BDA Bond Dealers of America

21 Dupont Circle, NW • Suite 750
Washington, DC 20036
202.204.7900
www.bdamerica.org

January 31, 2013
VIA ELECTRONIC MAIL

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

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

To whom it may concern:

On behalf of the Bond Dealers of America (BDA), a Washington, D.C.-based trade association representing middle-market fixed income securities dealers across the nation, I am pleased to provide comments on the Notice of proposed rulemaking regarding "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring," printed in the Federal Register on November 29, 2013 (Docket ID OCC-2013-0016). We will focus our comments on the proposal to exclude municipal bonds from eligibility as High Quality Liquid Assets (HQLA).

Three-quarters of the total U.S. investment in infrastructure is accomplished with municipal bonds, which are issued by over 50,000 state and local governments and authorities. Nearly four million miles of roadways, 500,000 bridges, 1,000 mass transit systems, 16,000 airports, 25,000 miles of intercoastal waterways, 70,000

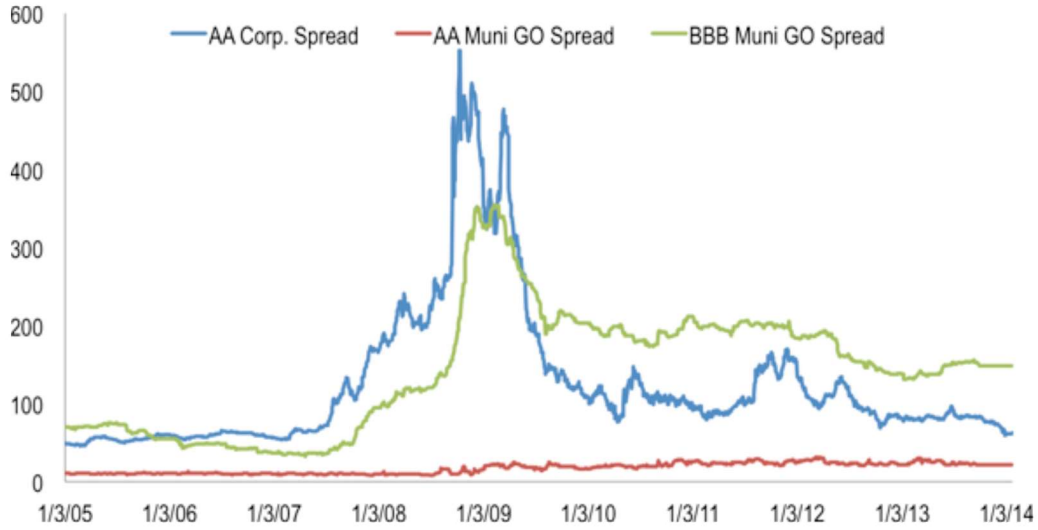
dams, 900,000 miles of pipe in water systems, and 15,000 wastewater treatment plants have been financed through tax-exempt municipal bonds. BDA's members collectively were responsible for one-third of all underwriting transactions in 2013 with such entities, including many small to mid-sized municipal issuers. We have significant insight into the municipal market operations holistically. We bring this perspective to urge you to thoroughly consider whether there is a legitimate and beneficial policy basis for excluding all municipal bonds from HQLA when doing so will diminish demand for municipal bonds by commercial banks at significant expense to over 50,000 state and local government issuers and the citizens they serve.

BDA recognizes the urgency of ensuring that banks appropriately manage liquidity risks. Yet the proposed rule fails to explain the absence of domestic municipal bonds – even as it includes qualifying foreign sovereign state obligations as HQLA. The only substance contained in the proposed rule to explain the disqualification of municipal bonds is, "…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 under this proposed rule. For example, securities issued by public sector entities generally have low average daily trading volumes . . . ."

We disagree that municipal bonds are not readily marketable in U.S. markets. Municipal securities are simply marketed in a manner that is different from other securities and liquidity must therefore be evaluated through a different lens than other securities. There are over one million different municipal bonds outstanding, and numerous, diverse issuers. An individual municipal security, examined in isolation, can be said to have a low average daily trading volume. But looking at the expansive, 3.7 trillion dollar marketplace as a whole, liquidity <u>can</u> be evaluated. For example, securities identifiers (CUSIPs) can be compared for the same or similar types of issuers, such as by utilizing spreads against the Muni Market Data-Line high-grade curve as a benchmark. While individual maturities or CUSIPS may seem to exhibit low trading volumes, bonds of the same issuer generally trade in tandem with each other. It is relatively easy to gauge the market price for an issuer's bonds or CUSIPs based on the maturities that actually have traded on a given day. It is important to look at both trading volume associated with individual maturities as well as the volume associated with all of an issuer's core CUSIPs on outstanding bonds as indications of trading volume.

The unique characteristics of the market for the securities responsible for financing U.S. infrastructure should not form the basis to disregard their role in safe and secure financial markets. The municipal market is a dispersed and complex market given many different issuers and CUSIPs. However, municipal securities are generally of high credit quality with very low default rates. And, municipal securities perform particularly well in a flight to quality in times of economic and market stress, and this should be factored into your analysis.

For example, as depicted in the chart below, in times of extreme financial stress in 2008 and 2009, the spreads of highly rated municipal debt (expressed here in red as a spread of AA rated municipals to the AAA municipal benchmark) remained very steady. Alternatively, the spreads of AA corporate debt (expressed here in blue as a spread of AA rated corporate to U.S. Treasuries) in times of market stress have exhibited significantly higher volatility:



Source: Corporate Data is from Citigroup and Municipal data from Thomson Reuters.

Periods of reduced liquidity for municipal bonds, when they do occur, tend to be caused by such factors as policy proposals that create uncertainty regarding the value of the tax-exemption. A policy initiative to treat high-grade municipal securities as less liquid than corporate bonds would only create a self-fulfilling prophecy of reducing liquidity in a market whose liquidity and pricing is generally strong.

Given the strong performance of highly-rated municipal bonds in times of market stress and the tools available to evaluate liquidity, BDA urges you to reconsider your proposal to set aside municipal securities rather than include them for potential HQLA classification. The ramifications of setting them aside are significant, including, potentially, needlessly increasing borrowing costs for state and local governments. The support set forth in the proposed rulemaking suggests a cursory dismissal of the marketability of securities that are the building block of U.S.

infrastructure and for which there is strong demand from investors seeking a stable and well-understood form of domestic investment. Municipal bonds merit examination for potential HQLA qualification, just as foreign sovereign state obligations can, under your proposal, be determined to meet the HQLA criteria.

Thank you for your consideration of the comments of middle-market dealers focused on fixed income. Feel free to contact me with any questions or concerns.

Sincerely,

Michael Nicholas
Chief Executive Officer