Maryland Bankers Association

January 31, 2014

Legislative and Regulatory Activities Division
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

Mr. Robert de V. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1466

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

Re: Proposed Rule — Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Dear Sir or Madam:

On behalf of our members, the Maryland Bankers Association (MBA) respectfully submits the following comments in response to the proposed rule – Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring. The Proposed Rule would implement a quantitative liquidity requirement consistent with the liquidity coverage ratio ("LCR") standard established by the Basel Committee on Banking Supervision ("BCBS").

Founded in 1896, MBA is the only Maryland-based trade group representing banks in the state. The 123 banks operating in Maryland hold in excess of $120 billion in FDIC-insured deposits in about 1,800 branches across the state. The banking industry employs more than 45,000 banking professionals in Maryland. MBA's members include banks of all sizes and charter types including: Maryland state-chartered banks, national banks and thrifts, and state banks chartered outside of Maryland.

Under the proposal, banks with over $50 billion in assets would be required to hold a buffer of high quality liquid assets (HQLA) against the amount of funds assumed to leave the bank in a period of stress, net of assumed inflows. Banks are required to maintain a minimum ratio of 100%. HQLA generally fall into three categories: (1) Level 1 (e.g., Treasuries), not subject to haircuts; (2) Level 2A (e.g., GSE securities), subject to a 15% haircut; and (3) Level 2B (e.g., certain investment grade debt securities issued by non-financial corporates), subject to a 50% haircut. Total Level 2 assets are capped at 40% of total HQLA, and Level 2B assets are capped at 15% of total HQLA.

While the LCR targets larger institutions, the standard, along with a range of new regulations impacting banks of all sizes, will significantly impact the markets in which banks operate and trickle down to supervisory expectations of much smaller banks. Thus, MBA and our member banks believe the LCR will ultimately have a broader impact than the targeted institutions. The following commentary highlights several key concerns and recommendations raised on behalf of MBA's members.

- **Issue: Proposed regulatory treatment of state and local deposits**

Generally, deposits are considered to be among the most stable funding sources. Accordingly, the LCR favors most deposits relative to other types of bank funding, particularly if the depositor has other relationships with the bank. *The exceptions are financial institution deposits and collateralized deposits.*

Under the proposal, municipal deposits, because they must be collateralized, are not treated as deposits, but as "secured funding." The proposal does not consider the likely behavior of municipal depositors. Rather, the proposal considers the assumed liquidity of collateral backing these deposits. Classifying municipal deposits as secured funding – a category that includes repurchase transactions - creates significant and unnecessary distortions.

This is particularly evident when the deposits are backed by GSE securities, which the proposed LCR does not consider to be among the most liquid. Further, municipal deposits are long-term relationships that are generally established through RFPs and backed by collateral owned by the depository institution. The distortions arise from the requirement to unwind secured funding transactions for purposes of establishing a bank's level of HQLA.

The proposal requires that transactions under which HQLA is exchanged be unwound, or reversed back to its original position. This provision may be intended to prevent banks from using short-term transactions to manipulate their HQLA. However, applying the unwind to municipal deposits means that a bank must, for purposes of complying with the LCR, exchange a level 1 asset (cash) for a level 2 asset (GSE securities), thus decreasing their level of HQLA.

In addition, the proposal requires a 15 percent run-off rate for state and local deposits backed by level 2 securities. Municipal deposits collateralized by non-HQLA such as Federal Home Loan Bank letters of credit, would be assigned an outflow assumption of 40 percent - significantly higher than historical outflows for these types of deposits—even in stress periods.

The LCR's current treatment of municipal deposits is unnecessarily harsh and, if implemented as

proposed, will have a significant negative impact on state and municipal deposit and funding relationships.

Recommendation: ***To alleviate the distortions, MBA respectfully recommends that the regulators treat municipal deposits as deposits and, at the very least, not subject them to the unwind.***

- **Issue: Proposed Regulatory Treatment of GSE obligations and FHLBank Consolidated Obligations:**

MBA appreciates that GSE obligations are included as HQLAs. We recommend this is strengthened by the Agencies including GSE obligations in the level 1 liquid asset category. Additionally, MBA recommends that FHLBank Consolidated Obligations, also be classified as level 1 liquid assets – or if this is not possible, to consider that the 40 percent cap be increased and the haircut reduced. Overtime, FHLBank Consolidated Obligations have held the same ratings as U.S. government obligations and are viewed as low-risk, high-quality investments. Nearly every MBA member is a member of the FHLBank System and the Consolidated Obligations are an important form of low-risk capital for these Maryland institutions.

Recommendation: ***Include GSE obligations and FHLBank Consolidated Obligations as level 1 liquid assets.***

- **Issue: Proposed Regulatory Treatment of Financial Institution Deposits:**

The LCR considers financial institution deposits to be among the most likely to leave a bank in a period of stress. Thus financial institution deposits are given the highest run-off rate. While we appreciate the intent may be to reduce the interconnectivity among financial institutions, this change will have meaningful consequences. For example, we anticipate the cost of using Fed funds will likely increase, as will the cost of holding financial institution deposits for banks required to comply with the LCR. We anticipate this will in turn result in an increase in the costs of services, including correspondent banking.

Recommendation: ***We recommend the agencies reconsider the proposed risk associated with financial institution deposits.***

- **Issue: Proposed Regulatory Treatment of Mortgage Collateral and Mortgage Loans:**

The proposed rule includes select publically-traded corporate debt securities and publically-traded shares of common stock under the category of level 2B assets. MBA is concerned that the exclusion of mortgage-related assets and mortgage loans from HQLAs may have unintended consequences for the mortgage market such as: causing a devaluation of mortgage-related assets, reducing mortgage lending by LCR impacted institutions that will receive less liquidity credit for those assets, and increasing costs of mortgage lending and housing. In terms of mortgage loans, the quality of certain mortgages, the critical role mortgages play in the broader economy, and recent actions taken to improve the quality of and credit risk of loans should be considered.

***Recommendation:* We request that the Agencies consider adding these assets to HQLAs - possibly under the category of level 2B assets.**

- **Issue: Proposed Regulatory Treatment of Other Assets, FHLB Advance Availability and Committed Lines of Credit:**

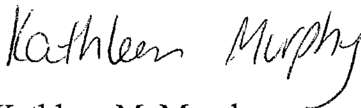
The proposed rule provides for an exception that permits collateral covered by a blanket lien from a GSE to be included in HQLA. MBA supports this exception and we recommend it be expanded to include any asset pledged to FHLBanks in support of FHLBank advance availability – which are currently categorized by the proposal as level 1, 2A and 2B assets. This source of liquidity, would enable FHLBank member institutions (which include nearly every MBA member banks) to retain collateral that can be converted into cash advances through the FHLBank and used for lending purposes.

Similarly, MBA urges the Agencies to modify the definition of HQLA to allow FHLBank committed lines of credit and advance availability to be included as 2B liquid assets. As this liquidity, supported by collateral, has proven to be very stable during times of market stress and has played a very important role in providing liquidity during crisis periods. MBA also recommends that institutions that have lines of credit with the FHLBanks be permitted to count that liquidity as reliable sources of credit under the LCR.

***Recommendation:* Include assets pledged by FHLBanks in support of FHLBank advance availability, FHLBank committed lines of credit and advance availability in HQLA.**

As in the past, supervisory and market expectations are likely to trickle down to much smaller institutions. Thus, it is important to consider the long term impact of the proposed rules – which are very likely to have a broader impact than institutions with $50 billion or greater in assets. Thank you for your consideration of MBA's concerns and recommendations. Please contact me if you have questions or would like to discuss MBA's concerns in greater detail. Thank you for your consideration of MBA's position and for the opportunity to comment on this critical proposal.

Sincerely,



Kathleen M. Murphy
President and CEO
Maryland Bankers Association