

**Government Finance Officers Association  
National Governors Association  
U.S. Conference of Mayors  
National Association of Counties  
National League of Cities  
National Council of State Legislatures  
National Association of State Auditors, Comptrollers and Treasurers  
International City/County Management Association  
American Public Power Association  
Council of Infrastructure Financing Authorities  
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  
National Association of Local Housing Finance Agencies**

September 14, 2016

**RE: Classifying Municipal Securities as High Quality Liquid Assets**

Dear Senator:

On behalf of the organizations listed above we request that you join as a co-sponsor of proposed legislation by Sens. Warner (VA), Rounds (SD), and Schumer (NY) 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). It is similar to H.R. 2209 that passed the U.S. House earlier this year by voice vote.

This important 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 U.S. regulators classified foreign sovereign debt securities as HQLA, the rule excluded municipal securities in any of the acceptable investment categories. Further, in the Fed final rule *Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets*, consideration is made only to a limited portion of GO bonds, thus covering only a small section of municipal bonds outstanding. 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 the attachment below.

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 during times of national economic stress, or even forgo the purchase of municipal securities. The resulting cost

impacts for state and local governments could be significant since bank holdings of municipal securities and loans increased by 86 percent since 2009.<sup>1</sup>

With the American Society of Civil Engineers estimating a \$3.6 trillion cost to state and local governments over the next four 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. .

Again, we hope that you will cosponsor this important legislation..

Sincerely,

Government Finance Officers Association, Emily Brock, 202-393-8467  
National Governors Association, David Parkhurst, 202-624-5328  
International City/County Management Association, Elizabeth Kellar, 202-962-3611  
National League of Cities, Carolyn Coleman, 202-626-3023  
U.S. Conference of Mayors, Larry Jones, 202-861-6709  
National Council of State Legislatures, Jeff Hurley, 202-624-7753  
American Public Power Association, John Godfrey, 202-467-2929  
Council of Infrastructure Financing Authorities, Rick Farrell, 202-547-1866  
Large Public Power Council, Noreen Roche-Carter, 916-732-6509  
National Association of Counties, Mike Belarmino, 202-942-4254  
National Association of Health and Higher Education Facilities Authorities, Chuck Samuels, 202-434-7211  
Airports Council International – North America, Annie Russo, 202-293-8500  
National Association of Local Housing Finance Agencies, Marc Selvitelli, 202-367-1211  
National Association of State Auditors, Comptrollers and Treasurers, Cornelia Chebinou, 202-624-5451  
National Council of State Housing Agencies, Garth Rieman, 202-624-7710  
The National Association of Towns and Townships, Heidi Schott, 202-261-3690

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<sup>1</sup> 2014 SIMFA Data.

## **MUNICIPAL SECURITIES SATISFY REGULATORY HQLA CRITERA**

### **Low Price Volatility**

Investment grade municipal securities are significantly less risky than other investment vehicles,<sup>2</sup> 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 data<sup>3</sup>, 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**

More than 70 percent of all outstanding municipal securities are held by thousands of individual investors, either directly or through mutual funds and money market funds.<sup>4</sup> 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.

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

<sup>3</sup> SIFMA's Outstanding U.S. Bond Market Debt

<sup>4</sup> 2010 Thompson Reuters.