

## MEMORANDUM

TO: Public File - Notice of Public Rulemaking: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring, (RIN 3064-AE04) (“Liquidity Coverage Ratio NPR”)

FROM: Sue Dawley, Senior Attorney, Legal Division

DATE: April 14, 2014

SUBJECT: Meeting with Representatives from TD Bank N.A.

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On March 12, 2014, FDIC staff, together with staff of the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, met with representatives of TD Bank N. A. (TD Bank)

Representatives of TD Bank presented their concerns and views with regard to certain provisions of the Liquidity Coverage Ratio NPR, which was issued in the Federal Register of November 29, 2013 (78 FR 71818), including (1) affiliated sweep deposits; (2) public and other collateralized deposits; and (3) harmonization of high-quality liquid asset designations across Basel jurisdictions.

The FDIC representatives at this meeting were:

- Kyle Hadley, Section Chief for Examination Support, Capital Markets/RMS
- Becca Berryman, Senior Capital Markets Specialist, Capital Markets/RMS
- Eric Schatten, Policy Analyst, Capital Markets/RMS
- Greg Feder, Counsel, Legal Division
- Sue Dawley, Senior Attorney, Legal Division

TD Bank’s representatives in attendance at this meeting were:

- Scott Ferguson, Senior Vice President, Treasury & Balance Sheet Management, U.S. Holding Company
- James E. Reilly, Senior Vice President, Director, Dodd-Frank Act Implementation
- Stephen J. Boyle, Executive Vice President, Chief Financial Officer
- Alan Jette, Executive Vice President, Treasury and Balance Sheet Management
- Trevor Hicks, Associate Vice President, Treasury and Balance Sheet Management

Materials provided by TD Bank are attached.



# **Liquidity Coverage Ratio (LCR) Considerations**

**Meeting with US Regulatory Agencies**

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TD Bank N.A.

March 12<sup>th</sup>, 2014

- We strongly support the objectives of the Liquidity Coverage Ratio (LCR) proposal in promoting liquidity risk management practices of the banking industry
- TD Bank is party to a long-standing sweep deposit program with its affiliate, TD Ameritrade. With regard to sweep deposits:
  - We agree that depositor relationship is a key indicator of deposit stability but in the case of sweep deposit programs we believe the relationship should be based on legal “affiliation”
  - Given our experience with sweep deposits through our relationship with TD Ameritrade, we recommend proposed outflow rates be adjusted to more properly reflect the underlying deposit liquidity characteristics
- Despite the collateral requirement, public and other collateralized deposits arise out of a banking relationship similar to other commercial deposits and should not be viewed as wholesale secured funding transactions.
- To the greatest degree possible, harmonization of acceptable High Quality Liquid Assets (HQLA) across Basel jurisdictions will reduce regulatory arbitrage transactions and unlevel playing fields.
  - Foreign banks should be permitted to use home country HQLA definitions if they are able to clearly demonstrate ability to create liquidity from qualifying debt instruments.



- TD US Holding Company is the 12<sup>th</sup> largest bank holding company in the United States with total assets of \$232 billion held primarily through its two banking subsidiaries (“the Banks”)
- Wholly owned subsidiary of TD Bank Group, second largest banking organization in Canada.

Conservative liquidity position due to strong liquidity risk management framework and structure of balance sheet:

- Internal liquidity risk management framework in line with LCR
  - Conservative policy limit - 90-day combined idiosyncratic and market event
  - Board policy requires “surplus” – defined as sources > requirements – at various points in time to 90 days.
- Balance sheet of a large US regional
  - Deposits raised through branches and TD Ameritrade sweep program. Deposit and capital used to fund personal and business loans and a high quality, liquid AFS/HTM investment portfolio
  - No trading assets or liabilities, no wholesale funding. Use of derivatives for ALM purposes only.

# Affiliated Sweep Deposits - Background

## *TD Bank and TD Ameritrade Relationship*



- **Affiliation**
  - TD Bank Group is the owner of 45% of TD Ameritrade's publicly traded parent company.
  - Our ownership level is capped under shareholder agreement.
  
- **Mutually beneficial sweep deposit program**
  - For the Banks, sweep deposit balances represent a stable source of relatively non-rate sensitive funds which can be invested in high quality (government and Agency securities, "AAA" asset-backed securities) at a positive return relative to the fee paid
  - For TD Ameritrade, the program allows more effective management of interest rate risk and lower levels of capital and expenses than would otherwise be associated with operating a banking subsidiary in full compliance with regulatory requirements.
  
- **Strong agreement in place containing elements which make deposit withdrawal highly unlikely during a liquidity stress event**
  - TD Bank has an exclusive bilateral sweep deposit relationship with TD Ameritrade, and does not bid on deposits to obtain funding, unlike the traditional brokered deposit or brokered sweep deposit models
  - TD Ameritrade is required to indemnify the Banks for any losses incurred due to changes in interest rates should TD Ameritrade not offer competitive interest rates to its customers and realize higher than expected deposit run-off
  - Banks have access to data in a detail sufficient to perform its own liquidity analysis and stress testing on a regular basis
  - Banks have access to deposit rate elasticity analysis and customer pricing details to establish a prudent non-trading interest rate risk position

# Affiliated Sweep Deposits

## *Affiliation contribution to sweep deposit stability*



- We agree with the notion implicit in the LCR Proposal that a relationship between counterparties adds to the stability of the deposits given the intermediary relationship involved
- However, we do not view “consolidation” as a necessary pre-condition for alignment of liquidity risk management between affiliates
- The concept of affiliation is well recognized in U.S. banking law. The existing regulatory framework covering transactions between affiliates (including Federal Reserve Act Sections 23A and 23B and Regulation W) requires all covered transactions to be on market terms and conditions consistent with arm’s length transactions and safe and sound banking practices.
  - TD Bank and TD Ameritrade are under common control for BHCA purposes
- Affiliate factors contributing to deposit stability and reducing liquidity risk of the receiving banks include:
  - Well structured deposit legal agreement that meets affiliate regulations and clearly sets out termination and withdrawal rights that minimize the risk of accelerated, non-client driven fund withdrawal

### **TD Bank / TD Ameritrade Deposit Agreement Provisions:**

- Two-year minimum notice period for termination,
- Orderly withdrawal provisions based on laddered maturity of underlying investments.
- Clear penalty language for early terminations due to client withdrawals to keep the Banks whole.

- Pricing on market terms to meet affiliate regulations, ensuring the banks are not paying above market rates
- Shared liquidity risk management practices including cross participation in governance forums (Board committees, Asset-Liability Committee).
- Provision of services, banking products and other arrangements between the parties
- Use of cross-marketing and common TD corporate shield / logo strengthens identity

These factors related to affiliation, verifiable through ongoing supervision, establish a high degree of alignment of liquidity risk management that protects the Bank in adverse or stress scenarios

# Affiliated Sweep Deposits

## *Stability of deposits*



- From a liquidity and interest rate risk perspective, we apply the same principles to the modeling of sweep deposits as we apply to other retail deposits. As shown in the following slides, our experience with sweep deposits (which we believe consistent with industry experience) demonstrates a significantly level of deposit stability, consistent with other retail deposit types.
- Sweep deposits do not share characteristics typically viewed as indicators of higher level of liquidity risk:
  - By definition, the deposits arise out of a broader “transactional” relationship with the broker. The cash deposit is not separately promoted and is only one aspect of a broader brokerage relationship.
  - Sweep deposits are not gathered through high customer rates.
- We have found balance stability at the customer level can be largely attributed to two characteristics:
  - **Balance level** – presence of deposit insurance
  - Nature of the **depositor** – individual vs managed by an investment adviser
- Recommended maximum outflow rates for affiliated sweeps aligned with those characteristics:
  - Insured individual depositor or adviser balance – no more than 10%
  - Uninsured individual depositor – no more than 20%
  - Uninsured adviser balance – no more than 40%

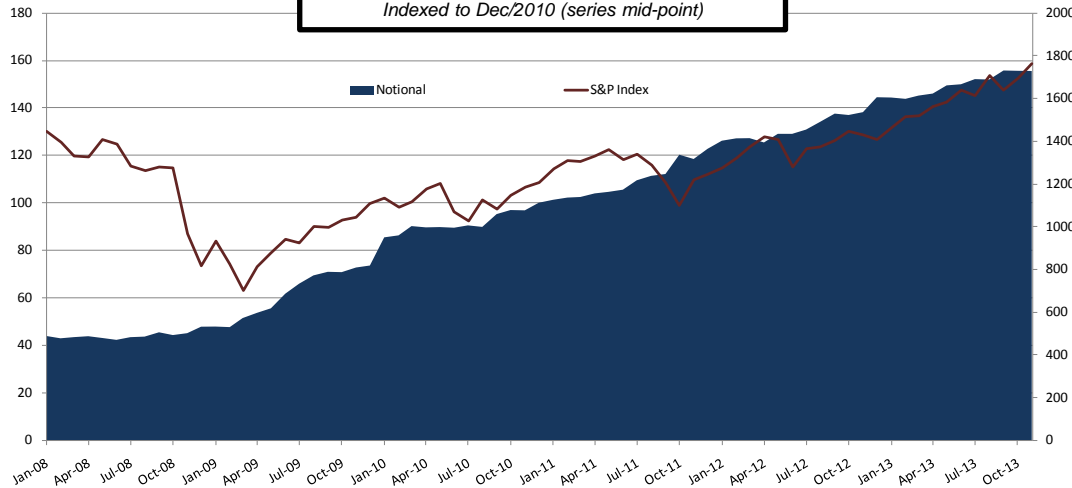
# Affiliated Sweep Deposits

## Historical Analysis

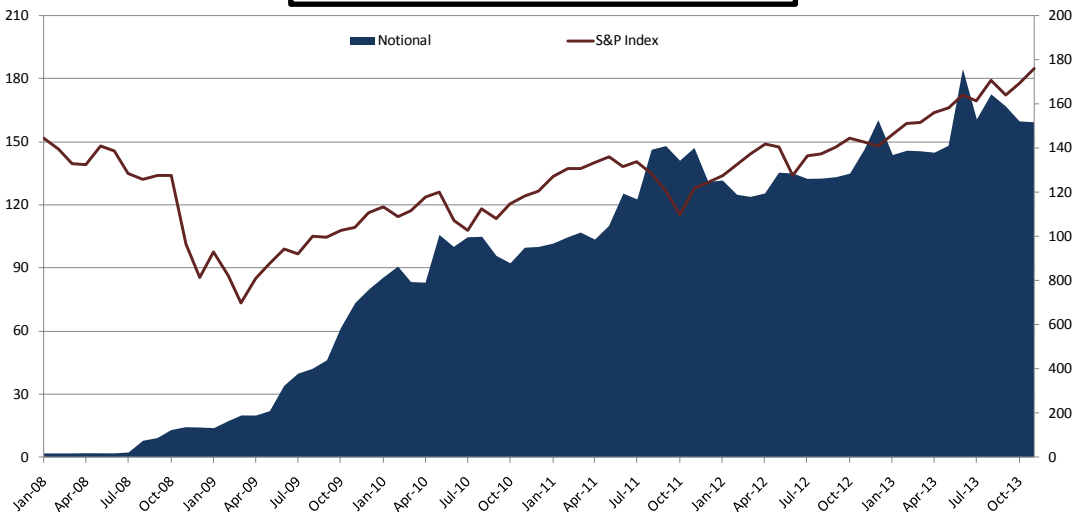


Consistent growth in both Retail and Adviser total balances over time and across equity market conditions

**Figure 1: Retail Segment Balance Growth**  
Indexed to Dec/2010 (series mid-point)



**Figure 2: Adviser Segment Balance Growth**  
Indexed to Dec/2010 (series mid-point)



Note: A degree of variability in cash balances (particularly in the Adviser segment) can be attributed to equity market conditions (with S&P 500 Index as a proxy) however this can be viewed as “right way” market liquidity risk as cash balances seen to have increased in reaction to the type of market declines that could be associated with a broad liquidity event.

**High level of deposit insurance coverage adds to stability and supports operational nature:**

Retail Segment:

- 92% of balances insured (83% fully insured)

Adviser Segment:

- 84% of balances insured (75% fully insured)

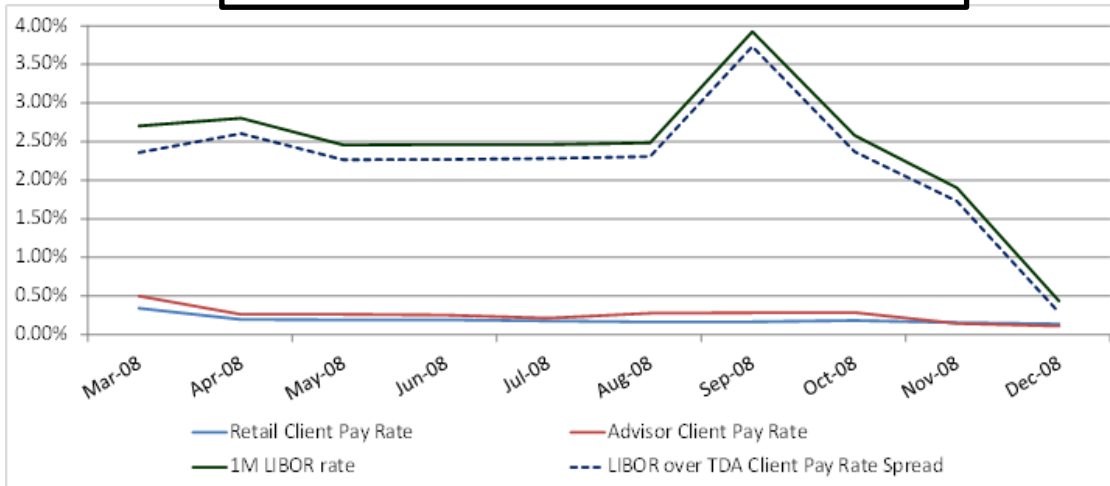


# Affiliated Sweep Deposits

## Not attracted through rate



Figure 3: Retail & Adviser Segment Pay Rate Pre-2009 History



Not attracted through high rates and not rate sensitive.

### Client pay rates\*

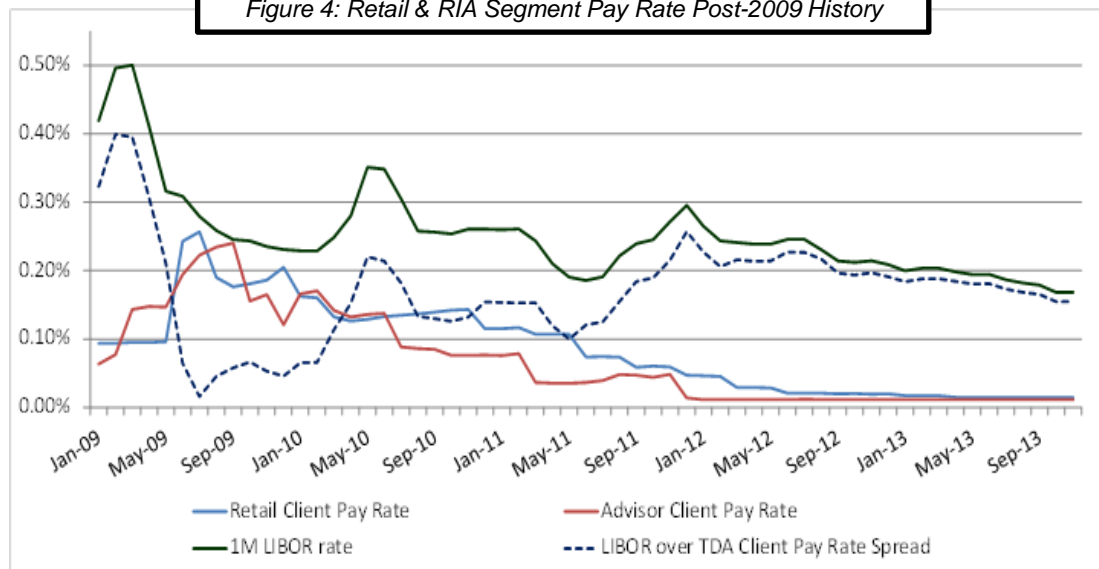
#### Retail deposits:

- 93.1% of balances at 0.01%
- Total portfolio pay rate: 1.4 bps
- Highest posted rate: 0.10%

#### Adviser deposits:

- 96.6% of balances at 0.01%.
- Total portfolio pay rate: 1.1 bps
- Highest posted rate: 0.05%

Figure 4: Retail & RIA Segment Pay Rate Post-2009 History



Compare to industry offered savings account rates of 0.40% - 0.60%+.

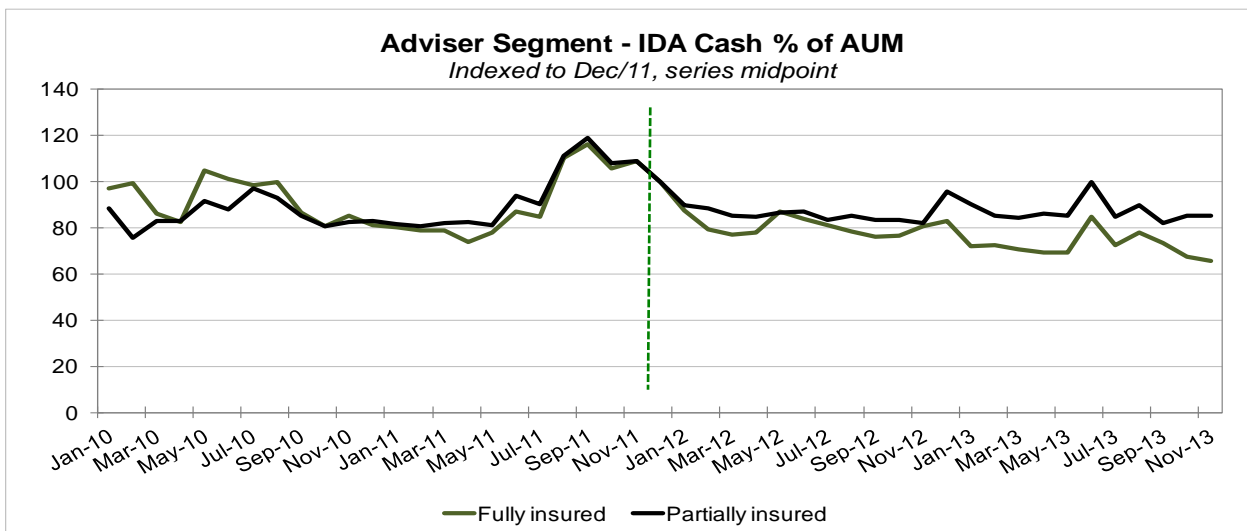
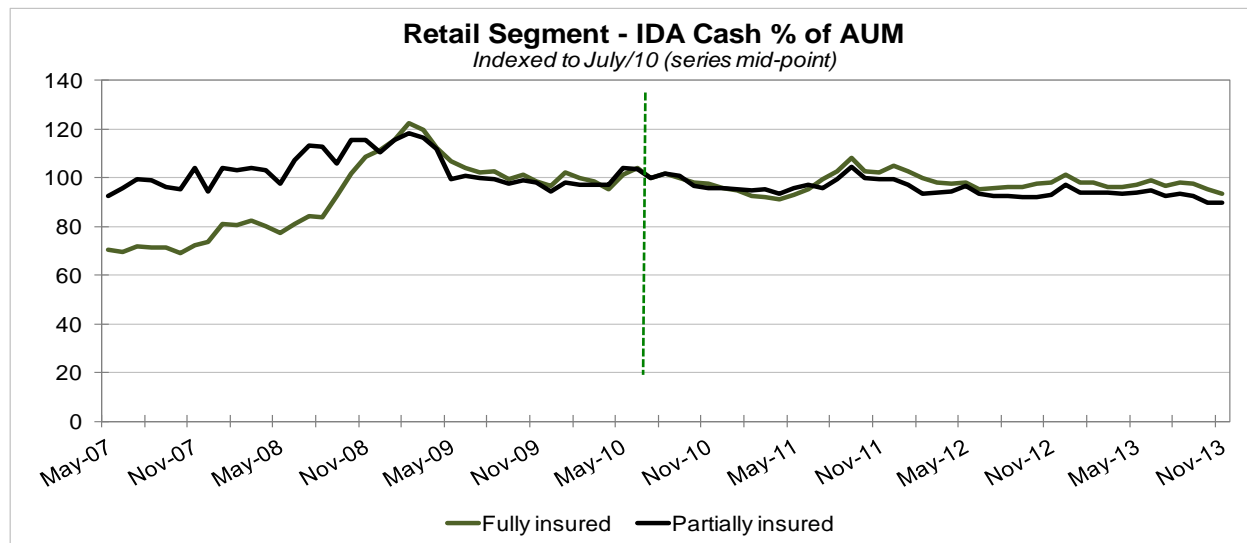
\* As at Mar/2014

# Affiliated Sweep Deposits

## Historical Trend – Cash % of Assets under Mgmt



Cash allocation relative to total account holdings shows a high degree of stability, supporting the assertion that cash balances perform a function as a “safe” investment in asset allocation and are not sensitive to market conditions.



Increases in retail cash allocation seen in late 2008 / early 2009 a function of market declines (increases denominator), money market mutual fund concern and active programs by TD Ameritrade to re-designate default sweep account option.

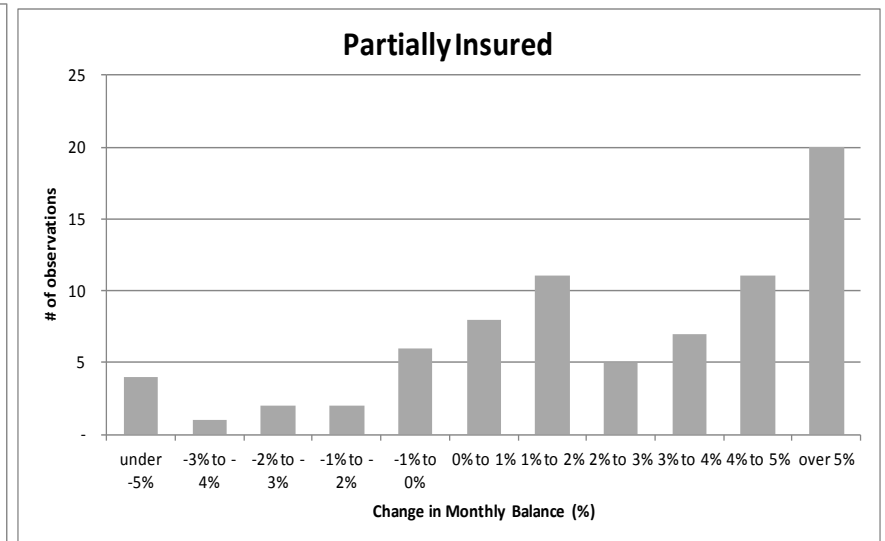
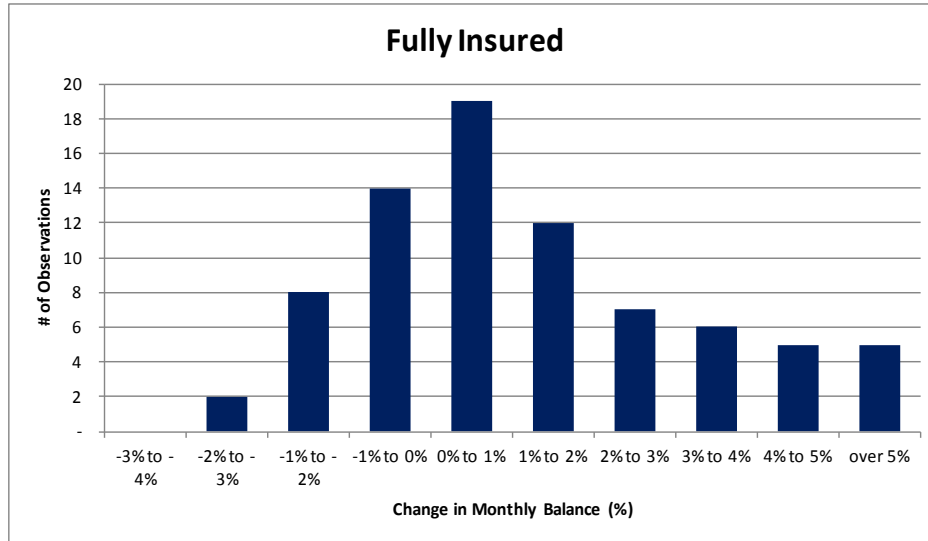
# Affiliated Sweep Deposits

## Balance decline statistics - Retail



Historical balance experience demonstrates stability with monthly balance fluctuations approximating a normal distribution with a positive “skew” (greater frequency of balance increases vs declines). Balance volatility consistent with retail deposit experience.

As at Nov 30, 2013		For Period May 31, 2007 to Nov 30, 2013				
		Average Decline	Maximum Decline	Standard Deviation Decline	Standard Deviation Total	
1	Fully Insured	83%	-1.0%	-2.8%	0.7%	3.2%
2	Partially Insured	17%	-3.1%	-12.2%	3.3%	5.3%
3	<b>Total</b>	<b>100%</b>	<b>-0.9%</b>	<b>-2.6%</b>	<b>0.8%</b>	<b>2.2%</b>



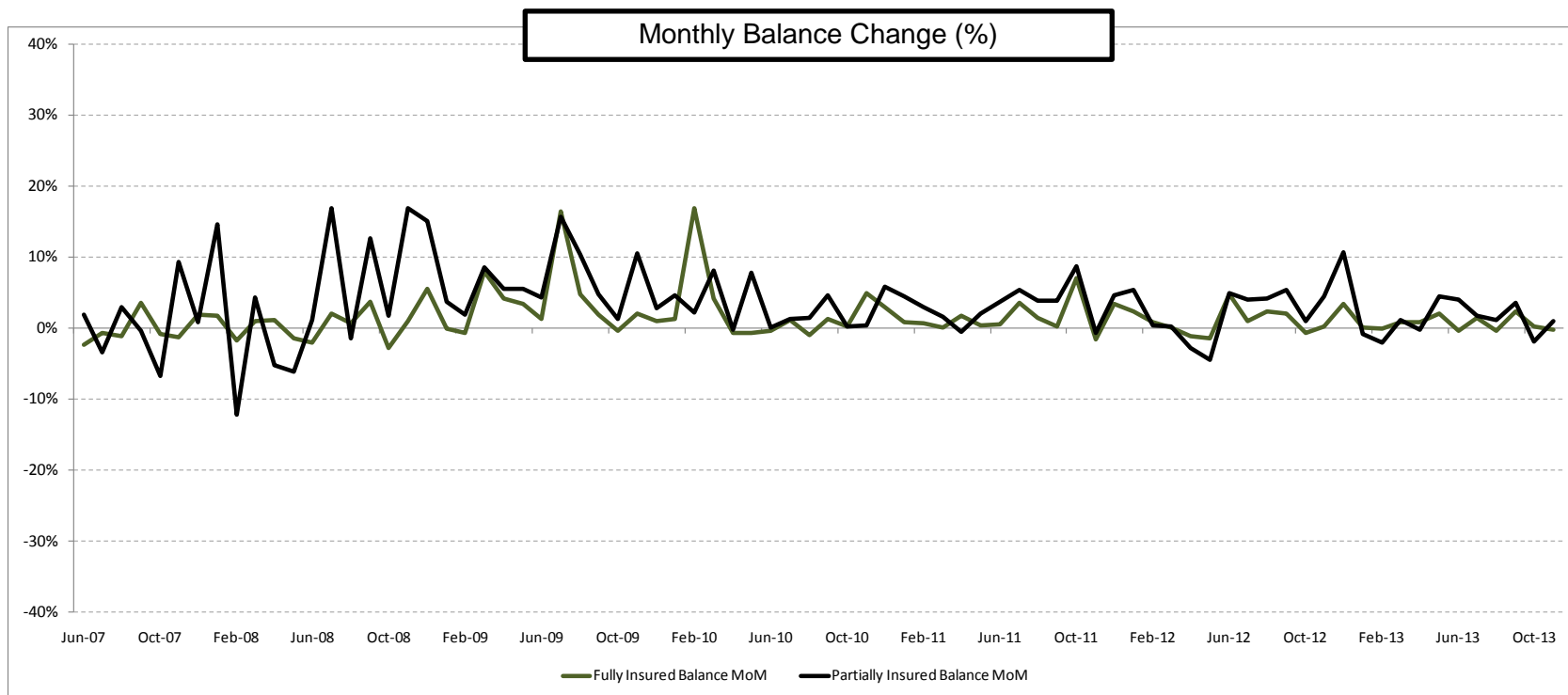
# Affiliated Sweep Deposits

## Balance decline statistics - Retail



Stability further evident when viewed as a trend line. Note that drops from peaks are not necessarily outflows, only reduced growth rates.

As at Nov 30, 2013		For Period May 31, 2007 to Nov 30, 2013				
		Average Decline	Maximum Decline	Standard Deviation Decline	Standard Deviation Total	
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# Affiliated Sweep Deposits

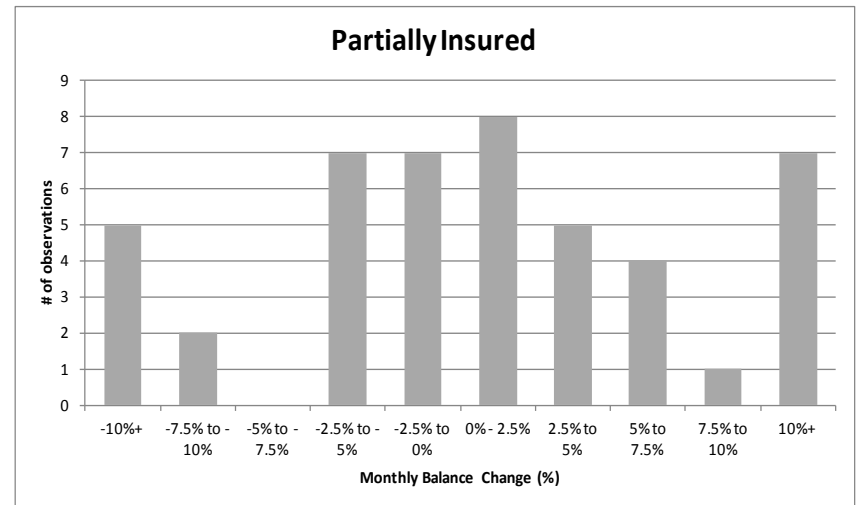
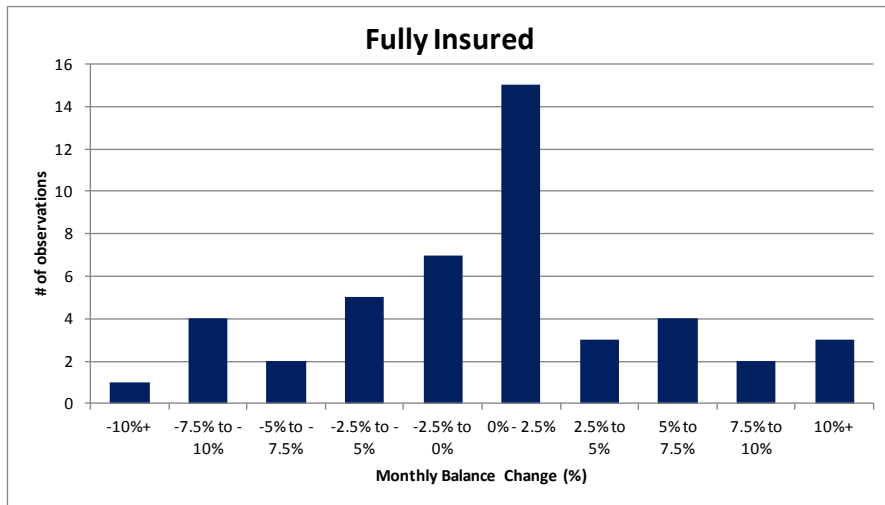
## Balance decline statistics - Adviser



As expected, somewhat greater volatility with accounts managed by investment advisers due to higher degree of active asset management, particularly on higher balances.

This volatility arises from active asset management and can be viewed as a positively correlated liquidity risk in that cash allocations will increase in response to negative market conditions and vice versa.

As at Nov 30, 2013		For Period Jan 31, 2010 to Nov 30, 2013				
		Average Decline	Maximum Decline	Standard Deviation Decline	Standard Deviation Total	
1	Fully Insured	75%	-4.1%	-10.5%	3.1%	5.5%
2	Partially Insured	25%	-6.4%	-20.0%	5.9%	10.7%
3	<b>Total</b>	<b>100%</b>	<b>-4.7%</b>	<b>-12.9%</b>	<b>3.8%</b>	<b>6.5%</b>



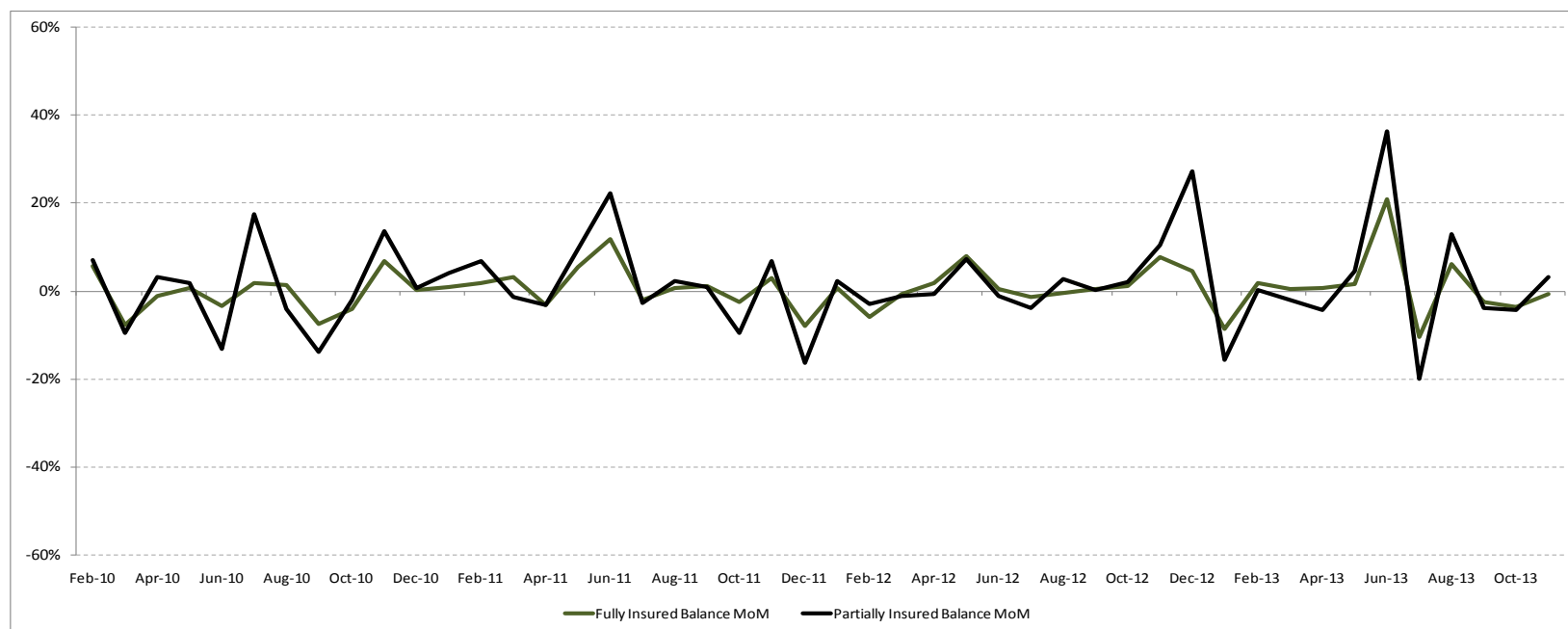
# Affiliated Sweep Deposits

## Balance decline statistics - Adviser

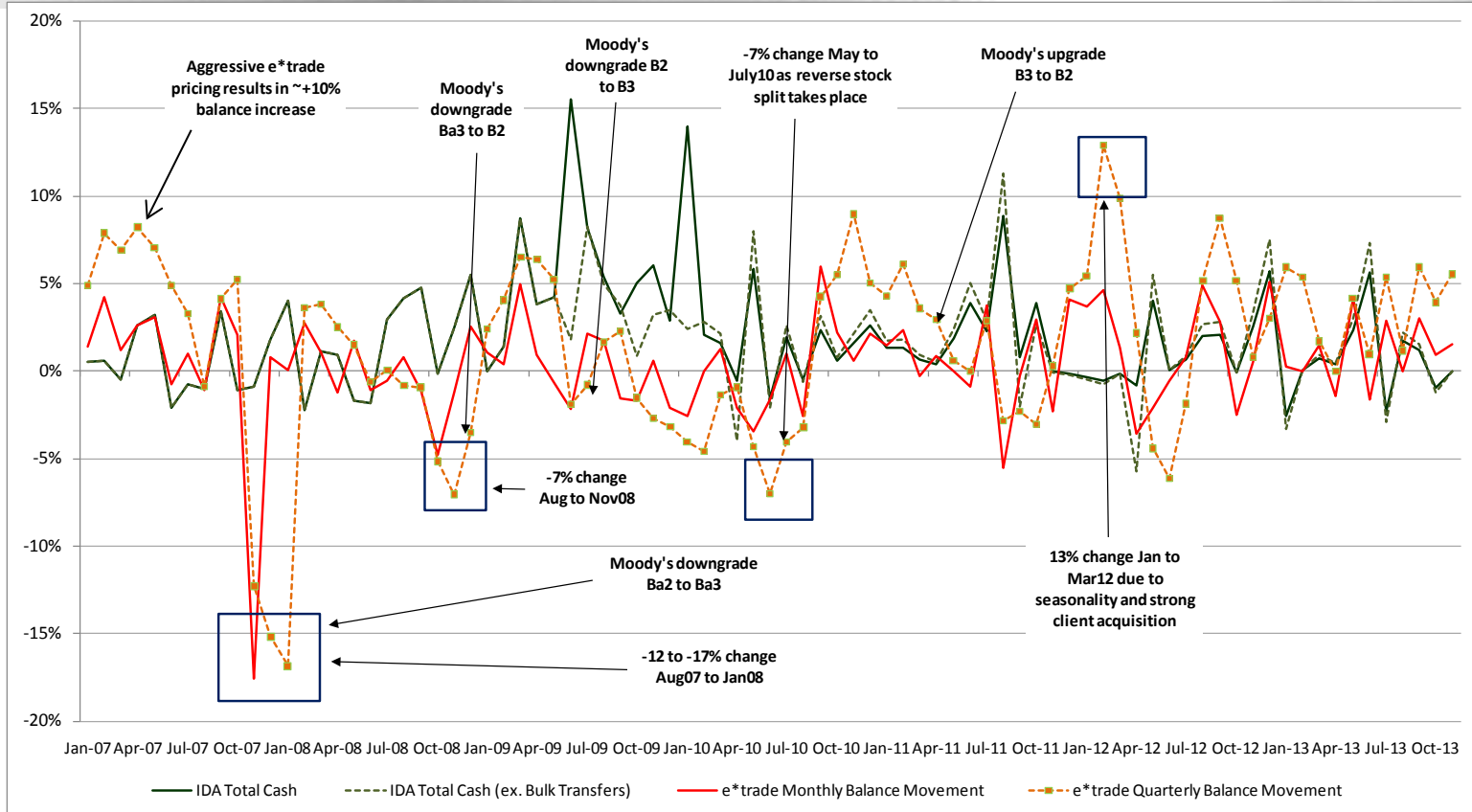


Trend line also supports a higher degree of active management. Note that peak decline in 2013 was preceded in the prior month by significant increase in cash balances. This was a reversal of an inflow, not outflow from “base” position. This is a pattern also observed in prior periods.

As at Nov 30, 2013	% of Adviser Segment	For Period Jan 31, 2010 to Nov 30, 2013			
		Average Decline	Maximum Decline	Standard Deviation Decline	Standard Deviation Total
1 Fully Insured	75%	-4.1%	-10.5%	3.1%	5.5%
2 Partially Insured	25%	-6.4%	-20.0%	5.9%	10.7%
<b>3 Total</b>	<b>100%</b>	<b>-4.7%</b>	<b>-12.9%</b>	<b>3.8%</b>	<b>6.5%</b>



# Idiosyncratic Stress – E\*Trade



- Publicly available cash balance results for E\*Trade over the past 6+ years incorporate relevant firm-specific factors
- Studied period includes negative press around credit exposure, credit rating downgrades and reverse stock split
- Results were used to calibrate TDAMT deposit analysis although much higher use of aggressive deposit pricing and lower deposit insurance limits need to be considered.

	For Period January 31, 2007 to November 30, 2013	Average Decline	Maximum Decline	Standard Deviation Decline
1	Month over Month	-2.4%	-17.6%	3.1%
2	3-Month over 3-Month	-4.3%	-16.9%	5.2%

Three month decline < 1 month decline points to short-lived deposit run-off.

# Public and Other Collateralized Deposits



- As written, the Proposal treats collateralized public and other deposits as secured funding transactions, in line with wholesale capital market repo activity:
  - Deposits are subject to the HQLA unwind requirements, creating the potential for a significant negative net outflow given most securities used as collateral are classified as level 2
  - The treatment of deposits secured by non-HQLA assets (e.g. FHLB Letters of Credit) is unclear but there is no clear recognition that this asset pledging adds to the stability of the deposit, which we believe it does
  
- We do not believe these deposit types do not behave as short-term secured funding transactions, they are stable relationship / operational balances:
  - Typically placed with banks for extended periods of time through a tender / RFP process
  - Deposit levels in GB accounts follow predictable cash cycles that follow their revenue and expense cycles.
  - The collateral requirement is typically mandated by applicable state law and by-laws
  - New deposit relationships or incremental deposit inflows not easily obtained in short periods of time
    - High level of friction costs (expense and time) in switching deposit providers.
  
- While collateral is not the primary driver of the relationship, the presence of collateral does add stability and we are recommending run-off factors based on viewing collateral as a proxy for deposit insurance:
  - Collateralized balances meeting definition of operational: 5%
  - Collateralized balances not meeting definition of operational: 20%



# Public deposits

## TD experience

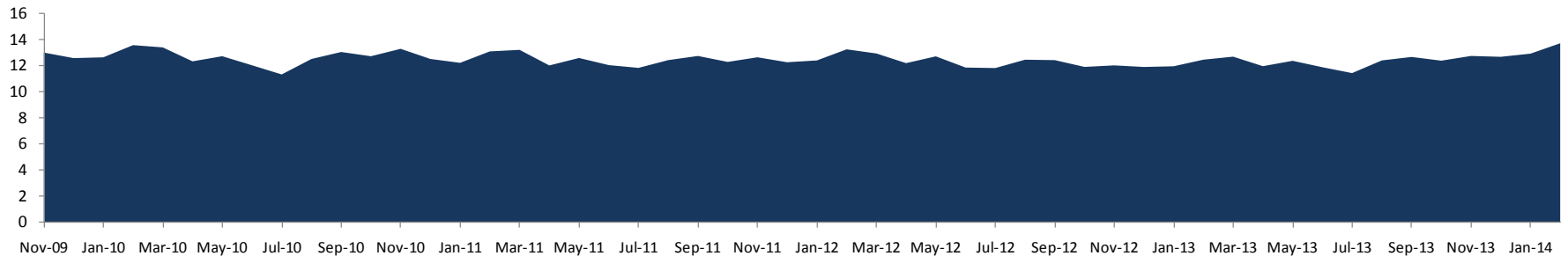


**TD Government Banking portfolio:** 3,000 State and Local Government Entities, with 14+ years avg. customer relationship length. Over \$13B in deposit volume, 5th largest in U.S.

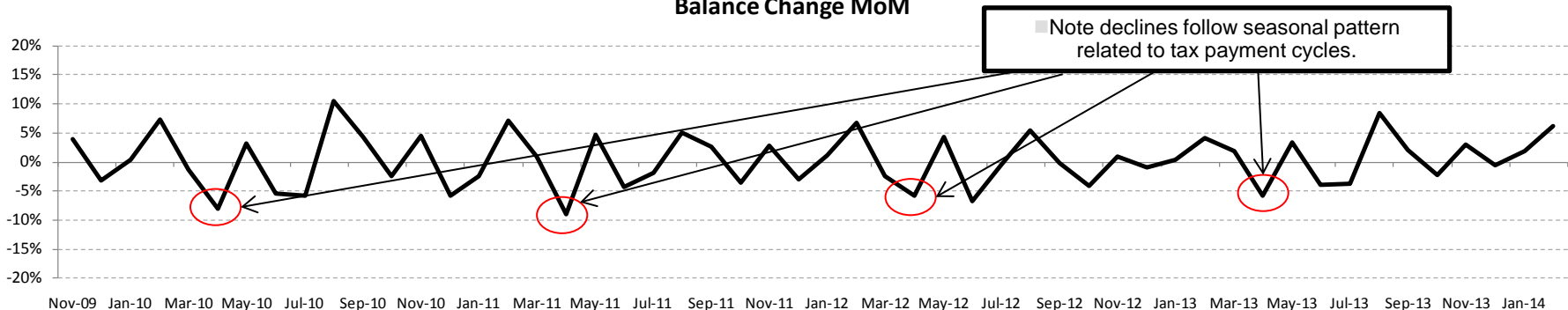
High degree of stability with quarterly seasonality due to tax revenues, supporting operational nature. 85% of deposit volume is in non-interest bearing or managed rate accounts.

For Period Nov 2009 to Feb 2014			
Average Decline	Maximum Decline	Standard Deviation Decline	Standard Deviation Total
-3.7%	-9.0%	2.4%	4.6%

Average Volume (\$B)



Balance Change MoM



# High Quality Liquid Assets (HQLA)

## *Alignment across jurisdictions*



- Inconsistency of acceptable HQLA definitions across Basel jurisdictions will potentially create unlevel playing fields and incent regulatory arbitrage transactions.
- This is especially true with Level 1 HQLA given leverage associated with the 40% Level 2 cap so that each dollar of Level 1 HQLA can “free up” additional level 2 assets previously disallowed.
- We recommend that where a Basel jurisdiction has provided explicit guidance as to acceptable Level 1 HQLA assets and a Covered Bank has demonstrated irrevocable access to that liquidity through existing infrastructure, the Covered Bank can also apply the Level 1 HQLA asset definition from its home country regulator.
  - Precedent – Home country sovereign debt excluded from single counterparty concentration limit calculation for US operations of FBOs under final Enhanced Prudential Standards.
- Alternatively, full faith and credit obligations of Basel jurisdiction sovereigns could be exempted from “liquid and readily marketable” requirement

### **Specific TD example:**

- Canadian regulator, OSFI, has provided explicit guidance as to NHA MBS qualification as Level 1 HQLA. NHA MBS are fully sovereign guaranteed by “full faith and credit” of the Canadian government as to payment of principal and interest.
- The level 1 designation is not fully supported by market trading levels but by unequivocal and proven government support in both normal and stressed markets.
- TD Bank’s US operations have the ability to access this Canadian government support via repo or sales on market terms to the Parent

- Given significant infrastructure enhancements required to produce daily, robust calculation called for by the Proposal, particularly for banks not currently subject to daily regulatory liquidity reporting, recommendation that daily calculation be delayed and that operational deposit calculations be initially done on a “best efforts” basis, subject to normal supervision.
  - Especially true for regional bank models that do not rely on short-term wholesale funding resulting in more stable liquidity inflows and outflows, reducing the need for full daily calculation.
  
- A technical interpretation of the Proposal appears to require that all outflows related to non-maturity deposits be treated as occurring entirely on the first day of the 30-day period. This “front loads” the 30-day outflow calculation and has a disproportionate impact on banks funded by retail and business deposits that are rightly recognized as being lower liquidity risk.
  
- The Proposal rightly recognizes the stability benefit of deposit insurance but treats all partially uninsured balances equally, regardless of whether deposit is 99% or 10% covered by deposit insurance. In our view, higher levels of coverage will result in greater stability, particularly with transactional balances. Deposit clients may reduce balances to insured levels but still require a deposit account for day-to-day banking.
  - Recommend graduated outflow factors based on proportion of insurance coverage.