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NUVEEN ASSET MANAGEMENT

January 30, 2014

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

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Attn: Robert de V. 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: Notice of Proposed Rulemaking, Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring
FRB (Docket No. R-1466)

Nuveen Asset Management, LLC ("NAM") appreciates the opportunity to comment on the Notice of Proposed Rulemaking, 78 Fed Reg 71818, No 230 (November 29, 2013) (the "Notice"), setting forth a proposed rule (the "Proposed Rule") that would implement a quantitative liquidity requirement consistent with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision. NAM is a registered investment adviser that manages, on a discretionary basis, over $75 billion of municipal securities in mutual funds, closed-end funds and separate accounts. Under the Proposed Rule, municipal securities would not be classified as High Quality Liquid Assets ("HQLA"). The Notice expressly solicits comments on whether assets not proposed to be treated as HQLA, such as municipal securities, should be classified as such.

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We strongly believe that investment grade municipal securities should be classified as Level 2A HQLA. As discussed in further detail below, contrary to the Notice's assertion, municipal securities do in fact exhibit the liquidity characteristics deemed necessary to be classified as HQLA. We believe the Proposed Rule would unnecessarily result in municipal securities enjoying less liquidity than they do today, as many financial institutions would need to evaluate the impact on their liquidity coverage ratios in deciding whether to purchase and make markets in municipal securities. Indeed, the Proposed Rule presents the risk of a self-fulfilling prophecy in that declaring an asset to be illiquid can cause it to be less liquid by reducing the willingness of a class of investors and market-makers to hold or trade in that asset class.[1] A reduction in liquidity can be expected to adversely impact the value of outstanding municipal securities and increase the borrowing costs for state and local issuers of municipal securities.

I. Municipal securities possess liquidity characteristics of HQLA

The Notice indicates that, for an asset to qualify as HQLA, it "should be easily and immediately convertible into cash with little or no loss of value during a period of liquidity stress."[2] The Notice then identifies three general categories of liquidity characteristics to be considered when evaluating the HQLA eligibility of an asset class: (i) risk profile, (ii) market characteristics, and (iii) central bank eligibility. As we discuss below, we believe that investment grade municipal securities clearly satisfy the criteria for HQLA set forth within each such category.

A. Risk profile

The Notice states that HQLA should be lower risk, such that they "would be expected to remain liquid across various stress scenarios and not lose their liquidity upon the occurrence of a certain type of risk."[3] This category focuses on the need for HQLA to withstand abnormal price declines during periods of stress, as the Notice observes that HQLA would generally experience a "flight to quality" during such periods. Thus some assets, such as securities issued by financial sector participants, are not considered to be HQLA since they typically experience outsized price declines and suffer liquidity constraints during times of financial stress.

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[1] See discussion in Section III, *infra*, on the important role banks play as major participants in the municipal securities markets.

[2] Notice at 71823

[3] Notice at 71823.

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The credit risk of municipal securities is generally lower than that of corporate bonds. As shown in the following table, the cumulative 10-year default rates for municipal securities were significantly lower than corporate bonds across all ratings categories:

10-year Cumulative Default Rate[4]

Rating	Municipal	Corporate
Aaa	0.00%	0.50%
Aa	0.01%	0.92%
A	0.05%	2.48%
Baa	0.30%	4.74%
Speculative	5.67%	33.88%

The lower credit risk of municipal securities translates directly into decreased liquidity risk in times of stress. As discussed in more detail in Section I.B.2 below, during the recent financial crisis, investment grade municipal securities experienced price declines below volatility thresholds established for Level 2A HQLA.[5] Indeed, although investment grade corporate bonds would be Level 2B HQLA eligible under the Proposed Rule, municipal securities outperformed corporate bonds during the worst months of the financial crisis in 2008. In light of this, the Notice's suggestion that municipal securities are not eligible for any HQLA category seems particularly questionable.

B. Market-based characteristics

The Notice states that HQLA assets should have the following market-based characteristics: (1) they should have "active outright sale or repurchase markets at all times with significant diversity in market participants as well as high volume;" (2) they should have "prices that do not incur share price declines, even during times of stress;" and (3) they should be "easily and readily valued."[6] We address each of these criteria below.

[4] Moody's Investors Service, U.S. Municipal Bond Defaults and Recoveries, 1970-2012 (2013). Rating shown is the rating at the beginning of a given 10-year period. Results of multiple 10-year periods were averaged.

[5] The Proposed Rule would establish a quantitative market price volatility threshold for Level 2A HQLA of 10% during a 30 day period of significant stress. See § __.20(b)(2)(iii)(A).

[6] Notice at 71823-71824.

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1. Active markets and diverse participants

Because of the great number of local governments and authorities that can issue tax-exempt bonds, and because most issues are sold with a combination of serial and term maturities, the number of outstanding municipal securities is much larger than the number of issues in the taxable fixed income markets. For example, the Barclays Municipal Bond Index contained 46,548 individual CUSIPs as of November 2012 (where each maturity of a given issue represents a separate CUSIP). By contrast, the Barclays U.S. Corporate Bond Investment Grade Index held 4,843 CUSIPs at that time, and the U.S. Treasuries Index held 239 securities. Given the vast number of individual securities, it is not surprising that not every municipal security is traded every day. However, enough trades occur in securities with comparable maturity, credit profile and purpose to allow market participants to value securities and to have confidence in their ability to trade those securities at prices close to the prices at which they are carried. For example, in 2012, the average daily volume of municipal bond transactions was 38,544, and the average number of issues that traded per day was 14,314.[7]

This significant trading volume is driven by a large and diverse market comprised of hundreds of committed market makers and hundreds of thousands non-market maker participants on both the buying and selling sides of transactions. The Federal Reserve Board's classification of holders of municipal debt gives an indication of the diversity of market participants. The following table, taken from the Federal Reserve's Flow of Funds report, shows the amount of municipal bonds held by the different classes of investors:

Holdings of Municipal Securities and Loans
(as of 09/30/13)

Type of Holder	($Billions)
Households	$1,639.8
Banks	412.7
Property Casualty Insurance	331.9
Life Insurance	133.2
Money Market Funds	305.1
Mutual Funds	620.5
Closed-end Funds	86.1
Exchange-Traded Funds	11.5
Rest of the World	63.3
Brokers/Dealers	18.3
Others	63.3
Total	$3,685.7

[7] Municipal Securities Rulemaking Board, 2012 Fact Book.

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In the above table, the category denoted as "Households" is a residual that includes bonds held directly by individuals through brokerage accounts, separately managed accounts and hedge funds. According to the Internal Revenue Service's Statistics of Income report for 2011, 5,988,308 individual taxpayers reported that they had received tax-exempt interest income in that year, suggesting that municipal bonds are held by millions of Americans, either directly or through various investment products. The Investment Company Institute reports that, at the end of 2012, there were 557 long-term open end funds, 180 tax-exempt money market funds, 223 closed-end funds and 31 exchange-traded funds that passed through tax-exempt municipal interest income to their shareholders.[8] Bank holdings of municipal debt are also well-distributed. The Bond Buyer, an industry publication specializing in the municipal market, periodically lists the dollar value of the 500 largest portfolios of municipal debt held by U.S. banks. As of June 30, 2013, the smallest position in municipal debt held among the 500 banks was $66 million.

Finally, another market-based indicator of the liquidity of municipal securities is the existence of narrow spreads between purchase and sale prices of a security. The trading data collected by the Municipal Securities Rulemaking Board allow one to compute the difference between the price at which a broker-dealer purchases a bond and the price at which it sells the bond to a retail customer (the bid-ask spread). In 2012, the average amount of the spread varied by the par value of the bonds traded, as follows:

Par Value	Bid-Ask Spread
$25,000 or Less	1.90%
$25,000 - $100,000	1.68%
$100,000 - $1 Million	1.20%
Over $1 Million	0.88%

That broker-dealers are willing to purchase bonds at prices that are, on average, less than one percent lower than the price at which they think they can sell the bonds is an indication of the efficiency and liquidity of the market.

2. Price stability during times stress

The Notice states that "HQLA generally tend to have prices that do not incur sharp price declines, even during times of stress."[9] Available data demonstrates that municipal securities

[8] Investment Company Institute, 2013 Investment Company Fact Book.

[9] Notice at 71824.

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have indeed performed well in times of stress, particularly compared to corporate bonds. Since the beginning of 2007, the Barclays Municipal Bond Index (which consists solely of investment grade bonds) produced its lowest monthly total return, -4.69%, in September of 2008. In the following month, the Barclays Municipal Bond Index returned -1.05%. These declines, during the depths of the worst financial crisis in a generation, are well below the Proposed Rule's 10% maximum market price decline for Level 2A HQLA. Moreover, although corporate bonds are proposed to be Level 2B HQLA eligible, they experienced steeper and more persistent declines than municipal bonds during the financial crisis, as evidenced by the following comparison between the Barclays Municipal Bond Index and the Barclays U.S. Corporate Bond Investment Grade Index and their respective maturity-based sub-indices:

Index	September 2008	October 2008
Barclays Municipal Bond Index	-4.69%	-1.02%
Barclays U.S. Corporate Bond Investment Grade Index	-7.77%	-6.44%
Barclays Municipal Bond Index (time to maturity of less than two years)	-0.48%	0.40%
Barclays U.S. Corporate Bond Investment Grade Index (time to maturity of 1-3 years)	-5.17%	-2.02%
Barclays Municipal Bond Index (time to maturity 22 years or longer)	-8.01%	-4.21%
Barclays U.S. Corporate Bond Investment Grade Index (time to maturity of 10 years or longer)	-9.67%	-11.21%

3. Easily and readily valued

As the Notice and Proposed Rule recognize, the liquidity of the market is enhanced to the extent that market participants agree on the value of the securities being traded. One measure of the capacity of the market to form a consensus on the value of individual municipal securities is the variation between the evaluations provided by different pricing services. As the manager of over $24 billion of municipal securities held in open-end mutual funds for which a daily net asset value must be determined, NAM and its parent company, Nuveen Fund Advisors, has extensive experience in evaluating the efficacy of pricing services that provide the marketplace with daily valuations, and we believe that those services generally provide information that is reliable and accepted by market participants. On a weekly basis, NAM compares the prices received from its two pricing services, Standard & Poor's and Interactive Data Corporation. As of November 29, 2013, the market-value weighted average absolute difference between the prices from the two services on 13,952 CUSIPs with a total market value of $56.561 billion was 1.22%. The largest differences were, not surprisingly, on bonds in default and bonds rated below investment grade. When only investment grade bonds were included, the average difference was 0.92%.

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The Notice also recognizes that "[w]hether an asset is listed on an active and developed exchange can serve as a key indicator of an asset's price transparency and liquidity."[10] The municipal market has increasingly benefited from the existence of electronic exchanges through which municipal securities can be traded. One such electronic exchange is The Muni Center (TMCBonds.com), which is jointly owned by several large investment banking firms, including Bank of America Merrill Lynch, Citi Global Markets, and Morgan Stanley & Co. TMC Bonds is a privately held entity that operates as an Alternative Trading System (ATS) under SEC Rule 600(b)(23) of Regulation NMS. According to a representative of The Muni Center, in a typical month, 1,400 traders, representing 500 firms, will engage in transactions in municipal securities through The Muni Center. In addition, The Muni Center can be accessed directly from the desktops of 125,000 retail dealers. In August, 2013, over 30% of the dealer-to-dealer trades reported in the MSRB system were transacted through The Muni Center.

C. Central bank eligibility

The Notice states that in order to be HQLA eligible, an asset should be eligible to be pledged "at a central bank as collateral for intraday liquidity needs and overnight liquidity facilities."[11] We note that the Federal Reserve Bank accepts municipal securities as collateral.[12]

II. Municipal securities are "liquid and readily marketable"

Despite municipal securities possessing the necessary risk profile, market-based characteristics and central bank eligibility to be considered HQLA, the Notice states that municipal securities would likely not be classified as HQLA:

> "the agencies believe that, at this time, these assets are not liquid and readily marketable in U.S. markets and thus do not exhibit the liquidity characteristics necessary to be included in HQLA....For example securities issued by public sector entities generally have low average trading volumes."[13]

[10] Notice at 71824.

[11] Notice at 71824.

[12] http://www.frbdiscountwindow.org/frcollguidelines.pdf

[13] Notice at 71827.

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The Proposed Rule defines "liquid and readily marketable" as follows:

> "Liquid and readily-marketable means, with respect to a security, that the security is traded in an active secondary market with:
>
> (1) More than two committed market makers;
> (2) A large number of non-market maker participants on both the buying and selling sides of transactions;
> (3) Timely and observable market prices; and
> (4) A high trading volume."[14]

Except for the absence of high trading volume on a CUSIP-by-CUSIP basis, investment grade municipal securities clearly satisfy this definition. As discussed in more detail above, investment grade municipal securities are traded in an active secondary market with hundreds of committed market makers and thousands of non-market maker participants on both the buying and selling sides of transactions and timely and observable market prices. For reasons convincingly set forth in the comment letter submitted by Citigroup Global Market Inc.,[15] the absence of high trading volume in individual municipal securities is not, in our view, an indicator of a lack of liquidity.

III. Failure to classify municipal securities as HQLA would have a negative effect on the municipal market and provide an unnecessary disincentive for banks to achieve more balance sheet diversification by making that asset class a less desirable holding.

Banks provide crucial support to the efficient functioning of the municipal market in the following ways:

1. Banks invest in municipal securities and loans for their own accounts. According to the Federal Reserve Board's Flow of Funds report, as of September 30, 2013, banking organizations held municipal securities and loans with a market value of $413 billion, which represented 11.2% of all municipal securities and loans outstanding. Banks have been an increasing source of demand, as their holdings of municipal securities and loans have grown by 15.7% since September 30, 2012, and by 60.5% since the end of 2010.

[14] §__.3.

[15] Letter from Howard Marsh, Citigroup Global Markets Inc., December 27, 2013.

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2. Bank holding companies, through their investment banking affiliates, underwrite new issues of municipal bonds and make markets in outstanding municipal bonds.

3. Banks provide liquidity facilities that enable a portion of the supply of long-term, fixed rate municipal bonds to be converted into variable-rate securities that qualify for purchase by money market funds, thereby expanding the market for municipal issuers.

The failure to classify municipal securities as HQLA would likely cause banks to reduce their role in the municipal market, thereby reducing liquidity and increasing borrowing costs for state and local governments. Any such result would contradict Congress's explicit recognition of the importance of banks as a source of funding for infrastructure improvements in the Internal Revenue Code.[16]

Creating what we believe is an unnecessary disincentive for banks to hold municipal securities would result in banks being more concentrated in other asset classes, some of which clearly pose more liquidity risk than municipal securities. While we agree with the regulatory goal of requiring banks to hold a requisite amount of liquid asset in times of market stress, we urge reconsideration of the proposed treatment of investment grade municipal securities given their historical performance in stressed markets.

Respectfully,

Nuveen Asset Management, LLC

By: Cadmus M. Hicks, Jr.
Cadmus Hicks
Managing Director

[16] For example, as a general policy, taxpayers are not permitted to deduct the investment expenses associated with borrowings incurred for the purpose of purchasing tax-exempt bonds. However, banks are permitted to deduct 80% of the carrying costs associated with their ownership of "bank-qualified" municipal bonds, i.e., bonds sold for general government purposes or for purposes that qualify under 501(c)(3) by issuers that sell no more than $10 million of debt in a given calendar year (see Internal Revenue Code section 265(b)(3)). Moreover, with respect to larger issuers, banks, like other corporations, can deduct carrying costs to the extent that their tax-exempt holdings constitute less than 2% of the total value of their assets.

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