should interested parties follow when they need additional guidance on how to interpret the brokered deposit provisions of the final liquidity rule? How will future interpretations of the FDI Act issued by the FDIC affect the liquidity rule?

II. Other Concerns Raised by the Proposal

A. How Will the Proposal Impact the Housing Industry?

To some extent, the Proposal discourages covered companies from investing in the housing industry. GSE-backed securities would be subject to a 15 percent haircut when counting as high quality liquid assets, and any expected inflow from mortgage commitments within the next 30 days will be excluded from the net outflow calculation. It is unclear what impact this would ultimately have on mortgage markets.

B. How Will the Proposal Impact the Municipal Bond Market?

The Proposal also appears to discourage covered companies from participating in the municipal bond markets by excluding from the definition of high quality liquid assets securities and covered bonds issued or backed by states and municipalities. With fewer benefits for the largest institutions to participate in the market, it is unclear whether smaller institutions will make up the difference in providing support to the state and municipal bond markets.

III. Conclusion

In conclusion, we urge the Agencies to reconsider the importation of the brokered funds concepts from the deposit broker rules into the liquidity proposal.

Respectfully yours,

Rebecca H Laird,

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