MONTEREY COUNTY

AUDITOR - CONTROLLER

(831) 755-5040 • FAX (831) 755-5098 • 168 W. ALISAL ST., THIRD FLOOR • SALINAS, CALIFORNIA 93902

MICHAEL J. MILLER, CPA, CISA
AUDITOR-CONTROLLER

ALFRED R. FRIEDRICH, CGFM
ASSISTANT AUDITOR-CONTROLLER

January 22, 2014

Department of the Treasury
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Attn: Legislative and Regulatory Activities Division
Docket ID OCC-2013-0016

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

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Comments / Legal ESS
Robert E. Feldman, Executive Secretary
RIN No. 3064-AE04

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

The County of Monterey, California] appreciates the opportunity to respond to the request for comment issued by the Office of the Comptroller of the Currency, Department of the Treasury, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, "the Agencies") on the proposed rule to implement a quantitative liquidity requirement (the "proposed rule") consistent with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision ("BCBS") for large, internationally active banking organizations, covered nonbank companies and their consolidated subsidiary depository institutions with total assets greater than $10 billion. In this letter, the County of Monterey is commenting specifically on those aspects of the proposed rule that we believe would have the greatest impact on the U.S. municipal securities market[1] and our ability to continue to finance critical public works projects.

Monterey County has issued $377 million of tax exempt bonds within the last 5 years to finance critically needed infrastructure improvements within our county. Several of these financings were direct placements with subject banks. Had the new rules been adopted previously, access to markets would have been severely limited with increased borrowing costs. The County currently needs to construct $80 million in jail expansion and $40 million to construct a new juvenile justice center, both of which are severely overcrowded and in disrepair. Numerous other projects have been identified in our five year Capital Improvement Plan.

The County of Monterey fully supports the efforts of the Agencies to enhance liquidity risk management in the banking sector and ensure strong and resilient financial markets. We believe, however, that the proposed exclusion of municipal securities from the High Quality Liquid Asset ("HQLA") definition is unjustified based on the Agencies' own liquidity criteria and our understanding of the municipal market. The Agencies have stated, for example, that they consider the depth and breadth of markets as key indicators of liquidity and, for that reason, have specifically proposed to require the existence of a large and diverse number of market participants as part of their HQLA criteria. The largest concentration of holders in the municipal securities market is, by far, the household sector. According to the Federal Reserve's own data[2], more than 44% of all outstanding municipal securities are held either directly in retail hands or in separately managed individual accounts. Almost half of the market then is held by a sector which is itself a diverse population of thousands of individual investors.

The Agencies have also imposed certain diversification requirements with respect to a covered company's stock of HLQA. According to Federal Reserve data[3], municipal securities currently comprise less than 4% of U.S. Depository Institutions' total assets. That is less than either corporate bonds or Agency and GSE-backed securities. From this perspective, municipal securities present less systemic risk. We believe, therefore, that this under-concentrated exposure among U.S. banks to municipal securities should make the asset class desirable for inclusion in HQLA.

The Agencies also specifically require that HQLA be eligible to be pledged at a central bank. It is important to note then that the U.S. Federal Reserve accepts all U.S. municipal bonds at a 2%-5% haircut, depending on maturity. These are the same haircuts that the Federal Reserve applies to U.S. Agency and GSE securities. By comparison, the Federal Reserve accepts U.S. AAA corporate bonds at a 3%-6% haircut and all other investment grade corporate bonds at a 5%-8% haircut. Thus, the U.S. Federal Reserve already acknowledges the high credit, diversification and liquidity value of municipal securities by accepting them at the same haircuts as U.S. Agency and GSE securities and at better haircuts than U.S. corporate bonds. We do see any justification for the Agencies to diverge on this point, as has been proposed.

Lastly, but certainly not least important, the proposed rule creates a dichotomy that would disadvantage U.S. state and local issuers. The proposed rule permits foreign sovereign state obligations to be categorized as HQLA. Depending on the standard risk weighting and subjective criteria, such obligations may be counted as Level 1 (e.g., France, Italy, Slovenia, Spain and

---

[1] This letter is specifically in response to Questions 12 and 22 in the Notice of Proposed Rulemaking as they relate to the municipal securities market.

[2] Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.211, September 25, 2013.

[3] Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.110, September 25, 2013. Holdings of private residential and commercial CMOs and other structured MBS have been excluded from corporate bond data.

Taiwan) or Level 2A (e.g., Botswana, Chile, Saudi Arabia and United Arab Emirates). Sovereign obligations of U.S. states (e.g., California), however, are specifically excluded from consideration in any category of HQLA. This dichotomy unfairly discriminates against the liquid debt markets of U.S. States and instrumentalities and penalizes U.S. banks for servicing domestic public sector clients.

Beyond the inconsistencies and illogical outcomes, we are most concerned with the potential for significant and adverse unintended consequence. We believe that the proposed rule may serve to impair a long history of legislative motivation for banks to serve and support the municipal securities market. Without having offered any demonstration of diminished liquidity, the Agencies have proposed not to allow municipal securities to qualify as High Quality Liquid Assets at this time and, in doing so, we believe, propose to dampen bank demand for the asset class. In response to the exclusion, we expect that regulated companies would need to either reduce their participation in the municipal securities market, which, while not a majority, is still a meaningful percentage, whose absence would be detrimental, or be forced to raise their pricing schematics accordingly. We believe that the immediate and direct consequence of this exclusion to Monterey County and our taxpaying constituents will, therefore, be unnecessary, and potentially unbearable, increases in the cost of financing desperately needed repair and replacement of our jail and juvenile justice center, which serve our thousands of residents every day.

Thus, in order to avoid any unintended and unnecessary increases in the cost of improving municipal infrastructure and engaging in new public works projects, which are vital not only to the county and our residents, but to the health of the U.S economy more broadly, we urge the Agencies to amend the proposed rule in order to reclassify all investment grade municipal securities as eligible for inclusion as Level 2A High Quality Liquid Assets.

Monterey County appreciates this opportunity to comment and welcomes any questions that the Agencies may have for us.

Respectfully,

Michael J. Miller

Michael J. Miller, CPA, CISA
Auditor-Controller