American Hospital Association
American Public Gas Association
American Public Power Association
Council of Infrastructure Financing Authorities
Education Finance Council
Government Finance Officers Association
International City/County Management Association
International Municipal Lawyers Association
Large Public Power Council
National Association of Counties
National Association of Health and Higher Education Facilities Authorities
National Association of Local Housing Finance Agencies
National Association of State Auditors, Comptrollers and Treasurers
National Association of State Treasurers
National Council of State Housing Agencies
National League of Cities
U.S. Conference of Mayors

January 31, 2014

Mr. Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20051

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

Mr. Thomas J. Curry, Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218, Mail Stop 9W-1
Washington, DC 20219

RE: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring Federal Reserve System [Docket ID OCC-2013-0016]

Dear Secretary deV. Frierson, Executive Secretary Feldman and Comptroller Curry:

We appreciate the opportunity to comment to the aforementioned Agencies on the proposed rule released in October 2013, which incorporates certain international capital standards for banking institutions as proposed by the Basel Committee on Banking Supervision (BCBS). The organizations listed above represent state and local governments and public sector entities (PSEs) who issue municipal bonds and are very interested in this rulemaking.

We greatly appreciate your efforts to strengthen the banking system through clarifying credit and liquidity standards for banks' capital requirements, as that strength provides security to the economy broadly as well as specifically to our members. However, as drafted the proposal does not include a very strong and stable investment category with deep funding markets – municipal securities. We are very concerned that proposal's failure to classify municipal securities as High Quality Liquid Asset (HQLA) not only overlooks an investment category that contributes to greater market stability, but we also believe that this oversight will have significantly negative effects on the municipal securities market and communities across the country. Failing to qualify municipal bonds as HQLA would significantly reduce the appeal of municipal securities for banks to underwrite these securities and investors to purchase them, resulting in increased borrowing costs for state and local governments and PSEs to finance desperately needed infrastructure projects.

<u>Characteristics of Municipal Securities Are Consistent with Those of Level 2A and 2B Investments</u>

Municipal securities behave similarly to HQLA investment categories Level 2A and 2B outlined in the proposed rule, demonstrating equally limited price volatility, high trading volumes and deep and stable funding markets, and should qualify as such under any final Liquidity Coverage Ratio Rule issued by the Agencies.

With regard to price volatility, investment grade general obligation municipal bonds are significantly less risky than other investment vehicles, [1] and compare well with other investment categories that were given HQLA status under the proposed rule (U.S. Treasuries, government agency obligations, investment-grade corporate bonds). During the 2008 financial crisis municipal general obligation and revenue bonds retained their value more consistently than high and lower investment grade corporate bonds, and performed similarly to government sponsored enterprise (GSE) secured bonds. As data from a report[2] from members of the Federal Reserve Bank shows, the 40-year total cumulative default rate on municipal bonds, both general obligation and revenue bonds, that generally met the Office of the Comptroller of the Currency's Type I and Investment-Grade definitions, has been extremely low. The data shows that the number of defaults on Investment-Grade rated municipal bonds was less than 0.25 percent. The data also shows the number of defaults per issuer on those bonds which would not meet that definition was substantially higher - over 4 percent. Still, under the proposed rule GSE bonds and BBB- corporate bonds would be considered HQLA while municipal securities would not.

With respect to the Agencies' condition that high trading volume is a requirement for HQLA, it is important to note that the municipal market trades as a percentage of the total outstanding market is nearly at the same volume as corporate and GSE bonds. According to SIFMA data[3], the municipal market trades 0.31 percent of its total outstanding par every day, compared to the corporate bond market trades of 0.20 percent per day and the GSE bond market trades of 0.33 percent per day.

Finally, we believe that municipal securities meet the Agencies' HQLA precondition of an investment categories' reliance on a deep and diverse markets to establish strong liquidity. More than 70 percent of all outstanding municipal securities are held by thousands of individual investors, either directly or through mutual funds and money market funds.[4] Individual investor behavior has demonstrated a strong correlation between demands and yields, with retail investors historically opting to add to maintain or add to their holdings in periods of rising rates. This consistent correlation demonstrates a high level of liquidity in the municipal market. In addition to retail investors, a long list of other investors comprises

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[1] Moody's Investor Service Special Comment, March 7, 2012: U.S. Municipal Bond Defaults and Recoveries, 1970-2011. Page 2

[2] 2 "The Untold Story of Municipal Bond Defaults" – Jason Appleson, Eric Parsons, and Andrew Haughwout, August 2012

[3] SIFMA's Outstanding U.S. Bond Market Debt

[4] 2010 Thompson Reuters.

the remaining 30 percent of municipal securities investors, and includes property, casualty and life insurance companies, GSE's, broker dealers, credit unions, U.S. banks and foreign governments.

For all of the reasons above we believe that investment grade municipal securities should be categorized as Level 2A HQLA. Further, we believe that qualifying these securities as such would advance the Agencies' stated goal of "improving the banking sector's ability to absorb shocks arising from financial and economic stress."

Municipal Securities Should Receive HQLA Classification Over Foreign Sovereign Debt Securities

Municipal securities are known as the second safest available investment, aside from U.S. Treasuries, with state and local governments having nearly a zero default rate, and meeting the Agencies' qualifications for limited price volatility, high trading volumes and deep and stable funding markets as discussed above. Yet the Agencies' proposal would qualify U.S. Treasuries as Level 1 HQLA and GSE securities as Level 2A, while failing to qualify even investment grade municipal securities in either of these categories. Equally concerning is the proposal's qualification of foreign sovereign debt securities as Level 1 HQLA while still failing to include investment grade municipal securities in any of the three HQLA categories. This preference unfairly favors foreign debt securities over U.S. state and local debt securities, and in doing so would threatens to increase costs for national infrastructure development, three-quarters of which is financed through tax-exempt bonds.

Municipal and PSE Deposits Should Not Be Classified Secured Funding

The Agencies' proposal mischaracterizes municipal deposits as secured funding, as opposed to treating them as deposits, based on the assumption that municipalities and PSE's would withdraw deposits with non-HQLA investments in times of fiscal stress. We do not believe that this assumption is correct, and we are concerned that this provision of the proposal would motivate banks to unwind their municipal and PSE deposits and accounts, and would ultimately disrupt relationships between these entities and drive up banking and borrowing costs for municipal issuers.

Thank you very much for the opportunity to comment on this important rulemaking. Public policy and national interests implemented at the state and local levels through debt financing benefit the country as a whole by ensuring our citizens have essential infrastructure to provide for education, health care, roads, bridges, water delivery systems, transportation systems, public power, affordable housing and public safety. We hope that you will consider this and our comments contained in this letter, and that you will reevaluate municipal securities as an investment to include within the HQLA definition.

Sincerely,

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American Public Gas Association, Dave Schryver, 202-464-0835
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