December 27, 2013

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

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

I. INTRODUCTION

Citigroup Global Markets Inc.[1] ("Citi") 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 for large, internationally active banking organizations, nonbank financial companies designated by the Financial Stability Oversight Council for Board supervision that do not have substantial insurance activities ("covered nonbank companies"), and their consolidated subsidiary depository institutions with total assets greater than $10 billion. In this letter, Citi 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.[2]

The Agencies have stated that the intent behind the proposed rule is "to promote the short-term resilience of the liquidity risk profile of internationally active banking organizations, thereby improving the banking sector's ability to absorb shocks arising from financial and economic stress, as well as

[1] Citigroup Global Markets Inc. is a registered broker-dealer and one of the largest municipal securities dealers in the U.S. Citi has been the leading underwriter of negotiated municipal bonds for 13 of the last 17 years. Citigroup Global Markets Inc. is an indirect wholly-owned subsidiary of Citigroup, Inc., a bank holding company and the indirect parent of Citibank, N.A., a national banking association.

[2] This letter is specifically in response to Questions 12, 22 and 54 in the Notice of Proposed Rulemaking as they relate to the municipal securities market.

improvements in the measurement and management of liquidity risk."[3] Citi fully supports the efforts of the Agencies to enhance liquidity risk management in the banking sector and ensure strong and resilient financial markets. As presently constructed, however, the proposed rule also serves 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 not to allow municipal bonds to qualify as High Quality Liquid Assets ("HQLA") at this time and, in doing so, propose to dampen bank demand for the asset class. The immediate and direct consequence of the exclusion to municipal issuers and their taxpaying constituents will be unnecessary, and in many instances unbearable, increases in the cost of financing desperately needed repair and replacement of municipal infrastructure.

As detailed herein, Citi quantitatively and qualitatively demonstrates that municipal bonds exhibit (1) limited price volatility, (2) high trading volumes that are generally commensurate with or better than transaction volumes on the U.S government-sponsored enterprise ("GSE") debt and investment grade, nonfinancial corporate bonds that are proposed to be eligible HQLA and (3) deep and stable secured funding markets. In light of these demonstrations and in consideration of the impact that an exclusion would have on the ability of municipal issuers to finance necessary infrastructure projects, we strongly suggest that the Agencies revise the proposed rule in order to make investment grade U.S. municipal securities eligible to qualify as Level 2A High Quality Liquid Assets. This revision, we believe, would not only be entirely consistent with the Agencies' stated intent, but would also serve to improve the liquidity risk profiles of banks by further diversifying the stock of eligible HQLA to include an asset class that has an inherently diverse investor base and one to which the financial sector is underexposed. Importantly, the revision would also reaffirm the ability and role of U.S. banks to fund and serve U.S. state and local governments in their mission to provide critical public services.

In addition to the recommendation to make investment grade U.S. municipal securities eligible for HQLA designation, Citi further urges the Agencies to reconsider their outflow rate assumptions for secured funding to U.S. banks that is generated from U.S. public sector entities ("Preferred Deposits"). In this letter we will demonstrate that such deposits are, in fact, stable. As such, they serve to diversify the sources of stable funding available to banking entities and therefore warrant outflow rates commensurate with other HQLA-secured financing transactions and with a maximum outflow rate of 25%, as recommended in BCBS 238.

II. EXCLUSION OF SECURITIES ISSUED BY PUBLIC SECTOR ENTITIES FROM HQLA

As stated in the proposed rule, the liquid asset criteria established by the Agencies are intended "to ensure that a covered company's HQLA amount only includes assets with a high potential to generate liquidity through sale or secured borrowing during a stress scenario."[4] This means that securities classified as HQLA should be readily convertible into cash with little or no realized price depreciation during periods of diminished liquidity. In satisfaction of this objective, the Agencies considered certain liquidity characteristics when establishing their proposed criteria for HQLA qualification. Specifically, per the proposed rule, assets that should be classified as HQLA "exhibit low risk and limited price volatility, are traded in high-volume, deep markets with transparent pricing, and…are eligible to be pledged at a central bank."[5]

[3] Summary of the Notice of Proposed Rulemaking.
[4] Proposed rule in II.A.
[5] Proposed rule in II.A.2.

For certain Level 1 Liquid assets as well as all Level 2A and 2B Liquid Assets, the Agencies have proposed to further require specific demonstrations of these liquidity characteristics by mandating that such assets satisfy the definition of *liquid and readily-marketable.* This term has been proposed to mean, "with respect to a security, that the security 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."[6]

While we largely agree with the Agencies regarding the characteristics that should be considered for establishing the HQLA criteria, we disagree with their interpretation of the relative liquidity value of municipal securities as measured using these metrics. Despite being assigned a 20% risk weight under the Agencies' own regulatory capital rules, the Agencies, in direct contradiction to the Basel Committee's BIII LCR, have stated that they do not expect municipal securities to qualify as HQLA; they "believe that, at this time, these assets are not liquid and readily-marketable in U.S. markets and thus do not exhibit the liquidity characteristics necessary to be included in HQLA under this proposed rule."[7] As discussed in further detail below, we believe that the liquidity in the municipal market is, by each measure, at least comparable to, and in some regards greater than, the liquidity in the investment grade, nonfinancial corporate bond and GSE debt markets. As such, we believe that municipal securities, as an asset class, do satisfy the proposed definition of *liquid and readily marketable*, and so should be eligible for classification as High Quality Liquid Assets.

PRICE VOLATILITY

In order to classify certain assets as Level 2A or 2B liquid, the Agencies have proposed to institute quantitative market price and secured funding haircut volatility thresholds. Specifically, in order to qualify for HQLA, the Agencies would require that these assets be issued by entities "whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions."[8] Sufficient demonstration of the forgoing for relevant Level 2A Liquid Assets would require that, during a 30 calendar-day period of significant stress, the market price of the asset, or equivalent securities of the same issuer, did not decline by more than 10%. The threshold is increased to 20% for Level 2B Liquid Assets that are publicly traded corporate debt securities and to 40% for publicly traded common equity shares.

We agree that historical evidence of relative price stability during periods of financial market turmoil is generally demonstrative of a liquid asset class and that realized price volatility should, therefore, be considered when establishing the HQLA criteria. In consideration of this, using the same data that the Federal Reserve publishes in its H.15 Interest Rate tables plus the Bond Buyer's index for municipal revenue bonds, we compare changes in monthly average market prices for long-term U.S. Treasury securities, AAA corporate bonds, AA municipal general obligation bonds, single A municipal revenue obligations and BBB corporate bonds. Table 1 below depicts the 5 worst month-over-month movements since 1925 for each asset class[9]. In demonstration of the relative price stability in the municipal market, the maximum price declines realized on AA municipal general obligation and single A municipal revenue bonds were less than the worst depreciation in long-term Treasury prices. Moreover, the greatest decline in AA municipal general obligation bonds was more muted than in any other asset class. By contrast, BBB corporate bonds, which are proposed to be Level 2B eligible, exhibited the most

[6] §__.3 Definitions of the proposed rule.
[7] Proposed rule in II.A.2.b.
[8] §__.20 High-Quality Liquid Asset Criteria of the proposed rule.
[9] U.S. Agency MBS was excluded from the comparison as calculation of price changes is not possible without the mortgage prepayment models that were used at each point in time over the last 88 years.

volatility in every period. Considering relative price stability as indicative of liquidity, we believe that it would thus be consistent to also include investment grade municipal securities as eligible for classification as High Quality Liquid Assets.

Table 1 [10]

U.S. Treasury Long-Term Composite		AAA Corporate Bonds		AA Municipal General Obligations		Single-A Municipal Revenue Obligations		BBB Corporate Bonds	
Date	Price Δ	Date	Price Δ	Date	Price Δ	Date	Price Δ	Date	Price Δ
Feb-80	-11.8%	Feb-80	-9.7%	Apr-87	-9.2%	Oct-08	-10.3%	Oct-08	-15.7%
Jul-03	-7.5%	Oct-08	-8.0%	Mar-80	-9.1%	Mar-80	-9.9%	Apr-32	-14.4%
Oct-79	-6.8%	Jul-03	-7.0%	Aug-81	-8.3%	Apr-87	-9.6%	Dec-31	-13.2%
Apr-87	-6.7%	Oct-31	-6.2%	Sep-39	-7.9%	Aug-81	-8.1%	Oct-31	-9.6%
Sep-39	-6.2%	Nov-79	-6.2%	Feb-80	-7.9%	Feb-80	-7.3%	Feb-80	-8.2%

TRANSACTION VOLUME

Citi concurs with the Agencies' stipulation that HQLA should be traded in high volume. It is important that the Agencies give further consideration to how this characteristic is measured, however. Given that there are approximately 1.1 million[11] outstanding CUSIPs in the municipal market, the average transaction volume of the asset class, when evaluated on a per CUSIP basis, appears to be rather low. Trading volumes should not be evaluated in this manner though. New York City, for example, has more than 3,000[12] distinct general obligation bond CUSIPs outstanding. Some of those bonds may trade very rarely because they are owned by retail customers or held-to-maturity bank portfolios. Other NYC bonds may trade frequently. Regardless of which specific CUSIP is being considered, a dealer or customer will readily provide a bid for the security based on where other New York City general obligation bonds are trading. Citi strongly believes, therefore, that all New York City general obligation bonds are highly liquid because New York City general obligation bonds, in aggregate, trade in high volume relative to the amount of New York City general obligation debt outstanding. For purposes then of comparing transaction volumes of one asset class versus another, we suggest that the Agencies consider the amount traded as a percentage of the total market outstanding.

Using data recently published by SIFMA, Table 2 below compares trading volumes across asset classes in this manner. Indicative of the relative liquidity in the municipal market, we see that transaction volumes on municipal securities are comparable to trading volumes on corporate and GSE bonds. According to SIFMA's data, the municipal market trades 0.31% of its total outstanding par every day. By comparison, the corporate bond market trades 0.20% per day and the GSE debt market trades 0.33% per day.

[10] All values are based on monthly averages of daily or weekly yield data for the period extending from January 1925 through October 2013. Price conversions were calculated assuming par coupons equal to each prior period's average rate. U.S. Treasury Long-Term Composite yields for January 1925 through June 2000 are from the Federal Reserve's H.15 Interest Rate Tables; yield data for July 2000 through October 2013 is from the U.S. Department of the Treasury's online Data Center. AAA and BBB corporate bond yields are from the Federal Reserve's H.15 Interest Rate Tables. AA municipal general obligation and single-A revenue obligation yields are Bond Buyer data for the "20-Bond GO Index" and "Revenue Bond Index" respectively. Consistent with the descriptions of each of the contributing indices, price conversions assume a 20-year maturity for the U.S. Treasury Long-Term Composite, a 25-year maturity for AAA and BBB corporate bonds, a 20-year maturity for AA municipal general obligations and a 30-year maturity for single-A municipal bonds.

[11] Citi estimate based on data provided by JJ Kenny and Bloomberg LP.

[12] Citi estimate based on data provided by JJ Kenny and Bloomberg LP.

Table 2 [13]

Asset Class	Description of Asset Class	Outstanding Market Size ($ billions)	Avg Daily Trading Volume ($ billions)	% Market Traded Daily
Municipal Debt	All Municipal Debt.	3,721.0	11.4	0.31%
Corporate Debt	Non-convertible corporate debt, MTNs and Yankee bonds. Excludes CDs and 144A Securities.	9,348.9	18.5	0.20%
GSE Debt	Agency debt of Fannie, Freddie, Farmer Mac, FHLB, Farm Credit System and Federal Budget Agencies. Excludes maturities of 1 year or less.	2,074.2	6.8	0.33%
Mortgage Related	GNMA, FNMA, FHLMC MBS, CMO and private-label MBS/CMO.	8,540.8	234.6	2.75%

In the subsequent Table 3, Citi has adjusted the outstanding market sizes and daily trading volumes for each asset class in order to create a more relevant comparison by excluding non-investment grade and nonfinancial debt along with TBA trades and other securities that may not meet the criteria for HQLA. Considering these modifications, we see that the municipal market trades a larger percentage of its outstanding par each day than either the investment grade, non-financial corporate or GSE debt markets. Moreover, if we were able to parse the municipal securities that large banks actually own – primarily those of the largest municipal issuers – the average trading volumes on those issuers' bonds would be materially higher. Thus, we again demonstrate high trading volume in the municipal market that is both consistent with the proposed Liquid Asset criteria and commensurate with or greater than the transaction volumes on other eligible HQLA.

Table 3 [14]

Asset Class	Description of Asset Class	Outstanding Market Size ($ billions)	Avg Daily Trading Volume ($ billions)	% Market Traded Daily	Proposed HQLA Classification
Municipal Debt	IG Municipal debt. Excludes ARS and VRDN.	3,097.0	6.7	0.22%	Non-Qualifying
Corporate Debt	Nonfinancial, IG Corporate Bonds.	4,777.4	6.1	0.13%	L2B
GSE Debt	Excludes GNMA.	6,137.6	6.7	0.11%	L2A
Agency & GSE MBS	Includes GNMA. Excludes CMO. Excludes TBA trading volume.	1,485.8	16.3	1.10%	L2A
Total GSE Market (Proxy)	GSE Debt + Agency & GSE MBS.	7,623.4	23.0	0.30%	L2A

[13] Outstanding market sizes are from SIFMA's Outstanding U.S. Bond Market Debt table as of Q2 2013. Average daily trading volumes are from SIFMA's U.S. Bond Market Average Daily Trading Volume table 2013 YTD (Last Updated 11/19/2013).

[14] Municipal Debt outstanding is a Citi estimate based on data from JJ Kenny and Bloomberg LP. Average daily trading volume for municipal debt is a Citi estimate based on MSRB data. Corporate Debt outstanding is the Nonfinancial corporate business line in the Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.212, September 25, 2013 minus Citi's estimate of $1,300 billion non-IG, nonfinancial corporate bonds outstanding based on data from Bloomberg LP. Average daily trading volume for corporate debt is a Citi estimate based on trading data from Bloomberg LP. GSE Debt outstanding is the Government-sponsored enterprises line in the Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.210, September 25, 2013. Average daily trading volume for GSE Debt is from the TRACE Fact Book Q3 2013 – Agency Debt table. Agency and GSE MBS outstanding is the Agency- and GSE-backed mortgage pools line in the Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.210, September 25, 2013. Agency and GSE MBS average daily trading volume is from the TRACE Fact Book Q3 2013 – Securitized Products table (MBS tab).

Lastly, we consider the correlation between trading volumes and yields in the municipal securities market. Using trade data from the Municipal Securities Rulemaking Board ("MSRB"), we evaluate the four largest sell-offs[15] since January 2000.[16] When we compare the average daily trading volume for the entire duration of each sell-off to the average daily trading volume for the 3 months immediately preceding, in each instance we see that transaction volumes increased by 10% to 25% during the sell-off. Beyond demonstrating the liquidity of the municipal market, this depicts the right-way risk that, as the Agencies have discussed, makes an asset appropriate for designation as HQLA.

SECURED FUNDING

As described above, in order to classify certain assets as Level 2A or 2B liquid, the Agencies have proposed instituting quantitative market price and secured funding haircut volatility thresholds. Specifically, in order to qualify for HQLA, the Agencies would require that these assets be issued by entities "whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions."[17] Sufficient demonstration of the forgoing for relevant Level 2A Liquid Assets would require that, during a 30 calendar-day period of significant stress, the haircut charged on secured lending and funding transactions collateralized by the asset, or equivalent securities of the same issuer, did not increase by more than 10 percentage points. The threshold is increased to 20 percentage points for Level 2B Liquid Assets that are publicly traded corporate debt securities and to 40 percentage points for publicly traded common equity shares.

Similar to the repurchase agreement ("repo") markets for Treasuries, Agencies, GSE debt and corporate bonds, there are deep, diverse and well-developed secured funding markets for municipal securities. Citi funds its own municipal bond inventory, and customer inventory, with a balanced mix of repo, securities lending (borrow versus cash), tender options bonds ("TOBs") and Preferred Deposits. During the 2008/2009 crisis, Citi did not experience any outflows or changes in haircuts for secured funding of municipal securities. Citi's current municipal secured financing portfolio for both its own and customer positions is $26B, consisting of $1B of repo, $14B of TOBs, $4B of securities lending and $7B of Preferred Deposits. By comparison, Citi currently has approximately $3B of corporate bond financing in place. Citi's corporate bond and municipal bond financing strategies are comparable, each sized to the needs of our trading, investing and customer businesses.

Across the entire market, Citi estimates that there is approximately $5B of repo, $20B of securities lending, $70B of TOBs, and $300B of Preferred Deposits that are eligible to finance municipal securities. In consideration of the diverse investor base in the municipal market (see "Deep and Diverse Markets" below), and the prevalence of "buy and hold" investors, this represents a very significant amount of secured financing. Given the size, depth and stability of these financing options, municipal securities clearly meet the Agencies' requirement of "a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions" and should, therefore, be eligible for classification as HQLA.

Since the Agencies specifically require that HQLA be eligible to be pledged at a central bank, it is important to note that the U.S. Federal Reserve accepts all U.S. municipal bonds at a 2% to 5% haircut, depending on maturity. These are the same haircuts that the Fed applies to U.S. Agency and GSE securities. By comparison, however, the Fed accepts U.S. AAA corporate bonds at a 3% to 6% haircut and all other investment grade corporate bonds at 5% to 8% haircut. The U.S. Federal Reserve already

[15] Calculated on a yield-to-worst basis.
[16] MSRB trade data for the period from January 18, 2000 through December 12, 2013. Includes trades on IG, fixed-rate municipal coupon bonds with at least one year to call or maturity.
[17] §__.20 High-Quality Liquid Asset Criteria of the proposed rule.

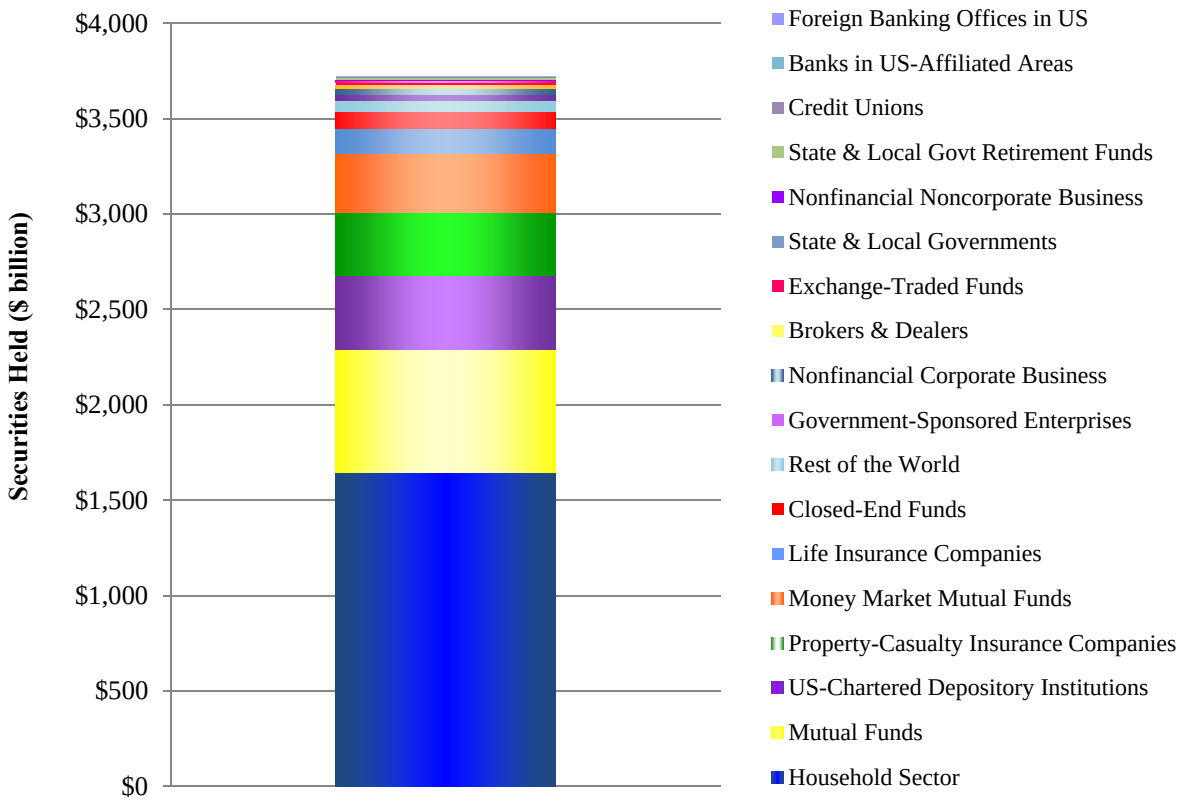
acknowledges the high credit, diversification and liquidity value of municipal securities by accepting them at the same haircut as U.S. Agencies and GSE issues and at better haircuts than U.S. corporate bonds. We respectfully request, therefore, that the Agencies amend the proposed rule in order to be consistent with the U.S. Federal Reserve's own liquidity criteria by permitting municipal securities to be eligible for qualification as HQLA.

DEEP AND DIVERSE MARKETS

The Agencies also consider the depth and breadth of markets as key indicators of liquidity. For that reason, with regard to certain asset classes the Agencies have specifically proposed to require the existence of both a large and diverse number of market participants as well as at least two committed market makers as part of their HQLA criteria. The MSRB regulates over 1,600 registered broker-dealers who make markets in municipal securities. Using data from the Federal Reserve's most recent statistical release on the Financial Accounts of the United States to chart the composition of municipal securities holders, in Diagram 1 below we see that there exists a core investor base comprised of the household sector, mutual funds and insurance companies in addition to deposit-taking entities and the brokers and dealers that make markets. Most notably, the largest concentration of holders is by far the household sector, which is itself a diverse population of thousands of individual investors.

Diagram 1 [18]

Composition of Investors in the Municipal Securities Market



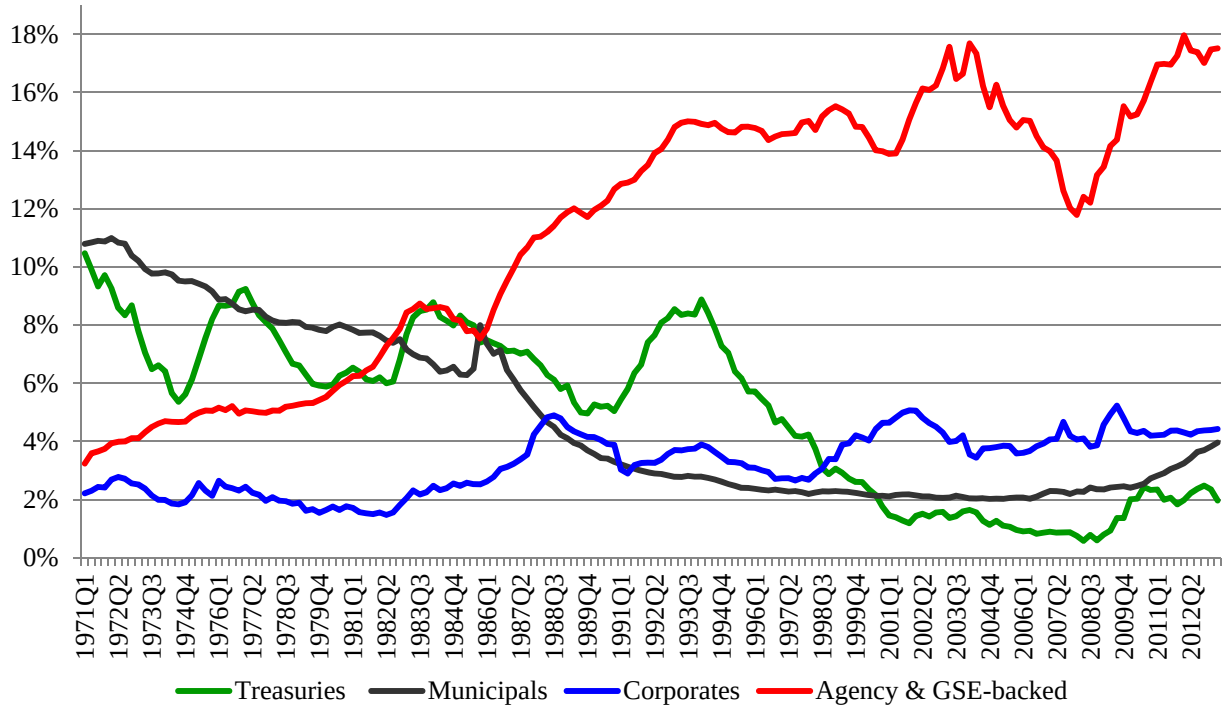
[18] Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.211, September 25, 2013.

According to the Federal Reserve data, more than 44% of all outstanding municipal securities are held either directly in retail hands or in separately managed individual accounts. Property and Casualty Insurance Companies hold close to another 9%. Both of these investor classes have demonstrated a lesser inclination to sell in rising rate environments. As evidenced in 2013, for example, direct retail purchases of municipal securities increased by 30% to 50% when yields rose by more than approximately 100 bps.[19] As the Agencies discuss in their proposal, this positive correlation between investor demand and yields, or right-way risk as they describe it, has a significant and positive impact on the liquidity of the market.

As demonstrated in Diagram 1 and discussed above, U.S. depository institutions hold a relatively small percentage (approximately 10%) of all outstanding municipal debt, a positive factor for the liquidity of the market. In addition, municipal securities comprise a small percentage of U.S. depository institutions' total diversified investment portfolios. Diversification with respect to the composition of liquid assets has been explicitly mandated by the Agencies: pursuant to the proposed rule, compliance with certain operational requirements, which include ensuring appropriate diversity of HQLA, is a prerequisite for including any security in the stock of Liquid Assets. According to the Federal Reserve data, as depicted in the Diagram 2 below, municipal securities currently comprise less than 4% of bank portfolios. That's less than either corporate bonds or Agency and GSE-backed securities. As such, municipal bonds present less systemic risk. From a diversification perspective, this under-concentrated exposure to municipal securities should make the asset class desirable for inclusion in HQLA.

Diagram 2 [20]

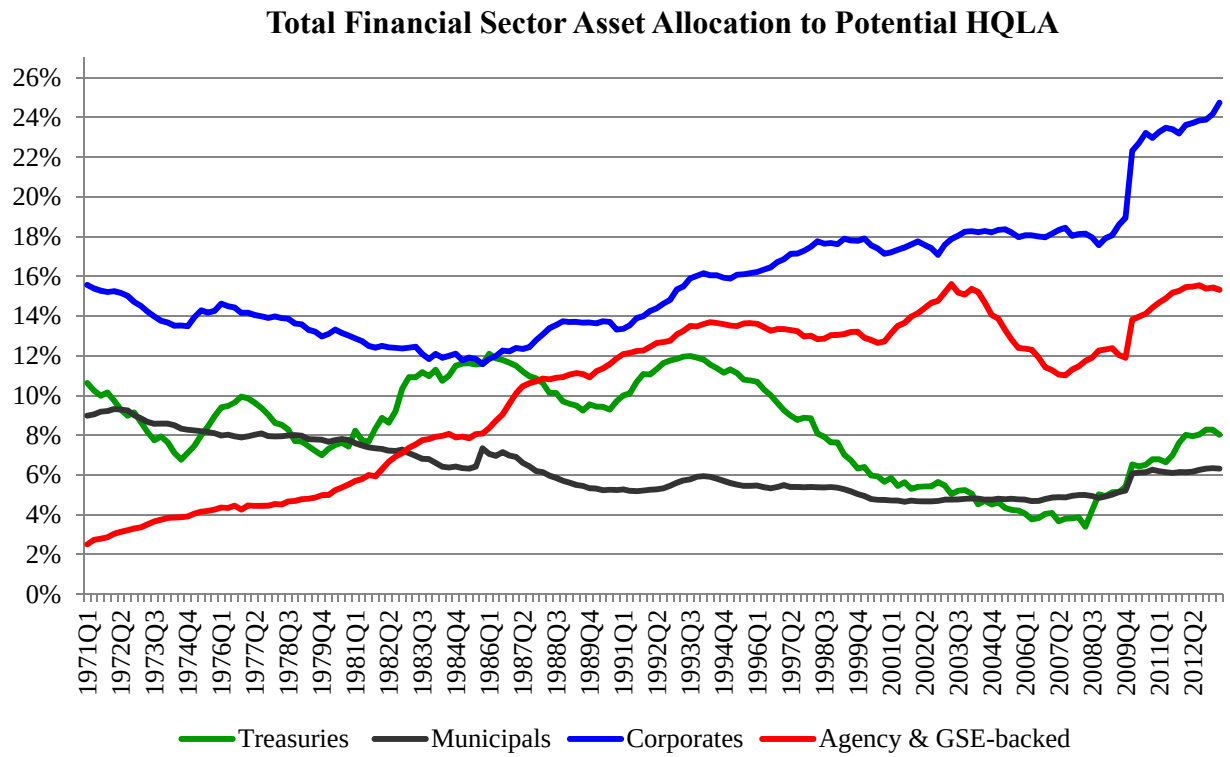
U.S. Depository Institution Asset Allocation to Potential HQLA



[19] Citi estimate based on MSRB trade data.
[20] 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.

When we consider the asset allocation of the financial sector more broadly, investments in municipal securities provide an even greater diversification benefit. The Agencies have defined the term "Financial Sector Entities" to include regulated financial companies, investment companies, non-regulated funds, pension funds, investment advisers or a consolidated subsidiary of any of the foregoing. The Agencies have proposed to exclude any asset issued by a Financial Sector Entity from inclusion in HQLA due to the high correlation between the health of these companies and the health of covered companies and, thus, the financial markets generally. Such assets, they assert, have historically exhibited wrong-way risk, being more prone to lose value and become less liquid during periods of financial stress. This high correlation among non-bank financial sector entities and covered companies makes it similarly necessary to consider the diversification of potential HQLA across not only the U.S. depository institutions that will be subject to the proposed liquidity requirements, but across the U.S. financial sector more broadly. As depicted in Diagram 3 below, in broadening our analysis to include all Financial Business, which the Federal Reserve has defined in their Z.1 statistical release as the sum of all financial sectors, we more accurately see the relative under-concentration in municipal securities. Considering the holdings of life insurance companies, mutual funds and other non-bank financial entities causes the exposure to corporate bonds to increase dramatically. To a lesser, but nonetheless notable extent, the asset allocation of Treasury investments also rises as mutual funds and pension funds are brought into scope. Holdings of municipal securities remain low, however; at just over 6% of total investments, municipal securities are the least concentrated asset class in the collective financial sector.

Diagram 3 [21]



[21] Federal Reserve Statistical Release, Z.1 Financial Accounts of the United States, L.107 & L.110, September 25, 2013. Consistent with the Agencies' definition of "Regulated Financial Company," L.108 (Monetary Authority) & L.123 (GSEs) are excluded. Holdings of private residential and commercial CMOs and other structured MBS have been excluded from corporate bond data.

The municipal market has a deep and diverse composition of buyers, sellers and dealers. The financial sector owns a small portion of the market, and municipal securities constitute a small portion of financial sector assets. In consideration of the foregoing, we request that the Agencies acknowledge the beneficial correlation and diversification qualities of municipal securities by making them eligible for inclusion as HQLA.

III. OUTFLOW RATE ASSUMPTIONS FOR PREFFERED DEPOSITS

According to FDIC Call Reports, U.S. banks have over $300B of Preferred Deposits from U.S. public sector entities. Such deposits require that collateral be posted by the bank to the depositor, and are hence considered Secured Funding transactions in the proposed rule. As currently proposed, to the extent that such deposits are collateralized with municipal securities, banks would have to assume 100% outflow, which drastically diverges from the BCBS 238 maximum outflow rate of 25% for such deposits.

Citi understands that the Agencies believe that municipalities would withdraw deposits secured by non-HQLA. This, however, is incorrect for municipal securities both in theory and in practice. During the 2008/2009 crisis, Citi did not experience public sector deposit outflows and did not experience any public sector depositor preference for Treasury collateral over municipal collateral. In fact, Citi's public sector clients have never expressed concern regarding municipal collateral but have asked questions regarding how U.S. government collateral would be treated under sequester, government shut down or default.

Eligible collateral for U.S. public sector deposits is governed by each state's law, but generally limits security to some combination of U.S. Treasuries, U.S. Agency and GSE securities, U.S. state obligations, and/or any municipal obligations within the state of the depositor. For example, the State of New York deposits funds with Citi and Citi, in turn, pledges securities, including bonds issued by the State of New York (Personal Income Tax Bonds), the New York State Thruway Authority and the Metropolitan Transportation Authority. This deposit tends to be stable and not subject to significant outflows in times of stress, since the State of New York is comfortable with the pledge of bonds from its own instrumentalities.

Citi notes that <u>unsecured</u> deposits from the same public sector entities would receive a 20% to 40% outflow rate under the proposed rule. This inconsistency should be remedied by accepting investment grade municipal bonds as HQLA and limiting the public sector Preferred Deposit outflow rate to the BCBS 238 recommended maximum of 25%. Unsecured outflow rates for public sector entities would remain the same, capped at 40%. Based on our experience with public sector entities, this would be a consistent and reasonable outcome.

IV. CONCLUSION

As demonstrated above, the liquidity in the municipal market is, by each of the Agencies' own measures, at least comparable to, and in some regards greater than, the liquidity in the investment grade, nonfinancial corporate debt and GSE markets. As also discussed above, holding municipal securities simultaneously improves the diversification of and reduces the correlation among potential HQLA in bank portfolios. We've noted that it would be both consistent with international regulatory standards and well-aligned with domestic public policy concerns to include municipal securities in HQLA. Lastly, we now draw attention to the dichotomy that would be created via an exclusion of municipal securities from the Liquid Asset definition.

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., New York, Texas, Pennsylvania, Florida and Ohio), however, are specifically excluded from consideration in any category of HQLA. This dichotomy, which unfairly discriminates against the liquid debt markets of U.S. States and instrumentalities and penalizes U.S. banks for servicing domestic public sector clients, thereby increasing financing costs for U.S. municipalities, is, in Citi's opinion, contrary not only to U.S. public policy but to the stated purpose of the proposed rule as well. We do not believe that the Agencies consider Spanish sovereign debt to be more liquid than Aaa / AAA Texas General Obligation bonds nor do we believe that this outcome was intentional.

Thus, in order to achieve greater consistency with international standards, improve HQLA diversification, more closely satisfy the defined objectives of the proposed rule and avoid unnecessary increases to the cost of improving municipal infrastructure, we suggest that the Agencies reclassify all investment grade municipal securities as Level 2A HQLA eligible and that they assign a maximum outflow rate of 25% to Preferred Deposits collateralized with municipal securities.

Citi appreciates the opportunity to comment on the proposed rule. If you have any questions or wish to discuss any of the statements or opinions contained herein, please contact the undersigned at 212.723.5373.

Respectfully,

Citigroup Global Markets Inc.

By: /s/ Howard Marsh
Howard Marsh
Managing Director
Head of the Municipal Securities Division