Carolinas HealthCare System

Edward J. Brown III
Chairman

Michael C. Tarwater, FACHE
Chief Executive Officer

Joseph G. Piemont
President & COO

January 31, 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

Submitted Via Email to: regs.comments@occ.treas.gov

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

The Charlotte-Mecklenburg Hospital Authority 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, we are 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] but more importantly, our ability to continue to finance the on-going capital needs of our health care system.

The Charlotte-Mecklenburg Hospital Authority, which directly and indirectly through its affiliates does business as Carolinas HealthCare System ("CHS"), was organized in 1943 under the North Carolina Hospital Authorities Act.

[1] Specifically in response to Questions 12, 22 and 54 in the Notice of Proposed Rulemaking as they relate to the municipal securities market.

CHS, with its headquarters in Charlotte, North Carolina, is one of the leading healthcare organizations in the Southeast and one of the largest public, non-for-profit systems in the nation. CHS operates more than forty hospitals and serves patients at more than 900 care locations including physician practices, freestanding emergency departments, outpatient surgery centers, pharmacies, laboratories, imaging centers and other centers as well as nursing homes and other home care, medical equipment and hospice services. As a comprehensive system that provides health care and related services, including education and research opportunities, CHS is greatly impacted by constantly changing technology in an industry that is very capital intensive. Over the past several years, capital expenditures have exceeded $300 million annually and the tax-exempt debt markets have been prominent in financing such capital needs as evidenced by CHS issuing an aggregate of $2.1 billion of tax-exempt debt over six of the past seven years, including a total of $850 million in new money issuance. As of December 31, 2013, CHS has outstanding tax-exempt debt of approximately $1.8 billion, including underlying variable rate debt of $723 million. Banks play a key role in the cost effectiveness of our variable rate debt as four banks provide liquidity / credit support on $485 million of debt while three banks directly hold debt of $238 million over varying maturities. Thus, the use of affordable tax-exempt debt, and especially banks being able to either support or directly hold tax-exempt debt at reasonable rates, has been critical in allowing CHS to finance it capital needs.

CHS 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 not justified 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. Thus, almost half of the market 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. 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.

---

[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.

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 not 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 situation 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 Taiwan) or Level 2A (e.g., Botswana, Chile, Saudi Arabia and United Arab Emirates). Sovereign obligations of U.S. states (for example, the State of North Carolina), however, are specifically excluded from consideration in <u>any</u> category of HQLA. Thus, the proposed rule 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 issues noted above, 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 <u>not</u> 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 that has grown in the past several years, 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 CHS and our patients will be unnecessary and potentially significant increases in the cost of financing that is routinely needed to repair and replace our health care facilities and related equipment, which allows us to provide more than 10.5 million patient encounters annually.

Thus, in order to avoid any unintended and unnecessary increases in the cost of maintaining and improving our health care facilities and engaging in new capital projects, which are critical not only to our patients in North and South Carolina, 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.

With respect to the deposits that we and other public sector entities place with insured depository institutions and which, pursuant to state law, are required to be secured or collateralized ("Preferred Deposits"), the Agencies have also proposed to require that, to the extent that such deposits are collateralized with municipal securities, covered companies assume a 100% outflow rate for purposes of calculating the Liquidity Coverage Ratio ("LCR"). By contrast, unsecured deposits from the same public sector entities are proposed to receive outflow rates of only 20%-40%. Thus, not only does the Agencies' proposal drastically diverge from the Basel Committee's suggested maximum outflow rate of 25% for Preferred Deposits, but it also creates an illogical outcome for secured versus unsecured funding.

As a public authority, CHS typically will have $100-$150 million in Preferred Deposits placed with U.S. Depository Institutions, the eligible collateral terms for which are dictated by the laws of the State of North Carolina.

These laws allow for obligations of the State of North Carolina, along with the obligations of the various municipal issuers in the State of North Carolina and the general obligation bonds of other U.S. states, to be pledged as security for our deposits. The Agencies' proposed 100% outflow rate assumption for Preferred Deposits secured by municipal collateral, which will likely result in us earning lower rates of interest on these funds at a time when those rates are already significantly reduced, suggests that we would be inclined to withdraw our deposits in a stressed scenario because we were not comfortable with the credit or liquidity value of the debt of the State of North Carolina, other issuers in our state, or other U.S. states. We are no less comfortable holding these municipal obligations than any other security and are, therefore, no more inclined to withdraw these funds. Given then the stability of these deposits, and in order to avoid unnecessary further reductions in our interest income, we request that the Agencies amend their outflow rates assumptions for Preferred Deposits collateralized with municipal securities in order to establish a 25% maximum outflow rate, as recommended by the BCBS.

In order then to reaffirm the ability and role of U.S. banks to fund and serve U.S. state and local governments in their mission to provide critical public services (including health care for CHS) and, in doing so, to support the health and growth of the broader national economy, Carolinas HealthCare System respectfully requests that the Agencies thoughtfully consider our suggestions.

We appreciate this opportunity to comment and welcome any questions that the Agencies may have regarding such comments.

Respectfully,

Carolinas HealthCare System

R Mark Keener

By: R. Mark Keener
Vice President, Treasurer