LA 14-420

Congress of the United States
Washington, DC 20515

FDIC

JUN 30 2014

OFFICE OF LEGISLATIVE AFFAIRS

June 23, 2014

The Honorable Thomas Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

The Honorable Janet Yellen
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: OCC Docket ID OCC–2013–0016, Federal Reserve Docket No. R–1466, and FDIC RIN 3064–AE04.)

Dear Comptroller Curry, Chairman Gruenberg and Chairman Yellen,

As members of the California congressional delegation, we are writing to comment on the proposed rule your agencies issued on November 29, 2013 that would implement a quantitative liquidity requirement consistent with the liquidity coverage ratio (LCR) standard established by the Basel Committee on Banking Supervision. We are concerned that the proposed LCR rule's treatment of municipal securities and collateralized deposits would restrict the ability of state and local governments to raise capital to finance infrastructure investment and pay day-to-day bills.

The $3.7 trillion municipal securities market is the principal means for state and local governments to raise capital to finance public investment in schools, roads, water and sewer systems, airports and other infrastructure. In 2013, state and local governments in California issued over $63 billion in bonds and notes to finance a variety of public investment.

Large financial institutions play a vital role in providing financing to states and localities. As of the end of 2013, banks held over $416 billion of municipal securities, or 11 percent of the total outstanding. Although we support increased liquidity, we are concerned by prudential rules that could discourage financial institutions from investing in municipal securities. The result could be reduced demand for state and local debt and an increase in the financing costs for states and local governments that issue municipal bonds to fund infrastructure projects.

HQLA Treatment

The LCR proposal lays out the criteria that the OCC, the Fed and the FDIC believe represent "High Quality Liquid Assets" (HQLA). Even though the LCR proposal would explicitly exclude

municipal securities from HQLA treatment, municipal securities appear to meet or exceed the criteria established in the rule for HQLA treatment. For example,

- Trading volume as measured by turnover rate is comparable to other categories of securities like investment-grade corporate bonds that would receive HQLA treatment under the proposal.
- Municipal securities exhibit price stability, even in stressed market conditions. Historical price declines for municipal securities in stressed markets are better than or as good as those for assets that would be HQLA.
- Municipal securities are eligible as collateral for Discount Window advances at Federal Reserve Banks, and haircuts are as favorable or more favorable than other assets that would count as HQLA under the proposal.

Moreover, the proposed LCR rule would favor securities issued by foreign governments, even small nations whose sovereign securities are illiquid or even distressed, over the biggest, most well-known U.S. state and local governments. The proposed rule is inconsistent with the LCR guidelines issued by the Basel Committee on banking Supervision. The Basel Committee recommends Level 2A liquid asset treatment for "marketable securities representing claims on or guaranteed by sovereigns, central banks, PSEs or multilateral development banks" meeting certain conditions. Public sector entities (PSEs) are defined as governmental entities other than a central government and encompass U.S. state and local governments.

We urge you in the final rule to provide for "Level 2A" High Quality Liquid Asset treatment for investment-grade municipal securities, which is consistent with the Basel Committee's recommendation.

Treatment of Collateralized Deposits

The proposed treatment of deposits placed by states and municipalities, which, under state law, must be collateralized (so called "preferred deposits"), is also punitive and more stringent than required under the Basel III framework. As a result, banks may have to limit the amount of preferred deposits they accept and further reduce the interest paid on preferred deposits. The proposal states that banks must plan for 100% of collateralized public deposits to be withdrawn in a market or bank event. This means that the bank would have to hold high quality liquid assets equal to the deposit that the public entity has with the bank. These assets would be in addition to the collateral currently being held to secure the public deposits, effectively doubling the collateral held to secure public deposits, severely increasing the costs associated with public deposits.

The treatment of secured deposits of U.S. municipalities, and public sector entities, as secured funding transactions that are subject to the requirement of a 100 percent unwind basis will lead to a negative distortion in the HQLA calculation. The U.S. LCR proposal could create incentives for institutions to stop offering particular products and services to public sector entities, which could cause U.S. municipalities to have difficulties in providing critical public services to citizens, and meeting payroll for public servants.

We urge you, in finalizing the LCR rule, to provide Level 2A HQLA treatment for investment-grade municipal securities and to exclude collateralized deposits from U.S. municipalities and public sector entities from the 100 percent unwind requirement. Ensuring unfretted access to capital and other financial services is imperative for the infrastructure investments and day-to-day services offered by our municipalities and public sector entities.

Sincerely,

JEFF DENHAM
Member of Congress

GARY MILLER
Member of Congress

DEVIN NUNES
Member of Congress

KEN CALVERT
Member of Congress

GLORIA NEGRETE MCLEOD
Member of Congress

JUAN VARGAS
Member of Congress

BRAD SHERMAN
Member of Congress

GRACE NAPOLITANO
Member of Congress

TONY CARDENAS
Member of Congress