American Bankers Association
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Submitted Electronically
Mr. Robert deV. Frierson,
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, DC 20551

Re: Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets

Dear Sir:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the proposed revisions to the LCR, *Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets* (Proposal). The Proposal would amend the Liquidity Coverage Ratio (LCR) to allow bank holding companies and state member banks covered by the LCR to include certain U.S. municipal securities as high-quality liquid assets (HQLA). The LCR is a quantitative liquidity requirement, finalized on September 3, 2014, by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.[2] The LCR requires a company subject to the rule to maintain an amount of HQLA at least equal to its total net cash outflows over an assumed 30 day period of stress.[3]

An Important, Modest Step.

ABA supports the principles behind the Proposal and commends the Federal Reserve for recognizing both the high quality nature of municipal securities and that asset classes not originally specified in the final LCR may be suitable for HQLA eligibility. We encourage the Federal Reserve, however, to broaden the set of municipal securities eligible for HQLA and increase the holding limit from five percent of HQLA. Banks are important investors in the municipal markets. Discouraging bank investment in municipal securities would make funding for state and local entities more expensive and difficult while unnecessarily constricting the supply of HQLA.

While we applaud the Federal Reserve's decision to allow municipal securities to be eligible for HQLA, the band of eligible assets is still too narrow. Under the final LCR rule, HQLA is dangerously concentrated on sovereign instruments, comprised mostly of cash and Treasury securities, with a limited allowance for other assets. ABA supports a robust definition of HQLA to ensure an ample supply of HQLA in times of financial stress. Systemic shortages of HQLA could seriously exacerbate economic downturns and could even foment panic. Inadequate supplies of HQLA will mean that firms will tend to hoard what HQLA they have, and those that have insufficient supplies to continue their operations will be forced to retrench, reinforcing economic

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.
[2] 79 FR 61440 (October 10, 2014).
[3] The LCR applies to large and internationally active banking holding companies and certain of their subsidiaries; a modified LCR applies to bank holding companies and certain savings and loan holding companies with $50 billion or more in total consolidated assets but are not considered large and internationally active firms.

recession. The credibility of the LCR can be maintained—and in fact strengthened—by ensuring that the definition of HQLA incorporates the significant variety of liquidity sources that banks have safely relied upon in the past.

Dangers of Herding and Hoarding.

As ABA has noted before,[4] we believe that the definition of HQLA, even with this welcome though modest expansion, is overly conservative and does not sufficiently recognize either the strength of U.S. financial markets or the depth of assets available for liquidity purposes. Further, ABA continues to believe that the LCR's narrow definition of HQLA will create significant market distortions, particularly when it is considered with other regulatory reform efforts that increase demand for the very instruments identified by the LCR as HQLA. One risk is that of herding, where regulations force banks to seek the same sources of HQLA, increasing the likelihood of highly correlated "herd" behavior – especially in times of stress. Another risk, and perhaps even more worrisome, is that of hoarding, where the constrained supply of HQLA could precipitate panicked acquisition of HQLA in times of financial stress, when demand would likely rise sharply and supply disappear. This, in turn, will crowd out other investors including banks not covered under the LCR.

To help mitigate these risks, we strongly encourage the Agencies to consider expanding the definition of HQLA to include more assets. Additionally, we strongly encourage the Federal Reserve, in conjunction with other agencies, to provide a mechanism which allows for future asset classes to meet the definition of HQLA.

Need for Important Technical Corrections.

As the Federal Reserve Board is aware, the LCR is in need of many technical fixes and clarifications. We urge the Federal Reserve, in conjunction with the FDIC and the OCC, to issue these fixes and clarifications in a public and transparent manner, ideally with public notice and comment. We respectfully remind the Federal Reserve that the revised instructions for reporting form FR 2052 are not the proper place for official LCR guidance. We appreciate the establishment of the LCR mailbox, a joint agency process through which bankers and other interested parties may submit questions regarding LCR interpretative issues, and encourage the agencies to make public both the questions and the answers so that other institutions may benefit from the guidance.

We appreciate your consideration of these comments and would welcome the opportunity to discuss them further. If you have any question or need further information, please contact the undersigned at 202-663-5182 or atouhey@aba.com.

Sincerely,

Alison Touhey
Senior Regulatory Advisor

[4] ABA comment letter on the LCR Proposal, January 31, 2014