THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
SCOTT M. STRINGER

January 30, 2014

Attention: Legislative and Regulatory Activities Division
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
Docket ID OCC-2013-0016
regs.comments@occ.treas.gov

Attention: Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1466
regs.comments@federalreserve.gov

Robert E. Feldman, Executive Secretary
Attention: Comments/ Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN No. 3064-AE04
comments@FDIC.gov

Re: Investment Grade Municipal Securities and the Proposed Liquidity Coverage Ratio Rule

Ladies and Gentlemen:

We have reviewed the agencies' notices of proposed rulemaking to implement a quantitative liquidity requirement (the "proposed rule") in connection with the liquidity coverage ratio framework established by the Basel Committee on Banking Supervision.

I applaud the efforts of your agencies to promote the liquidity resilience of nationally and internationally significant banking organizations. We all want to see continued improvement in the banking sector's ability to absorb shocks arising from financial and economic stress, as well as enhanced measurement and management of liquidity risk. However, I believe that the

proposed exclusion of investment grade municipal securities from the high quality liquid asset ("HQLA") definition is inappropriate based on the proposed liquidity criteria and on my office's extensive experience with and understanding of the municipal market.

As City Comptroller, I was recently elected to a four-year term as the chief fiscal officer of New York City (the "City"). The City's Mayor and Comptroller are jointly responsible for debt of the City and several related debt issuing entities, including the New York City Transitional Finance Authority and the New York City Municipal Water Finance Authority. Collectively, these issuers make New York City the second largest issuer of municipal debt in the nation, after the State of California. In calendar year 2013 we sold over $11.8 billion of bonds to finance or refinance capital projects, and across our related credits have over $100 billion of bonds outstanding.

I appreciate the opportunity to respond to your request for comments. I am commenting specifically on those aspects of the proposed rule that I believe would have the greatest impact on the U.S. municipal securities market and the City's continued ability to finance critical public works projects at an affordable cost. Accordingly this letter will focus on questions 12 and 22 in the notices of proposed rulemaking. However the following points about the investment grade municipal market's attributes also support more favorable treatment of these securities with respect to outflow assumptions for bank liquidity facilities and collateralized deposits.

<u>Question 12</u>: *What other assets, if any, should the Agencies include in Level 2A liquid assets? How should such assets be identified and what are the characteristics of those assets that would justify their inclusion in Level 2A liquid assets?*

Investment grade municipal securities should also be included in Level 2A liquid assets for the following reasons:

- <u>Depth and breadth of municipal investors.</u> Municipal bonds are widely held, with Federal Reserve data as of December 9, 2013 showing that 44% of municipal bonds are held by individual investors, by definition a broad and diverse group. This clearly meets the HQLA criteria for depth and breadth of markets as key indicators of liquidity.

- <u>Absolute and relative quality of investment grade municipal securities</u>. There is much empirical evidence showing municipal bond credit quality. For example, a recent analysis by BNY Mellon, based upon Moody's data, shows that the cumulative ten-year default rate for municipal securities in the BBB rating category, the lowest rating category which qualifies as "investment grade," is 0.3%, comparing quite favorably to the 4.7% percent default rate for corporate bonds in the BBB rating category. The statistic demonstrates both the absolute low rate of investment grade municipal defaults and the low rate relative to corporate credits for a significant period of time. Accordingly, the credit risk profile of investment grade municipal bonds clearly satisfies HQLA criteria.

- <u>Diversification into municipal securities can reduce systemic risk.</u> Federal Reserve data show that banks have low exposure to municipal securities compared with other asset classes, with municipals comprising less than 4% of all credit market instruments held by U.S. depository institutions. That is less than either corporate bonds or Agency and U.S.

Government-Sponsored Enterprises-backed securities ("GSEs") From this vantage point, municipal securities present low systemic risk and warrant inclusion in HQLA.

- Eligibility for pledging to the Federal Reserve as required for HQLA. The Federal Reserve Banks accept U.S. municipal bonds as collateral at comparable margin levels to certain foreign debt securities and GSEs and more favorably than investment grade corporate bonds. This indicates that the U.S. Federal Reserve recognizes the high quality and substantial market presence of municipal securities.

- Favorable municipal trading characteristics. Municipal bonds have traditionally exhibited relatively limited price volatility and high trading volume. During the recession of 2008-2009, for example, price declines on AAA corporate bonds were greater than the price declines of both AA municipal general obligation bonds and municipal revenue bonds, according to data provided by the Federal Reserve's Interest Rate tables. Further, the municipal market trades a larger fraction of its outstanding par each day than corporate bonds and Agency debt, according to data from a Federal Reserve Statistical Release dated September 25, 2013. Both the relatively limited price volatility and high trading volume metrics point towards including investment grade municipal bonds as HQLA.

Question 22: The Agencies seek comment on all aspects of the criteria for HQLA, including issues of domestic and international competitive equity, and the adequacy of the proposed HQLA criteria in meeting the agencies' goal of requiring a covered company to maintain a buffer of liquid assets sufficient to withstand a 30 calendar-day stress period.

Excluding investment grade municipal securities would place our nation's own governmental entities at an inappropriate and unfair competitive disadvantage compared to foreign sovereign securities.

- Sovereign status is no guarantee of foreign debt quality. Experience of the last five years makes this plain. U.S. municipal securities are in many cases of higher credit quality than securities of certain foreign sovereigns, whether measured by ratings or by the interest rate the market demands. New York City's core credits are rated from AA to AAA and our 30 year bond cost of funds is currently well below 5%.

- Fair treatment for U.S. issuers compared to foreign sovereigns. The proposed rule permits foreign sovereign obligations to be categorized as HQLA but sovereign obligations of U.S. states are excluded from consideration as HQLA, thereby potentially penalizing U.S. banks for servicing domestic public sector clients. It would be fiscally prudent and sound public policy to include investment grade municipal securities as HQLA in a comparable manner to foreign sovereign obligations that are already included in the proposed rule.

The proposed rule will likely result in decreased bank appetite for investment grade municipal securities. Unfortunately, a further consequence would be unnecessary increases in the cost of financing for desperately needed infrastructure such as repair and replacement of our schools, roads, bridges, tunnels and water and sewer systems.

New York City, with a population of over eight million people, has tremendous infrastructure needs. Over the course of the past decade, the City has spent approximately $80 billion on thousands of infrastructure projects. Most of the City's capital spending derives from the proceeds of municipal bond issues. Due to the size of our capital program, our individual bond sales are necessarily large, often in excess of $800 million.

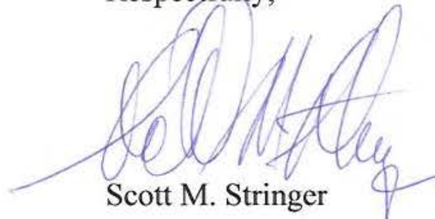
New York City thus needs a large and diverse base of bond purchasers and holders to finance its capital program at attractive interest rates. Strong demand holds down both the City's interest expense and the potential "tax expenditure" by the federal government. Banks – particularly the large banks that would be subject to the proposed rule – are significant purchasers of City debt. For example, in an $896 million bond sale completed earlier this month, bank purchases totaled $145 million or 16.2% of the total tax-exempt fixed rate offering. Banks have also made direct purchases and/or provided necessary liquidity support for the City's variable rate demand bonds, providing lower-cost funding to make our capital program more affordable.

The Federal Reserve Bank's own Financial Accounts report of December 9, 2013 showed that U.S.-chartered depository institutions accounted for 11% of all current municipal holdings, at $404 billion. This is a 112.5% increase since 2006 in the amount held by such banks, while total municipal debt outstanding only increased by 14.7% in the same time period. Clearly New York City and other state and local governments benefit significantly from banks' demand for our investment grade municipal bonds.

In conclusion, I urge you to amend the proposed rule in order to reclassify all investment grade municipal securities as eligible for inclusion as High Quality Liquid Assets.

I appreciate this opportunity to comment. My staff and I are available and welcome any questions that you may have for us.

Respectfully,



Scott M. Stringer