LPL Financial

9785 Towne Centre Drive
San Diego, CA 92121-1968

858 450 9606 *office*

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:

LPL Financial LLC ("**LPL**") appreciates the opportunity to comment on the notice of proposed rulemaking (the "**NPR**" and the rules set forth therein, the "**Proposed Rules**") published by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), the Office of the Comptroller of the Currency (the "**OCC**") and the Federal Deposit Insurance Corporation (the "**FDIC**", and, collectively, the "**Agencies**")[1] entitled *Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring.* The NPR proposes a quantitative liquidity coverage ratio ("**LCR**") requirement that broadly follows the international liquidity standards published by the Basel Committee on Banking Supervision[2] and would apply to certain large domestic depository institution holding companies, depository institutions and nonbank financial companies designated by the Financial Stability Oversight Council.

---

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

2 See Basel Committee on Banking Supervision, *Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring* (Dec. 2010); Basel Committee, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013).

LPL is one of the nation's leading diversified financial services companies and is registered with the Securities and Exchange Commission as both an investment adviser and a clearing broker-dealer. LPL and its affiliates, taken together, are the largest independent broker-dealer in the United States, a top custodian for registered investment advisors and a leading independent consultant to retirement plans. LPL provides financial professionals with the front, middle, and back-office support they need to serve the large and growing market for brokerage services and independent investment advice. The treatment of brokered sweep deposits[3] is an important issue for LPL and our clients. We believe that our experience with brokered sweep deposits and brokered sweep deposit programs may prove helpful to the Agencies in finalizing the treatment of such deposits.

The use of brokered deposits as a funding source is largely unique to U.S. banks and LPL appreciates the Agencies' efforts to address their treatment in the NPR. However, as discussed below, we believe that non-affiliate brokered sweep deposits swept from retail brokerage accounts are no less stable than affiliate brokered sweep deposits and, accordingly, non-affiliate and affiliate brokered sweep deposits should be assigned the same outflow rate.

Discussion

The Agencies note in the preamble of the Proposed Rules that the Proposed Rules assign brokered sweep deposits progressively higher out-flow rates depending on "the affiliation of the broker sweeping the deposits,"[4] but fail to cite any studies or data in support of assigning non-affiliate brokered sweep deposits a higher outflow rate than the rate assigned to affiliate brokered sweep deposits. Nor do the Agencies point to characteristics of brokered sweep deposits from non-affiliates ("**non-affiliate brokered sweep deposits**") versus brokered sweep deposits from affiliates ("**affiliate brokered sweep deposits**") that provide a rationale for a higher outflow rate for the former. The unstated premise of the Proposed Rules' more favorable treatment of affiliate brokered sweep deposits would appear to be that such deposits are more stable than non-affiliate brokered sweep deposits. We strongly disagree with this premise for several reasons, including (i) the fundamentally stable nature of non-affiliate brokered sweep deposits swept from

---

3 The term "**brokered sweep deposits**" is used in this letter with the meaning assigned to the term in Section 3 of the Proposed Rules. In addition, unless otherwise noted, our comments in this letter focus on and address only fully insured retail brokered sweep deposits. Accordingly, references in this letter to "brokered sweep deposits" mean fully insured brokered sweep deposits provided by a retail customer or counterparty.

4 78 Fed. Reg. at 71840. The Proposed Rules would assign outflow rates of 10% to fully insured brokered sweep deposits and 25% to fully insured non-affiliate brokered sweep deposits. Proposed Rules § 32(g)(5) and (6).

retail brokerage accounts, (ii) the lack of any differences in stability characteristics between non-affiliate and affiliate brokered sweep deposits that would justify assigning the former a significantly higher outflow rate and (iii) the potential adverse consequences to retail brokerage account holders, banks and broker dealers without bank affiliates if non-affiliate brokered sweep deposits are assigned a higher outflow rate than affiliate brokered sweep deposits. Each of these points is addressed in additional detail in the following sections.

I. Non-affiliate brokered sweep deposits swept from retail brokerage accounts are a fundamentally stable source of bank funding.

The Agencies noted in the preamble of the NPR that they consider brokered deposits[5] for retail customers or counterparties to be a "more volatile form of funding than stable retail deposits", regardless of the presence of deposit insurance, among other reasons, because of the structure of the third-party relationship and the potential instability of such deposits in a liquidity stress event.[6] The Proposed Rules reflect the Agencies' views, with which we agree, that some brokered deposits – certain brokered sweep deposits and reciprocal brokered deposits – are more stable than others. However, we strongly believe that the Proposed Rules' distinction between non-affiliate and affiliate brokered sweep deposits is unwarranted and that non-affiliate brokered sweep deposits should be assigned the same outflow rate as affiliate brokered sweep deposits. Non-affiliate brokered sweep deposits swept from retail brokerage accounts[7] are a highly stable form of bank funding, even during times of stress. We believe that such deposits have several key characteristics that contribute to their stability, including certain characteristics that they share with affiliate brokered sweep deposits:

- Similar to stable retail deposits, brokered sweep deposits are held by millions of individual underlying clients with relatively small balances. Promontory Interfinancial Network, LLC administers its Insured Network Deposits® program ("**IND**") for broker-dealers with, as of year-end 2013, almost 7,000,000 underlying clients with over $100

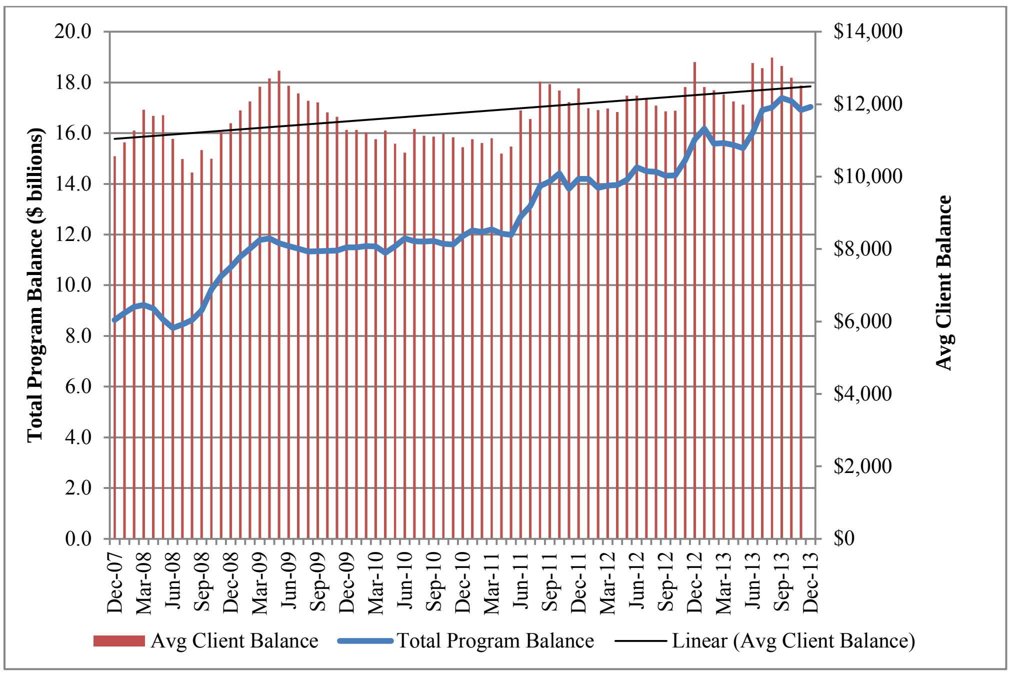
---

5 The Proposed Rules' definition of brokered deposits is identical to the definition the Federal Deposit Insurance Corporation uses in its regulations implementing Section 29(a) of the Federal Deposit Insurance Act. The Agencies have applied and construed that definition to treat sweep deposits from retail customers accounts at broker-dealers (*e.g.*, including IND (as defined below) deposits) as brokered, notwithstanding that such deposits have characteristics and behavior more akin to core deposits than to typical brokered deposits.

6 78 Fed. Reg. at 71840.

7 As noted in footnote 3, "brokered sweep deposits" for purposes of this letter only refers to fully insured retail brokered sweep deposits.

billion in total deposits.[8] Since the inception of the IND program in 2006, the overall average retail broker-dealer client cash balance has been approximately $11,000 during the years 2008 to 2012 (although this has increased modestly to approximately $14,000 at the end of 2013). LPL uses the IND program and has approximately 1,350,000 clients with an average account balance of $11,000 to $12,000. Over 80% of LPL's clients maintain an account balance of less than $10,000, with those accounts having an average balance of around $1,700. These account balances, in the aggregate, have remained exceptionally stable over time, even during times of market stress, as illustrated in the chart below.

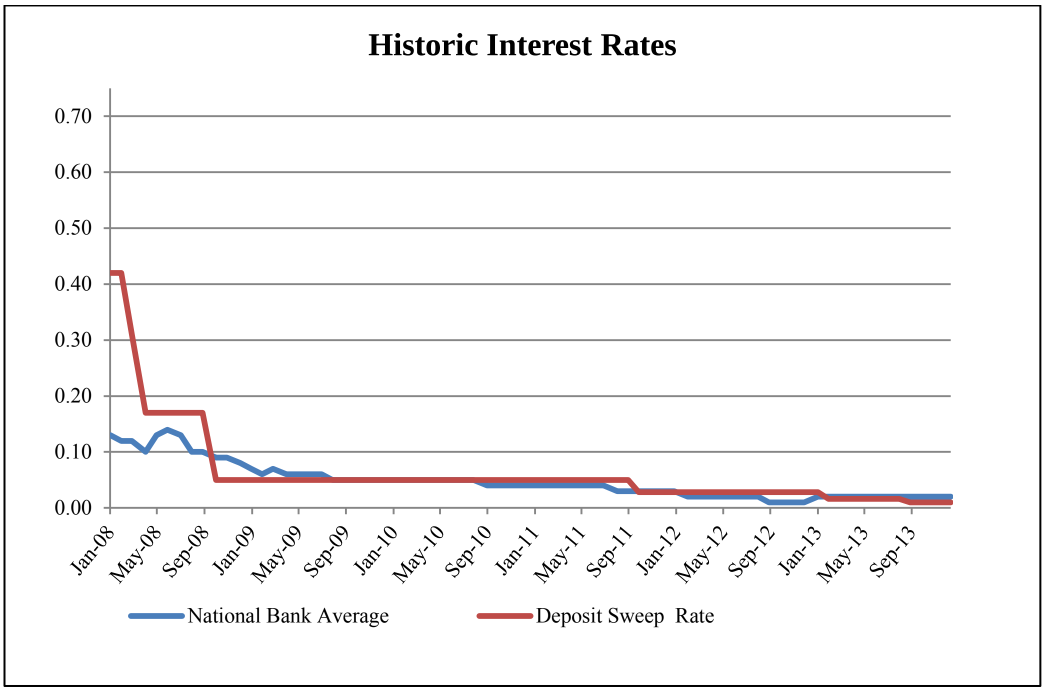


- Similarly, average IND customer deposit account balances have remained exceptionally stable over time, including during times of market stress. In fact, average customer deposits for the five broker-dealers with the highest IND deposits actually increased as the S&P index declined during the financial crisis in 2008 and 2009 and when there was significant concern regarding Euro-region sovereign debt in August through September 2011.

---

8 Data included in this letter relating to the IND program, other than such data relating to LPL's participation in the IND program, are based on information provided by Promontory Interfinancial Network LLC.

- Unlike conventional brokered deposits, funds in non-affiliate brokered sweep programs like the IND program are not primarily being swept for the purpose of seeking the highest yield. Indeed, the interest rate paid on the large majority of non-affiliate brokered sweep deposits at LPL is generally comparable to the interest national banks pay on checking accounts as illustrated in the chart below.[9]



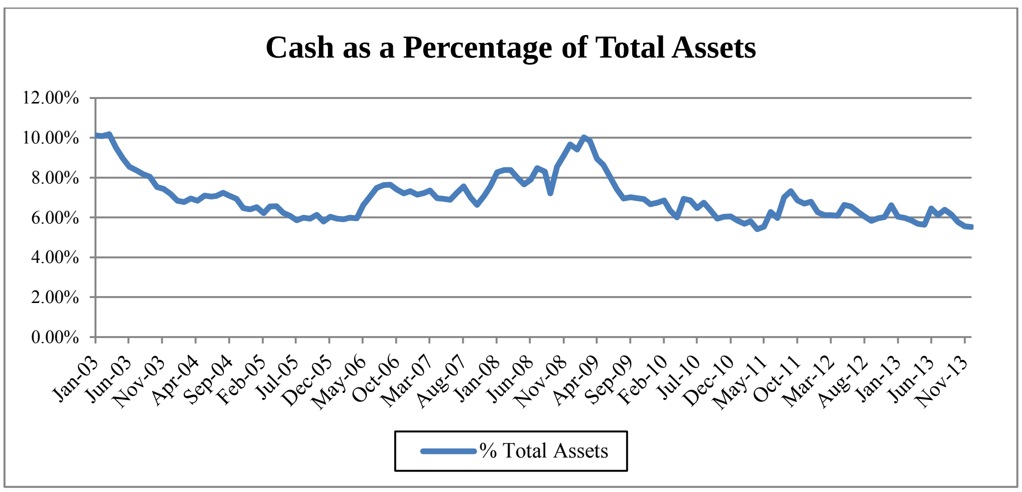
- The underlying retail brokerage accounts from which the client's cash is swept are fundamentally transactional. There are multiple aspects to the brokerage account relationship, including not only the use of the account for securities transactions, but also transactions such as direct deposit, bill pay and checking.

---

9 The Federal Reserve Economic Data ("**FRED**") database from the Federal Reserve Bank of St. Louis was used to assemble the data used in the chart below. *See* FRED, Federal Reserve Bank of St. Louis: Interest Checking Accounts: National Rate of Banks (BNKICRW156N); Bankrate, Inc.; http://research.stlouisfed.org/fred2/; (Report Series ID BNKICRW156N) (accessed January 17, 2014). From January 2008 through September 2008, the Deposit Sweep Rate is the rate received by clients with less than $150,000 in total assets. From October 2008 forward, it is the average rate received by all clients.

- Non-affiliate brokered sweep deposits in the IND program are fully insured. The combination of small per account balances (as noted above), deposit insurance and the large number of accounts that use the IND program also contributes to the exceptional stability of brokered sweep deposits over time, including in periods of financial stress.

- The behavior of customers and the characteristics of their excess cash balances also contribute to the stability of these deposits. Retail brokerage clients keep a relatively small amount of cash in their brokerage accounts for their transactional needs. The historical average in our experience is generally 6% to 8% of the total assets in the investment account, as illustrated in the chart below. Because of the small average size of the excess cash that is being swept, customers are less likely to move deposits out of a program such as IND unless the customer moves its entire relationship away from a broker-dealer.



- As noted above, the Agencies cited the structure of the third-party relationship as one of the reasons justifying higher outflow rates for brokered deposits. However, there are additional structural relationships in place at brokered sweep deposit programs such as the IND program that further enhance the stability of brokered sweep deposits. For example under the IND program, the end retail customer ultimately decides whether to participate in the IND program and has the primary authority whether to exclude any banks from receiving its excess cash balances (just as it could if it were making a retail deposit with a particular bank). This feature of the IND program significantly contributes to the stable nature of non-affiliate brokered sweep deposits.

- As the Agencies have recognized, funding diversification is part of prudent funding and liquidity risk management.[10] Brokered sweep deposit programs such as the IND program offer participating banks the ability to diversify their exposure across a large number of broker-dealers and retail brokerage account holders, leaving banks less vulnerable to funding disruptions that could occur if the banks were reliant on just one or a small number of broker-dealers.

As illustrated above, non-affiliate brokered sweep deposits, like affiliate brokered sweep deposits, are quite different from traditional "brokered deposits", which are raised primarily on the basis of offering higher interest rates than those offered for traditional retail deposits. We believe that the key characteristics of these deposits well illustrates their stable nature and justifies assigning the same outflow rate to non-affiliate and affiliate brokered sweep deposits.

II. The underlying characteristics of retail brokerage accounts and the behavior of the relevant retail parties do not differ materially depending on whether excess cash balances are swept to affiliates or non-affiliates.

In light of the apparent lack of data regarding affiliate versus non-affiliate brokered deposits, including the absence of a centralized database that tracks brokered sweep deposits based on whether they were swept to an affiliate or non-affiliate,[11] we appreciate the challenge the Agencies face in determining outflow rates for affiliate and non-affiliate brokered sweep deposits, and believe that our experience with these deposits may prove helpful. Based on our experience with the IND program and similar programs, we are not aware of any material differences in the use of excess cash in retail brokerage accounts depending on whether the excess cash is swept into deposit accounts of an affiliate or a non-affiliate – whether cash is swept to an affiliate or a non-affiliate, the underlying retail brokerage account functions, as described above, like a transactional account. Similarly, the characteristics of the underlying retail brokerage account (*i.e.*, the average balances of the account and the account usage) do not differ in any material ways depending on whether excess cash is swept to an affiliate or non-affiliate. Finally, based on our experience with the IND program and knowledge of the industry,

---

10 *See, e.g.,* Agencies, Office of Thrift Supervision and National Credit Union Administration, *Interagency Guidance on Funding and Liquidity Risk Management* (Mar. 17, 2010).

11 *See, e.g.*, FDIC, *Study on Core Deposits and Brokered Deposits* (July 8, 2011) (noting that because of the lack of sufficient data the analysis in the FDIC's study "could not reach firm conclusions" but nevertheless suggested that deposits swept from affiliated broker-dealers "appeared likely to pose fewer problems than other brokered deposits"). As noted above, the Agencies did not cite to or otherwise reference any studies in support of assigning non-affiliate brokered sweep deposits a higher outflow rate than affiliate brokered sweep deposits.

we believe there is no appreciable difference in outflow rates for affiliate and non-affiliate brokered deposits from banks in financial distress.

In the absence of data suggesting otherwise, we do not believe it is appropriate to assign non-affiliate brokered sweep deposits swept from retail brokerage accounts higher outflow rates than affiliate brokered sweep deposits.

III. Assigning non-affiliate brokered sweep deposits swept from retail brokerage accounts an outflow rate of 25% could result in adverse consequences for retail brokerage customers, banks that rely on such funding and broker dealers that do not have an affiliated bank.

If the final version of the Proposed Rules retains the Proposed Rule's treatment of non-affiliate brokered sweep deposits, we are concerned that this could have the unintended consequence of depriving millions of underlying retail brokerage clients of the ability to select a cash sweep that is insured. Broker-dealers generally offer two sweep options for clients, an insured deposit sweep program and money market funds. If banks no longer use, or significantly reduce their use of, these deposits as a funding source because of the comparatively high outflow rate assigned to non-affiliate brokered sweep deposits, a bank deposit sweep program may no longer be available to investment firm clients and, additionally, banks (many of which are community banks) effectively will be deprived of an important and stable funding source. In addition, a substantial portion of these funds, which currently flow to these banks, would be diverted to money market mutual funds ("**MMMFs**") and other investments outside the banking system.[12] The IND program alone supports over $100 billion in deposits that could potentially leave the regulated banking system, the impact of which on the safety and soundness of the broader financial system is unclear.

Given the inherently stable nature of non-affiliate brokered sweep deposits, we also believe that assigning non-affiliate brokered sweep deposits a higher outflow rate than affiliate brokered sweep deposits gives an unnecessary and unfair competitive advantage to large broker-dealers with affiliated banks. If a more favorable treatment is applied to affiliate brokered sweep deposits, such institutions will have no impediments to continuing to sweep client's cash to their affiliated banks, whereas broker-dealers without an affiliated bank may have limited or no ability to offer their clients a bank deposit sweep option.

---

[12] As a result of experience with MMMFs during the financial crisis, we expect we share your concern that any regulatory action, by the Agencies or otherwise, that could have the consequence of diverting funds from the banking system to MMMFs should be addressed with great care.

In light of the potential adverse impact on retail brokerage customers, banks and the unnecessary and unfair competitive advantage that will be bestowed on large broker dealers with affiliated banks, we urge the agencies not to penalize non-affiliate brokered sweep deposits and to assign them the same outflow rate as affiliate brokered sweep deposits.

* * *

For all of the foregoing reasons, we urge the Agencies to assign non-affiliate and affiliate brokered sweep deposits the same outflow rate.

We appreciate the opportunity to provide our comments and hope that the Agencies will find them constructive.

Very truly yours,

Robert J. Moore
President
LPL Financial LLC