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State of Washington  
Office of the Treasurer

February 13, 2012

Board of Governors of the Federal Reserve System  
Federal Deposit Insurance Corporation  
Office of the Comptroller of the Currency  
Securities and Exchange Commission

Proposed Rule Making:

- Board of Governors of the Federal Reserve System, [Docket No. R-1432] (RIN 7100-AD82)
- Federal Deposit Insurance Corporation, (RIN 3064-AD85)
- Office of the Comptroller of the Currency, [Docket No. OCC-2011-14] (RIN 1557-AD44)
- Securities and Exchange Commission, [Release No. 34-65545; File No. S7-41-11]

Dear Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Securities and Exchange Commission:

I am writing in support of your adoption of a simple and straightforward Volcker Rule that would prohibit banks insured by the Federal Deposit Insurance Corporation and their affiliates from making directional bets on the markets. I urge you to approve this important reform to curb proprietary trading backed by the FDIC.

It is difficult to determine if in its current form, the proposed "Volcker Rule" related to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act will accomplish these broad goals. Unfortunately, much of the complexity of the current proposed rule may detract from its effectiveness.

In particular, I am especially concerned about the implications of the proposed Volcker Rule for the municipal bond market because the State of Washington and our local governments depend heavily on the municipal bond market to fund critical capital and transportation infrastructure investments. The comments in this letter are directed to the proposed rulemakings referenced above, namely the proposed "Volcker Rule" related to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and specifically related to questions 120 and 124 in the proposed rule. **I urge each agency above to replace the proposed exemption for obligations of states and political subdivisions so that it is consistent with the definition of "municipal securities" included in the Securities Act of 1934<sup>1</sup> ("the '34 Act").**

The proposed rule appropriately seeks to exempt municipal securities from the section related to banking institutions engaging in certain proprietary trading activities in keeping with the statute and Congress' intent. However, the proposed rule would create an exemption for municipal obligations that is defined too narrowly to include only "obligations of states and political subdivisions thereof." This definition is grossly under-inclusive and differs from the well-established and relied upon definition of municipal securities found in the '34 Act - "obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more states, or any security

<sup>1</sup> Section 3(a)(29) of the Securities Act of 1934.



which is in an industrial development bond." If made final, the definition in the proposed rule would exclude thousands of municipal securities, disrupting the municipal market and raising costs for state and local governments. Given that one of the principal purposes behind the Volcker Rule is to mitigate risk, the lack of uniformity would unfairly treat economically similar debt instruments differently from one another for the purposes of municipal securities trading. Additionally, "one-off" rulemaking should not be used to develop a new, separate definition of municipal securities. Municipal debt is issued both by governmental entities (e.g., states, cities, and counties) for their own purposes and also through statutorily defined authorities and agencies who issue for defined, circumscribed, and critical purposes such as for water and sewer, electricity, airports, housing, health care and education. Due to the variety of ways in which debt can be issued pursuant to federal, state and local laws, most expert reviewers believe the definition in the proposed rule does not adequately capture our market, and could leave at least 40% of the market exposed to Volcker Rule restrictions on proprietary trading, therefore limiting market liquidity and increasing costs for municipal securities. There is absolutely no indication that Congress contemplated or supported this severe bifurcation and distortion of the market. Indeed, other areas of financial regulation have interpreted "obligations of states and political subdivisions thereof" broadly to include all municipal securities in the '34 Act.

Washington would be put to a severe disadvantage by the proposed rule because virtually all "conduit" revenue bonds are required to be issued by instrumentalities rather than by the State and political subdivisions. Accordingly, many of the bonds issued by the Washington Housing Finance Commission to support low income housing, bonds issued by the Washington Higher Education Facilities Authority for capital acquisition and construction at independent colleges and universities, bonds issued by the Washington Health Care Facilities Authority to finance nonprofit health care facilities and equipment, and financings managed by the Washington Economic Development Finance Authority related to manufacturing, recycling and waste disposal facilities would not be exempt.

In addition, cities and counties in Washington frequently establish public corporations to independently carry out some specific functions. Bonds issued by these public development authorities (PDA) such the Pike Place Market PDA and the Seattle Art Museum PDA, would not be exempt from the restriction on proprietary trading even if guaranteed by the city even though bonds issued directly by the city for the exact same purpose would be exempt from the restriction on proprietary trading. There is no reasonable basis for such a distinction.

Expanding the exemption for municipal securities under the Volcker Rule would pose no additional risk to banks or the banking system. Municipal securities are among the safest assets in the U.S. capital markets. Default rates for municipal securities are among the lowest of all sectors of the capital markets, second only to bonds backed directly by the U.S. government. Banks have been active participants in the U.S. municipal bond market, holding nearly nine percent of the over \$3.7 trillion of municipal obligations outstanding and have been active municipal bond investors for many decades. We are aware of no cases where municipal securities holdings have caused safety and soundness problems for either individual banks or on a systemic basis.

We believe that the intent of the proposed Rule, as well as the Dodd Frank Act itself, is to exclude all municipal securities from being captured under the Volcker Rule. Previous rulemaking by the agencies involved in developing the proposed rules demonstrates a more inclusive definition of municipal securities, mirroring the definition included in the Securities Act of 1934.

Again, I urge the Fed, OCC, SEC and FDIC to amend the exemption contained in the proposed rule and have it align with the common definition of municipal securities found in the '34 Act that has served our country well for 80 years. I also urge these bodies to approve a simplified Volcker Rule.

Thank you again for the opportunity to comment on this important issue.

Sincerely,



James L. McIntire  
Washington State Treasurer