

Client Alert

April 7, 2016



Half-Hearted Relief for Munis: The Fed Adopts a Final Rule to Include Certain Municipal Securities as HQLAs Under the LCR Rule

On March 31, 2016, the Board of Governors of the Federal Reserve System (the “Federal Reserve”) adopted a final rule (the “Final Rule”) to amend the Federal Reserve’s Liquidity Coverage Ratio Rule and Modified Liquidity Coverage Ratio (together, the “LCR Rule”) to now encompass specific types of U.S. municipal securities as high-quality liquid assets (“HQLAs”).¹ Specifically, companies subject to the LCR Rule will now be able to treat certain U.S. municipal securities as Level 2B liquid assets for purposes of calculating the company’s total HQLAs under the LCR Rule, subject to a number of limitations unique to municipal securities. The Federal Reserve originally proposed a rule to treat certain U.S. municipal securities as Level 2B liquid assets on May 18, 2015 (the “Proposed Rule”). The Final Rule goes into effect on July 1, 2016.

The adoption of the Final Rule comes one month after the U.S. House of Representatives passed H.R. 2209, authored by U.S. Representatives Luke Messer and Carolyn B. Maloney, which amends the Federal Deposit Insurance Act for purposes of “requir[ing] the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets” under the LCR Rule.² While there is some overlap among the provisions contained in the Final Rule, the Proposed Rule and H.R. 2209, there are certain notable differences as discussed in greater detail below.³

The 2014 passage of the LCR Rule and, specifically, the failure to include municipal bonds as HQLAs for purposes of calculating a covered entity’s liquidity buffer, met the ire of numerous local communities and municipalities. These groups argued that the decision to exclude municipal securities from the definition of HQLAs would diminish the demand for such securities by large financial institutions, therefore raising the costs for municipalities attempting to raise funds for infrastructure projects. However, in 2014, federal banking regulators, such as Chairman of the Federal Deposit Insurance Corporation (the “FDIC”), Martin J. Gruenberg, stood firm, explaining that “[it] is our understanding that banks do not generally hold municipal securities for liquidity purposes.”⁴ Similarly, in March 2015, Thomas J. Curry, the Comptroller of the Office of the Comptroller of the Currency (the “OCC,” and together with the Federal Reserve and the FDIC, the “Federal Banking Agencies”), asserted that the LCR Rule had not had a detrimental impact on the cost of municipal bonds; on the contrary, he

¹ See Board of Governors of the Federal Reserve System, *Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets* (Final Rule) (Apr. 1, 2016), available at <https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160401a1.pdf>.

² See H.R. 2209, 114th Cong. (2015-2016), available at <https://www.congress.gov/bill/114th-congress/house-bill/2209/text>.

³ See the Summary Chart provided in Part III below.

⁴ See Statement of Martin J. Gruenberg, Chairman, FDIC Final Rule on the Liquidity Coverage Ratio, Sept. 3, 2014, available at <https://www.fdic.gov/news/news/speeches/spsep0314a.pdf>.

noted that “since the [LCR Rule] became final in October 2014 banks have *increased* their overall holdings of municipal securities.”⁵

Nevertheless, the Final Rule is significant because it represents a loosening of the LCR Rule’s strict regulatory requirements that have constrained large financial institutions since its passage in 2014. Moreover, the Final Rule is significant because it should reduce the cost of underwriting, selling and purchasing municipal securities. However, as discussed in greater detail below, the scope of the Final Rule is limited because it only applies to Federal Reserve-regulated financial institutions that are subject to the LCR Rule and contains a number of restrictions unique to municipal securities. It remains to be seen whether interest in municipal securities will pick up among financial institutions once the Final Rule becomes effective.

This client alert is separated into three parts. Part I provides a brief overview of the HQLA requirements set forth under the LCR Rule. Part II provides a summary of the Final Rule, including the ways in which the Final Rule differs from the Federal Reserve’s Proposed Rule. Part III provides a chart summarizing the notable differences and similarities between H.R. 2209, the Proposed Rule and the Final Rule.

I. The LCR Rule

The LCR Rule, adopted by the Federal Banking Agencies in 2014, is designed to safeguard the short-term liquidity profile of both domestic and international banking organizations. U.S. firms subject to the LCR Rule are required to be fully compliant with its provisions by January 1, 2017.⁶

Any entity subject to the LCR Rule must generally maintain a certain amount of HQLAs that is no less than 100 percent of its total net cash outflows over a prospective 30 calendar-day period of significant stress.⁷ The LCR Rule definition of HQLAs includes certain asset classes that have historically served as sources of liquidity during times of stress. The LCR Rule divides HQLAs into one of three categories of liquid assets:⁸ (i) Level 1;⁹ (ii) Level 2A;¹⁰ or (iii) Level 2B.¹¹ Level 1 liquid assets are considered to have the highest quality and greatest liquidity. Because Level 2A and Level 2B liquid assets are considered to not rise to the same level of quality and stability, they must meet certain liquidity and marketability requirements, as defined in the LCR Rule, in order to qualify as HQLAs. Level 2A liquid assets and Level 2B liquid assets are subject to 15 percent and 50 percent haircuts, respectively, and Level 2A and Level 2B liquid assets may not exceed 40 percent of a company’s total HQLA

⁵ See Comptroller of the Currency Issues Statement Regarding Bank Investment in the Municipal Securities Market, OCC Press Release, Mar. 18, 2015, available at <http://www.occ.treas.gov/news-issuances/news-releases/2015/nr-occ-2015-37.html> (emphasis added).

⁶ See *Liquidity Coverage Ratio: Liquidity Risk Measurement Standards*, 79 Fed. Reg. 61440, 61440-41 (Oct. 10, 2014).

⁷ See *id.* at 61443.

⁸ See *id.* at 61444.

⁹ Level 1 assets are limited to: (1) balances held at the U.S. Federal Reserve Bank; (2) foreign central bank withdrawable reserves; (3) securities issued by, or unconditionally guaranteed as to timely payment of principal and interest by, the U.S. Department of the Treasury; (4) securities issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, a U.S. government agency (other than the U.S. Department of Treasury) whose obligations are fully and explicitly guaranteed by the full faith and credit of the U.S. government; and (5) certain securities issued by, or unconditionally guaranteed as to timely payment of principal and interest by, a sovereign entity, certain international organizations or a multilateral development banks. See *id.* at 61529.

¹⁰ An asset is deemed to be a Level 2A liquid asset if it is liquid and readily marketable and consists of one of the following types of assets: (1) certain securities issued by, or guaranteed as to the timely payment of principal and interest by, a U.S. government sponsored enterprise (or an entity established or chartered by the federal government to serve public purposes specified by the U.S. Congress, but whose debt obligations are not explicitly guaranteed by the full faith and credit of the U.S. government); and (2) certain securities issued by, or guaranteed as to the timely payment of principal and interest by, a sovereign entity or a multilateral development bank that are not eligible to be treated as Level 1 liquid assets. See *id.* at 61528-29.

¹¹ An asset is deemed to be a Level 2B liquid asset if it is liquid and readily marketable and consists of one of the following types of assets: (1) certain corporate debt securities and (2) certain publicly traded common equity shares. See *id.* at 61529.

amount.¹² As originally adopted, debt securities issued or guaranteed by a “public sector entity” (*e.g.*, municipal securities), which the LCR Rule defines as any state or local authority or other governmental subdivision that does not reach the level of a U.S. sovereign entity, are not treated as HQLAs under the LCR Rule.¹³ This omission is significant because other regulatory requirements, most notably the leverage ratios, discourage the holding of low yield but high-credit quality securities, creating the potential for a market differential based on whether or not a security qualifies as an HQLA.

II. Summary of The Final Rule

This Part II provides a summary of the Final Rule, including: (A) the specific types of companies that are subject to the Final Rule (“Covered Companies”); (B) the specific criteria that must be satisfied in order for a U.S. municipal security to qualify as a Level 2B liquid asset under the LCR Rule; (C) quantitative limitations that restrict the total amount of U.S. municipal securities that can be included as part of a Covered Company’s HQLA calculation; and (D) methodologies for calculating HQLAs under the Final Rule.

A. Covered Companies

The Final Rule applies to financial institutions that are (1) regulated by the Federal Reserve and (2) subject to the LCR Rule, including the following categories of entities:

1. any bank holding companies (“BHCs”), savings and loan holding companies (“SLHCs”) without significant commercial or insurance operations, and state member banks with at least (i) \$250 billion in total consolidated assets or (ii) \$10 billion in on-balance sheet foreign exposure;
2. state member banks with at least \$10 billion in total consolidated assets that are consolidated subsidiaries of BHCs subject to the LCR Rule (pursuant to category one above);
3. nonbank financial companies that have been designated by the Financial Stability Oversight Council as a systemically important financial institutions (each, a “SIFI”), to which the Federal Reserve has applied the LCR Rule by separate rule or order; and
4. BHCs and certain SLHCs that (i) maintain at least \$50 billion in consolidated assets, (ii) fail to meet the threshold in any of the above categories (listed in one through three above) and (iii) are subject to the Federal Reserve’s modified liquidity coverage ratio rule.¹⁴

B. Criteria for Evaluating Whether U.S. Municipal Securities Qualify as Level 2B Liquid Assets

A U.S. municipal security may only qualify as a Level 2B liquid asset under the Final Rule if it meets specific liquidity and readily marketable standards set forth under the LCR Rule. Specifically, the U.S. municipal securities must: (1) be “general obligation” municipal securities; (2) be “investment grade” municipal securities; and (3) have a proven track record as a reliable source of liquidity.¹⁵ Additionally, a Covered Company may include as Level 2B liquid assets U.S. general obligation municipal securities that have a guarantee from a financial institution, without taking into consideration any applicable insurance, as long as all necessary criteria are satisfied for purposes of inclusion as Level 2B liquid assets (*i.e.*, the U.S. municipal securities are both “investment

¹² See *id.* at 61444.

¹³ See *id.* at 61526.

¹⁴ See 12 C.F.R. § 249.20(c)(2).

¹⁵ See Final Rule, *supra* note 1.

grade” and issued or guaranteed by a public sector entity with obligations that have a “proven track record as a reliable source of liquidity”).¹⁶

U.S. “General Obligation” Municipal Securities. First, the Final Rule specifies that U.S. municipal securities will only qualify as Level 2B liquid assets if such municipal securities are “general obligation” securities of a public sector entity. The Final Rule defines the term “general obligation” as any “bond or similar obligation that is backed by the full faith and credit of a public sector entity.”¹⁷ This definition differs from the one in the Proposed Rule, in which a U.S. municipal security would have qualified as a Level 2B liquid asset only if it was a “general obligation of the *issuing* entity . . . that [is] backed by the full faith and credit of the *issuing* public sector entity.”¹⁸

U.S. “Investment Grade” Municipal Securities. Second, the Final Rule states that Covered Companies may only include “investment grade” U.S. municipal securities if such securities meet additional criteria for inclusion as Level 2B liquid assets and satisfy any applicable limitations (as discussed in great detail below). As noted by the Federal Reserve, the purpose of utilizing the “investment grade” criterion is to “ensure that only U.S. municipal securities with high credit quality are included in a [Federal Reserve]-regulated covered company’s HQLA amount.” However, higher credit quality of an entity’s security alone will not “guarantee its liquidity.”¹⁹

In November 2012, the Federal Reserve issued guidance to determine when a particular security is considered “investment grade” and not “predominantly speculative in nature.”²⁰ Specifically, a U.S. municipal security will satisfy the “investment grade” test if the “issuer has an adequate capacity to meet its financial commitments under the security for the projected life of the asset or exposure.”²¹ In evaluating an issuer’s “adequate capacity,” the Federal Reserve will consider whether: (1) the risk of default by the obligor is low and (2) the full timely repayment of principal and interest is expected.²²

Proven Record as a Reliable Source of Liquidity. Third, U.S. municipal securities under the Final Rule must “have a proven record as a reliable source of liquidity” to qualify as Level 2B liquid assets. To satisfy this requirement, a Covered Company would need to demonstrate that either: (1) the market price of the U.S. municipal securities or equivalent securities of the issuer declined by “no more than 20 percent during a 30-day period of significant stress”²³ or (2) “that the market haircut demanded by counterparties to secured lending and secured funding transactions that were collateralized by such securities or equivalent securities of the issuer increased by no more than 20 percentage points during a 30 calendar-day period of significant stress.”²⁴ This criterion is consistent with those applicable to corporate debt securities that are included as Level 2B liquid assets under the LCR Rule. The Federal Reserve notes that the purpose of this criterion is to “exclude volatile U.S. municipal securities” that “may not hold their value during a period of significant stress.”²⁵ While the Federal Reserve neither specifies what a “period of significant stress” entails for purposes of evaluating the proven record of a U.S. municipal security nor any “quantitative, measurable standards for such an assessment,” the Federal

¹⁶ *Id.*

¹⁷ See 12 C.F.R. § 249.3.

¹⁸ See *Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets*, 80 Fed. Reg. 30383, 30385 (May 28, 2015).

¹⁹ See Final Rule, *supra* note 1.

²⁰ See *Supervision and Regulation Letter 12-15* (Nov. 15, 2012), available at

<https://www.federalreserve.gov/bankinforeg/srletters/sr1215.htm>.

²¹ See *id.*

²² See *id.*

²³ See 12 C.F.R. §§ 249.20(c)(2)(ii)(A)-(B).

²⁴ See Final Rule, *supra* note 1.

²⁵ See *id.*

Reserve notes that a Covered Company may refer to “historical market prices and available funding haircuts of the U.S. general obligation municipal security during periods of significant stress, such as the . . . financial crisis.”²⁶

Obligations of a Financial Sector Entity or its Consolidated Subsidiaries. Lastly, the Final Rule specifies that a Covered Company may include as a Level 2B liquid asset a U.S. general obligation municipal security that “has a guarantee from a financial institution as long as the company demonstrates that the underlying U.S. general obligation municipal security meets all of the other criteria to be included as a Level 2B liquid asset without taking into consideration the insurance.”²⁷ Accordingly, a Covered Company may include a U.S. general obligation municipal security that is the obligation of a financial sector entity, or a consolidated subsidiary of a financial sector entity, as long as the U.S. municipal security is (i) “investment grade” and (ii) issued or guaranteed by a public sector entity with obligations that have a “proven record as a reliable source of liquidity” during stressed market conditions.²⁸ Pursuant to the LCR Rule, the term “financial sector entity” includes any “regulated financial company, investment company, non-regulated fund, pension fund, investment adviser, or a company that the [Federal Reserve] has determined should be treated the same as the foregoing for the purposes of the LCR [R]ule.”²⁹

C. Limitations on the Amount of Municipal Securities That May Comprise a Covered Company’s HQLAs

Under the Final Rule, a Covered Company will be quantitatively limited in the amount of U.S. general obligation municipal securities that can be included in the company’s HQLA amount (in the aggregate). Specifically, a Covered Company may only include a limited amount of U.S. general obligation municipal securities that are from a single issuer. Moreover, a Covered Company must not exceed a 5 percent backstop, which limits the amount of U.S. general obligation municipal securities that may be included (in the aggregate) to 5 percent of a Covered Company’s total HQLA amount.³⁰ A Covered Company is not, however, limited in the amount of U.S. municipal securities that it may hold for purposes other than complying with the LCR Rule.³¹

Limitation of Municipal Bonds from a Single Issuer. As in the Proposed Rule, under the Final Rule, a Covered Company may only include as part of its eligible HQLA amount a limited amount of securities issued by a single public sector entity. Specifically, the Final Rule states that a Covered Company may not include as part of its eligible HQLA amount more than two times the average daily trading volume of all U.S. general obligation municipal securities issued by a public sector entity.³²

In reaching this limitation, the Federal Reserve “analyzed data on the historical trading volume of U.S. municipal securities in order to determine the general level of increased sales of U.S. municipal securities that could be absorbed by the market during periods of significant stress.”³³ The Federal Reserve maintained this limitation in

²⁶ See LCR Rule, 79 Fed. Reg. at 61459.

²⁷ See Final Rule, *supra* note 1.

²⁸ See 12 C.F.R. § 249.20(c)(2)(iii).

²⁹ See 12 C.F.R. § 249.3.

³⁰ The Proposed Rule additionally included a third limitation that would have implemented a 25 percent maximum for U.S. general obligation municipal securities with the same Committee on Uniform Security Identification Procedures (“CUSIP”) number that could be included as a Covered Company’s Level 2B liquid asset. See Proposed Rule, 80 Fed. Reg. at 30389. However, the Final Rule eliminated such a limitation. In doing so, the Federal Reserve noted that the establishment of a 25 percent limitation ran the risk of preventing Federal Reserve-regulated Covered Companies “from including certain municipal securities from issuances, particularly small issuances as Level 2B liquid assets, even though some portion of them are highly liquid.” See Final Rule, *supra* note 1.

³¹ See *id.*

³² *Id.*

³³ *Id.*

the Final Rule, notwithstanding that numerous commenters to the Proposed Rule expressed concerns that this limitation would cause “operational difficulties” for a Covered Company as “a system to monitor daily trading volumes of individual municipal issuers’ securities does not currently exist.”³⁴ While acknowledging that an “automated system to monitor daily trading volume . . . does not appear . . . available,” the Federal Reserve explains that such “data on the trading of an individual municipal issuers’ securities is [nevertheless] publicly available.” Accordingly, the monitoring of “such trading volumes” can be conducted “with limited operational difficulties.”

Five Percent Backstop. As in the Proposed Rule, the Final Rule limits a Covered Company from including more than 5 percent of U.S. general obligation municipal securities as part of the company’s HQLA amount (in the aggregate). The 5 percent limitation functions as a “backstop” by “ensuring that a [Covered Company’s] HQLA amount is not overly concentrated in and reliant on U.S. municipal securities.”³⁵ The 5 percent backstop is in addition to, and not in place of, the already existing limitations on the specific kinds of assets that can be included in a Covered Company’s total HQLA amount under the existing LCR Rule, including: (i) the 40 percent limitation on the aggregate amount of Level 2A and Level 2B liquid assets and (ii) the 15 percent limitation on Level 2B assets. Like the already existing limitations under the LCR Rule, the 5 percent backstop applies on both an “unadjusted basis and after adjusting the composition of the HQLA amount upon the unwinding of certain secured funding transactions, secured lending transactions, asset exchanges and collateralized derivatives transactions.”³⁶

D. Calculating HQLAs Under the Final Rule

The Final Rule, consistent with the Proposed Rule, additionally amends the methodology for calculating HQLAs as originally provided under the existing LCR Rule. The Final Rule adds the 5 percent limitation to the calculation provided under Section 249.21 of the LCR Rule by amending “the calculations of the unadjusted excess HQLA amount and the adjusted excess HQLA amount on the LCR Rule.”³⁷ Additionally, the Final Rule incorporates four new calculations to the LCR Rule: (1) the public sector entity liquidity asset amount; (2) the public sector entity security cap excess amount; (3) the adjusted public sector entity security liquid asset amount; and (4) the adjusted public sector entity security cap excess amount. Under the Final Rule, the unadjusted excess HQLA amount equals the sum of the “level 2 cap excess amount,” the “level 2B cap excess amount” and the “public sector entity security cap excess amount.”³⁸ Adjusted excess HQLA amounts equal the sum of the “adjusted level 2 cap excess amount,” the “adjusted level 2B excess amount” and the “adjusted public sector entity cap excess amount.”³⁹

³⁴ *Id.*

³⁵ *Id.*

³⁶ See *id.*; and 12 C.F.R. § 249.21.

³⁷ See Final Rule, *supra* note 1; and 12 C.F.R. §§ 249.21(c), (f).

³⁸ The Final Rule specifies that the public sector entity security cap excess amount is calculated as the greater of:

(i) the public sector entity security liquid asset amount (*minus*) the level 2 cap excess amount (*minus*) the level 2B cap excess amount (*minus*) 0.0526 (or 5/95, the ratio of the maximum allowable public sector entity liquid assets to level 1 assets and other level 2 liquid assets); or (ii) zero. See 12 C.F.R. § 249.21(f)(1).

³⁹ Under the Final Rule, the adjusted public sector entity security cap excess amount is calculated as the greater of:

(i) the adjusted public sector entity security liquid asset amount (*minus*) the adjusted level 2 cap excess amount (*minus*) the adjusted level 2B cap excess amount (*minus*) 0.0526 (or 5/95, the ratio of the maximum allowable adjusted public sector entity security liquid assets to the adjusted level 1 liquid assets and other adjusted level 2 liquid assets) (*times*) the total of: (a) the adjusted level 1 liquid asset amount (*plus*) the adjusted level 2A liquid asset amount (*plus*) the adjusted level 2B liquid asset amount (*minus*) the adjusted public sector entity security liquid asset amount; or (ii) zero. See 12 C.F.R. § 249.21(k)(1).

III. Summary Table

COMPARISON OF H.R. 2209, THE PROPOSED RULE AND FINAL RULE			
Newly Added Definitions			
	H.R. 2209	Proposed Rule	Final Rule
<i>“Investment Grade”</i>	<ul style="list-style-type: none"> Has the same meaning as set forth under 12 C.F.R. Part 1. 	<ul style="list-style-type: none"> Has the same meaning as set forth under 12 C.F.R. Part 1. 	<ul style="list-style-type: none"> Has the same meaning as set forth under 12 C.F.R. Part 1.
<i>“Municipal Obligation”</i>	<ul style="list-style-type: none"> Obligation of a state or any political subdivision thereof, or any agency or instrumentality of a state, or any political subdivision thereof. 	<ul style="list-style-type: none"> Does not specify. 	<ul style="list-style-type: none"> Does not specify.
<i>“General Obligation”</i>	<ul style="list-style-type: none"> Does not specify. 	<ul style="list-style-type: none"> Any bond or similar obligation that is backed by the full faith and credit of the <i>issuing</i> public sector entity. 	<ul style="list-style-type: none"> Any bond or similar obligation that is backed by the full faith and credit of a public sector entity.
Covered Entities			
	H.R. 2209	Proposed Rule	Final Rule
	<ul style="list-style-type: none"> All entities covered by the existing LCR Rule. 	<p>All Federal Reserve-regulated financial institutions that are subject to the LCR Rule, including:</p> <ul style="list-style-type: none"> BHCs, certain SLHCs and state member banks with ≥ \$250 billion in total consolidated assets <u>or</u> ≥ \$10 billion in on-balance sheet foreign exposure; State member banks (1) with ≥ \$10 billion in total consolidated assets <u>and</u> (2) that are consolidated subsidiaries of BHCs that are subject to the LCR Rule; SIFIs, to which the Federal Reserve has applied the LCR Rule by separate order or rule; <u>and</u> BHCs and certain SLHCs that (1) maintain ≥ \$50 billion in total consolidated assets, (2) fail to qualify for any other category above and (3) are subject to the modified LCR Rule. 	<p>All Federal Reserve-regulated financial institutions that are subject to the LCR Rule, including:</p> <ul style="list-style-type: none"> BHCs, certain SLHCs and state member banks with ≥ \$250 billion in total consolidated assets <u>or</u> ≥ \$10 billion in on-balance sheet foreign exposure; State member banks (1) with ≥ \$10 billion in total consolidated assets <u>and</u> (2) that are consolidated subsidiaries of BHCs that are subject to the LCR Rule; SIFIs, to which the Federal Reserve has applied the LCR Rule by separate order or rule; <u>and</u> BHCs and certain SLHCs that (1) maintain ≥ \$50 billion in total consolidated assets, (2) fail to qualify for any other category above and (3) are subject to the modified LCR Rule.
Treatment of Qualifying Municipal Securities Under the LCR Rule			
	H.R. 2209	Proposed Rule	Final Rule
	<ul style="list-style-type: none"> Treats as a Level 2A liquid asset certain “municipal obligations.” 	<ul style="list-style-type: none"> Treats as a Level 2B liquid asset certain “general obligation” municipal securities of an issuing public sector entity that meet similar criteria as corporate debt securities that are included as Level 2B liquid assets. Municipal securities must be liquid and readily marketable under the LCR Rule. 	<ul style="list-style-type: none"> Treats as a Level 2B liquid asset certain “general obligation” municipal securities of a public sector entity that meet similar criteria as corporate debt securities that are included as Level 2B liquid assets under the LCR Rule. Municipal securities must be liquid and readily marketable under the LCR Rule.

COMPARISON OF H.R. 2209, THE PROPOSED RULE AND FINAL RULE, CONT'D

Qualifying Criteria for U.S. Municipal Securities

H.R. 2209	Proposed Rule	Final Rule
<ul style="list-style-type: none"> • Must, as of the calculation date of the HQLAs, be a municipal obligation that is: <ul style="list-style-type: none"> ○ liquid; ○ readily marketable; and ○ investment grade. 	<ul style="list-style-type: none"> • Must: <ul style="list-style-type: none"> ○ be an “investment grade” municipal security; ○ be a “general obligation” municipal security; ○ have a “proven record as a reliable source of liquidity”; <u>and</u> ○ be liquid and readily marketable. • Must <u>not</u> be an obligation of a financial sector entity or a consolidated subsidiary of a financial sector entity (as defined under the LCR Rule). 	<ul style="list-style-type: none"> • Must: <ul style="list-style-type: none"> ○ be an “investment grade” municipal security; ○ be a “general obligation” municipal security; ○ have a “proven record as a reliable source of liquidity”; <u>and</u> ○ be liquid and readily marketable. • <u>May</u> include general obligation municipal securities that have a guarantee from a financial institution, <i>as long as</i> the Covered Company demonstrates that the securities meet all other criteria to be included as Level 2B liquid assets without taking insurance into consideration.

Limitations on the Amount of U.S. Municipal Securities That Can Be Included as HQLAs

H.R. 2209	Proposed Rule	Final Rule
<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • Restrictions on the amount of U.S. municipal securities with the same CUSIP number (\leq 25 percent of total outstanding securities with same CUSIP number); • Restrictions on the amount of a particular U.S. municipal security that can be included in a Covered Company’s HQLA amount (\leq 2x the average daily trading volume of all U.S. general obligation municipal securities from a single issuer); <u>and</u> • Restrictions on the overall amount of U.S. municipal securities that a can be included in a Covered Company’s total HQLA amount (\leq 5 percent of total HQLA amount). 	<ul style="list-style-type: none"> • Restrictions on the amount of a particular U.S. municipal security that can be included in a Covered Company’s HQLA amount (\leq 2x the average daily trading volume of all U.S. general obligation municipal securities from a single issuer); <u>and</u> • Restrictions on the overall amount of U.S. municipal securities that can be included in a Covered Company’s total HQLA amount (\leq 5 percent of total HQLA amount).

Methodology for Calculating HQLAs

H.R. 2209	Proposed Rule	Final Rule
<ul style="list-style-type: none"> • Not applicable. 	<ul style="list-style-type: none"> • Adds the 5 percent limitation to the calculation provided under Section 249.21 of the LCR Rule. • Amends the calculations of the unadjusted excess HQLA amount and the adjusted excess HQLA amount under the LCR Rule. • Incorporates four new calculations into the LCR Rule: <ul style="list-style-type: none"> ○ the public sector entity liquidity asset amount; ○ the public sector entity security cap excess amount; ○ the adjusted public sector entity security liquid asset amount; <u>and</u> ○ the adjusted public sector entity security cap excess amount. 	<ul style="list-style-type: none"> • Adds the 5 percent limitation to the calculation provided under Section 249.21 of the LCR Rule. • Amends the calculations of the unadjusted excess HQLA amount and the adjusted excess HQLA amount under the LCR Rule. • Incorporates four new calculations into the LCR Rule: <ul style="list-style-type: none"> ○ the public sector entity liquidity asset amount; ○ the public sector entity security cap excess amount; ○ the adjusted public sector entity security liquid asset amount; <u>and</u> ○ the adjusted public sector entity security cap excess amount.

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