

**National Governors Association
U.S. Conference of Mayors
National Association of Counties
National League of Cities
National Conference of State Legislatures
National Association of State Treasurers
National Association of State Auditors, Comptrollers and Treasurers
International City/County Management Association
American Public Power Association
National Association of Health and Higher Education Facilities Authorities
Airports Council International – North America
The National Association of Towns and Townships
National Council of State Housing Agencies
Large Public Power Council
Government Finance Officers Association**

April 14, 2017

RE: Classifying Municipal Securities as High Quality Liquid Assets (S. 828)

Dear Chairman Crapo and Ranking Member Brown:

The organizations signed above collectively represent tens of thousands of public sector entities that issue debt to finance and build the infrastructure that contributes to strong economies at the State and local levels across the United States. Together our members agree that legislation classifying Municipal Securities as High Quality Liquid Assets would keep demand for the municipal bond high, thus keeping the interest costs of issuance low. Keeping interest costs low, especially during times of fiscal stress, translates to more flexibility in providing and maintaining infrastructure across the United States. The legislative proposal referenced in this letter is bipartisan legislation sponsored by Sens. Rounds (SD), Warner (VA), Donnelly (IN), Cotton (AR), Kennedy (LA), Heitkamp (ND), Scott (SC), Tester (MO), Tillis (NC) and Van Hollen (MD).

Description of the Proposal: Please see Attachment A for the language of the proposed legislation (S. 828) that would direct the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency (OCC) to classify all qualifying investment-grade, liquid and readily marketable municipal securities as High Quality Liquid Assets (HQLA), Level 2B. This legislation is necessary to amend the 2014 *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule - 79 Fed. Reg. 61439*.

The rule by federal regulators established a minimum liquidity requirement for large banking organizations and identified acceptable investments – deemed HQLA – to meet this capital adequacy requirement. While the rule classified foreign sovereign debt securities as HQLA, it excluded U.S. municipal securities. In doing so, regulators overlooked core features of municipal securities that are consistent with all of the criteria proposed by regulators to be characterized as HQLA, including limited price volatility, high trading volumes and deep and stable funding markets, as discussed in Attachment B and evidenced in the State of Washington’s analysis demonstrating strong trading liquidity in stable times and in times of financial stress and volatility in Attachment C.

Impact on Economic Growth: Municipal bonds not only provide a higher quality of life to individuals in communities across the United States, they also provide jobs and keep local economies strong. The municipal bond is the bedrock by which State and local governments, authorities and nonprofits of all sizes can cost effectively access the capital markets and in turn provide essential infrastructure for their citizens. Tax-exempt municipal bonds have been used to finance repairs to and construction of: roads, highways, and bridges; public transportation; seaports and marine terminals; airports; water and wastewater facilities; elementary schools, high schools, and colleges and universities; acute care hospitals; single- and multi-family housing; libraries; parks; town halls; electric power and natural gas facilities; and other public projects. Hundreds of thousands of jobs are created through infrastructure project construction and maintenance, as well as through delivering the services they provide.

With the American Society of Civil Engineers estimating a \$2.1 trillion¹ funding gap in ten years to meet our nation's infrastructure needs, the ability of States and localities to finance infrastructure at the lowest possible cost is critical. Classifying investment grade municipal securities as HQLA will help ensure low-cost infrastructure financing remains available for municipal securities issuers to continue to build the infrastructure for commerce, public safety, job creation and the development of an educated workforce upon which our communities and national economy rely.

Impact on the Ability of Consumers, Market Participants and Financial Companies to Participate in the Economy: After U.S. Treasuries, municipal securities are the safest available investment, with State and local governments having nearly a zero default rate. Not classifying municipal securities as HQLA will increase borrowing costs for State and local governments to finance public infrastructure projects, as banks will likely demand higher interest rates on yields on the purchase of municipal bonds or during times of national economic stress, even forgo the purchase of municipal securities.

To be clear, not all municipal securities will be classified as HQLA. However, all issuers will benefit through market pricing effects due to investor demand (i.e. the positive effects of classifying municipal bonds as HQLA on the yield curve). The resulting cost impacts for State and local governments could be significant since bank holdings of municipal securities and loans have more than doubled since 2009.²

We look forward to working with you and supporting your efforts to help State and local governments on this high quality liquid assets issue and other regulatory and financial matters of mutual interest.

Sincerely,

Government Finance Officers Association, Emily Brock, 202-393-8467
National Governors Association, David Parkhurst, 202-624-5328
U.S. Conference of Mayors, Larry Jones, 202-861-6709
National Association of Counties, Jack Peterson, 202-661-8805
National League of Cities, Brett Bolton, 202-626-3183
National Conference of State Legislatures, Max Behlke, 202-412-3586
National Association of State Treasurers, Preston Weyland, 202-347-3863
National Association of State Auditors, Comptrollers and Treasurers, Cornelia Chebinou, 202-624-5451
International City/County Management Association, Elizabeth Kellar, 202-962-3611
American Public Power Association, John Godfrey, 202-467-2929

¹ American Society of Civil Engineers 2017 Infrastructure Report Card "Cumulative Infrastructure Needs by System Based on Current Trends"
<http://www.infrastructurereportcard.org/the-impact/economic-impact/>

² 2016 SIFMA Data.

National Assn. of Health and Higher Education Facilities Authorities, Chuck Samuels, 202-434-7211
Airports Council International – North America, Annie Russo, 202-293-8500
The National Association of Towns and Townships, Jennifer Imo, 202-261-3690
Large Public Power Council, Noreen Roche-Carter, 916-732-6509
National Council of State Housing Agencies, Garth Rieman, 202-624-7710

115TH CONGRESS
1ST SESSION

S. _____

To amend the Federal Deposit Insurance Act to require the appropriate Federal banking agencies to treat certain municipal obligations as level 2B liquid assets, and for other purposes.

IN THE SENATE OF THE UNITED STATES

Mr. ROUNDS (for himself, Mr. WARNER, Mr. TESTER, Mr. SCOTT, Mr. DONNELLY, Ms. HEITKAMP, Mr. COTTON, Mr. TILLIS, Mr. VAN HOLLEN, and Mr. KENNEDY) introduced the following bill; which was read twice and referred to the Committee on _____

A BILL

To amend the Federal Deposit Insurance Act to require the appropriate Federal banking agencies to treat certain municipal obligations as level 2B liquid assets, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. TREATMENT OF CERTAIN MUNICIPAL OBLIGA-**
4 **TIONS.**

5 (a) IN GENERAL.—Section 18 of the Federal Deposit
6 Insurance Act (12 U.S.C. 1828) is amended—

2

1 (1) by moving subsection (z) so that it appears
2 after subsection (y); and

3 (2) by adding at the end the following:

4 “(aa) TREATMENT OF CERTAIN MUNICIPAL OBLIGA-
5 TIONS.—

6 “(1) DEFINITIONS.—In this subsection—

7 “(A) the term ‘investment grade’, with re-
8 spect to an obligation, has the meaning given
9 the term in section 1.2 of title 12, Code of Fed-
10 eral Regulations, or any successor thereto;

11 “(B) the term ‘liquid and readily-market-
12 able’ has the meaning given the term in section
13 249.3 of title 12, Code of Federal Regulations,
14 or any successor thereto; and

15 “(C) the term ‘municipal obligation’ means
16 an obligation of—

17 “(i) a State or any political subdivi-
18 sion thereof; or

19 “(ii) any agency or instrumentality of
20 a State or any political subdivision thereof.

21 “(2) MUNICIPAL OBLIGATIONS.—For purposes
22 of the final rule entitled ‘Liquidity Coverage Ratio:
23 Liquidity Risk Measurement Standards’ (79 Fed.
24 Reg. 61439 (October 10, 2014)), the final rule enti-
25 tled ‘Liquidity Coverage Ratio: Treatment of U.S.

1 Municipal Securities as High-Quality Liquid Assets’
2 (81 Fed. Reg. 21223 (April 11, 2016)), and any
3 other regulation that incorporates a definition of the
4 term ‘high-quality liquid asset’ or another substan-
5 tially similar term, the appropriate Federal banking
6 agencies shall treat a municipal obligation as a high-
7 quality liquid asset that is a level 2B liquid asset if
8 that obligation is, as of the date of calculation—

9 “(A) liquid and readily-marketable; and

10 “(B) investment grade.”

11 (b) AMENDMENT TO LIQUIDITY COVERAGE RATIO
12 REGULATIONS.—Not later than 90 days after the date of
13 enactment of this Act, the Federal Deposit Insurance Cor-
14 poration, the Board of Governors of the Federal Reserve
15 System, and the Comptroller of the Currency shall amend
16 the final rule entitled “Liquidity Coverage Ratio: Liquidity
17 Risk Measurement Standards” (79 Fed. Reg. 61439 (Oc-
18 tober 10, 2014)) and the final rule entitled “Liquidity
19 Coverage Ratio: Treatment of U.S. Municipal Securities
20 as High-Quality Liquid Assets” (81 Fed. Reg. 21223
21 (April 11, 2016)) to implement the amendments made by
22 this Act.

ATTACHMENT B:

MUNICIPAL SECURITIES SATISFY REGULATORY HQLA CRITERIA

Low Price Volatility

Investment grade municipal securities are significantly less risky than other investment vehicles,³ and compare well with other investment categories that were given HQLA status under the rule (U.S. Treasuries, government agency obligations, investment-grade corporate bonds). During the 2008 financial crisis municipal general obligation and revenue bonds retained their value more consistently than high and lower investment grade corporate bonds, and performed similarly to government sponsored enterprise (GSE) secured bonds. Still, under the rule GSE bonds and BBB- corporate bonds are considered HQLA while municipal securities are not.

High Transaction Volume

The municipal market trades as a percentage of the total outstanding market in nearly the same volume as corporate and GSE bonds. According to SIFMA data⁴, the municipal market trades 0.31 percent of its total outstanding par every day, compared to the corporate bond market trades of 0.20 percent per day and the GSE bond market trades of 0.33 percent per day.

Deep and Stable Funding Markets

About 70 percent of all outstanding municipal securities are held by thousands of individual investors, either directly or through mutual funds and money market funds.⁵ Individual investor behavior has demonstrated a strong correlation between demands and yields, with retail investors historically opting to maintain or add to their holdings in periods of rising rates. This consistent correlation demonstrates a high level of liquidity in the municipal market. In addition to retail investors, a long list of other investors comprises the remaining 30 percent of municipal securities investors, and includes property, casualty and life insurance companies, GSE's, broker dealers, credit unions, U.S. banks and foreign governments.

³ Moody's Investor Service Special Comment, March 7, 2012: U.S. Municipal Bond Defaults and Recoveries, 1970-2011. Page 2

⁴ SIFMA's Outstanding U.S. Bond Market Debt

⁵ 2015 Thompson Reuters.



Trading Liquidity Analysis





Executive Summary

- The State of Washington has prepared a detailed analysis of trading in the State's General Obligation Bonds ("WA GO Bonds") and representative corporate bonds
- Key findings:
 - *Trading Analysis:* Trading volumes, trade par amounts and trading frequency all compare favorably to corporate bonds in stable and volatile market environments
 - *Diverse Market Participants:* Trading flows are balanced in all market environments; most trades in stressed market conditions are sales to end investors
 - *Orderly Markets:* A review of two turbulent market periods - the Financial Crisis and the May-August 2013 bond market sell-off - shows orderly trading and relatively modest price declines for WA GO Bonds
 - *Robust Primary Market:* Successful primary market sales in volatile markets offers further evidence of strong liquidity
- The analysis clearly supports the designation of the WA GO Bonds as Level 2B High Quality Liquid Assets



Background To Trading Analysis





Trading Analysis: WA GO Bonds vs. Microsoft and Exxon

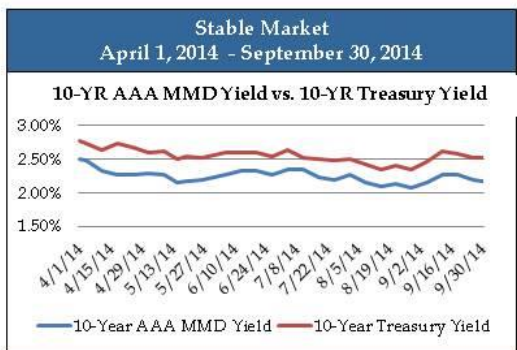
- State of Washington general obligation debt
 - WA GO Bonds are secured by the full faith, credit and taxing power of the State
 - Tax-exempt, fixed-rate Various Purpose (VP) and Motor Vehicle Fuel Tax (MVFT) General Obligation Bonds
 - VP and MVFT GO Bonds price identically in the primary and secondary markets
 - Trading data source: EMMA (Municipal Securities Rulemaking Board public website)
- Microsoft Corporation senior unsecured bonds (“Microsoft Bonds”) and Exxon Corporation senior unsecured bonds (“Exxon Bonds”)
 - Fixed rate USD public, senior, unsecured bonds
 - Trading data source: Bloomberg Finance, LLP

	State of Washington	Microsoft	Exxon
Total Outstanding 2014	18,443,000,000	15,200,000,000	NA
Total Outstanding 2013	17,692,000,000	8,450,000,000	NA
Total Outstanding 2008	13,680,000,000	-	6,800,000,000
Credit	General Obligation	Senior Unsecured	Senior Unsecured
Credit Ratings	Aa1/AA+/AA+	Aaa/AAA/AA+	Aaa/AAA/NR
Maturity Structure	Annual Serial Bonds	Index-eligible Bullets	Index-eligible Bullets
Debt Service Structure	Level Annual P&I Payments	Interest Only + Balloon	Interest Only + Balloon
CUSIPs	Multiple Per Issue	Single Per Issue	Single Per Issue



Time Periods Analyzed

Time Periods Analyzed
April – September 2014: Recent, stable market conditions
May – August 2013: Significant bond market sell-off
September – October 2008: Financial Crisis





Results of Trading Analysis





Trading Analysis: Results

- WA GO Bonds demonstrate strong trading liquidity in stable markets and in times of financial stress and market volatility
 - In stable markets over the last six months, trade metrics on WA GO Bonds compare favorably with those of a highly rated corporate bond
 - Similar evidence of robust trading in stressed markets: during the Financial Crisis (Sep - Oct 2008) and significant bond market sell-off (May - Aug 2013)

	Stable Market Apr - Sep 2014		Bond Market Sell-Off May - Aug 2013		Financial Crisis Sep - Oct 2008	
	State of Washington	Microsoft	State of Washington	Microsoft	State of Washington	Exxon
	Total Par Traded	5,360,310,000	2,360,690,000	3,285,900,000	2,144,077,000	1,854,050,000
Traded Par/Outstanding	29%	16%	18%	25%	14%	6%
# of Trades	1,053	910	651	770	332	N/A
% of Trading Days with Trades	95%	96%	94%	99%	86%	80%
Average Trade Par	5,030,122	2,594,165	4,970,661	N/A	5,584,488	N/A
Median Trade Par	2,500,000	2,000,000	2,250,000	N/A	2,500,000	N/A
Max Trade Par	49,550,000	5,000,000	40,195,000	N/A	34,475,000	N/A
Avg. Par Traded Per Trading Day	42,207,165	18,588,110	37,626,744	24,931,128	42,137,500	9,825,682
Median Par Traded per Trading Day	19,830,000	17,250,000	22,710,000	21,621,500	37,907,500	7,650,000
Avg. Trades per Trading Day	9	7	8	9	9	N/A
Median Trades per Trading Day	7	7	7	8	8	N/A

Note: trading data for all trades with a par amount of \$1 million or greater



WA GO Bond Trades by Maturity

- There is active trading of WA GO Bonds in all maturity ranges in both stable and stressed markets
- Trading activity across all maturities ensures sufficient price information and transparency at all points on the yield curve

Stable Market 4/1/2014 through 9/30/2014				
Maturity	Trade Count	Total Par	Average Par	Median Par
0-5 Years	225	894,925,000	3,977,444	2,500,000
5-10 Years	318	1,918,745,000	6,083,789	3,765,000
10-15 Years	240	1,095,480,000	4,564,500	2,482,500
15-20 Years	189	815,395,000	4,314,259	2,000,000
20-30 Years	81	635,765,000	7,848,951	4,500,000

Bond Market Sell-Off 5/1/2013 through 8/30/2013				
Maturity	Trade Count	Total Par	Average Par	Median Par
0-5 Years	96	370,340,000	3,778,980	1,700,000
5-10 Years	146	620,060,000	4,246,986	3,000,000
10-15 Years	217	1,270,520,000	5,854,931	3,175,000
15-20 Years	127	601,060,000	4,732,756	1,960,000
20-30 Years	63	373,920,000	5,985,238	1,535,000

Financial Crisis 9/1/2008 through 10/31/2008				
Maturity	Trade Count	Total Par	Average Par	Median Par
5-10 Years	21	48,430,000	2,306,190	1,500,000
10-15 Years	78	346,665,000	4,444,423	1,650,000
15-20 Years	133	821,875,000	6,179,511	4,750,000
20-25 Years	100	637,080,000	6,370,800	3,095,000



Market Participants: Trading Flows

- Trading flows in WA GO Bonds are well balanced in all time periods analyzed
- Notably, there is no spike in customer sales during down markets and, in fact, customer purchases comprise the greatest portion of trade flows in these down markets
- Market liquidity not overly reliant on inter-dealer trade flows

	Stable Market Apr - Sep 2014		Bond Market Sell-Off May - Aug 2013		Financial Crisis Sep - Oct 2008	
	State of Washington	Microsoft	State of Washington	Microsoft	State of Washington	Exxon
Customer Sold Volume	1,386,355,000	905,186,000	792,135,000	NA	575,625,000	NA
Customer Sold % of Volume	26%	38%	24%	NA	31%	NA
Customer Bought Volume	2,053,285,000	869,902,000	1,484,100,000	NA	747,425,000	NA
Customer Bought % of Volume	38%	37%	46%	NA	40%	NA
Inter-dealer Volume	1,920,670,000	585,602,000	959,665,000	NA	531,000,000	NA
Inter-dealer % of Volume	36%	25%	30%	NA	29%	NA



Price Volatility Analysis





Price Volatility During Down Markets

- Price declines in times of market stress have been identified as a key factor in assessing liquidity
- WA GO Bond maximum 30 calendar-day price declines of 16% during the Financial Crisis and 9% during the 2013 bond market sell-off are well below the 20% threshold specified for Level 2B corporate bonds

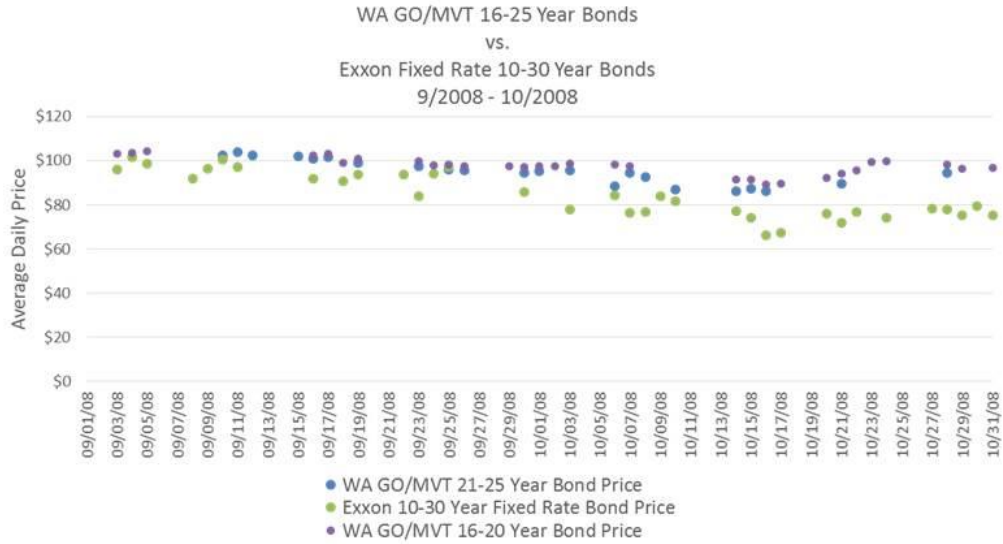
Max Price Declines - Financial Crisis 9/1/2008 through 10/31/2008			
Coupon	State of Washington (15-20 Year Maturities)	State of Washington (20-25 Year Maturities)	Exxon (10-30 Year Maturities)
5%	13%	16%	N/A
5-6%	N/A	N/A	32%

Max Price Declines - Bond Market Sell-Off 5/1/2013 through 8/30/2013			
Coupon	State of Washington (15-20 Year Maturities)	State of Washington (20-25 Year Maturities)	Microsoft (10-30 Year Maturities)
2%	N/A	N/A	5%
3%	5%	N/A	11%
4%	8%	9%	8%
5%	6%	7%	7%



Price Volatility During Down Markets

- WA GO Bond trading during the Financial Crisis was orderly
- Price trends similar to but less severe than representative corporate bonds



MONTAGUE & DE ROSE
AND ASSOCIATES, LLC

11



Primary Market Liquidity





Primary Market Liquidity

- The State scheduled the competitive sale of \$934 million refunding bonds on October 15, 2014 (\$626.8 million VPGO Bonds and \$307.3 million of MVFT GO Bonds)
- The fixed income markets experienced significant intra-day market volatility on October 15
- Despite volatility in the Treasury, equity and oil markets, the State proceeded with the sale



10-Year UST Yield			
	Time (ET)	Yield	Change
Open Yield	8:30 AM	2.16%	
Intra-day Low Yield	9:38 AM	1.86%	-0.30%
Intra-day High Yield	3:37 PM	2.16%	0.30%
Close Yield	5:00 PM	2.13%	-0.03%



Primary Market Liquidity

- Bonds were sold via the municipal market's standard electronic competitive bid process
 - Bid award based on lowest True Interest Cost (TIC) for each issue
 - Dealers commit to underwrite the entire bond issue (all-or-none bid)
 - Limited pre-selling to investors given uncertainty regarding which bidder would be successful

- The State received five bids on each series
 - Bids were aggressive and tight, with the winning bidders committing \$746 million and \$369 million on the two series

- Bidding process provides strong evidence of dealers' confidence in secondary market liquidity

\$626,765,000 Series R- 2015C Various Purpose General Obligation Refunding Bonds 8:00 am PT - October 15, 2014		
Bid Par Amount:	\$626,765,000	
Number of bids:	5	
Bid Results	TIC (%)	Variance From Winning Bid (%)
Bank of America Merrill Lynch	2.843874	
J.P. Morgan Securities	2.844120	0.000246
Barclays Capital	2.867331	0.023457
Citigroup Global Markets	2.899109	0.055235
Morgan Stanley & Co.	3.049818	0.205944

\$307,285,000 Series R- 2015D Motor Vehicle Fuel Tax General Obligation Refunding Bonds 8:30 am PT - October 15, 2014		
Bid Par Amount:	\$307,285,000	
Number of bids:	5	
Bid Results	TIC (%)	Variance From Winning Bid (%)
J.P. Morgan Securities	2.947635	
Bank of America Merrill Lynch	2.961734	0.014099
Citigroup Global Markets	2.962584	0.014889
Barclays Capital	2.982748	0.035053
Morgan Stanley & Co.	3.089930	0.142235

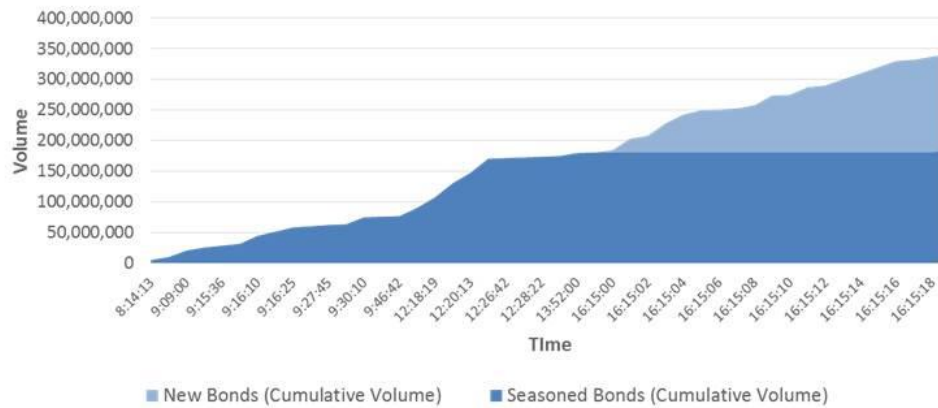


Primary Market Liquidity

- On October 15, trading in WA GO Bonds was very active, both in seasoned bonds as well as in the newly issued bonds

Total Trading Volume:	341,130,000
Seasoned Bond Trading Volume:	180,580,000
New Bond Trading Volume:	160,550,000

State of Washington GO Bond Cumulative Trading Volume
October 15, 2014





Conclusion



Executive Summary

- The State of Washington has prepared a detailed analysis of trading in the State's General Obligation Bonds ("WA GO Bonds") and representative corporate bonds
- Key findings:
 - *Trading Analysis:* Trading volumes, trade par amounts and trading frequency all compare favorably to corporate bonds in stable and volatile market environments
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