

August 6, 2018

TO: The Board of Directors

FROM: Doreen R. Eberley
Director, Division of Risk Management Supervision

SUBJECT: *Interim final rule.* Liquidity Coverage Ratio Rule: Treatment of Certain Municipal Obligations as High-Quality Liquid Assets

Summary: Pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), the FDIC, the Board of Governors of the Federal Reserve System (FRB), and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies) are jointly issuing and inviting comment on an interim final rule that amends the agencies' liquidity coverage ratio rule (LCR rule) to treat liquid and readily-marketable, investment-grade municipal obligations as high-quality liquid assets (HQLA). Section 403 of the EGRRCPA amends section 18 of the Federal Deposit Insurance Act and requires the agencies, for purposes of their LCR rule and any other regulation that incorporates a definition of the term "high-quality liquid asset" to treat a municipal obligation as HQLA that is a level 2B liquid asset if that obligation is, as of the calculation date, (A) liquid and readily-marketable and (B) investment grade.

Staff recommends that the Board of Directors (Board) find that good cause exists to publish this rule as final with an immediate effective date, because this rule implements, without change, the provisions of section 403 of EGRRCPA, which became effective on May 24, 2018.

Recommendation: That the Board adopts and issues the attached interim final rule with an immediate effective date upon publication in the *Federal Register* and a 30-day, public comment period and authorizes its publication in the *Federal Register*.

Concur:

Charles Yi
General Counsel

Background

The liquidity coverage ratio rule (LCR rule)¹ established a quantitative liquidity requirement that is designed to promote the short-term resilience of the liquidity risk profile of large and internationally active banking organizations,² thereby improving the banking sector's ability to absorb shocks arising from financial and economic stress, and to further improve the measurement and management of liquidity risk.³ Companies subject to the LCR rule generally must maintain an amount of HQLA⁴ equal to or greater than their projected total net cash outflows over a prospective 30 calendar-day period.

The Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) was enacted on May 24, 2018.⁵ Section 403 of the EGRRCPA amends section 18 of the Federal Deposit Insurance Act⁶ and requires the agencies, for purposes of the LCR rule and any other regulation that incorporates a definition of the term “high-quality liquid asset” or another substantially similar term, to treat a municipal obligation as a high-quality liquid asset that is a level 2B liquid asset if that obligation is, as of the calculation date, (A) liquid and readily-marketable and (B) investment grade.⁷ Section 403 also defines the terms “investment grade,” “liquid and readily marketable,” and “municipal obligation.”

¹ 79 Fed. Reg. 61440 (October 10, 2014), codified at 12 CFR part 50 (OCC), 12 CFR part 249 (FRB), and 12 CFR part 329 (FDIC).

² The LCR rule generally applies to a bank holding company, savings and loan holding company, or depository institution if (1) it has total consolidated assets equal to \$250 billion or more; (2) it has total consolidated on-balance sheet foreign exposure equal to \$10 billion or more; or (3) it is a depository institution with total consolidated assets equal to \$10 billion or more and is a consolidated subsidiary of a firm that is subject to the LCR rule (covered companies).

³ 79 FR 61440.

⁴ The LCR rule defines three categories of HQLA—level 1, level 2A, and level 2B liquid assets—and sets forth qualifying criteria for treatment of an asset as HQLA and compositional limitations for an asset's inclusion in the HQLA amount.

⁵ Pub. L. 115-174, 132 Stat. 1296 (2018).

⁶ 12 U.S.C. 1828(aa).

⁷ In 2016, the FRB adopted a final rule amending its LCR rule to include certain U.S. municipal securities as HQLA that are level 2B liquid assets, subject to certain limitations (2016 Amendments). 81 Fed. Reg. 21223 (April 11, 2016), codified at 12 CFR part 249 (FRB).

Description of the Interim Final Rule

The interim final rule amends the LCR rule⁸ to implement section 403 of the EGRRCPA, which requires the agencies to treat a municipal obligation as a level 2B liquid asset if the obligation, as of the calculation date, is liquid and readily-marketable and investment grade.⁹ To effect this change, the interim final rule makes certain amendments¹⁰ to each agency's LCR rule. First, the interim final rule (as required by EGRRCPA) amends the HQLA criteria with respect to level 2B liquid assets by adding municipal obligations that are liquid and readily-marketable and investment grade under 12 CFR part 1 as of the LCR's calculation date to the list of assets that are eligible for treatment as level 2B liquid assets.¹¹ Second, the interim final rule adds a definition to the agencies' rule for the term "municipal obligations," which, consistent with the EGRRCPA, means an obligation of (1) a state or any political subdivision thereof or (2) any agency or instrumentality of a state or any political subdivision thereof. Third, the interim final rule amends the OCC's and FDIC's definitions of "liquid and readily-marketable," found at 12 CFR part 50 and 12 CFR part 329, respectively, to add a cross-reference to the FRB's definition of liquid and readily-marketable¹² at 12 CFR 249.3, or any successor to it, consistent with the definition in section 403 of the EGRRCPA.¹³ The interim final rule does not otherwise affect

⁸ 12 CFR part 50 (OCC), 12 CFR part 249 (FRB), and 12 CFR part 329 (FDIC).

⁹ The EGRRCPA specifically refers to the OCC's definition of "investment grade" under 12 CFR 1.2, which provides that "investment grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected."

¹⁰ The interim final rule also rescinds the FRB's 2016 Amendments to 12 CFR part 249 to implement section 403's requirement to treat eligible municipal obligations as level 2B liquid assets.

¹¹ 12 CFR 50.20 (OCC), 12 CFR 249.20 (FRB), and 12 CFR 329.20 (FDIC).

¹² Under this provision of the FRB's LCR rule, a "liquid and readily-marketable" security is a security that is traded in an active secondary market with: (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.

¹³ In 2016, the FRB amended its LCR rule to include certain U.S. municipal securities as HQLA, subject to certain limitations. The FRB is also rescinding those amendments in this IFR.

covered companies' obligations under the LCR rule.

Effective Date/Request for Comment

The agencies are issuing the interim final rule without prior notice and the opportunity for public comment and the 30 day delayed effective date ordinarily prescribed by the Administrative Procedure Act (APA).¹⁴ Pursuant to section 553(b)(B) of the APA, general notice and the opportunity for public comment are not required prior to the issuance of a final rule if an agency, for good cause, finds (and incorporates the finding and a brief statement of reasons in the rules issued) that “notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”¹⁵

As discussed above, this interim final rule implements the provisions of section 403 of the EGRRCPA, which became effective on May 24, 2018, and directs the agencies to make certain changes to the criteria for HQLA by amending LCR rules within 90 days after enactment of the EGRRCPA. The interim final rule adopts without change the statutory definition for “municipal obligations” and the requirement that municipal obligations be treated as level 2B liquid assets, if the obligations are liquid and readily-marketable and investment grade. Because these changes to the LCR rule are mandated by the EGRRCPA, the agencies have determined that publishing a notice of proposed rulemaking is unnecessary. In addition, the agencies believe that the public interest is best served by implementing Congress’s legislative directive as soon as possible because immediate implementation would provide clarity to the public regarding the liquidity rules applicable to them and would be consistent with Congress’s directive to the agencies, under section 403(b) of the EGRRCPA, to amend the LCR rule within 90 days after enactment of the EGRRCPA. For the reasons described above in connection with APA section

¹⁴ 5 U.S.C. 553.

¹⁵ 5 U.S.C. 553(b)(B).

553(b)(B), the agencies find good cause to publish the interim final rule with an immediate effective date upon publication in the *Federal Register*.

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA),¹⁶ in determining the effective date and administrative compliance requirements for a new regulation that imposes additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider any administrative burdens that such regulation would place on depository institutions and the benefits of such regulation. In addition, section 302(b) of the RCDRIA¹⁷ requires such new regulation to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form, with certain exceptions, including for good cause. For the reasons described above in connection with the APA section 553(b)(B) requirement, the agencies find good cause exists under section 302 of RCDRIA to publish this interim final rule with an immediate effective date.

Conclusion

FDIC staff recommends that the Board adopt the attached interim final rule with an immediate effective date upon publication in the *Federal Register* and authorize its publication in the *Federal Register* for a 30-day public comment period.

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¹⁶ 12 U.S.C. 4802(a).

¹⁷ 12 U.S.C. 4802(b).