Dear Governor Tarullo, Comptroller Curry and Chairman Gruenberg:

First, I want to thank each of you and your agencies for the hard work and coordination that has gone into developing the Liquidity Coverage Ratio (LCR) rule and commend all of your efforts to promote liquidity resilience amongst our financial institutions both large and small. I also would like to thank you for your thoughts and comments expressed during the Senate Banking Committee hearing on Tuesday September 9th. That said, I remain concerned about elements of the LCR rule that was recently finalized and particularly its exclusion of all investment grade municipal bonds from consideration as High Quality Liquid Assets (HQLA). By excluding municipal bonds from being considered as High Quality Liquid Assets, federal regulators have run the risk of limiting the scope of financial institutions willing to take on investment grade municipal securities.

The United States will have an infrastructure gap of $3.6 trillion by 2020, and states and cities across the country rely on these debt issuances to maintain adequate funding to support existing infrastructure projects and finance new development. Municipal bonds are the lifeblood of local government finance in the United States, and this rule, if not modified, threatens to stifle the job growth and investment in infrastructure that is critical to sustaining our economic recovery.

Investment grade municipal bonds not only serve as a mechanism through which we are able to create jobs and finance critical infrastructure, but these securities can also serve as high quality assets that adequately cover liquidity outflows during periods of stress. Investment grade municipal bonds have been shown to be widely held, with high trading volume and limited price volatility. In fact, in 2008 and 2009 price declines on AAA corporate bonds were greater than the price declines of both AA municipal general obligation bonds and municipal revenue bonds.

The blanket exclusion of this type of debt from being considered as a HQLA under the LCR has the potential to create a disincentive for banks to hold investment grade municipal securities, in addition to increased costs to cities and states seeking financing for infrastructure projects across the country. This is particularly impactful for cities like New York City, which is the second largest issuer of municipal debt in the nation. In 2013, for instance, New York City sold over $11.8 billion of bonds to finance or refinance capital projects. As is the case for many cities, most of New York City's capital spending comes directly from the proceeds of municipal debt offerings. Thus, the city needs a large and diverse base of bond purchasers and holders to finance its infrastructure projects at affordable costs, and there is real concern that the current rule will reduce the appeal of municipal securities for banks to underwrite and investors to purchase, and harm the municipal bond market.

These debt issuances from certain state and local municipalities are considered high quality liquid assets by the markets and they should be treated as such under the rule. Developing criteria to assess the liquidity and performance of various municipal bond offerings would have been a more tailored approach than what was used in the rule finalized on September 3rd. However, I was encouraged to hear each of you confirm that your agencies plan to conduct further research and analysis of this issue and evaluate the circumstances under which flexibility can be offered to account for certain municipal securities. I would appreciate it if your offices would inform me of when to expect a proposed supplemental rule.

During the hearing, Governor Tarullo stated that the Board has asked staff to prepare a proposal that would allow for recognition as HQLA those state and municipal bonds which "are in the same league as very liquid corporate [bonds]." Notably, Governor Tarullo went on to say that the Staff would be considering different "liquidity characteristics" when attempting to establish a process for "identifying the most liquid state and muni bonds" that should be considered as a highly liquid assets. I hope that your agencies will provide further public details and insight into the standards established for each of the "liquidity characteristics" of municipal bonds that are necessary for these debt securities to qualify as HQLA.

Thank you again for your willingness to reevaluate the rule and consider making adjustments to account for those municipal bond offerings that are very highly liquid and appropriately meet the liquidity standards necessary to qualify as High Quality Liquid Assets. I would encourage the Federal Reserve, FDIC, and the OCC to take a more tailored approach, and issue supplementary rules that allow for these critical debt instruments within the scope of the Liquidity Coverage Ratio's HQLA requirements.

Sincerely,

U.S. Senator Charles E. Schumer

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