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May 27, 2014

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

2014 JUN -3 P 4: 13

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

The State of Florida Division of Bond Finance appreciates the opportunity to respond to the request for comment issued by the Office of the Comptroller of the Currency, Department of the Treasury, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, "the Agencies") on the proposed rule to implement a quantitative liquidity requirement (the "proposed rule") consistent with the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision ("BCBS") for large, internationally active banking organizations, covered nonbank companies and their consolidated subsidiary depository institutions with total assets greater than $10 billion. In this letter, the Division of Bond Finance is commenting specifically on those aspects of the proposed rule that we believe would have the greatest impact on the U.S. municipal securities market[1] and our ability to continue to finance critical public works projects.

The Division of Bond Finance issues bonds on behalf of the State of Florida, the proceeds of which help finance and construct K-12 and post-secondary education facilities, expand and improve

1 This letter is specifically in response to Questions 12 and 22 in the Notice of Proposed Rulemaking as they relate to the municipal securities market.

Florida's roads, highways and bridges, preserve Florida's coastline and the Everglades as well as acquire environmentally-sensitive land, construct classrooms and research facilities, dormitories, parking facilities, student services facilities and athletic facilities at state colleges and universities, construct prisons and improve Florida's 15 seaports. In addition, since Fiscal Year 2011, the Division of Bond Finance has issued 50 refunding bond transactions to reduce outstanding debt service requirements thereby saving nearly $1.3 billion for the citizens of the State of Florida.

As an active participant in the municipal bond market, the Division of Bond Finance has issued more than $27 billion in tax-exempt bonds over the last ten years. Critical infrastructure financed with tax-exempt bond proceeds includes the recent issuance of $267,405,000 of Turnpike Revenue Bonds. These bonds are a part of a multi-billion dollar, multi-year expansion project for the Florida Turnpike System, which provides important road infrastructure for local communities throughout the State of Florida. Over the next ten years, the Division of Bond Finance could issue an additional $5 billion of tax exempt bonds for important infrastructure projects. If a major current purchaser of municipal bonds exits the market, financing costs would significantly increase for the nearly 20 million citizens of Florida and possibly translate into less infrastructure investment at a time when such investment is critical to preserve the health and well-being of Americans as well as support a fragile economic recovery through creation of construction jobs.

The Division of Bond Finance fully supports the efforts of the Agencies to enhance liquidity risk management in the banking sector and ensure strong and resilient financial markets. We believe, however, that the proposed exclusion of municipal securities from the High Quality Liquid Asset ("HQLA") definition is unjustified based on the Agencies' own liquidity criteria and our understanding of the municipal market. The Agencies have stated, for example, that they consider the depth and breadth of markets as key indicators of liquidity and, for that reason, have specifically proposed to require the existence of a large and diverse number of market participants as part of their HQLA criteria. The largest concentration of holders in the municipal securities market is, by far, the household sector. According to the Federal Reserve's own data[2], more than 44% of all outstanding municipal securities are held either directly in retail hands or in separately managed individual accounts. Almost half of the market then is held by a sector which is itself a diverse population of thousands of individual investors.

The Agencies have also imposed certain diversification requirements with respect to a covered company's stock of HQLA. According to Federal Reserve data[3], municipal securities currently comprise less than 4% of U.S. Depository Institutions' total assets. That is less than either corporate bonds or Agency and GSE-backed securities. From this perspective, municipal securities present less systemic risk. We believe, therefore, that this under-concentrated exposure among U.S. banks to municipal securities should make the asset class desirable for inclusion in HQLA.

The Agencies also specifically require that HQLA be eligible to be pledged at a central bank. It is important to note then that the U.S. Federal Reserve accepts all U.S. municipal bonds at a 2%-5% haircut, depending on maturity. These are the same haircuts that the Federal Reserve applies to U.S. Agency and GSE securities. By comparison, the Federal Reserve accepts U.S. AAA corporate bonds at a 3%-6% haircut and all other investment grade corporate bonds at a 5%-8% haircut. Thus, the U.S. Federal Reserve already acknowledges the high credit, diversification and liquidity value of municipal securities by accepting them at the same haircuts as U.S. Agency and GSE securities and

2 Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.211, September 25, 2013.
3 Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.110, September 25, 2013. Holdings of private residential and commercial CMOs and other structured MBS have been excluded from corporate bond data.

at better haircuts than U.S. corporate bonds. We do not see any justification for the Agencies to diverge on this point, as has been proposed.

Lastly, but certainly not least important, the proposed rule creates a dichotomy that would disadvantage U.S. state and local issuers. The proposed rule permits foreign sovereign state obligations to be categorized as HQLA. Depending on the standard risk weighting and subjective criteria, such obligations may be counted as Level 1 (e.g., France, Italy, Slovenia, Spain and Taiwan) or Level 2A (e.g., Botswana, Chile, Saudi Arabia and United Arab Emirates). Sovereign obligations of U.S. states (e.g., Florida), however, are specifically excluded from consideration in <u>any</u> category of HQLA. This dichotomy unfairly discriminates against the liquid debt markets of U.S. States and instrumentalities and penalizes U.S. banks for servicing domestic public sector clients.

Beyond the inconsistencies and illogical outcomes, we are most concerned with the potential for significant and adverse unintended consequence. We believe that the proposed rule may serve to impair a long history of legislative motivation for banks to serve and support the municipal securities market. Without having offered any demonstration of diminished liquidity, the Agencies have proposed <u>not</u> to allow municipal securities to qualify as High Quality Liquid Assets at this time and, in doing so, we believe, propose to dampen bank demand for the asset class. In response to the exclusion, we expect that regulated companies would need to either reduce their participation in the municipal securities market, which, while not a majority, is still a meaningful percentage whose absence would be detrimental, or be forced to raise their pricing schematics accordingly.

Post-credit crisis, U.S. commercial banks have become a significant source of credit for state and local government capital investment in infrastructure. The financial stress and credit rating downgrades of the monoline bond insurers caused significant dislocation in short term municipal bond market products (i.e., variable rate demand bonds and auction rate securities). U.S. commercial banks were a solution to this problem for hundreds if not thousands of governmental and non-profit issuers. Since that time, U.S. commercial banks have evolved into a significant buyer of intermediate and long term tax exempt bonds. Banks have also provided a significant amount of credit to state and local governments through direct bank loans. The banks' active participation in the tax exempt markets have provided liquidity, stability and a low-cost source of credit for tax exempt borrowers. This, in turn, has contributed significantly to the economy's recovery by funding infrastructure investments and job creation. The banks' role in these efforts should not be underestimated, which simply underscores the importance of not diminishing the banking sector's appetite for providing credit to state and local governments. The proposed rules would not only increase the cost of funding infrastructure investments but would also diminish the capital projects that state and local governments would be willing to fund while diminishing the stability of the tax exempt markets overall. These consequences need to be seriously considered in connection with the proposed treatment of municipal bonds.

The State of Florida currently has over $24.6 billion of debt outstanding, which is more than many major corporate borrowers, and benefits from excellent secondary market liquidity because of our high rating (AAA/AAA/AA1), name recognition, active investor outreach and investors' familiarity with the credit. The fact that the municipal market is largely comprised of buy-and-hold investors should not be viewed negatively or as an indicator of an illiquid market. Buy-and-hold investors provide a great degree of stability to the tax exempt securities market because their objective is to be a long term investor with a view of holding until maturity rather than a trading account looking for short term opportunities. When the pricing of tax exempt securities becomes attractive relative to taxable securities, opportunistic buyers (hedge funds, crossover taxable buyers,

arbitrage accounts etc.) emerge to provide additional liquidity to the market. We have observed this dynamic repeatedly and predictably over many years. This is because it is a nuance reflecting the unique nature of the tax exempt securities market that may not be fully appreciated without many years of experience and observation in varying market conditions.

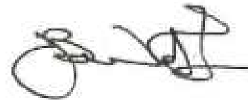
Thus, in order to avoid any unintended and unnecessary increases in the cost of improving municipal infrastructure and engaging in new public works projects, which are vital not only to the State of Florida and our residents, but to the health of the U.S economy more broadly, we urge the Agencies to amend the proposed rule in order to reclassify all investment grade municipal securities as eligible for inclusion as Level 2A High Quality Liquid Assets.

In order to reaffirm the ability and role of U.S. banks to fund and serve U.S. state and local governments in our mission to provide critical public services and, in doing so, to support the health and growth of the broader national economy, the Division of Bond Finance respectfully requests that the Agencies thoughtfully consider our suggestions.

The Division of Bond Finance appreciates this opportunity to comment and welcomes any questions that the Agencies may have.

Respectfully,

State of Florida, Division of Bond Finance



J. Ben Watkins, Director