Government Finance Officers Association
National Association of State Treasurers
SIFMA

The Honorable Jelena McWilliams
Chair
Federal Deposit Insurance Corporation
550 17th St NW
Washington, DC 20429

The Honorable Joseph M. Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve
Constitution Ave NW & 20th St NW
Washington, DC 20551

July 17, 2018

Dear Chair McWilliams, Comptroller Otting, and Chairman Powell:

As you know, recently Congress passed and the President signed into law the "Economic Growth, Regulatory Relief, and Consumer Protection Act" (PL 115-174) (the "Act"). Section 403 of the Act amends the Federal Deposit Insurance Act to require federal banking agencies to amend their Liquidity Coverage Ratio ("LCR") rules to provide treatment as Level 2B High Quality Liquid Assets ("HQLA") for certain municipal securities. The law requires the Federal Reserve (the "Fed"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC", together, the "Agencies") to complete rulemaking on this matter no later than August 22, 2018.

Under the new change in law, municipal securities that are liquid and readily marketable and investment grade will be Level 2B HQLA under the Agencies' rules. The Government Finance Officers Association[1] (GFOA), The National Association of State Treasurers (NAST)[2], and SIFMA[3] write you today to address

[1] The Government Finance Officers Association (GFOA), founded in 1906, represents public finance officials throughout the United States and Canada. The association's more than 19,800 members are federal, state and local finance officials deeply involved in planning, financing, and implementing thousands of governmental operations in each of their jurisdictions. GFOA's mission is to advance excellence in state and local government financial management.

[2] The National Association of State Treasurers seeks to provide advocacy and support that enables member states to pursue and administer sound financial policies and programs benefiting the citizens of the nation. As part of its mission to be the nation's leading advocate for responsible state treasury programs and related financial practices and policies, NAST furthers its federal relations through the association's headquarters in Washington, DC. The organization's advocacy is guided by resolutions adopted by the membership.

[3] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly one million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the US, serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, DC, is the US regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

applying the "liquid and readily marketable" test to municipal securities. We urge the Agencies to make their best efforts to meet the statutory deadline for action on this new provision. We also urge the Agencies in their rulemaking to apply all existing provisions of the LCR Rule to municipal securities in the same manner as to other HQLA.

Background

The Agencies finalized their LCR rules in December 2014. In May 2015, the Fed, acting alone, proposed amendments to its LCR rule to permit certain municipal securities to be treated as Level 2B HQLA. In April 2016 the Fed finalized those amendments.

While we appreciate the Fed's work in attempting to accommodate certain municipal securities as HQLA under previous law, the 2016 rulemaking regarding municipal securities has not been successful for several reasons. First, the fact that the OCC and FDIC have not made corresponding changes to their LCR rules makes the Fed's amendments much less useful, since most LCR banks are subject to the rules of all three agencies. Most LCR banks appropriately have decided that they will comply with the most restrictive of the three rules, which means the Fed's action, without corresponding rulemaking by the other two agencies, is if very limited use.

Second, The Fed's 2016 rule changes are too restrictive and don't reflect the realities of the municipal securities market. In its 2016 amendments, the Fed "gold-plated" regulations governing municipal securities relative to other HQLA. The Fed's 2016 rules include these provisions which do not apply to other HQLA:

- Only general obligation ("GO") municipal securities are eligible for HQLA status under the Fed's amendments. Revenue bonds are not eligible. There is little basis for that distinction. Investment-grade revenue bonds exhibit similar liquidity and credit performance as like-rated GO bonds.
- The 2016 rule amendments limit the amount of securities issued by a single issuer that a bank may include as eligible HQLA to two times the average daily trading volume of that issuer based on a presumption about the liquidity of municipal securities in a stressed market This conclusion is not consistent with what we observe in the market. A distinct issuer concentration rule based on trading volume is no more necessary for municipal securities than for corporate bonds or other Level 2B HQLA.
- The 2016 rule changes specify that municipal securities in the aggregate can comprise no more than five percent of a bank's overall HQLA based on a perception of the municipal market's overall liquidity. There are more refined ways of addressing that issue in regulation than placing an overall limit on municipal securities holdings that count towards compliance. Moreover, this limitation is superfluous given the 50-percent haircut and the 15-percent limit that apply to a bank's overall Level 2B assets.

Again, none of these types of restrictions applies to any other eligible HQLA assets. Under the prevailing LCR rules, "liquid and readily marketable securities" are defined as having:

1. More than two committed market makers;
2. A large number of non-market maker participants on both the buying and selling sides of transactions;
3. Timely and observable market prices; and
4. A high trading volume.

We three organizations and others have commented extensively over the last several years on how the liquidity and credit performance of investment-grade municipal securities is comparable to that of corporate debt securities and are comparable and that a significant portion of the investment-grade municipal market meets the liquid-and-readily-marketable standard.[4] Our comments addressed issues such as trading volume in the municipal market. We pointed out that while average daily municipal securities trading volume is slightly lower than corporate bond volume, the turnover rate—the portion of outstanding bond volume that trades daily—averages higher than in the corporate market. We also discussed how municipal securities tend to be issued in series of smaller maturities known as serial bonds. Because trading in an issuer's securities is spread over more individual CUSIPs, it is important to evaluate trading volume by issuer, not by security. We also point out that municipal bond trading volume has been consistent within a range for years.

Conclusion

It is unusual for Congress to weigh in with legislation on such a narrow and technical regulatory issue as treatment of municipal securities as HQLA. Congress would not have taken this step if they did not expect the agencies to respond with rulemaking that provides a meaningful and workable application of the LCR rule to municipal securities. Unfortunately, the Fed's 2016 rule changes impose so many restrictions and limitations that there is little practical opportunity for banks subject to the LCR rule to apply the amendments to their investments in municipal securities, and clearly Congress agrees.

As you all begin to work through your rulemaking response to the Act, our recommendation is to treat municipal securities exactly like other Level 2B assets are treated under the rule. There is no practical justification for any other approach.

[4] See, for example, letter from Michael Decker, SIFMA, to the Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, Mr. Robert deV. Frierson, Board of Governors of the Federal Reserve System, and Robert E. Feldman, Federal Deposit Insurance Corporation on "Docket ID OCC-2013-0016," January 31, 2014. See also Letter from the Public Finance Network (American Hospital Association, American Public Gas Association, *et al.*) to Mr. Robert deV. Frierson, Board of Governors of the Federal Reserve System, Mr. Robert E. Feldman, Federal Deposit Insurance Corporation, and Mr. Thomas J. Curry, Office of the Comptroller of the Currency, on "Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring Federal Reserve System [Docket ID OCC-2013-0016]," January 31, 2014.

Thank you for your consideration. We would welcome the opportunity to discuss this matter further with you or your staff.

Best regards,

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