June 3, 2014

The Honorable Janet Yellen, Chair
cc: Michael S. Gibson, Director
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551
Attention: Division of Banking Supervision and Regulation

The Honorable Thomas J. Curry, Comptroller
Office of the Comptroller of the Currency
Department of the Treasury
400 7th Street, S.W., Suite 3E-218
Mail Stop 9W-11
Washington, D.C. 20219
Attention: Legislation and Regulatory Activities Division

The Honorable Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429
Attention: Robert E. Feldman, Executive Secretary

Re: Notice of Proposed Rulemaking, 78 Fed Reg 71818, No 230 (November 29, 2013)

Dear Ladies and Gentlemen:

Police protection, firefighting, emergency management, K-12 education, career training, clean water, safe streets, public transit, affordable housing, social services, economic development. These are but some of the essential services local governments provide every day to keep our nation strong and vibrant. Expenditures by state and local government represent over 15% of the U.S. GDP and directly affect the lives of 100% of Americans. While finding additional federal funding for these essential services is always a challenge, federal officials can and must avoid taking actions that would impose significant financial harm to local governments without commensurate benefits to the national economy. For that reason, we eighteen cities are writing to implore you to classify municipal bonds as Level 2 Highly Qualified Liquid Assets ("HQLA") for purposes of the Liquidity Coverage Ratio ("LCR"). The facts support our request and the policy implications are clear: imposing standards against all municipal issuers that are more conservative than the international standard will hurt the real engines of the U.S. economy, not strengthen it.

We understand that the purpose of establishing the LCR (currently, the "Proposed Rule") is to "strengthen the liquidity risk management of banks and savings associations."[1] Since we rely on banks for credit support as well as bond investors, our interests are aligned in strengthening

[1] Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency. OCC and FDIC. Propose Rule to Strengthen Liquidity Risk Management. FDIC. 30 Oct. 2013. Web. 1 May 2014.

their financial footing. Our proposal will strengthen the banking community, increase municipal market transparency and lower interest costs to taxpayers throughout the country.

While there are over 60,000 municipal bond issuers nationwide, the bulk of the issuance and related trading volume comes from the states and largest municipalities. As such, special consideration should be given to those entities. The industry has made significant strides in providing pre- and post-trade transparency. In addition, the industry, at large, has been increasing market information and providing greater transparency through universally available platforms, such as its Electronic Municipal Market Access ("EMMA") web platform (http://emma.msrb.org).

In addition to outlining our proposal, we also wante to highlight the cost of not including municipal securities in the Level 2A pool. Using the City of Chicago as just one example, it has approximately $20 billion of bonds outstanding and over $6 billion of credit exposure to commercial banks. Imposition of the Proposed Rule will increase borrowing costs and dramatically reduce the pool of banks willing to grant credit to Chicago on an ongoing basis. Assuming a conservative estimate of 10 basis points of increased cost, for every $100 million borrowed, City taxpayers would incur over $3 million in additional interest costs over the course of the loan. As leaders of large, legacy cities, it is critical to use our limited resources to fund our chronically underfunded capital programs instead of paying interest to investors. Ironically, international banks that have accepted the Basel III standards would be in a far better position to serve American governments than our own local banks. That is unacceptable and should be rejected outright by you as our nation's finance leaders.

Every dollar that we spend on interest and bank fees is a dollar that does not go to providing necessary public services. As municipal leaders, we can attest to the need to use our limited financial resources to provide services and funding that impact the quality of schools your children will attend; the condition of the roads you drive; the amount of property taxes that you pay and the police protection you demand.

Importance of Municipalities

Of the 100 largest economies in the world, 36 belong to metropolitan areas of the United States and 80% of the U.S. population lives in large cities.[2] In 2012, virtually all of our nation's population gains occurred in metropolitan areas.[3] By 2025, more than 10% of global GDP growth will come from American cities with a population of 150,000 or more. Every City CFO that is a signatory to this letter represents a city even larger than that. We collectively manage the finances of the cities that will create that growth for the U.S. economy.

Municipal bonds are the backbone of local government finance in the U.S., and municipal debt can be traced back to the very beginnings of our country. Tax-exempt and taxable municipal bonds are used to pay for a broad array of capital projects and for refunding of outstanding debt for savings. Unique in the world, the tax-exempt bond market in the U.S. has long been a

[2] Manyika, James, Jaana Remes, Richard Dobbs, Javier Orellana, and Fabian Schaer. Urban America: US Cities in the Global Economy. Rep. McKinsey Global Institute, Apr. 2012. Web. 1 May 2014.

[3] Smith, Scott, Kevin Johnson, Stephanie Rawlings-Blake, Michael B. Coleman, and Tom Cochran. U.S. Metro Economies: Outlook – Gross Metropolitan Product, with Metro Employment Projections. Rep. IHS Global Insight (USA), Inc., 2013. Web. 1 May 2014.

competitive advantage for our country, providing $300-400 billion/year for infrastructure improvements and other needs. Chicago's most recent general obligation bond issuance in March 2014 was over $883 million and a material portion of those bonds were purchased by American banks. If banks are required to comply with a liquidity coverage ratio that discourages investment in municipal securities as the Proposed Rule will do, local governments will be significantly less equipped to provide fundamental civil services for its people.

Sticking with Chicago as an example, 70% of bond-financed projects are for improving infrastructure in the city, 14% for neighborhood-specific uses (such as sidewalks, residential street surfacing, street lighting, curb and gutter replacement), 12% for greening and streetscapes, and 4% is used for improving city facilities.

And, without funds generated through the issuance of bonds, American cities simply will not be able to function. Banks also provide liquidity for variable rate demand bonds, making capital programs more affordable for our taxpayers. The fact is, local governments require a sizable, diverse base of bond purchasers to finance capital needs. Unfortunately, the LCR as proposed makes financing these fundamental needs significantly more difficult.

As chief financial officers of Albuquerque, Atlanta, Boston, Chicago, El Paso, Fort Worth, Houston, Indianapolis, Jacksonville, Los Angeles, Louisville, Milwaukee, Oklahoma City, Philadelphia, Phoenix, San Diego, Seattle, and Washington, D.C., we are responsible for our governments' debt as well as their future financial health, and therefore we have serious interest in the practical effects of the Proposed Rule.

It is critical to the economic well-being of the United States that the local governments making up the fabric of our nation have the freedom and the ability to take care of our own needs. The following facts illustrate why it is clear that, contrary to the assertion of the Fed, the OCC, and the FDIC (collectively, the "Agencies"), municipal securities <u>are</u> assets "liquid and readily marketable in U.S. markets,"[4] and therefore, <u>do</u> in fact "exhibit the liquidity characteristics necessary"[5] to be classified as Level 2A HQLA under the Proposed Rule. An appendix following this letter explains each reason in greater detail.

- History shows that municipal securities remain liquid across various stress scenarios and do not immediately lose their liquidity upon the occurrence of risk.
- The municipal securities market exhibits characteristics that are market-based in nature, including:
    - An active outright sale or repurchase market at all times
    - Significant diversity in market participants
    - A high volume of transactions
    - Price stability and low volatility during times of stress
    - Assets that are easily and readily valued
- Federal Reserve Banks generally allow municipal securities, even unrated municipal securities, to be pledged at a central bank.

[4] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 78127.
[5] *Ibid.*

- Excluding municipal securities from HQLA classification will defeat its sole purpose of strengthening the financial resolve of American banks by adversely affecting issuers of municipal securities, thousands of state and local governments because doing so:
    - Increases borrowing costs; and
    - Puts the American market at a disadvantage relative to foreign sovereigns.

Because of the facts above and the significant likelihood that the Proposed Rule will greatly impede the ability of state and local governments across the nation, we, eighteen of the largest cities in the United States, strongly urge the Agencies to **(1) designate all municipal securities as Level 2A HQLA and (2) reduce the assumed outflow rates for CMDs secured by municipal securities to 15 percent**.

Thank you,

Lou D. Hoffman
City of Albuquerque, New Mexico
Director, Dept. of Finance & Administrative Services

J. Anthony "Jim" Beard
City of Atlanta, Georgia
Chief Financial Officer

David Sweeney
City of Boston, Massachusetts
Chief Financial Officer

Lois A. Scott
City of Chicago, Illinois
Chief Financial Officer

Carmen Arrieta-Candelaria
City of El Paso, Texas
Chief Financial Officer

Aaron J. Bovos
City of Fort Worth, Texas
Chief Financial Officer

Ronald C. Green
City of Houston, Texas
Chief Financial Officer

Jason Dudich
City of Indianapolis, Indiana
Controller and Director of Office of Finance and Management

C. Ronald Belton
City of Jacksonville, Florida

Miguel Santana
City of Los Angeles, California

Chief Financial Officer

Steve Rowland
City of Louisville, Kentucky
Chief Financial Officer

Craig Freeman
City of Oklahoma City, Oklahoma
Finance Director

Neal Young
City of Phoenix, Arizona
Chief Financial Officer

Glen Lee
City of Seattle, Washington
Finance Director

City Administrative Officer

Martin Matson
City of Milwaukee, Wisconsin
Comptroller

Nancy E. Winkler
City of Philadelphia, Pennsylvania
Treasurer

Mary Lewis
City of San Diego, California
Chief Financial Officer

Jeffrey S. DeWitt
Washington, District of Columbia
Chief Financial Officer

APPENDIX

Municipal Securities Possess the Liquidity Characteristics of HQLA

Largely because of the recent financial crisis and resultant breakdown of funding markets worldwide, propelling the world into recession, the Agencies developed a rule that seeks to promote the "short term resilience of the liquidity risk profile of internationally active banking organizations."[6] Currently, federal regulations "do not require banking organizations to meet a quantitative liquidity standard."[7] We certainly commend the Agencies for taking decisive action and requiring banks to meet a high quality liquidity standard. However, the Proposed Rule requires a "covered company to maintain an amount of HQLA...that is no less than 100 percent of its total net cash outflows over a prospective 30 calendar-day period,"[8] while simultaneously expressly excluding municipal securities from qualification as HQLA, or any bond or security issued by a public sector entity below the level of a sovereign.[9]

Question 12 of the Notice of Proposed Rulemaking (the "Notice") asks, **"What other assets, if any, should the Agencies include in Level 2A liquid assets? How should such assets be identified and what are the characteristics of those assets that would justify their inclusion in Level 2A liquid assets?"**

We strongly believe that investment grade municipal securities should be classified as Level 2A HQLA because 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 implementation of the Proposed Rule as currently written would unnecessarily result in the municipal security market enjoying less liquidity than it does today and reduce the ability of state and local governments to provide essential services to U.S. citizens by increasing the cost of capital.

The Proposed Rule likely would not permit covered bonds and securities issued by public sector entities, such as a state, local authority, or other government subdivision below the level of a sovereign (including U.S. states and municipalities) to qualify as HQLA at this time. While these assets are assigned a twenty (20) percent risk weight under the standardized approach for risk-weighted assets in the agencies' regulatory capital rules, the agencies believe that, at this time, these assets are not liquid and readily marketable in U.S. markets. Thus, the Agencies believe bonds and securities issued by public sector entities do not exhibit the liquidity characteristics necessary to be included in HQLA under the Proposed Rule.[10]

The Agencies consider the following characteristics when determining liquidity, characteristics generally consistent with those of the Basel III LCR: (a) risk profile, (b) market-based characteristics, and (c) central bank eligibility.[11] Further, HQLA must be "easily and immediately convertible into cash with little or no loss of value during a period of liquidity stress."[12]

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[6] *Ibid*, 71820.
[7] *Ibid*.
[8] *Ibid*, 78122.
[9] *Ibid*, 78127.
[10] *Ibid*.
[11] *Ibid*, 71823.
[12] *Ibid*.

As these characteristics are discussed *infra*, we strongly believe municipal securities firmly satisfy the liquidity characteristics sought by the Agencies for qualification as HQLA. Without a doubt, if the Proposed Rule is to be implemented, municipal securities must be considered HQLA.

Municipal Securities Remain Liquid Across Various Stress Scenarios and Do Not Immediately Lose Their Liquidity Upon the Occurrence of Risk.

The Proposed Rule would exclude from HQLA those assets that tend to be higher risk: HQLA "would be expected to remain liquid across various stress scenarios and should not suddenly lose their liquidity upon the occurrence of a certain type of risk."[13] The Agencies consider liquidity risk, credit risk, and foreign exchange risk when assessing an asset's risk profile.[14]

Credit Risk

The credit risk of municipal bonds is generally lower than that of corporate bonds. As shown in the following table, the cumulative average 10-year default rates for municipal bonds have been significantly lower than corporate bonds in each major ratings category:

Rating	U.S. Municipal Bonds	U.S. Corporate Bonds
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%

10-year Cumulative Default Rate, Municipal Bonds[15]

Liquidity Risk

Since municipal bonds expose less credit risk, holders of these bonds also enjoy decreased liquidity risk during times of stress. As illustrated on page 12, investment-grade municipal securities tend to experience price volatility significantly lower than the limits allowed for assets qualifying as Level 2A HQLA.[16]

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[13] *Ibid.*
[14] *Ibid.*
[15] *U.S. Municipal Bond Defaults and Recoveries, 1970-2012*. Rep. Moody's Investors Service, 2013. Web. 1 May 2014.
[16] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71828. Footnote 34 reads: "[historical market prices during times of general liquidity stress] would be demonstrated if the market price of the security or equivalent securities of the issuer declined by no more than 10 percent."

Foreign Exchange Risk

Municipal securities do not pose foreign exchange risk to U.S. financial institutions and generally present significantly less bankruptcy risk than corporate debt. Under Chapter 9 of the U.S. Bankruptcy Code, a creditor cannot force a municipality into bankruptcy and the standing of holders of municipal securities in bankruptcy is explicitly stated in legally enforceable bond indentures.

The Municipal Securities Market Exhibits Characteristics that are Market-Based in Nature

The second category of characteristics used by the agencies to determine whether an asset is liquid enough to qualify as HQLA is whether that asset class exhibits characteristics that are "market-based in nature"[17] (emphasis added).

To be market-based in nature, assets "tend to have active outright sale or repurchase markets at all times with significant diversity in market participants as well as high volume"[18] (emphasis added). The Agencies use historical evidence, including evidence during recent periods of market liquidity stress, to determine market-based liquidity.[19]

Active Outright Sale or Repurchase Markets

Because the market for municipal securities is vast, just like the market for investment-grade corporate and Government-Sponsored Enterprise ("GSE") debt securities, it is essentially impossible for every municipal security to trade every day. Still, the municipal market is liquid in that it is always possible to obtain from dealers executable price quotes for transactions of virtually any size.

One factor contributing to an active municipal securities market is that bonds with like characteristics of coupon, credit profile, or maturity, for example, tend to trade in a similar fashion. This enables dealers and investors to analyze the municipal securities market for assets they want to trade based on trades for similar securities. It also makes it easier for market price levels to be easily determined.

Diversity in Market Participants

The municipal securities market is quite diverse. The Municipal Securities Rulemaking Board (the "MSRB") regulates more than 1,600 registered broker-dealers who serve as market-makers for municipal securities, holding only 0.4% of all outstanding municipal bonds, and hundreds of thousands of non-market-maker participants.[20]

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[17] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71823.
[18] *Ibid.*
[19] *Ibid.*
[20] Board of Governors of the Federal Reserve System. *Z.1 Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts*. Rep. 9 Dec. 2013. Web. 1 May 2014.

As shown in the table below, households hold about 44 percent of the municipal securities market, followed by mutual funds at 17 percent, and American chartered depository institutions at 11 percent.[21]

Type of Holder	($ in billions)
Households and Nonprofit Organizations	$1,639.8
Mutual Funds	621.0
U.S.-chartered depository institutions	412.7
Property Casualty Insurance	331.9
Money Market Mutual Funds	305.1
Life Insurance	133.2
Closed-end Funds	86.1
Rest of the World	63.3
Nonfinancial Corporate Business	29.0
Security Brokers & Dealers	18.3
Gov't-sponsored Enterprises & Sallie Mae	14.0
State & Local Gov'ts[22]	12.0
Exchange-Traded Funds	11.5
Nonfinancial Noncorporate Business	6.0
Credit Unions Excl. Corporate Credit Unions	5.0
Banks in U.S.-affiliated areas	3.0
State & Local Gov't Employee Retirement Funds	3.0
Total	**$3,694.9**

Holdings of Municipal Securities and Loans (as of 09/30/13)[23]

High Transaction Volume

We agree with the Agencies that HQLA should be traded in high volume and the most effective method should be used to measure trading volume. However, we disagree with the proposed method for measuring the trading volume. One view is that the average transaction volume of municipal securities appears somewhat low when evaluated on a per CUSIP basis given that there are approximately 1.1 million outstanding CUSIPs in the municipal securities market.

However, this method is considerably inaccurate. A more precise method of measuring trading volume is to consider the amount traded as a percentage of the total market outstanding.

When analyzed in this manner, transaction volumes on municipal securities are comparable to those on corporate and GSE bonds. SIFMA data indicates that in 2013, the municipal market traded 0.31% of its total outstanding par every day, while the corporate bond market traded 0.20% per day and the GSE debt market traded 0.33% per day.

[21] Includes bonds held directly by individuals through brokerage accounts, separately managed accounts and hedge funds.
[22] Excluding employee retirement funds.
[23] Board of Governors of the Federal Reserve System. *Z.1 Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts*. Rep. 9 Dec. 2013. Web. 1 May 2014. Table L.211, p. 97.

Asset Class	Description of Asset Class	Outstanding Mkt Size ($b)	Avg Daily Trading Vol ($b)	% of Mkt Traded Daily
Municipal Debt	All municipal debt	3,721.0	11.4	0.31%
Corporate Debt	Non-convertible corporate debt, MTNs and Yankee bonds. Excludes CDs and 144A securities.	9,348.9	18.5	0.20%
GSE Debt	Agency debt of Fannie, Freddie, Farmer Mac, FHLB, Farm Credit System and Federal Budget Agencies. Excl. maturies < 1 yr.	2,074.2	6.8	0.33%

Asset Transaction Volumes as a Percentage of Total Market Outstanding, 2013[24]

In the following table,[25] non-investment grade and nonfinancial debt, TBA trades and other securities that may not meet the criteria for HQLA are excluded in order to show a more relevant comparison of the asset classes for purposes of trading volumes.

Asset Class	Description of Asset Class	Outstanding Mkt Size ($b)	Avg Daily Trading Vol ($b)	% Mkt Traded Daily	Proposed HQLA Classification
Municipal Debt	IG Municipal Debt excluding ARS and VRDN	3,097.0	6.7	0.22%	Non-Qualifying
Corporate Debt	Nonfinancial, IG Corporate Bonds	4,777.4	6.1	0.13%	L2B
GSE Debt	Excluding GNMA.	6,137.6	6.7	0.11%	L2A
Agency & GSE MBS	Includes GNMA. Excluding CMO, TBA trading volume	1,485.8	16.3	1.10%	L2A
Total GSE Market (Proxy)	GSE Debt + Agency & GSE MBS	7.623.4	23.0	0.30%	L2A

Asset Transaction Volumes as a Percentage of Total Market Outstanding, 2013, not including non-investment grade or nonfinancial debt.

Using data from the MSRB, we also see the municipal securities market's average daily trading volume increased by 10% to 25% during the four largest sell-offs from January 2000 (calculated

[24] SIFMA's Outstanding U.S. Bond Market Debt table as of Q2 2013 and SIFMA's U.S. Bond Market Average Daily Trading Volume table 2013 YTD (Last updated 11/19/2013) as cited by Marsh, Howard. "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring." Letter to Department of Treasury Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, & Federal Deposit Insurance Corporation. Citigroup Global Markets Inc., 27 Dec. 2013. Web. 1 May 2014 ("Citi Comment").

[25] Based on estimates made by Citigroup Global Markets Inc. December 2013 using data from JJ Kenny, Bloomberg LP, MSRB data, Federal Reserve Statistical Release, Z.1 Financial Accounts of the U.S., L.210 and L.212, September 25, 2013, and the TRACE Fact Book Q3 2013.

on a yield-to-worst basis) when compared to the three months immediately preceding each sell-off.[26]

This data illustrates the liquidity of the municipal securities market and that these securities retain exactly the kind of "right-way risk" that the Agency seeks in assets to be classified as HQLA.

Price Stability and Low Volatility during Times of Stress

The Agencies require HQLA to have prices that do not incur sharp price declines, even during times of stress.[27] However, data suggests that municipal securities in fact withstand streaks of stress very well, so why they are specifically excluded is unclear to us.

During the six-month period from when Lehman Brothers failed in September 2008 through to when the stock market imploded in February 2009, the primary municipal bond market performed with notable strength: more than $135 billion in capital was raised by issuers in almost equal amounts each month.[28]

The Proposed Rule sets a 10% maximum market price decline for Level 2A HQLA. The reality is that during the worst months of the 2008 financial crisis, municipal securities outperformed the soon-to-be lower grade Level 2B HQLA eligible investment grade corporate bonds.

The following table illustrates this point from data compiled by the Barclays Municipal Bond Index, which consists solely of investment-grade bonds, and the Barclays U.S. Corporate Bond Investment Grade Index.

Index	September	October
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 < 2 years)	-0.48%	0.40%
Barclays U.S. Corporate Bond Investment Grade Index (time to maturity 1-3 years)	-5.17%	-2.02%
Barclays Municipal Bond Index (time to maturity 22+ years)	-8.01%	-4.21%
Barclays U.S. Corporate Bond Investment Grade Index (time to maturity of 10 years or longer)	-9.67%	-11.21%

Change in Average Price
Sept. – Oct. 2008[29]

[26] MSRB trade data from January 18, 2000 through December 12, 2013, including trades on IG, fixed-rate municipal coupon bonds with at least one year to call or maturity. As concluded in Citi Comment.
[27] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71824.
[28] Hicks, Cadmus M., Jr. "Re: Notice of Proposed Rulemaking, Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards and Monitoring." Letter to Department of Treasury Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, & Federal Deposit Insurance Corporation. 30 Jan. 2014. Nuveen Asset Management, 30 Jan. 2014. Web. 1 May 2014.
[29] *Ibid.*

Municipal Securities are Easily and Readily Valued

The preamble to the Proposed Rule clarifies that "assets that can serve as HQLA tend to be easily and readily valued."[30]

The municipal market is completely price transparent. The implementation of a transparency initiative in 2005 – the MSRB's Real-Time Transaction Reporting System – helped facilitate this price transparency, making assets in the municipal market even more easily and readily valued. In 2009, the MSRB's Short-Term Obligation Rate Transparency system was implemented. The STORT collects and dispenses information for municipal auction rate securities. Price dispersion – where investors buying or selling the same amount of securities at the same time are paying or receiving different prices – has decreased significantly since transactions have been reported in real-time.[31]

The municipal market commonly uses various pricing benchmarks, such as Thomson Reuters' MMD Scale, which offers a twice-daily offer-side indicative yield curve reflecting the institutional market for AAA-rated state general obligation bonds; the Bloomberg BVAL Benchmark Municipal Curve; the Municipal Market Advisors Median Par AAA General Obligation and 5% AAA General Obligation curves as well as indexes published by Standard & Poor's, *The Bond Buyer*, Barclay's, and more.

The municipal market features strong real-time price transparency so that market participants can value securities with significant ease. MSRB Rule G-14 requires brokers and dealers of municipal securities to report within 15 minutes of each trade information about each purchase and sale transaction including the CUSIP number, price, yield, par amount, whether the trade was a customer buy, customer sell, or interdealer, and other data.[32]

The MSRB also maintains a dynamic system for the real-time collection and dissemination of all secondary market transactions in municipal securities through EMMA (see p. 2) and directly to data subscribers. EMMA provides access to issuer disclosure and other documents as well as a real-time "ticker" of municipal market transactions that can be searched by a plethora of parameters within the database of all trades.

It is clear that the municipal securities market is modernized and technologically advanced to ensure that assets traded in the market are quite easily and readily valued.

Federal Reserve Banks Generally Allow Municipal Securities to be Pledged at a Central Bank

The preamble of the Proposed Rule mandates that "[a]ssets that a covered company can pledge at a central bank as collateral for intraday liquidity needs and overnight liquidity facilities in a jurisdiction and in a currency where the bank has access to the central bank generally tend to be liquid and, as such, are appropriate for consideration as HQLA."[33]

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[30] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71824.
[31] Walter, Elisse B. "Speech by SEC Commissioner: Bringing Municipal Bond Trading Into the Light." SIFMA Municipal Bond Summit, New York. 1 Oct. 2013. Web. 1 May 2014.
[32] Municipal Securities Rulemaking Board, "MSRB Real-Time Transaction Reporting System Manual," Version 3.1, April 2013, p. 23.
[33] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71824.

Currently, municipal bonds are accepted by Federal Reserve Banks to secure discount window advances. They may also be used at Federal Reserve Banks to offset risk associated with extensions of daylight credit or master account activity.[34] The Federal Reserve System at this time does not place any rating restrictions on municipal securities eligible to be pledged as collateral. According to SIFMA, even unrated municipal securities may be acceptable in certain instances.[35]

The following table illustrates that Federal Reserve Banks generally require minimal haircuts for municipal securities that are pledged as collateral for discount window advances or daylight credit.

Duration	Market Value when Accepted as Collateral
Up to 5 Years	98 percent
Up to 10 Years	96 percent
Greater than 10 Years	95 percent

Federal Reserve Discount Margin Levels (updated January 23, 2014)[36]

These margin levels are identical to those applied to AAA-rated, dollar-denominated foreign sovereign and supranational debt securities, which would be treated as Level 1 HQLA under the Proposed Rule, and also to U.S. GSE bills, notes, and bonds, which would be treated as Level 2A liquid assets.[37] It truly belies explanation why these very similar debt instruments of America's own cities and states would be therefore excluded from the same consideration.

The Proposed Rule Hill Have Adverse Effects on American State and Local Governments by Increasing Borrowing Costs

Banks currently hold 11.2 percent of all municipal securities and loans outstanding.[38] If the Proposed Rule is implemented as it stands, participants in the municipal securities market will prefer to reduce the amount of HQLA they hold due to the failure of securities to be treated as HQLA. As a result, failure to classify municipal securities as HQLA will have strongly adverse effects on the municipal market, creating an unnecessary disincentive for banks to achieve more balance sheet diversification as it will make this asset class less desirable to hold.

The alternative for covered companies will likely be to seek higher revenues to offset losses of holding non-HQLA, which in turn will cause issuers to face higher costs of capital because of higher underwriting fees, reduced market liquidity, and wider bid-asked spreads. In plain terms,

[34] Federal Reserve System, "Federal Reserve Collateral Guidelines," January 2, 2013, p. 3.
[35] Decker, Michael. "Docket ID OCC-2013-0016." Letter to Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation. Securities Industry Financial Markets Association ("SIFMA"), 31 Jan. 2014. Web. 1 May 2014. ("SIFMA Comment").
[36] Federal Reserve System, "Federal Reserve Discount Window & Payment System Risk Collateral Margins Table 1," Effective Date: October 19, 2009 (updated January 23, 2014), www.frbdiscountwindow.org/discountmargins.xls, as cited by SIFMA Comment.
[37] *Ibid.*
[38] Federal Reserve Bank, Flow of Funds Report, September 30, 2013.

reducing the liquidity of issuers will impede the ability of cities like us to provide essential infrastructure and services to our citizens.

The Proposed Rule will have Adverse Effects on American State and Local Governments by Placing them at a Disadvantage Relative to Foreign Sovereigns

Question 22 of the notice states, **"The Agencies seek comment on all aspects of the criteria for HQLA, including issues of domestic and international competitive equity, and the adequacy of the proposed HQLA criteria in meeting the agencies' goal of requiring a covered company to maintain a buffer of liquid assets sufficient to withstand a 30 calendar-day stress period."**

Under the Proposed Rule, the debt of municipalities like Chicago, Houston, and Los Angeles would not qualify as HQLA. However, the debt of sovereigns like Slovenia, Saudi Arabia, the United Arab Emirates, Botswana, Chile, Italy, France, and Taiwan *would* be categorized as HQLA.[39] It is simply unfathomable that our national policymakers would choose to disadvantage their own constituency in this way.

This outcome will greatly harm American local governments relative to foreign sovereigns and truly jeopardize the ability of its cities to provide essential government services to their businesses and residents. Banks and other organizations that typically purchase municipal debt will have extremely strong incentives to purchase bonds from these foreign sovereigns rather than cities in the United States, and will virtually be penalized by holding domestic municipal debt.

We strongly believe the Proposed Rule is antithetical to the goals of the Agencies as well as the interest of the United States to implement the LCR as written. It is well understood that the foundations of a thriving democracy rest on the healthy functioning of its municipalities.

We urge the Agencies to designate all U.S. municipal securities as HQLA, and under the Proposed Rule, treat investment-grade U.S. municipal debt the same as it does foreign sovereign obligations.

Inaccurate Outflow Assumptions for Collateralized Municipal Deposits

American banks have over $300B of Preferred Deposits from state and local governments that require that such banks pledge collateral against those deposit balances that exceed deposit insurance limits.[40] State to state, the list of eligible collateral varies and is typically limited to a combination of U.S. Treasury, U.S. Agency, and GSE securities, but municipal securities are generally included and are often the preferred collateral of states, localities, and banks.[41]

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[39] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 71827: "The proposed rule likely would not permit covered bonds and securities issued by public sector entities, such as a state, local authority, or other government subdivision below the level of a sovereign (including U.S. states and municipalities) to qualify as HQLA at this time."

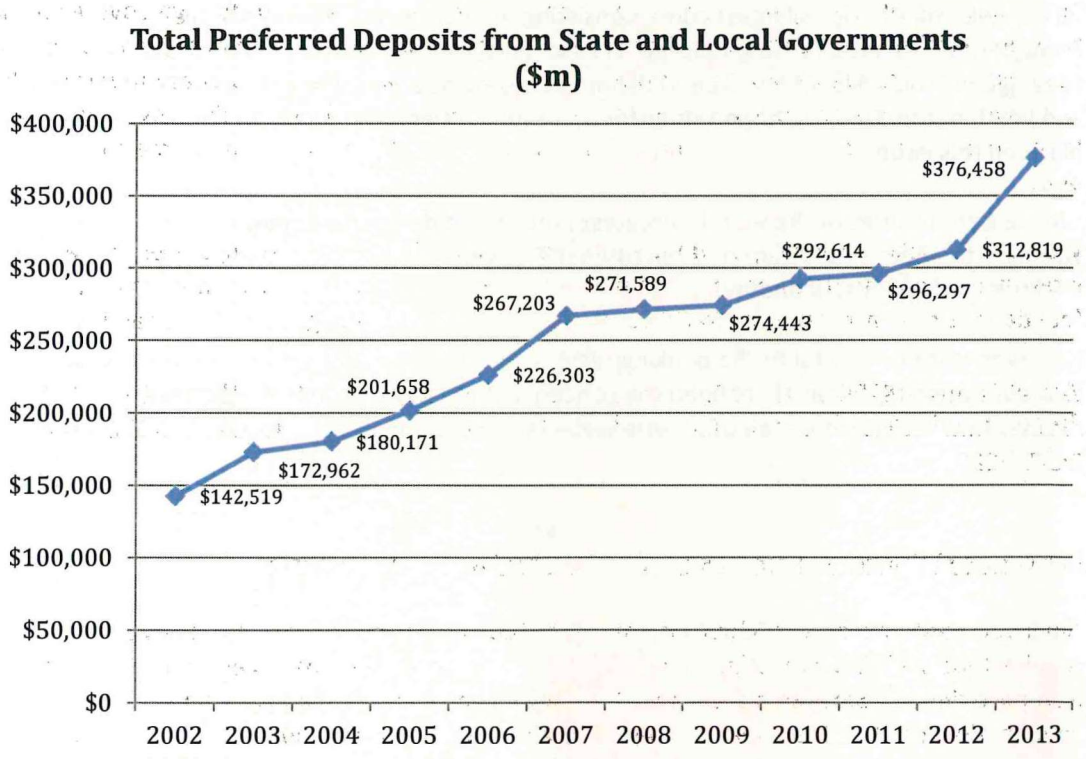
[40] FDIC Call Reports.

[41] Citi Comment p. 10 and SIFMA Comment p. 12.

Under the Proposed Rule, collateralized deposits are treated as secured funding transactions, and outflow assumptions for secured funding transactions would be based on the HQLA status of the collateral assets.

The Proposed Rule excludes municipal securities from HQLA classification, and collateralized deposits secured by municipal securities would be subject to a 100-percent outflow assumption.[42] Under Basel III/BCBS 238, banks would only have to assume 25-percent outflow at maximum, a difference quite significant from the rate set forth by the Proposed Rule.

A 100-percent outflow assumption is inconsistent with historical experience as municipalities generally do not withdraw funds over concern for the quality of the collateral underlying their deposits. During the highly stressful 2008-2009 financial crisis, municipal securities maintained their deposits and corresponding collateral. For example, Citigroup Global Markets, Inc. — one of the largest municipal securities dealers in the United States and the leading underwriter of negotiated municipal bonds for 13 of the last 17 years — "did not experience public sector deposit outflows and did not experience any public sector depositor preference for Treasury collateral over municipal collateral."[43]



Total Preferred Deposits from State and Local Governments (in $millions) as of December 31 of each year.[44] Preferred Deposits are deposits of any public unit at any insured depository institution which are secured or collateralized as required under State law.[45]

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[42] "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," 78 *Federal Register* 230 (29 Nov. 2013), p. 78122.
[43] Citi Comment p. 10.
[44] Federal Financial Institutions Examination Council: https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx.
[45] 12 U.S.C. §1813(m)(4).

The chart above shows that State & Local Government Preferred Deposit balances increased in each of the 11 years, including during the stress period that was the 2008-2009 financial crisis. It is more likely that a state or local government would withdraw unsecured deposits during a period of financial stress than it would those deposits secured by municipal securities.

However, deposits from the same public sector entities listed above that are *unsecured* would receive a 20- to 40-percent outflow rate under the Proposed Rule. The Basel Committee recommends a 25-percent outflow assumption for "secured funding transactions with domestic sovereign, PSEs or multilateral development banks that are not backed by Level 1 or 2A assets," and a 15-percent outflow assumption for deposits secured by Level 2A liquid assets.[46]

Because historical experience is blatantly inconsistent with the Proposed Rule, we urge the Agencies to consider municipal securities to be Level 2A HQLA and accordingly, reduce the outflow assumption for deposits secured by municipal securities to 15 percent.

CONCLUSION

As eighteen of America's largest cities, consisting of over twenty million people from Albuquerque, Atlanta, Boston, Chicago, El Paso, Fort Worth, Houston, Indianapolis, Jacksonville, Los Angeles, Louisville, Milwaukee, Oklahoma City, Philadelphia, Phoenix, San Diego, Seattle, and Washington, D.C., we hope this letter accurately reflects the heavy weight and urgency we place on this issue.

We are beneficiaries of the world's greatest functioning democratic government, and as such, we share the Agencies' desire to strengthen the solvency of America's banking system and its vital role in the global economy.

However, it is just as vital to the banking system and the very concept of our federalist system that our national policymakers heed the concerns of ten of its strongest municipalities as it decides how to implement an otherwise well-crafted and meaningful liquidity coverage ratio.

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[46] "Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools." January, 2013: p. 28. Basel Committee on Banking Supervision. Web. 1 Apr. 2014.