State of Connecticut

DENISE L. NAPPIER
TREASURER

Hartford

July 21, 2015

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 2 0551

Re: Docket No. R-1514; Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets

Dear Mr. Frierson:

Thank you for the opportunity to comment on the above referenced rulemaking proposal issued by the Board of Governors of the Federal Reserve System (the "Board"), which would make certain U.S. municipal securities eligible for Board-regulated banking institutions to classify as high-quality liquid assets (HQLA) for purposes of satisfying the Board's liquidity coverage ratio (LCR) requirements.

As Treasurer of the State of Connecticut, my office has responsibility for the State's issuance of debt obligations and management of its $20 billion debt portfolio. In addition, I serve as principal fiduciary of the State's $30 billion Connecticut Retirement Plans and Trust Funds, as well as its $5 billion Short-Term Investment Fund. In these capacities, I keep abreast of developments within the securities markets and, in particular, the municipal bond market.

At the outset, and as I wrote in comments[1] to the Board with respect to the initial proposal to adopt the Basel III Revised Liquidity Framework, I fully support the important, complex work of the U.S. regulatory bodies in promulgating rules to maintain the stability of our financial system. However, I expressed my concern with the wholesale exclusion of all municipal securities from qualification as high quality liquid assets and urged the regulatory bodies to include municipal securities. I am gratified, therefore, at the leadership shown by the Board in proposing such inclusion, albeit too limited in my view.

Adoption by the Board of this amendment would be of limited effect given the universe of banking institutions to which it would apply. In my opinion the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) should issue a similar proposal, so it applies to FDIC member banks or national banks that the OCC regulates.

[1] http://www.ott.ct.gov/pressreleases/press2014/PR013114BaselIIIMunicipalSecuritiesasHQLA.pdf .

The proposed amendment allows Board-regulated institutions to include eligible U.S. municipal securities as level 2B liquid assets, subject to satisfaction of additional criteria and several new limitations. In addition to requiring that bonds be liquid and readily marketable, the Board proposes to limit eligible municipal securities to only general obligation municipal securities, excluding all revenue bonds as well as any municipal securities that are secured by bond insurance. The proposed rule further limits inclusion to only U.S. general obligation municipal securities where the Board-regulated institution holds no more than 25 percent of the total amount of outstanding securities with the same CUSIP. At an issuer level, the proposed rule also limits the aggregate fair value of the eligible securities that could be included to no more than two times the average daily trading volume of all of the issuer's outstanding general obligation securities. Lastly, the proposed rule limits the total amount of U.S. general obligation municipal securities that can be included in a Board-regulated institution's HQLA amount to 5 percent of its total stock of HQLA.

I believe the Board's proposal is overly restrictive and fails to recognize some important aspects of municipal securities. I would, therefore, urge the Board to make the following changes:

- **High quality, state-issued general obligation bonds should be considered for Level 2A status.** Full faith and credit general obligation bonds of a state, backed by the unlimited taxing power of the state, should be equivalent to foreign sovereign securities and qualified as Level 2A assets, subject to the other limitations for inclusion. Such bonds share many of the same characteristics as foreign sovereign securities but are even more secure. They are enforceable in U.S., not foreign courts, they are not subject to currency exchange risks, the issuer cannot declare bankruptcy, and they are more familiar to investors than many foreign sovereign securities.

Some revenue bonds should be considered eligible HQLA, and depending on their characteristics, be classified as Level 2A or Level 2B assets. The Board excludes revenue bonds categorically because "during a period of significant stress, revenue derived from a particular project, such as a stadium, may fall dramatically. . ." While this may be true of project financing in the form of revenue bonds, it is not true of revenue bonds that are secured by a stream of tax revenues, a pool of full faith and credit securities issued by other public entities, or revenue bonds secured by the payment obligation of a private entity. For example, the State of Connecticut has almost $4 billion in outstanding Special Tax Obligation bonds, secured by a broad stream of transportation related revenues, which are not secured by revenue derived from a particular "project." Similarly, the State of Connecticut has approximately $950 million in outstanding Clean Water Fund bonds, which are rated AAA by all rating agencies and secured by deep reserves and full faith and credit repayment obligations of municipalities across the State. Each of these securities share some of the characteristics of the State's general obligation debt, and none of the characteristics of project financing.

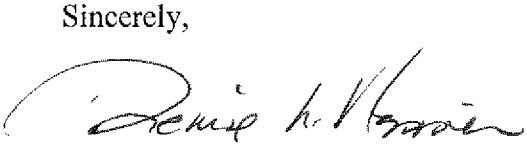
- **It should not be necessary to limit eligible securities to 25% of a particular CUSIP.** A unique aspect of the municipal securities market is the large number of CUSIPs involved, as bond issues are routinely structured with serial maturities from one to twenty years and within those maturities differing coupon structures are offered resulting in multiple CUSIPs for one bond issue. But this does not mean that the markets treat these securities as separate for credit purposes. For example, the September 2015 maturity of a State general obligation bond offering in 2009 trades identically with the September 2015 maturity of a State general obligation bond offering in 2010.

- **Securities carrying bond insurance should not be disqualified.** Bond insurance is less prevalent than in the past, but it is still the case that many municipal securities carry bond insurance. For some insured bonds, the underlying rating of the bonds is now higher than that of the original bond insurer and these securities should not be disqualified if the underlying bond would otherwise qualify.

I believe the Board's most recent proposal is an important step forward; however, further adjustments are needed to ensure that the inclusion of municipal securities as eligible, high quality liquid assets is implemented in the most effective manner for the benefit of both the strength of our financial system and our state and local governments. The expanded inclusion of municipal securities is important for state and local governments to be able to borrow for critical infrastructure projects at the lowest cost by continuing to attract important bank investors, will help to strengthen the financial stability of our banking system, and will maintain consistency between the treatment of corporate and municipal bonds under the Rule.

Thank you again for the opportunity to comment on this rulemaking proposal. Should you have any questions, please feel free to contact me.

Sincerely,



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