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January 31, 2014

Via Electronic Mail

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW., Suite 3E–218
Washington, DC 20219.
Docket ID OCC–2013–0016

Robert deV. Frierson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551.
Federal Reserve Docket No. R–1466

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429
FDIC RIN 3064–AE04

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

Ladies and Gentlemen:

Total Bank Solutions, LLC ("TBS") appreciates the opportunity to comment on the rule regarding the liquidity coverage ratio for depository institutions proposed by the Federal Reserve Board (the "Board"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC") (collectively, the "Agencies").[1] TBS provides customized deposit management services to the financial services industry through strategic partnerships with financially strong depository institutions. TBS provides back-office support to financial institutions that participate in deposit sweep programs as agents for their customers and

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

as depositories for deposits received in connection with such arrangements. Accordingly, TBS has a keen interest in the Agencies' request for comments on a proposed rule establishing a liquidity coverage ratio for depository institutions. As a major provider of FDIC insured deposit sweep services to banks and broker-dealers TBS has considerable experience in addressing the issues raised by the Agencies' proposal.

EXECUTIVE SUMMARY

TBS believes that the Agencies' proposal raises significant concerns by placing deposit sweep programs in which broker-dealers participate at a significant disadvantage without sufficient evidence, analysis or rational justification. In particular, TBS objects to the manner in which outflows associated with brokered deposits are treated and the outflow rates proposed to be assigned to such deposits. TBS takes strong issue with the Agencies' statement that insured brokered deposits for retail customers are a more volatile form of funding than stable retail deposits because of the structure of the attendant third-party relationship and the potential instability of such deposits during a liquidity stress event.

TBS's experience is that brokered deposit sweep programs are a stable source of funding throughout the business cycle, and such deposits do not threaten the stability of depository institutions that participate in these programs. Accordingly, we urge the Agencies to be sensitive to the potential unintended effects the proposed rule may have on depository institutions.

TBS's analysis of Call Report and TFR data suggests that retail deposits within the same category should not be presumed to be homogenous. TBS recommends that the Agencies consider defining in the final rule an objective formula for distinguishing stable from volatile portions of retail deposits. It has been TBS's experience that a portion of every deposit pool typically contains a highly stable segment that does not run off. Moreover, TBS believes the Agencies' assumptions and justification for higher run off for brokered deposits of all types is flawed. The proposal offers no direct evidence that run off is greater for brokered deposits than core deposits.

TBS suggests the Agencies reassess the assumptions regarding the sizable run off rate differences between vertically related sweep programs and cross party sweep programs. Regardless of sourcing, due diligence to assure immediate accessibility to funds is the same whether the broker is an affiliate or not.

TBS also questions the assumption about the differences in outflow risk among the different forms of brokered deposits. Our analysis does not indicate differences in flight among brokered deposit types. Such deposits typically move as a block regardless of whether they are reciprocal, vertical or cross entity sweeps, or whether they are insured or uninsured. In the absence of evidence we propose lower run off rates for all brokered deposits and much lower for brokered sweeps with stated maturity dates where the bank has available remedies in law to prevent run off.

TBS recommends the Agencies explicitly clarify the conformance expectations that will form the guidelines for examiners and what sensitivities will be provided in order to prevent

cross segment systemic risks. We also recommend that the Agencies study the policy and consequent effects on smaller institutions prior to "trickling down" regulatory expectations.

SCOPE OF PROPOSAL

The Agencies request public comment on a proposed rule to implement a quantitative liquidity requirement consistent with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision (the "BCBS"). The announcement states that the requirement is designed to promote the short term resilience of the liquidity risk profile of internationally active banking organizations in order to improve the banking sector's ability to absorb shocks arising from financial and economic stress, as well as improvements in the measurement and management of liquidity risk. The proposed rule would apply to all internationally active banking organizations, which includes bank holding companies, certain savings and loan holding companies, and depository institutions with more than $250 billion in total assets or more than $10 billion in on-balance sheet foreign exposure, and to their consolidated subsidiaries that are depository institutions with $10 billion or more in total consolidated assets.[2]

The Agencies state the recent financial crisis demonstrated significant weaknesses in the liquidity positions of certain banking organizations, many of which experienced difficulty meeting their obligations due to a breakdown of the funding markets, notwithstanding ample liquidity in the financial system. The rapid reversal in market conditions and the declining availability of liquidity during the financial crisis demonstrated the speed with which liquidity can vanish and the potential for protracted illiquidity during financial crises. Moreover, the Agencies conclude that the recent financial crisis highlighted the detrimental effect of a liquidity crisis on the financial system and recognized a need for banking organizations to improve their liquidity risk management practices and to control their liquidity risk exposures. In recognition of the need to strengthen liquidity and promote a more resilient financial sector, in 2013 the BCBS issued "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" ("Basel III LCR"), which establishes an internationally harmonized quantitative liquidity standard. Under the standard, beginning in January 2015, internationally active banking organizations would be required to hold high-quality liquid assets ("HQLA") to meet their obligations and other liquidity needs that are forecasted to occur during a 30 calendar-day stress scenario.

Building on the Basel III LCR, the proposal establishes a quantitative minimum liquidity coverage ratio that purportedly takes into account the liquidity coverage methodologies traditionally used by banking organizations to assess exposures to contingent liquidity events. The proposed liquidity coverage ratio would require a covered company to maintain an amount of HQLA meeting the criteria set forth in the proposed rule (the numerator of the ratio) that is no less than 100 percent of its total net cash outflows over a prospective 30 calendar day period, as calculated in accordance with the proposed rule (the denominator of the ratio). The measures of

[2] The proposal also applies to certain nonbank financial companies designated by the Financial Stability Oversight Council for Board Supervision. Because such companies do not accept deposits, our comments do not address the application of the proposed rule to such entities.

total cash outflow and total cash inflow, and the rates used in their determination, are said to reflect aspects of the stress events experienced during the recent financial crisis. These components are to take into account the potential impact of market-wide shocks, including those that would result in a partial loss of retail and brokered deposits.

TBS's primary concern is the manner in which the proposal treats outflows associated with brokered deposits and the outflow rates proposed to be assigned to such deposits. Under the proposal, a 3 percent outflow rate is applied to "stable retail deposits," and a 10 percent outflow rate is applied to "all other retail deposits" held at the institution. The proposal states that such outflow rates are appropriate because during the recent financial crisis, retail customers with deposit balances below the FDIC's deposit insurance ceiling did not generally withdraw their deposits in a way as to cause liquidity strains at banks.[3] However, the proposal applies progressively higher deposit outflow rates ranging from 10 percent to 40 percent for brokered sweep deposits. The applicable outflow rate would depend upon whether the arrangement provides for reciprocal deposits, the affiliation between the broker-dealer sweeping the deposits and the depository institution to which the funds are swept, and whether the deposits are covered by deposit insurance. TBS takes strong issue with the Agencies' position that brokered deposits for retail customers are a more volatile form of funding than stable retail deposits, even if deposit insurance coverage is present, because of the structure of the attendant third-party relationship and the potential instability of such deposits during a liquidity stress event.[4] As we demonstrate below, TBS's research and experience are that brokered deposit sweep programs are a stable source of funding throughout the business cycle and do not threaten the stability of depository institutions that participate in these programs.

QUESTIONS ADDRESSED

TBS's comments address the following questions posed by the Agencies:

Question # 47. The agencies seek commenters' views on the proposed outflow rates for brokered deposits. Specifically, what are commenters' views on the range of outflow rates to brokered deposits? Where commenters disagree with the proposed treatment, please provide alternative proposals supported by sound analysis as well as the associated advantages and disadvantages for such alternative proposals.

Question #48. Is it appropriate to assign a particular outflow rate to brokered sweep deposits entirely covered by deposit insurance that originate with a consolidated subsidiary of a covered company, and different outflow rates to other brokered deposits entirely covered by deposit insurance? Why or why not? What different outflow rates, if any should the agencies consider for application to all brokered sweep deposits entirely covered by deposit insurance? Provide justification and supporting information.

Question # 59. The agencies solicit commenters' views on the proposed criteria for each of the categories discussed above, their proposed outflow rates, and the associated underlying assumptions for the proposed treatment. Are there specific outflow rates for other types of transactions that have not been included, but should be? If so, please specify the types of

[3] 78 *Fed. Reg.* at 71835.
[4] 78 *Fed. Reg.* at 71840.

transactions and the applicable outflow rates that should be applied and the reasons for doing so. Alternatively, are there outflow rates that have been provided that should not be?

COMMENTS

1. General Observations

TBS has modeled the proposed LCR rule using its TBS Bank Monitor analytics system and applied it to all (more than 7,500) FDIC-insured institutions. The purpose was examine potential effects not just on institutions covered by the proposed rule but on institutions that may be affected by expectations to conform to the principles of the rule during future examinations. Our analysis concludes that the proposed rule causes disproportionate impacts for banks depending on what banking business model they have elected.

a. Potentially Stressful Operating Income Margin Effects on Depository Institutions that Emphasize Lending

Banks with lending emphasis business models that allocate 80 percent or more of their assets to lending versus investing appear to be particularly penalized by the proposed rule. As the Agencies are aware, bank lending is more profitable at the margin than investing in securities, roughly 300 basis points per lending dollar versus 100 basis points per investment dollar. There is an implied 200 basis point net interest margin (NIM) loss per asset dollar implied any time a lending asset is abandoned for an investment asset even if it is a high quality risk-free asset. This sets up the unusual scenario whereby a bank may wind up too liquid, but its business operating return will be negatively impacted by the net loss of per employed asset dollar decrementing its income stream. In the worst of outcomes, a bank may be driven into unprofitability because of the proposed rule. This is not a desirable consequence for the U.S. economy. Accordingly, we urge the Agencies to be sensitive to the potential unintended effects the proposed rule may have on depository institutions.

b. Some Institutions Must Walk Back Lending to Fund HQLA Shortfalls to Reach the 80 percent Ratio Minimum by 2015

TBS's analysis revealed a number of institutions - some of considerable size - that will find it difficult to reach an 80 percent HQLA to net outflow ratio by 2015. In general, even after shedding their existing 100 percent outflow category liabilities and replacing them with alternatives assigned a lower outflow rate, these institutions would exhaust all of their options to adjust the denominator portion of their HQLA to net outflow ratios and still not meet the LCR unless they significantly walk back their lending programs to fund investments in HQLA Level 1 instruments. TBS Bank Monitor modeling concluded that institutions experiencing this compliance stress effect can on average achieve only about a 50 percent HQLA to net outflow ratio without having to perform asset portfolio reallocations to exit lending in order to purchase and hold HQLA Level 1 assets.

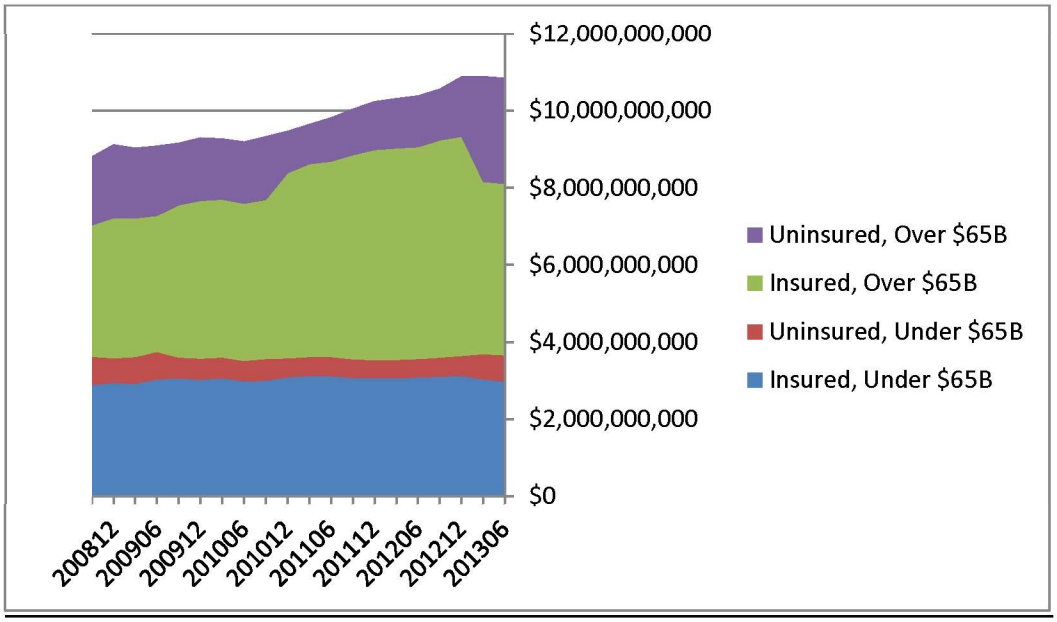
c. Lack of Clarity as to How Highly Liquid Institutions Would Fill Main Street Lending Vacuums

The TBS Bank Monitor analysis of banks processed through its LCR rule simulation model also discovered a number of institutions that handily pass the rule with several multiples over the minimum ratio. While this may be good news for these institutions, behaviorally this group of institutions tends not to lend commercially or have the infrastructure and staffing to expand into a lending demand vacuum in a safe and sound manner. This raises questions as to the strategic efficacy of the proposed rule's consequent effect on continued U.S. economic recovery. It is unclear how or if the proposed LCR rule will incentivize or equip these banks to enter the vacuum vacated by their peers that will be cutting back their lending programs to fund HQLA asset compliant holdings.

2. Observations on the Characterization of Deposit Stabilities

a. Deposits in General

Deposits in U.S. banks have been differentially volatile depending on which segment of the banking industry one has been monitoring since 2008. Larger banks have benefitted the most from deposit run ups in the last five years, whereas smaller depository institutions have been remarkably stable in total deposits on their balance sheets.



Aggregate insured and uninsured deposits from Call/TFR reports are shown further separated into over $65 billion asset and under $65 billion asset insured institutions.

The run up is largely from corporate deposits and deposits investors placed into banks as they deferred long term investments waiting out uncertain economic times. With both mortgage and industrial sectors weak during this period, these liabilities found little lending outlets at these banks. Nearly a third of the run up found its way into a holding pattern of high quality securities. It is unlikely that this wealth pool will remain in this configuration, particularly when the U.S. economy ultimately is on a firm path towards recovery.

b. Deposit Stability

While TBS agrees that the outflow characteristics of stable and other retail deposits differ, we question the validity of presuming that deposits within the same category should be treated as a homogenous lump sum for outflow purposes. We believe such an approach misses the exceptional efforts of many banks that have worked hard to stabilize their retail deposit foundations. Accordingly, TBS recommends that the Agencies consider defining in the final rule an objective formula for distinguishing stable from volatile portions of retail deposits.

TBS's analysis concludes that there is little basis for applying the 3 percent insured retail deposits run off rate arbitrarily to all banks. While the preamble to the proposed rule discusses stable versus unstable deposits, it has been our experience that a portion of every deposit pool typically contains a highly stable segment that does not run off. Assigning an arbitrary 3 per cent run off rate to this subset of liabilities seems inappropriate. A more realistic approach would be to assign a 0 percent run off rate to this portion of the brokered deposit sweep pool.

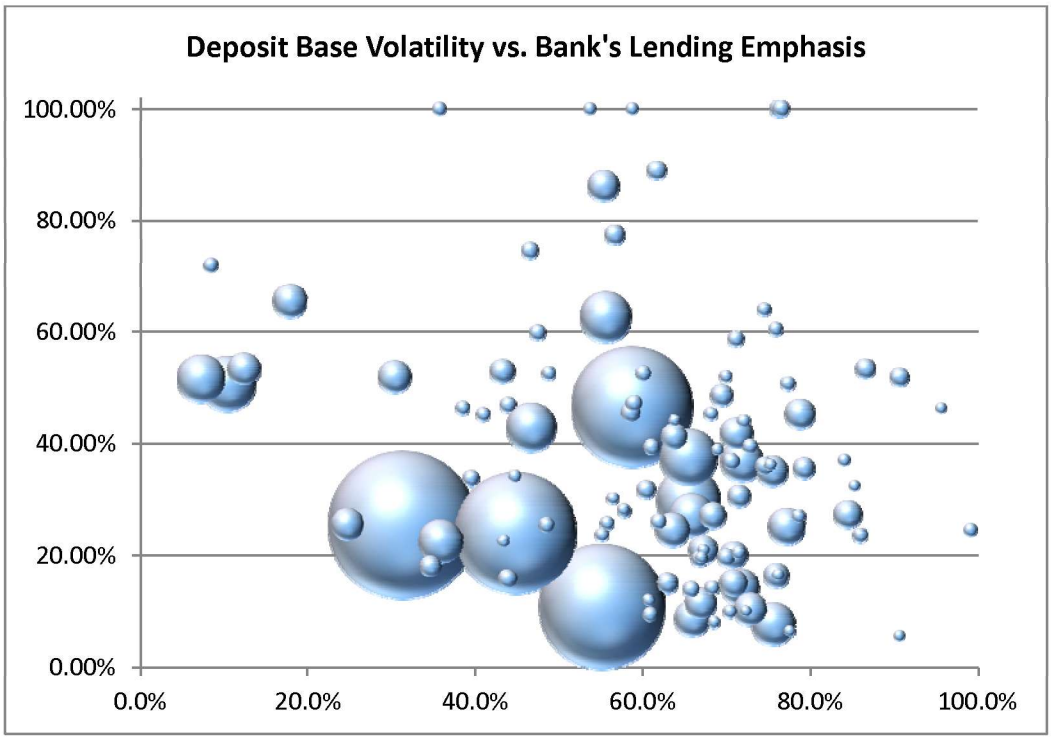
The basis for this suggestion is that certain liabilities are driven by forces that have inherent switching costs. Leaving programs, seeking rollover alternatives are not friction free financial events. Yet the proposal treats such deposits as such even under ideal circumstances when the bank is experiencing no operational stress, no asset degradation and remains well capitalized. It seems appropriate for the Agencies to take notice of the inertia factor in establishing run off rates.

Furthermore, we note that banks perform operational deposit studies constantly and measure the stable foundation and volatility of their funding book. We believe a computation similar to a Maximum Probable Loss (MPL) analysis used for computing economic capital should be employed. The average size of the asset over a sixteen quarter (more than one cycle) look back, less one standard deviation of the volatility of that asset during the look-back period would approximate a reasonable stable base. A running computation of the stable base can be performed quarterly and the stable base line adjusted to account for volatility increases, the primary cause of fall-back risk.

TBS suggests that this statistically stable base be recognized for what it is - a 0 percent run off balance sheet outflow item. We believe this approach better reflects the reality of

retail deposits such that only the truly volatile portion of the liquidity exposure would be subject to higher outflow rates.

Note from the chart below, which shows total deposit volatility as a function of the degree of lending emphasis of the business model of bank units with total assets over $10 billion, how a group of nominally safe and sound banks differ in their management strategy choices.



The size of the bubble indicates the asset size of the institution. The average deposit base volatility for this group is 37 percent, implying deposit retention at these banks is significant and should be accounted for in regulatory policy making. It is important to note that some of the largest institutions have retention stabilities that are better than the average for all other institutions.

TBS performs a deposit stability analysis for each of the 7,500 insured depository institutions. The data reveal firm differences in the CAMELS management approach of bankers to deposit stability. Our methodology computes a maximum probable run off using at least a full business cycle in order to properly assess firm specific deposit volatility to better understand liquidity exposures on a bank-by-bank basis. We further note that we are able to perform this analysis for the most part using information already collected as part of quarterly Call/TFR reporting by banks and savings associations. This suggests that 30 day run offs might be better characterized as follows:

Stability of Deposit	Recommended 30-Day Run Off Rate	Rationale
Stable Deposits	0 percent	For the portion of the deposit base a bank's deposit volatility history over greater than one business cycle shows to be stable, it is reasonable to conclude that the probable 30 day run off is zero.
Volatile Deposits for Well Performing Banks	1/12th of Maximum Probable Measured Volatility Where, Maximum Probable Volatility = 3 Standard Deviations of the 16 quarter volatility of the deposit base.	For the portion of the deposit base generously measured to be volatile as defined by a 3rd standard deviation inclusion margin, the logical expected 30 day run off should be 1/12th of the balance sheet base.
Volatile Deposits for Banks Operating Under Elevated Scrutiny	3 times the normal volatility buffer amount.	This is a backstop factor to provide the Agencies 90 days to be more proactive.

The above applies to a depository institution's total deposits. It also mathematically applies equally well to domestic deposits (DEPDOM), foreign deposits (DEPFOR), retail deposits, core deposits, insured or uninsured deposits, brokered deposits or any other subset class of deposit reported in the Call/TFRs.

Firm Specific Calculations

Examination of all FDIC-insured institutions indicates that the susceptibility and vulnerability to external beta risk events differs among banks. There are firm specific buffers that manifest in the data. This finding is consistent with other buffers against stress guidance issued in years past by the Agencies against interest rate risk during the Basel I era. We believe these differences in firm strength are not adequately accounted for in the proposed rule.

Using the above model, we observed that some banks have indeed seen extraordinary deposit run-ups since 2008. Their deposit volatility history supports categorization of run off risks rates similar to those suggested by the Agencies' proposed outflow rules for the volatile portion of their liabilities. These tend to be larger institutions in which U.S. corporations took advantage of federal deposit guarantees that expired at the end of 2012.

As of 2014, we are beginning to observe that competition to acquire and/or retain these deposits has begun to move into a new economic incentives phase. We have observed that the TBS deposit volatility computation is sensitive to these business retention risks, and therefore TBS recommends the Agencies give thought to using a similar approach.

We also note that many banks did not experience run up volatilities during the previous business cycle. It is these banks that are most harmed by a rule that presumes all deposits are equally vulnerable to elevated run off factor assumptions. Such a policy creates a strong incentive to abandon the extensive "know your customer" loyalties that are considered to be a bulwark of safe and sound commercial banking. We urge the Agencies to move with caution and consider the effects such a rule could have on the landscape of banking in the United States.

Finally, we note explicitly that all banks have a floor number beyond which run off is highly unlikely even over a complete business cycle. The proposed rule does not address this very real aspect.

We suggest that in order for the LCR to be reflective of the safe and sound business practices of these differing management factors that contribute to CAMELS risk, the Agencies consider adjusting the outflow portion of the proposed rule to properly reward good practices and use the rule to constrain only systemic risk for the volatile portion of our national assets.

c. Brokered Deposits

We observe that brokered deposits also exhibit firm specific stability volatility characteristics. Our observations – which include producing forensic reports on every failed institution since January 2008 – indicate that brokered deposit run off moves as a function of the counterparty quality of the bank regardless of the type of brokered deposit involved. It is our experience that brokered deposit programs perform asset quality diligence on brokered funds destination institutions on an ongoing basis. Furthermore, liquidity rules external to bank regulation – notably securities regulations – that require brokers to protect customers' funds against accessibility interruptions operate in parallel with wholesale funding placements. Brokered deposits – and uninsured brokered deposits in particular – are junior classes of liabilities in the event of bank failure. Accordingly, it makes sense that this category of funds will be more volatile during periods of firm specific stress.

TBS's stability analysis recognizes that brokered deposits serve the purpose of developing liabilities for a bank at a faster pace and at lower acquisition cost than organic retail deposit growth. Brokered deposits have known business flexibility advantages for banks that need to respond to changes in lending demand. Like other wholesale instruments, they tend to be simpler rate driven calculations for bankers doing portfolio planning that can be taken advantage of without the attendant efficiency ratio costs associated with organically

growing a retail deposit base. Brokered deposits are also often stickier and pose less moral hazard to the deposit insurance fund than some other source options.

We believe the Agencies are correct to treat this class of instruments to the degree reflected in the proposed rule. However, we respectfully suggest the Agencies revisit the following aspect of the rule proposal:

High Run off Assumptions Fail to Recognize Brokered Program Ongoing Diligence and Soft Landing Exits

We question the assumption about the differences in outflow risk among the different forms of brokered deposits. Our analysis does not indicate differences in flight among brokered deposit types. Such deposits typically move as a block regardless of whether they are reciprocal, vertical or cross entity sweeps or whether they are insured or uninsured.

Ultimately, these brokered deposits tend to enter and leave institutions in waves as counterparty risk analysis detected by professional analysts indicates the bank is deteriorating. We suggest that Agencies evaluate the data and consider aligning the outflow guidance in this area further.

We believe there are flaws in the Agencies' assumptions and analysis used to justify higher run off for brokered deposits of all types. The proposal offers no direct evidence that runoff is greater for brokered deposits than core deposits. The main study cited shows a weak, secondary correlation between brokered deposits and bank failures, but the analysis has nothing to do with run off. To the contrary, data provided by TBS shows the absence of a cause and effect relationship between brokered deposits, higher run off rates and bank failures in general. In the absence of evidence we propose lower run off rates for all brokered deposits and much lower for brokered sweeps with stated maturity dates where the bank has available remedies in law to prevent run off.

As there is no statistical cause and effect data which supports the proposed language about brokered sweep deposits and brokered deposits in general, there must be other factors to explain the explicit disadvantage assigned to them. The argument that seems to underlie the view expressed in the proposal is that there is a structural transparency advantage of troubled banks to entities that have access to IRB class analytics. For instance, FHLB run off is based on the fact that these institutions have access to the FDIC Watch List. During the period 2010-2012, Total Bank Solutions, as a client of Institutional Risk Analytics, gained a 6 to 12 month transparency advantage of a bank's degradation versus firms relying solely on ratings of rating agencies.

Consumers on the other hand have limited access to information, which when they choose to investigate, trail a bank's actual condition. Thus, run off of retail deposits is slowed by an informational disadvantage.

The reality is that despite having a transparency advantage, brokered sweep deposit program managers do not utilize it and tend to soft land deposit withdrawals from banks

that are becoming troubled. Also, to the extent deposits are subject to stated maturity dates, brokers are prevented from acting upon early information, and should be encouraged by a lower run off simply for that reason.

We further suggest that the Agencies reassess the assumptions regarding the sizable penalty differences between vertically related sweep programs and cross party sweep programs. Regardless of sourcing, due diligence performed to assure access to customer funds is the same whether the broker is an affiliate or at arm's length. The securities compliance officer on the broker's side must ensure no interruption to immediate access to funds even if the destination bank is an affiliate.

It seems inappropriate to institutionalize an incentive that could encourage practices that are unsound by an affiliated broker in the event that the bank counterparty risk deteriorates to the point that it warrants a repositioning of funds. The difference magnitude in outflow penalty as provided in the proposed rule could have such an undesired effect. We suggest it may be best to adjust the policy differential to lessen such incentives.

3. Silence on Guidance for Over 30 Day Stated Maturity Instruments

TBS notes a glaring omission in the proposal regarding the treatment of over 30 day maturing deposit instruments. This silence seems to be at odds with the core tenets of the Basel III Accord that nominally assign zero run off factors to such instruments. We have observed in anecdotal discussions that outside of the United States, sovereign regulators and foreign banks are actively exploring the creation of these types of over 30 day deposit instruments. We are concerned that the U.S. is not doing the same to prepare our banking system for this eventuality. This seems to be a strategic systemic risk within the current LCR proposal. Silence could severely disadvantage the U.S. in the competition for capital as national barriers are eliminated and money flows to more attractive opportunities. The Agencies' proposed rule leaves open the possibility that U.S. institutional funds will migrate to foreign uninsured deposits to yield superior rates of return.

Specifically, some brokered sweep deposit agreements have an inherent run off prevention feature of stated maturity dates over 30 days. The proposed rule does not recognize the existence nor the strength of fixed maturity date contracts between the broker and the bank. These agreements in fact provide a higher barrier to an early exit from a deposit agreement than most retail accounts that have no stated maturity date, CDs which have weak penalties, reciprocal deposits which have no penalties, and affiliated sweep deposits which have no penalties.

In order to comply with U.S. securities laws and regulations as well as the Board's Regulation D, these contract forms provide the broker with the ability under highly restricted and rare circumstances to exit the agreement early. The contract may contain clauses similar to the following:

i. On any given day, the broker may be under the agreed upon deposit amount by a small percentage without penalty;
ii. The broker may withdraw all or a substantial percentage of deposits if the broker's customers have unexpectedly withdrawn large percentages of the funds maintained in the broker's sweep program; and
iii. If the bank is no longer "well capitalized," the broker may withdraw funds over an agreed upon period.

In nearly all other cases, early withdrawal will substantially penalize the broker and require the broker to pay the bank all or a portion of the interest differential the bank lost due to the funds being withdrawn. In certain instances, the bank can simply not honor a request for early withdrawal by the broker.

Taken together, with the additional factors documented in the appendix, these explicit exit barriers provide a higher degree of deposit retention for the bank than all other deposits, with the possible exception of brokered and retail CDs with unwaivable and significant penalties for early withdrawal. Brokered sweep arrangements that comply with securities laws and regulations and provide for stated maturity dates should receive a 0 percent run off rate, or a run off rate equal to retail stable deposits.

In this regard we suggest the Agencies consider the following classes of instrument when they take action on the proposed rule:

Suggested Classes of Over 30 day Deposit Instruments

Instrument A: Restricted Redemption Funds Funding instruments with maturities of one (1) year or less that have restricted redemption features prior to 30 days of maturity and conversion incentives to renew to a follow on instrument prior to 31 days. We believe this instrument would be useful as a means of stabilizing liabilities by banks that co-offer soft services to large uninsured depositors.
Instrument B: Penalty Redemption Funds Funding instruments with contracted maturity terms of less than one (1) year would have penalty redemption provisions prior to 31 days that are nominally engineered to be liquidity neutral to the bank's LCR exposure. We believe this instrument would be useful for brokers that are required to maintain an avenue to liquidity of access to funds where the probability of triggering is acceptably business remote.
Instrument C: Evergreen Funds Evergreen funding instruments with contracted maturity terms of 31 days of more that constantly renew and have a penalty provision equal proportional to the remaining term for withdrawal or conversion to demand status. We believe this instrument would be useful to depositors who need to adjust their own utilization of funds more actively.

All three of the above instruments have tactical merit for keeping the U.S. banking and financial system globally competitive. We urge the Agencies to consider these proposed instruments when they next consider the proposed rule. We believe that failure to address this will generate a great deal of confusion. We note that the Agencies may find it appropriate to coordinate their rulemaking with the Securities and Exchange Commission ("SEC") because accommodations to create globally competitive financial instruments will likely be simultaneously subject to rules of the SEC as well as those of the Agencies.

4. Unfairly Penalizing Smaller Firms

The magnitude of differences in run off assumptions creates severe economic disadvantages for certain broker-dealers, especially smaller firms that utilize clearing companies. The Agencies' proposal results in a structural disadvantage for these firms. The impact of the run off differences creates a 20 basis point rate differential for brokered sweep deposits and will materially impact this source of approximately $200 billion of bank liquidity. This seems counterproductive to the ability of the economy to respond to future stresses and opportunities. We propose to the extent that there will be runoff differences for brokered sweep deposits, the magnitude of the difference in run off be reduced significantly.

However there is an even stronger systemic risk issue here. TBS's analysis indicates that the proposed rule may have unintended effects on institutions. We have used the TBS Bank Monitor to measure net outflow and HQLA in accordance with the proposed rule based on Call Reports and TFRs of all FDIC insured institutions. The analysis concludes that the proposed rule disproportionately penalizes banks that have management models that emphasize high proportions of assets deployed for domestic lending and adversely affects banks that rely on large amounts of retail deposits on the liability side of their balance sheets.

The proposal also seems to disproportionately favor institutions that are U.S. Treasury heavy and Main Street lending light. This result applies both to banks directly affected by the proposal and the vast majority of smaller banks that may be beset by pressure to conform to the tenets of the proposed rule. The net effect of the proposal may in fact be too much of a flight to quality and present its own form of moral hazard to the U.S. economy. There is even a chance that a preference for certain classes of deposits with the lowest or zero run off rates will drive interest rates up, and have the effect of reducing operating margins for banks that lend, creating lower capital accumulation, return on equity, and curtailing the acquisition of new capital to grow.

5. Unwarranted Advantages for Banks with Affiliated Broker-Dealers

The FDIC has long provided brokered deposit exceptions for major banks that accept deposits from affiliated broker-dealers. Prior to the normalization of deposit insurance premiums for well capitalized banks, this allowed for a material reduction in expenses for the largest banks to the disadvantage of smaller banks. The proposed rule grandfathers this unnecessary and

unwarranted advantage by allowing for a lower run off for these deposits. Such an exception constitutes a moral hazard and is not good public policy.

The proposal also flies in the face of known forms of business risk. Conferring favored status to related party transactions over market transactions increases firm specific risk and raises issues under other regulatory regimes such as the adequacy of internal controls provisions of the Sarbanes-Oxley Act. We suggest it is better policy for the Agencies to force related parties in the direction of arm's length risk management practices by eliminating vertical advantage from the proposal.

6. Shift from Prior Policy

The proposal is at marked variance to existing rules that create liquidity and deposit insurance fund equivalence between brokered deposits and all other deposits. This equivalence was specifically ratified and renewed in the FDIC's report to Congress regarding brokered deposits in July 2011.[5] No reasons are cited for the change and no new information has been provided.

In reaching the conclusions that form the underpinnings of the proposal the Agencies have reversed long held positions on the nature of the drivers of sound bank liquidity management. In its 2011 report to Congress, the FDIC concluded:

> ***"The FDIC's examination program views brokered deposits at well-capitalized institutions as being subject to the same considerations and concerns as any other type of funding. Potential concerns relate to volume, growth, availability, cost, volatility, maturities, and how the use of such funding fits into the bank's overall liability and liquidity management plans. The guidance explicitly states that there should be no particular stigma attached to the acceptance of brokered deposits per se and that the proper use of such deposits should not be discouraged. However, given the concerns raised by many commenters, it may be beneficial for the FDIC to issue a financial institution letter (FIL) that consolidates all of the sources of liquidity guidance. Doing so should alleviate any possible confusion about the treatment of deposits for supervisory purposes***."[6]

In addition to the above guidance, the FDIC has long recognized the equivalence of brokered deposits in connection with the calculation of deposit insurance premiums. For well capitalized banks the FDIC insurance premium costs are the same for brokered deposits as MMDAs, CDs and other retail core deposits. It is inconsistent for the FDIC to now believe that brokered deposits have a higher liquidity risk, in light of its equalizing FDIC premiums for such deposits and its statements in the FDIC Study.

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[5] "Study on Core Deposits and Brokered Deposits," Federal Deposit Insurance Corporation (July 8, 2011) ("FDIC Study")
[6] FDIC Study at 61.

Instead, the proposal reflects a new direction. It clearly establishes a stigma in the form of a pronounced economic disincentive in the use of brokered deposits for no good reasons. Other things being equal, a bank that wishes to use brokered deposits would be required to provide for higher levels of HQLA and lower its lending, given capital as a constraint. Under the proposal, the same dollar amount of brokered deposits requires more than five times the amount of HQLA than an Internet delivered super high rate CD without a penalty for early withdrawal.

Our analysis of the formulae for computing compliance under the proposal indicates that the Agencies are overly focused on mitigating the potential liability run off – specifically uninsured deposits run off – from banks in the aftermath of the Troubled Asset Guarantee program that expired in December 2012. A run off of these liabilities would have to be compensated for by banks either by proportionately reducing lending or assets parked in U.S. sovereign instruments, notably U.S. Treasuries. We find it systemically worrisome that the incentives structure set forth in the proposal is strongly biased towards maintaining domestic economic asset participation in U.S. securities to the clear detriment of the ability of the banking system to support Main Street or even Wall Street economic recovery. We strongly urge the Agencies to reconsider whether this policy approach furthers the national interest.

7. Departure from BIS Guidance

The original BIS draft issued to guide individual nations in Basel III implementation recognizes the sanctity and effectiveness of contracts with a stated maturity. The BIS recognizes that banks may enter into deposit agreements with counterparties for fixed contractual maturities that exceed the 30 day (or 21 day) LCR stress scenario time frame. The following excerpt from the *Federal Register* preamble is vague on the point and does not explain the rationale for rejecting the BIS guidance.

> "Under the proposed rule, all other brokered deposits would include those brokered deposits that are not reciprocal deposits or are not part of a brokered sweep arrangement. These accounts would be subject to an outflow rate of 10 percent if they mature later than 30 calendar days from a calculation date or 100 percent if they mature 30 calendar days or less from a calculation date."[7]

However, the BIS draft states the following:

> "Retail fixed-term deposits: the maturity of fixed or time deposits with a residual maturity or withdrawal notice period of greater than 30 days will be recognised (i.e., excluded from the LCR) if the depositor has no legal right to withdraw deposits within the 30-day horizon of the LCR, or if early withdrawal results in a significant penalty that is materially greater than the loss of interest.
>
> *"63. If a bank allows a depositor to withdraw such deposits without applying the corresponding penalty, or despite a clause that says the depositor has no legal right to*

[7] 78 *Fed. Reg.* at 71840.

withdraw, the entire category of these funds would then have to be treated as demand deposits (i.e., regardless of the remaining term, the deposits would be subject to the deposit run-off rates as specified in paragraphs 55-61). Supervisors in each jurisdiction may choose to outline exceptional circumstances that would qualify as hardship, under which the exceptional term deposit could be withdrawn by the depositor without changing the treatment of the entire pool of deposits."

The proposal ignores several pointed features of the BIS draft of the LCR, the chief being that BIS specifically provides a zero run off rate for deposits that have a stated contractual maturity date longer than 30 days. While it is true that the rest of the world does not expressly have brokered deposits, they have wholesale deposits that are functionally equivalent. The BIS draft recognizes that a contract between a bank and a strong counterparty means that the deposits will remain with the bank for the entire agreed upon contract period.

We note that the proposal contains a provision for all other over 30-day deposits assigned a run off computation that is consistent with the Basel III alignment. We believe that stated maturity instruments whether they are retail time deposits or brokered sweep deposits with call features fall into this category of financial instrument. TBS is not alone in this view. TBS has been approached by international banks seeking sources of liabilities with stated maturities greater than 30 days precisely because their governments treat these categories of contractually locked funds as 0 percent run off rate accounts. We ask the Agencies to acknowledge this alignment with the BIS guidance as implemented throughout the world.

8. TBS Recommends Against Applying the LCR Rule to Smaller Banks at this Time

The proposed rule does not apply to banks less than $50 billion in assets. Presumably this allows liquidity to be managed under the existing rules, whereby brokered deposits maintained by well capitalized banks enjoy the same treatment as all other deposits with the same risk characteristics.

Smaller banking institutions tend to be even more lending business model heavy than their larger counterparts and would be impacted more at the margin if they are unable to execute denominator adjustments to meet the rule and therefore would need to shift assets out of their lending programs to fund HQLA holdings.

This consequence is compounded by many banks and operatives in the brokered deposit market who detect a continued bias by the Agencies against brokered deposits for these smaller institutions even though the outflow factoring as proposed favors these instruments over a number of others. We expect a number of larger institutions will pursue liabilities sourcing allocations to take advantage of proposed outflow rates, while smaller banks may be penalized should they pursue the same avenues. We also note that there is a growing track record of small well run banks that have benefited from the use of brokered sweep deposits as an alternative to other wholesale funding sources without subsequently making bad loans.

We caution against the potential misapplication of rules meant to reduce risk in one segment of the banking industry that results in harm to other segments that could neutralize or even impair the very systemic safety objectives the Agencies wish to achieve.

The Fear of Conformance Risk

Banks over $1 billion in assets and under $10 billion in assets are expressly exempt from Basel III compliance. However, these institutions are concerned that they may be pressured by examiners to conform to the LCR rule, often to the detriment of the safety and soundness of the affected lower tier UBPR strata. The fear is that the conformance is subjective, arbitrary and possibly detrimental to safe and sound business principles. Banks are also concerned that failure to conform to the proposed LCR on best practices expectation grounds may result in reduced CAMELS ratings. This in turn raises the Initial Base Assessment Rate (IBAR) under FDIC deposit assessment computations, which would result in a tangible monetary penalty.

The Agencies' proposal is particularly harmful to banks with predominantly domestic lending and financing business models regardless of size. We believe that incorrectly applied pressures to conform would likely be materially harmful and may result in undue risk to the broader U.S. economy. Accordingly, TBS recommends the Agencies explicitly clarify the conformance expectations that will form the guidelines for examiners and what sensitivities will be provided in order to prevent cross segment systemic risks from manifesting.

We also recommend that the Agencies study the policy and consequent effects on smaller institutions explicitly prior to "trickling down" regulatory expectations.

CONCLUSION

TBS appreciates the opportunity to provide its views in connection with the Agencies' proposed liquidity coverage ratio rule.

Sincerely,

Eric A. Pierce
Managing Partner

Appendices

A: **Additional Discussion Regarding Special Exception for Stated Maturity Date and Fixed Deposit Amount Brokerage Sweep Contracts**

B: **Additional Discussion of Data Analysis Flaws that Disadvantage Brokered Deposits**

C: **The Agencies' Statistical Arguments**

D: **Differences in Run off Assumptions Create Business Economic Issues**

E: **Further Discussion of Disadvantages Imposed on Non-Affiliated Brokerages**

F: **Deposit Stability Observations at Selected Insured Depository Institutions**

Appendix A: Additional Discussion Regarding Special Exception for Stated Maturity Date and Fixed Deposit Amount Brokerage Sweep Contracts

The Agencies' proposal distinguishes between brokered sweep deposits and brokered deposits other than sweeps, and assigns a stiff run off penalty to brokered sweeps. The logic seems to be predicated upon the belief that broker-dealers have the ability to withdraw massive amounts of deposits from a bank, and that they have actually done so in the past. In reality deposit contracts between unaffiliated banks and broker-dealers typically take two forms. The more prevalent is a structure where either party can terminate the agreement after a relatively short notification period. However there are a growing number of contracts written with stated deposit amounts for stated contractual maturities. In the case of these contracts, brokers' ability to exit a deposit relationship with banks is severely constrained.

TBS urges that the Agencies adopt a meaningful distinction between the two types of sweep contracts and assign a zero percent run off rate to the second category for the following reasons:

1. **Penalties and contract terms as barriers to early outflow are much stronger for the brokerage sweep contract than a brokered CD.**

   The Agencies appear to believe that a brokered sweep deposit is 2.5 times more prone to run off risk than a high rate brokered CD. TBS believes that this is exactly opposite of the conclusion that should be reached based upon the following:

   a. A typical brokered CD is between an individual and a bank. The individual may obtain funds early by paying a penalty usually of about 90 days of interest which, using an average CD size of 10,000 and a 1 percent rate, amounts to $25. It is easy to see that if rates were to go up by 100 basis points to 2 percent, the depositor can withdraw the funds from Bank A by paying the $25 penalty and still net $75 more by depositing the withdrawn funds at Bank B.

   b. By contrast a fixed maturity brokered sweep deposit agreement is usually written for millions of dollars, often $50 million or more, and includes balances for thousands of individual customers. The broker-dealer commits to maintain the deposit for the entire contract period with usually only two exceptions: i) That the banks capitalization remains as agreed at the time of the deposit and ii) less frequently, that its own customers keep their funds at the broker. The broker is subject to all damages the bank can prove it has sustained from an early un-contracted for withdrawal. For example the bank may compute its damages to be the deposit rate and its cost of funds to replace the lost deposits, which during a period of rising interest rates would be a very large amount and enough to discourage the broker completely as there would be no net gain from a withdrawal as in the case of the brokered CD. In many instances the bank has the right to simply not act upon a request for an early return of the deposit which prevents the withdrawal from happening.

2. **Linkages from other products and services.**

The Agencies' proposal assigns great significance to the power of multiple relationships between a customer and a bank in mitigating deposit run off under stress scenarios. This concept applies to distinctions between brokered deposits and all forms of brokered sweep deposits.

a. A brokered CD is typically obtained by a customer that wishes a CD as a cash investment vehicle, and a higher rate is the principal point of differentiation between one bank's brokered CD and the next bank's. The relationship between the bank and the customer is nearly always constrained to the single service of the CD. Thus a brokered CD is exactly opposite a retail CD with respect to the linkage power to prevent run off

b. Brokered deposit sweeps manifest at least as many if not more linkages between customers and bank-like products. The difference of course is the linkages in the form of check writing, direct deposit, and ATM usage exist between customers, the broker-dealer and the bank instead of just the customer and the bank. The linkages act to keep customer in the broker-dealer's cash management product of which a bank is a part, and only one bank amongst a group of 8 to 10 banks. Rate is unimportant because the customer receives the same interest rate regardless of which bank in a broker-dealer's FDIC-insured deposit sweep program a customer's funds happens to reside.

3. **Active versus passive management.**

A broker-dealer that has written a contract for a stated deposit amount with a stated maturity date with a participating bank in its FDIC-insured brokered deposit sweep program has a considerable degree of freedom to make certain deposits stay "topped up" at the bank. If a customer (Customer A) chooses to select another bank (Bank B) within the program, the broker simply replaces Customer A's balances with another customer's funds by reducing Bank B's balance in the amount received from Customer A. Brokers can almost always make this work because the broker-dealer writes contract amount and maturity guarantees for only a portion of its cash management balances.

Appendix B: Additional Discussion of Data Analysis Flaws that Disadvantage Brokered Deposits

The Agencies' proposal penalizes brokered sweep deposits with a higher run off rate assumed than retail MMDAs, retail CDs, and retail checking accounts. As justification of this treatment, the Agencies cite data demonstrating that brokered deposits of all types and brokered sweep deposits in particular flee the bank in a stress scenario. TBS argues that there is no evidence that brokered deposits run off at any different rate than core deposits. Accordingly, TBS urges that brokered sweep deposits without a stated maturity date be assigned the same run off assumptions as stable retail deposits (i.e., 3%).

The Data: Brokered deposits do not have greater run off than retail deposits.

TBS has studied the data since 2007 in three distinct ways:

a. The aggregate growth/decline of brokered deposits across all banks from 2006 until 2013;
b. The growth/decline of brokered deposits at all banks that had brokered deposits in 2006 that were still active banks in 2013, thus eliminating distortions from banks being added or subtracted from the base;
c. The growth/decline of brokered deposits at specific banks that were in 2006 and still in 2013 utilizing brokered sweep deposits. The raw data were adjusted for this last group in the following ways:

    i. Banks that have had the deposits of affiliated broker-dealers reclassified by exemption to core deposits were assumed to be 100 percent funded by brokered sweep deposits; and
    ii. All brokered deposits at banks known to participate as brokered deposit sweep program banks were assumed to be brokered sweep deposits.

The findings are quite clear. Brokered deposits increased during all periods through and including the financial crisis for all banks. Brokered deposits grew significantly within the banks that had brokered deposits, and most notably grew at banks that participate in brokered deposit sweep programs. Core deposits increased as well, reflecting the enhanced liquidity of the banking system due to quantitative easing and other policy measures and economic conditions

We note a lack of statistical evidence supporting the Agencies' assertion that brokered deposits exit sooner or in greater degree than core deposits. In addition TBS has examined data from failed banks in an attempt to validate the alleged correlation between high levels of brokered deposits and bank failures. All failed banks list were examined. Our findings are:

- As a group failed banks had a lower percentage of brokered deposits to total deposits than banks in the aggregate; and

- As a group failed banks had a lower concentration of brokered deposits than small banks (banks under $50 billion in assets).

Our conclusion is that brokered deposits have been a stable source of funding widely used by many banks without material disruption at times of financial stress. Accordingly, there is little objective basis for the assignment of a higher run off rate for brokered deposits.

Appendix C: The Agencies' Statistical Arguments

It is critically important that the Agencies recognize that none of the statistical evidence regarding brokered deposits has any connection to the run off of brokered deposits from banks that eventually failed. All of the focus of the LCR is on assumed run off rates. Brokered deposits are simply assumed to have higher run off rates. Despite evidence to the contrary, the Agencies cite studies regarding how brokered deposits are correlated with bank failures. Those studies, however, do not calculate a run off rate or demonstrate any causal relationship between a run off rate and bank failure.

The 2011 FDIC Study alleges that brokered deposits correlate with bank failures. This statistical evidence is quite weak. While a correlation may be shown, causality is not demonstrated. Brokered deposits exist at banks that fail. They also exist at banks that do not fail. Of all the variables modeled brokered deposits are the least or second least predictive variable. The following excerpt from the FDIC Study illustrates the predictive weakness of the model:

"Table B-2 reports results of the failure loss rate models that include controls for equity and core deposits. The estimated coefficient on core deposits is -0.104 and statistically significant, implying that a 1% increase in core deposits to assets ratio is associated with a roughly 10 basis point decrease in failure loss rate."[8]

Core Deposits and FDIC Loss Rates Variables	Coefficient Estimates
Intercept	18.047***
Equity	-0.553***
Core deposits	-0.104***
Nonperforming loans	0.312***
Other real estate owned	0.714***
Income earned but not collected	3.912***
Loan to executive officers	0.272***
Bank size between $500 mil-$1 bil	-4.919***
Bank size > 1 billion	-8.171***
CRE loans	0.025***
C&D loans	0.109***
C&I loans	0.203***
Consumer loans	0.108***
R^2	0.399
No. of observations	1,757

[8] FDIC Study at 74.

What the forgoing means is that if there are two banks the same size, and the only difference between them is Bank A has 90 percent core deposits and 10 percent brokered, while Bank B has 80 percent core deposits and 20 percent brokered, Bank B will have a 1 percent higher probability of failure. So instead of a 1 percent chance of failure, Bank B has a 2 percent chance of failure. Both have a very small chance of failure stemming from the deposit mix variable.

Table B-2 shows core deposits with a -.104 coefficient estimate. Equity percentage is five times more predictive, non-performing loans three times more predictive and ORE seven times more predictive.

The Agencies undoubtedly recognize that banks fail primarily because they make bad loans. Equity enables a bank to make a few bad loans and remain in business. Deposits are merely a source for funding loans. Brokered deposits may enable a bank to make more bad loans than if the bank only used core deposits, but there is no causal relationship between the type of deposit and the making of a bad loan.

TBS data illustrate there is no direct correlation between bank failures and brokered deposits. The data also show that there is no evidence that brokered deposits exit earlier in a crisis than any other category of deposit funding.

Appendix D: Differences in Run off Assumptions Create Business Economic Issues

TBS modeling of the proposed rule indicates that a number of asset liability management (ALM) response strategies to the rule would occur.

Decreased Markets for 100% Outflow Liabilities

The proposal applies penalties for certain classes of bank liabilities that are categorized as 100 percent outflow items. We observe that banks having trouble making their net outflow denominator work may look at decreasing or exiting portfolio exposures in these categories. This could create strains in other segments of the financial system. Here is an example of one scenario examined by TBS as part of its evaluation of the potential effects of the proposed rule.

Scenario #2: 100% Outflow Item vs. Brokered Sweep After LCR

	Base Case			Post LCR			Convert to Cross Brokerage Sweep		
	Amount	Rate	Rev/ Expense	Amount	Rate	Rev/ Expense	Amount	Rate	Rev/ Expense
HQLA	$ -	2.00%	$ -	$ 800,000,000	2.00%	$ 16,000,000	$ 560,000,000	2.00%	$ 11,200,000
Loans	$ 1,000,000,000	6.00%	$ 60,000,000	$ 200,000,000	6.00%	$ 12,000,000	$ 440,000,000	6.00%	$ 26,400,000
Total	$ 1,000,000,000	6.00%	$ 60,000,000	$ 1,000,000,000	2.80%	$ 28,000,000	$ 1,000,000,000	3.76%	$ 37,600,000
Retail, Insured 3%	$ -	0.53%	$ -	$ -	0.70%	$ -	$ -	0.70%	$ -
Retail, Uninsured 10%	$ -	0.53%	$ -	$ -	0.70%	$ -	$ -	0.70%	$ -
100% Class Item	$ 1,000,000,000	0.53%	$ 5,300,000	$ 1,000,000,000	0.53%	$ 5,300,000	$ -	0.53%	$ -
Sweep, Insured 25%	$ -	0.25%	$ -	$ -	0.25%	$ -	$ 400,000,000	0.25%	$ 1,000,000
Sweep, Uninsured 40%	$ -	0.25%	$ -	$ -	0.25%	$ -	$ 600,000,000	0.25%	$ 1,500,000
Total	$ 1,000,000,000	0.53%	$ 5,300,000	$ 1,000,000,000	0.53%	$ 5,300,000	$ 1,000,000,000	0.25%	$ 2,500,000
Net Interest margin		5.47%	$ 54,700,000		2.27%	$ 22,700,000		3.51%	$ 35,100,000
Expenses	Efficiency Ratio (unique per bank)	65.00%	$ 35,555,000	10% Degradation for Deposit Acq. Cost Increase	75.00%	$ 17,025,000	Improve Eff 10% due to wholesale process simplification	65.00%	$ 22,815,000
EBIT			$ 19,145,000			$ 5,675,000			$ 12,285,000
NIAT	Tax Rate	35.00%	$ 12,444,250			$ 3,688,750			$ 7,985,250
ROA		1.24%			0.37%			0.80%	
Equity for Loans (8%)	$ 80,000,000			$ 16,000,000			$ 35,200,000		
Equity for HQLA	$ -			$ 16,000,000			$ 11,200,000		
Total Equity	$ 80,000,000			$ 32,000,000		ROE vs. Base Case	$ 46,400,000		ROE vs. Base Case
ROE		15.56%			11.53%	-26%		17.21%	11%

The above is an example of a scenario where multiple forces come into play including:

- Industry moves to pursuing statutory outflow categories not from how far they are from zero but how much improvement are they from 100 percent;

- Trading off retail vs. wholesale ALM portfolio pathways based on the operational impact on efficiency ratios. We believe this will become even more critical to banks as margins thin due to regulatory rules that channel business design into fewer sets of operating options;

- Numerator effects where banks must trade off lending capacity versus high quality liquid assets and specifically low earning HQLA Level 1 assets; and

- TBS also looked at asset shifting scenarios where banks elect to trim or exit the rule capped HQLA Level 2A and 2B asset categories in an effort to conform to the proposed rule. Again we note that a seemingly innocuous rule adaptation scaled up to compliance by large institutions and principles conformance many smaller ones may negatively affect the market demand sizing equations for Agency and Municipal instruments.

The Agencies' observations of the volatility of these liability categories and the potential moral hazards they may represent to the deposit insurance fund notwithstanding, we caution that decreasing demand for these instrument classes will have consequent effects particularly on the tools available to other government agencies tasked with initiatives such as incentivizing home ownership and other government funding source needs. For instance, certain home mortgages have built in fees that help fund social security.

Bank regulatory policy may also work at cross purposes with parallel agency regulatory policies. An example of this would be the interplay of incentives between brokered deposits in the banking industry and the SEC's efforts to rationalize policies and incentives for money market mutual funds.

A sizable sub-industry of deposit brokerage exists within the banking arena that places deposits from smaller broker-dealers that are not affiliated with banks. The size of this sub-industry is estimated to be between $150 and $200 billion. The economics of the brokered sweep deposit marketplace for unaffiliated banks is as follows

1. Gross bank deposit rate	25 basis points (Fed Funds plus 15 basis pts)
2. Service fees for deposit accounting	(8) basis points
3. Clearing company fees	(12) basis points
4. Customer rate paid	(2) basis points
5. Broker revenue	3 basis points

A reduction of 20 basis points in what banks pay for these deposits will create smaller and usually negative returns for the broker-dealer. The sub-industry will quickly dry up. Smaller broker-dealers that use clearing companies and are not affiliated with banks will be structurally disadvantaged versus their larger competitors, particularly those with affiliated banks. These affiliations already enjoy friction advantages in the transfer pricing rates between the bank and the affiliated broker-dealer through accounting mechanisms that depends upon where the parent holding company prefers to recognize earnings. The proposal amplifies this advantage and potentially causes a sub-systemic market segment collapse.

Consequences include instead of offering FDIC insured deposit sweep programs to customers, broker-dealers will turn back toward the use of money market mutual funds, which are inherently less safe and were a destabilizing influence during the last fiscal crisis. As the Agencies are aware, the SEC has been to slow to achieve useful reform. That process would not be aided by triggering another $200 billion of demand for these instruments as a consequence of LCR implementation. Such a lack of harmonization between agencies typically causes net negative systemic outcomes. We believe that it

would be prudent for the Agencies to examine these and other similar effects that may arise because of a policy shift.

Appendix E: Further Discussion of Disadvantages Imposed on Non-Affiliated Brokerages

The proposed LCR rules give banks that receive deposits from an affiliated broker-dealer a significant advantage over banks taking deposits only from unaffiliated sources. The advantage takes the form of a 60 percent lower run off assumption, which is also a detriment for broker-dealers that are not affiliated with banks. Such broker-dealers must accept lower deposit rates as their bank counterparties normalize their ROE to offset the dilution of asset yield due to the higher levels of HQLA imposed by the new rules.

TBS proposes that deposits emanating from an affiliated broker-dealer be treated the same for LCR run off purposes as any other brokered sweep deposit.

1. **Normal Customer Run off Behavior**. The purpose and uses customers have for FDIC insured brokered deposit sweep arrangements is identical within all broker-dealers that offer substantially the same product access features and levels of FDIC insurance. Run off rates that stem from product utilization and the ebbs and flows of the mix of consumer investment between cash and equity asset classes should be nearly identical in amount and timing.

2. **Run off as Customer Reaction to Bank Health**. All broker-dealers with FDIC insured brokered deposit sweep arrangements allow individual customers to opt out of banks for any reason. While the opt out option is more often a reflection of managing the total deposit exposure at a particular bank, a small number of customers will ask that their balances be withdrawn from a program bank that has experienced bad headlines or a bad quarter of earnings.

   Broker-dealers affiliated with banks sometimes have only one bank, and the customer does not have a choice to exit the bank and still remain in an FDIC insured deposit sweep program. When customers begin to be troubled by the condition of the affiliated bank, they exit the program entirely and, other things being equal, take a higher percentage of their cash from a one bank affiliated program than they would a multiple bank program. Accordingly, run off potential associated with programs involving affiliated banks and broker-dealers is higher, not lower.

3. **Resistance to Fiduciary Duty.** Nearly all broker-dealers that utilize Series 7 employees or independent financial advisors have some reasonable percentage (typically about 20 percent) of accounts where the firm acts as an investment advisor to the customer and has discretionary authority to pick investments on the customer's behalf. Cash is one asset class where discretion is exercised. Banks in which sweep deposits are placed represent a discretionary choice as they are selected by the broker-dealer. The broker-dealer has a fiduciary obligation as established by SEC rules and FINRA to put the customer's interests first. Despite the guarantee of FDIC coverage that protects principal, some broker-dealers believe their duty extends to taking customers out of a bank when it is clearly troubled. Often broker-dealers that do not have bank affiliates will insert capital adequacy clauses into their deposit agreements with program banks, thereby enabling the broker-dealer to take deposits back if the bank becomes less than well capitalized. This acts as an explicit expression of how the broker-dealer's fiduciary duty is measured and what the remedial action is when a bank falls below the standard.

Banks affiliated with broker-dealers are at least as likely to fail as independent banks. Broker-dealers with bank affiliates have the same obligation to exercise fiduciary care for its discretionary investment customers. However the broker-dealer may be hampered in making an objective rational judgment about the health and safety of its bank affiliate for the following reasons:

- There is only one bank, so rejection of the affiliated bank would cause massive disruption to the FDIC insured brokered deposit sweep program and likely result in either the loss of account balances;
- Placing customer funds into credit balances on the broker-dealer's balance sheet is not appealing because the broker-dealer would likely require additional capital infusion, thereby diverting potential capital away from the bank;
- The broker-dealer is often paid an above market rate on the deposits it places with an affiliated bank. Giving up those deposits by taking them back from the bank will cause at least short term earnings issues at the broker-dealer

The essence of the proposed LCR rule is that an affiliated broker-dealer is less likely to withdraw deposits from an affiliated bank. The rationale for that behavior, however, is based upon a moral hazard that the broker-dealer will breach its fiduciary duty. It is bad policy to reward actions that are derived from morally hazardous activities. The very existence of a run off differential creates a moral hazard that would be less prevalent than if no differential existed.

Appendix F: Deposit Stability Observations at Selected Insured Depository Institutions

The following table illustrates the firm specific nature of deposit stability for consideration by the Agencies. The stability estimates were calculated using the TBS Bank Monitor system using data from FDIC Call Reports/TFRs, based upon the following:

- Sixteen quarter look back test window.
- Analysis of total deposits balances – retail and brokered, domestic and foreign together, RIS variable DEP – quarter by quarter.
- The standard deviation of these balances over the stability observation period was calculated.
- The stability floor was established to be three standard deviations wide.
- The stability floor was assigned as the volatility percentage of the deposit base.
- Calculation in the same fashion were made for every FDIC insured institution with assets – RIS variable ASSET – greater than $10 billion reported on the most recent RIS released reporting period, 3rd Quarter, 2013.

This is an extreme beta risk calculation at the outside limit of six-sigma testing principles. We suggest practical real world volatility band for regulatory oversight - as opposed to extreme stress testing - are more likely closer to 1 to 1.5 standard deviations wide. However, we wished to point out that even under the most adverse systemic event circumstances the over $10 billion group statutorily required to comply with Basel III regulations leaves a good portion of the United States deposit base stable, particularly with respect to 30 day run off risks.

We note further that most of these banks have large fractions of their deposit bases that have been stable even in the midst of the turmoil of the crisis cycle. We believe that a final rule on liquidity coverage should reward the best of breed for their safe and sound practices even as it protects the economy from potential future volatile systemic risks.

Estimated Deposit Stabilities for Selected FDIC Insured Banks with Assets Over $10 Billion

Amounts in thousands

	Assets	Total Deposits	Retail	Brokered	Stable Deposits	Volatile Deposits	Percent
JPMORGAN CHASE BANK NA	$1,989,875,000	$1,329,877,000	$1,323,749,000	$6,128,000	$992,251,840	$337,625,160	25.40%
BANK OF AMERICA NA	$1,438,859,000	$1,118,256,000	$1,075,491,000	$42,765,000	$997,457,094	$120,798,906	10.80%
CITIBANK NATIONAL ASSN	$1,344,751,000	$972,202,000	$905,540,000	$66,662,000	$738,766,929	$233,435,071	24.00%
WELLS FARGO BANK NA	$1,328,010,000	$1,047,726,000	$994,483,000	$53,243,000	$559,501,959	$488,224,041	46.60%
U S BANK NATIONAL ASSN	$356,590,456	$269,648,386	$260,018,728	$9,629,658	$189,300,286	$80,348,100	29.80%
PNC BANK NATIONAL ASSN	$298,485,621	$220,576,899	$220,557,400	$19,499	$137,774,768	$82,802,131	37.50%
BANK OF NEW YORK MELLON	$291,475,000	$248,606,000	$248,606,000	0	$122,602,172	$126,003,828	50.70%
CAPITAL ONE NATIONAL ASSN	$234,771,390	$188,132,575	$187,005,295	$1,127,280	$70,244,529	$117,888,046	62.70%
TD BANK NATIONAL ASSN	$215,432,360	$181,812,969	$122,528,601	$59,284,368	$103,753,823	$78,059,146	42.90%

STATE STREET BANK&TRUST CO	$212,689,010	$157,795,371	$157,795,371	0	$76,297,913	$81,497,458	51.60%
HSBC BANK USA NATIONAL ASSN	$179,860,546	$121,136,360	$113,083,739	$8,052,621	$94,030,605	$27,105,755	22.40%
BRANCH BANKING&TRUST CO	$175,616,476	$133,335,658	$128,500,974	$4,834,684	$97,102,024	$36,233,634	27.20%
SUNTRUST BANK	$167,525,054	$131,670,970	$123,715,759	$7,955,211	$121,501,544	$10,169,426	7.70%
FIA CARD SERVICES NA	$157,016,000	$117,335,000	$110,273,000	$7,062,000	$74,059,182	$43,275,818	36.90%
FIFTH THIRD BANK	$123,338,495	$96,985,889	$91,069,957	$5,915,932	$83,072,996	$13,912,893	14.30%
CHASE BANK USA NATIONAL ASSN	$122,430,793	$46,346,763	$46,346,763	0	$34,651,475	$11,695,288	25.20%
REGIONS BANK	$116,068,082	$93,668,475	$89,231,408	$4,437,067	$85,605,665	$8,062,810	8.60%
GOLDMAN SACHS BANK USA	$111,117,000	$64,485,000	$26,377,000	$38,108,000	$22,261,916	$42,223,084	65.50%
UNION BANK NATIONAL ASSN	$104,956,215	$80,395,382	$73,806,038	$6,589,344	$60,582,296	$19,813,086	24.60%
MORGAN STANLEY BANK NA	$99,782,000	$83,534,000	$418,000	$83,116,000	$62,209,146	$21,324,854	25.50%
RBS CITIZENS NATIONAL ASSN	$98,282,921	$77,986,990	$74,186,069	$3,800,921	$69,917,520	$8,069,470	10.30%
CHARLES SCHWAB BANK	$97,864,000	$91,239,000	$89,903,000	$1,336,000	$42,490,828	$48,748,172	53.40%
NORTHERN TRUST CO	$95,631,363	$79,780,679	$79,775,654	$5,025	$38,275,997	$41,504,682	52.00%
ALLY BANK	$92,119,383	$52,407,963	$42,683,812	$9,724,151	$30,513,645	$21,894,318	41.80%
HARRIS NATIONAL ASSN	$90,835,347	$70,347,556	$68,386,241	$1,961,315	$9,790,078	$60,557,478	86.10%
KEYBANK NATIONAL ASSN	$88,092,809	$70,127,284	$69,188,354	$938,930	$62,230,970	$7,896,314	11.30%
MANUFACTURERS&TRADERS TR CO	$83,615,586	$67,542,068	$66,198,401	$1,343,667	$43,818,765	$23,723,303	35.10%
CAPITAL ONE BANK USA NA	$78,383,591	$39,489,016	$32,881,261	$6,607,755	$21,600,582	$17,888,434	45.30%
SOVEREIGN BANK	$74,218,976	$50,129,172	$48,524,894	$1,604,278	$39,602,550	$10,526,622	21.00%
DISCOVER BANK	$74,034,370	$43,115,611	$24,642,339	$18,473,272	$31,343,975	$11,771,636	27.30%
COMPASS BANK	$69,789,088	$52,394,586	$50,029,121	$2,365,465	$44,537,864	$7,856,722	15.00%
BANK OF THE WEST	$65,083,886	$47,769,418	$45,869,701	$1,899,717	$38,190,075	$9,579,343	20.10%
COMERICA BANK	$64,590,524	$53,520,592	$53,520,592	0	$39,015,108	$14,505,484	27.10%
USAA FEDERAL SAVINGS BANK	$62,039,513	$55,516,351	$48,556,768	$6,959,583	$32,651,460	$22,864,891	41.20%
HUNTINGTON NATIONAL BANK	$56,434,306	$47,689,461	$46,323,701	$1,365,760	$39,885,599	$7,803,862	16.40%
DEUTSCHE BANK TR CO AMERICAS	$53,228,000	$37,284,000	$35,419,000	$1,865,000	$17,510,537	$19,773,463	53.00%
E*TRADE BANK	$44,395,157	$32,253,764	$13,691,078	$18,562,686	$26,444,514	$5,809,250	18.00%
UBS BANK USA	$43,227,044	$39,096,437	$39,003,037	$93,400	$20,099,814	$18,996,623	48.60%
NEW YORK COMMUNITY BANK	$42,633,462	$23,012,684	$18,864,894	$4,147,790	$15,969,724	$7,042,960	30.60%
FIRST REPUBLIC BANK	$40,950,820	$31,290,369	$31,284,484	$5,885	$20,152,318	$11,138,051	35.60%
HUDSON CITY SAVINGS BANK	$39,185,448	$22,212,386	$22,212,386	0	$18,886,530	$3,325,856	15.00%
AMERICAN EXPRESS BANK FSB	$38,510,376	$27,577,029	$24,555,957	$3,021,072	$12,872,956	$14,704,073	53.30%
FIRST NIAGARA BANK NA	$37,314,587	$27,526,707	$26,472,789	$1,053,918	$6,250,377	$21,276,330	77.30%
GE MONEY BANK	$34,772,338	$22,394,129	$9,531,999	$12,862,130	$10,797,384	$11,596,745	51.80%
AMERICAN EXPRESS CENTURION B	$33,181,651	$21,735,222	$7,078,953	$14,656,269	$11,843,246	$9,891,976	45.50%
CITIZENS BANK OF PA	$32,509,460	$26,891,079	$26,891,079	0	$22,651,342	$4,239,737	15.80%
WELLS FARGO BANK S CNTL NA	$32,308,000	$27,149,000	$26,316,000	$833,000	$3,008,979	$24,140,021	88.90%
PEOPLES UNITED BANK	$31,269,732	$22,204,791	$22,204,791	0	$14,215,184	$7,989,607	36.00%
CITY NATIONAL BANK	$28,704,112	$25,393,854	$25,351,171	$42,683	$17,323,270	$8,070,584	31.80%
BANK OF OKLAHOMA NA	$26,911,962	$19,872,790	$19,428,096	$444,694	$5,019,557	$14,853,233	74.70%

BANCO POPULAR DE PUERTO RICO	$26,680,000	$20,435,000	$18,373,000	$2,062,000	$16,413,292	$4,021,708	19.70%
SYNOVUS BANK	$25,876,978	$21,188,586	$19,913,386	$1,275,200	$0	$21,188,586	100.00%
BANK OF AMERICA CA NA	$25,580,000	$17,156,000	$15,192,000	$1,964,000	$0	$17,156,000	100.00%
EAST WEST BANK	$24,471,822	$20,532,686	$18,907,057	$1,625,629	$12,981,017	$7,551,669	36.80%
ONEWEST BANK FSB	$24,222,377	$14,779,688	$14,779,688	0	$8,967,726	$5,811,962	39.30%
FIRSTMERIT BANK NA	$24,083,861	$19,619,818	$19,420,005	$199,813	$10,364,028	$9,255,790	47.20%
FIRST TENNESSEE BANK NA	$23,964,077	$16,418,833	$14,817,659	$1,601,174	$14,149,958	$2,268,875	13.80%
FROST NATIONAL BANK	$23,545,565	$20,027,898	$20,027,698	$200	$13,250,763	$6,777,135	33.80%
ASSOCIATED BANK NA	$23,386,535	$18,531,164	$16,252,330	$2,278,834	$14,924,057	$3,607,107	19.50%
SILICON VALLEY BANK	$22,347,287	$20,276,187	$20,276,187	0	$10,768,507	$9,507,680	46.90%
COMMERCE BANK NATIONAL ASSN	$22,311,155	$18,222,172	$18,215,694	$6,478	$13,586,972	$4,635,200	25.40%
MORGAN STANLEY TRUST	$21,708,000	$19,482,000	$17,000	$19,465,000	$7,805,786	$11,676,214	59.90%
FIRST-CITIZENS BANK&TRUST CO	$21,164,609	$18,088,395	$18,021,905	$66,490	$13,387,788	$4,700,607	26.00%
BARCLAYS BANK DELAWARE	$21,024,762	$11,387,979	$3,915,081	$7,472,898	$4,692,345	$6,695,634	58.80%
SIGNATURE BANK	$21,006,486	$16,049,563	$15,737,305	$312,258	$7,611,670	$8,437,893	52.60%
WEBSTER BANK NATIONAL ASSN	$20,573,651	$15,260,147	$15,070,287	$189,860	$13,838,102	$1,422,045	9.30%
SCOTTRADE BANK	$19,304,505	$18,042,251	$406,895	$17,635,356	$5,061,755	$12,980,496	71.90%
TCF NATIONAL BANK	$18,409,155	$14,570,209	$14,264,307	$305,902	$11,139,029	$3,431,180	23.50%
SUSQUEHANNA BANK	$18,376,403	$12,747,285	$12,087,082	$660,203	$7,709,913	$5,037,372	39.50%
ZIONS FIRST NATIONAL BANK	$18,059,579	$15,792,265	$15,764,623	$27,642	$13,565,659	$2,226,606	14.10%
EVERBANK	$17,611,692	$13,704,219	$10,253,606	$3,450,613	$6,740,240	$6,963,979	50.80%
GE CAPITAL FINANCIAL INC	$16,775,598	$13,104,930	$1,302,345	$11,802,585	$5,164,428	$7,940,502	60.60%
FIRST HAWAIIAN BANK	$16,690,680	$13,134,734	$13,134,734	0	$9,753,776	$3,380,958	25.70%
USAA SAVINGS BANK	$16,292,282	$766,914	$18,305	$748,609	$579,160	$187,754	24.50%
PROSPERITY BANK	$16,048,630	$12,463,582	$12,463,582	0	$6,678,290	$5,785,292	46.40%
VALLEY NATIONAL BANK	$15,963,980	$11,279,442	$11,065,569	$213,873	$8,970,250	$2,309,192	20.50%
ASTORIA FS&LA	$15,955,012	$10,260,752	$10,260,752	0	$7,493,637	$2,767,115	27.00%
BNY MELLON NATIONAL ASSN	$15,948,364	$12,869,516	$12,869,516	0	$6,086,473	$6,783,043	52.70%
UMB BANK NATIONAL ASSN	$15,905,248	$13,142,749	$13,134,938	$7,811	$7,206,455	$5,936,294	45.20%
TD BANK USA NATIONAL ASSN	$15,770,651	$14,069,460	$149,636	$13,919,824	$0	$14,069,460	100.00%
STATE FARM BANK FSB	$14,926,411	$10,008,562	$2,302,908	$7,705,654	$9,019,106	$989,456	9.90%
CIT BANK	$14,666,287	$11,784,376	$6,881,268	$4,903,108	$4,234,249	$7,550,127	64.10%
WELLS FARGO BANK NW NA	$14,407,000	$12,781,000	$11,917,000	$864,000	$8,410,326	$4,370,674	34.20%
FIRST NATIONAL BANK OF OMAHA	$14,255,620	$11,734,863	$11,151,602	$583,261	$6,573,636	$5,161,227	44.00%
BANKUNITED	$14,152,139	$10,015,136	$9,918,557	$96,579	$7,642,140	$2,372,996	23.70%
ARVEST BANK	$13,963,666	$11,803,460	$11,736,885	$66,575	$8,506,161	$3,297,299	27.90%
BANK OF HAWAII	$13,894,892	$11,667,312	$11,667,312	0	$9,047,446	$2,619,866	22.50%
PRIVATEBANK&TRUST CO	$13,837,450	$11,893,961	$10,590,365	$1,303,596	$9,933,836	$1,960,125	16.50%
RABOBANK NATIONAL ASSN	$13,806,000	$10,314,000	$8,498,000	$1,816,000	$5,642,028	$4,671,972	45.30%
INVESTORS SAVINGS BANK	$13,744,670	$8,721,181	$8,419,016	$302,165	$5,494,638	$3,226,543	37.00%
AMEGY BANK NATIONAL ASSN	$13,335,678	$10,976,100	$10,976,100	0	$8,667,466	$2,308,634	21.00%

FIRSTBANK OF COLORADO	$13,140,132	$11,908,930	$11,863,256	$45,674	$0	$11,908,930	100.00%
WASHINGTON FS&LA	$13,084,555	$9,163,751	$9,107,849	$55,902	$8,077,580	$1,086,171	11.90%
IBERIABANK	$13,078,782	$11,064,429	$10,301,127	$763,302	$5,303,660	$5,760,769	52.10%
BANCORPSOUTH BANK	$12,924,483	$10,649,840	$10,649,840	0	$9,792,760	$857,080	8.00%
FIRSTBANK OF PUERTO RICO	$12,770,679	$9,996,628	$6,466,810	$3,529,818	$6,381,598	$3,615,030	36.20%
HANCOCK BANK OF LOUISIANA	$12,695,065	$10,086,010	$10,086,010	0	$0	$10,086,010	100.00%
FIRST NB OF PENNSYLVANIA	$12,605,491	$9,836,700	$9,833,479	$3,221	$6,008,378	$3,828,322	38.90%
APPLE BANK FOR SAVINGS	$11,887,993	$10,779,141	$9,590,531	$1,188,610	$6,020,518	$4,758,623	44.10%
FLAGSTAR BANK FSB	$11,792,767	$6,841,799	$6,382,697	$459,102	$4,914,879	$1,926,920	28.20%
TRUSTMARK NATIONAL BANK	$11,691,188	$9,623,574	$9,509,252	$114,322	$6,717,034	$2,906,540	30.20%
UMPQUA BANK	$11,564,045	$9,149,276	$8,546,449	$602,827	$7,358,629	$1,790,647	19.60%
THIRD FS&LA OF CLEVELAND	$11,232,272	$8,619,169	$8,606,297	$12,872	$8,132,767	$486,402	5.60%
CATHAY BANK	$10,806,625	$7,948,738	$7,669,782	$278,956	$7,162,521	$786,217	9.90%
TEXAS CAPITAL BANK NA	$10,788,608	$9,042,919	$7,612,308	$1,430,611	$4,866,508	$4,176,411	46.20%
CALIFORNIA BANK&TRUST	$10,777,156	$9,214,611	$9,214,611	0	$8,625,029	$589,582	6.40%
RAYMOND JAMES BANK FSB	$10,513,239	$9,301,165	$9,003,369	$297,796	$6,283,670	$3,017,495	32.40%