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July 24, 2015

By Electronic Mail
Board of Governors of the Federal Reserve System
Attn.: Robert deV. Frierson
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

RE: Board of Governors of the Federal Reserve System's Request for Public Comment on "Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets" dated May 21, 2015

To Whom It May Concern:

Public Financial Management, Inc. (PFM) is the largest municipal financial advisor in the country,[1] and a registered Municipal Advisor with the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB) under the Dodd-Frank Act of 2010. PFM serves as financial advisor to state and local governments and authorities (including authorities that act as a conduit borrower for governments and public-service institutions; our clients also include public-service institutions themselves, such as universities and health systems). We understand the rationale of the Federal Reserve's (the Fed's) proposed amendments (the Proposal) to the Liquidity Coverage Ratio (LCR) requirement that would expand the definition of High-Quality Liquid Assets (HQLA) to include a select universe of municipal securities. However, the restrictions on eligible municipal securities as outlined in the Proposal unnecessarily limit the types of qualifying municipal securities that could accomplish the intended objectives of the LCR and HQLA. Further revisions to the Proposal could avoid the potential negative consequences of limiting the inclusion of municipal bonds as HQLA securities without increasing the risk profile of the regulated institutions.

In addition to the comments on the Proposal provided below, PFM strongly advocates for the Fed's support of H.R.2209, which would amend the LCR and HQLA calculations for all three of the U.S. financial regulatory bodies (the Fed; Office of Comptroller of Currency, or OCC; and Federal Deposit Insurance Corporation, or FDIC) on a consistent basis to include all "investment-grade" municipal securities as HQLA. This approach will not have a material impact on the risk profile of regulated financial institutions and will continue to provide the greatest benefit to the municipal market, municipal bond issuers, and the citizens that they serve.

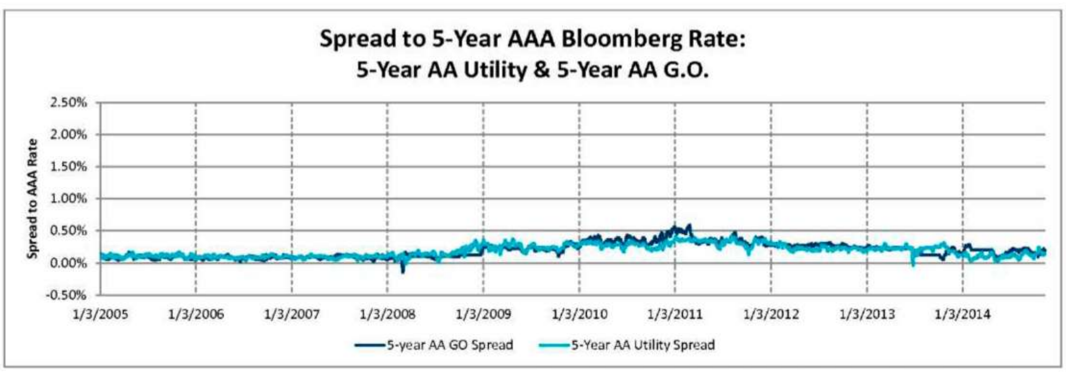
PFM's Comments on the Fed's Proposal:

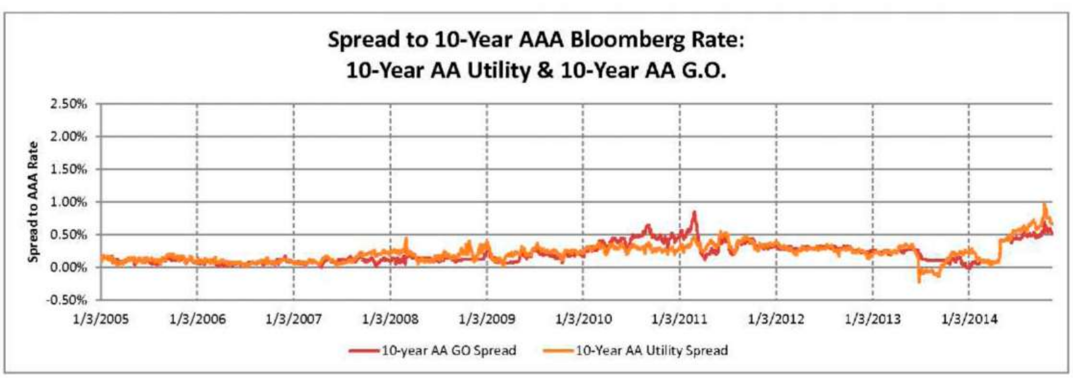
- **Credit/security of allowable municipal securities:** As written, the proposal includes only General Obligation (GO) bonds backed by the full faith and credit of an issuer for allowance in the calculation of HQLA. While it is evident that many GO-backed bonds will meet the minimum standards of an HQLA asset, expanding the criteria to include other, non-GO securities that have similar or more favorable volatility and liquidity characteristics to GO credits

[1] *Based on number of overall issues and par amount as of 12/31/14. Source: Thomson Reuters.*

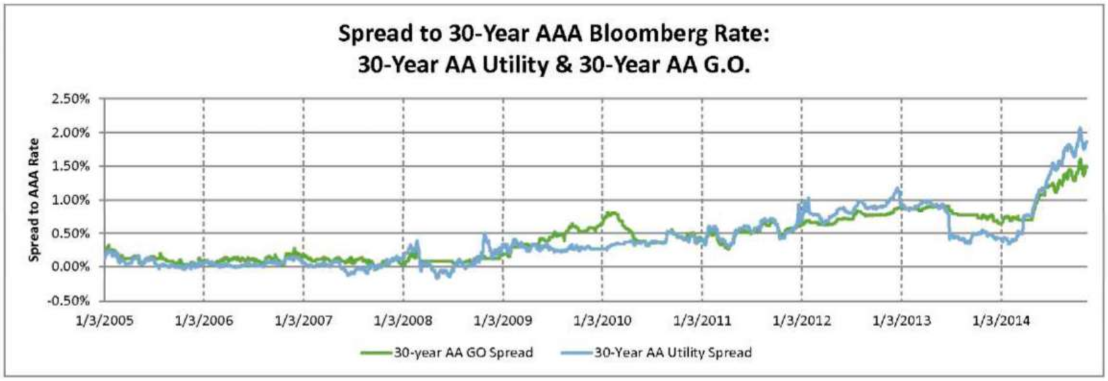
will be beneficial to the municipal marketplace and municipal bond issuers. By limiting eligible municipal securities to only GO bonds, and excluding all municipal bonds backed by dedicated revenue streams or other non-GO pledges (such as moral obligations, appropriation pledges, limited tax obligations, and pooled bonds), the proposed amendment reduces the universe of outstanding eligible municipal securities by more than $2 trillion. Within this category of securities, there is a high volume of investment-grade-rated debt issued by public entities that provide essential services (e.g., water, wastewater, power, etc.) with independent rate-setting authority and conservative debt service coverage covenants, as well as state-level issuers with substantial portfolios of outstanding debt with strong credit and security characteristics. By including securities such as these in the calculation of HQLA, the Fed would expand the universe of municipal bonds that are HQLA-eligible without impairing the objectives of the HQLA requirements, thus reducing the potential negative impacts that the original complete exclusion of municipal bonds from this calculation could have on municipal bond issuers.

Below, we have graphed AA-rated GO and Utility curve spot-rates (five-year, 10-year, 30-year) spreads to the respective Bloomberg AAA-rated GO benchmark curve spot rates.[2] As shown, the spreads have moved in very close correlation to one another, particularly during the 2008 financial crisis, evidencing the view that these credit types exhibit like levels of volatility in both stable and unstable financial conditions.





[2] *Source: Bloomberg L.P.*



- **Credit enhancement:** By excluding any municipal securities that have credit enhancement or insurance, the Proposal eliminates a subset of municipal bonds that would otherwise be eligible for HQLA inclusion under the proposal by virtue of having an underlying investment-grade credit rating. As an example, a GO bond with an Aa3/AA- underlying credit rating that is categorized by both the market and a bank as "investment-grade" might realize pricing benefits through the utilization of credit enhancement. Absent this enhancement and provided that it meets the minimum liquidity thresholds of the Proposal, this security would be eligible for HQLA inclusion; however, due to the fact that the timely payment of debt service is guaranteed by a financial sector entity, it would not be HQLA-eligible. This aspect of the Proposal unnecessarily restricts the universe of eligible municipal bonds that could otherwise have the necessary liquidity and credit strengths of an eligible security.

- **CUSIP identification:** As written in the Proposal, the CUSIP identifier is not clearly defined in regard to the limitations that the Proposal would impose on the amount of holdings of a single issuance that could be included as an HQLA. The differentiation between the use of the 6-character CUSIP, which refers to the issuing entity, and the 9-character CUSIP, which identifies an individual security (e.g., a serial bond maturity), is an important distinction for the holding limits that the Proposal places on an institution's HQLA-eligible municipal securities. Applying the 25% threshold for inclusion in the calculation at the security level (9-character CUSIP) will be significantly more limiting than utilizing the issuer-level CUSIP (6-character) for this calculation, as single maturities are necessarily smaller in size than an issuer's entire debt portfolio.

- **Measurement of stress/liquidity:** In the Proposal, a municipal security is classified as an HQLA if "the market price of the U.S. general obligation municipal securities or equivalent securities of the issuer declined by no more than 20 percent during a 30 calendar-day period of significant stress." However, the Fed does not directly define what constitutes a "period of significant stress." A clear definition of a stressful period will benefit the market, as well as noting prior periods that qualify. As a general point, it will be integrally important for any amendments to the LCR and HQLA calculations to include clearly defined terms and formulas for market participants that will be impacted. If not specifically addressed in a clear manner, conducting the necessary due diligence on the select municipal securities that would meet these requirements may prove so sufficiently burdensome for a municipal bond holder that the positive impact of including these municipal maturities may be offset by the unnecessarily high administrative costs associated with the calculation itself.

We appreciate the openness of your approach and the opportunity to submit comments on the proposed amendment. We would be happy to discuss our comments in more detail at any time.

Sincerely,

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