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FEDERAL RESERVE SYSTEM

12 CFR Part 249

[Docket No. R–1514; Regulation WW]

RIN 7100 AE–32

Liquidity Coverage Ratio: Treatment of U.S. Municipal Securities as High-Quality Liquid Assets

AGENCY: Board of Governors of the Federal Reserve System

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System (Board) is adopting a final rule that amends the Board's liquidity coverage ratio rule and modified liquidity coverage ratio rule (together, LCR rule) to include certain U.S. municipal securities as high-quality liquid assets (HQLA). This final rule includes as level 2B liquid assets under the LCR rule general obligation securities of a public sector entity (*i.e.,* securities backed by the full faith and credit of a U.S. state or municipality) that meet similar criteria as corporate debt securities that are included as level 2B liquid assets, subject to limitations that are intended to address the structure of the U.S. municipal securities market. The final rule applies to all Board-regulated institutions that are subject to the LCR rule: Bank holding companies, certain savings and loan holding companies, and state member banks that, in each case, have $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure; state member banks with $10 billion or more in total consolidated assets that are consolidated subsidiaries of bank holding companies described in the first instance; nonbank financial companies designated by the Financial Stability Oversight Council for Board supervision to which the Board has applied the LCR rule by separate rule or order; and bank holding companies and certain savings and loan holding companies, in each case with $50 billion or more in total consolidated assets, but that do not meet the thresholds described in the first through third instances, which are subject to the Board's modified liquidity coverage ratio rule.

DATES: *Effective Date:* July 1, 2016.

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I. Background and Overview

A. Background and Summary of the Proposed Rule

On May 28, 2015, the Board of Governors of the Federal Reserve System (Board) invited comment on a proposed rule (proposed rule) to allow Board-regulated institutions subject to the liquidity coverage ratio rule and modified liquidity coverage ratio rule (together, LCR rule) [1] to include certain U.S. general obligation municipal securities as high-quality liquid assets (HQLA).[2] The LCR rule, adopted by the Board, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) in 2014,[3] is designed to promote the short-term resilience of the liquidity risk profile of large and internationally active banking organizations, and to further improve the measurement and management of liquidity risk, thereby improving the banking sector's ability to absorb shocks arising during periods of significant stress. The LCR rule requires a company to maintain an amount of HQLA (the numerator of the ratio) [4] that is no less than its total net cash outflow amount over a forward-looking 30 calendar-day period of significant stress (the denominator of the ratio).[5] Community banking organizations are not subject to the LCR rule.[6]

[1] 12 CFR part 249.

[2] 80 FR 30383 (May 28, 2015).

[3] 79 FR 61440 (October 10, 2014).

[4] A company's HQLA amount for purposes of the LCR rule is calculated according to 12 CFR 249.21.

[5] A company's total net cash outflow amount for purposes of the LCR rule is calculated according to 12 CFR 249.30 or 249.63.

[6] The LCR rule applies to (1) bank holding companies, certain savings and loan holding companies, and depository institutions that, in each case, have $250 billion or more in total assets or $10 billion or more in on-balance sheet foreign exposure; (2) depository institutions with $10 billion or more in total consolidated assets that are consolidated subsidiaries of bank holding companies and savings and loan holding companies described in (1); (3) nonbank financial companies designated by the Financial Stability Oversight Council (Council) for Board supervision to which the Board has applied the LCR rule by separate rule or order; and (4) bank holding companies and certain savings and loan holding companies that, in

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Under the LCR rule, asset classes that count as HQLA are those that have historically served as sources of liquidity in the United States, including during periods of significant stress. In identifying the asset classes that qualify as HQLA under the LCR rule, the agencies considered several factors, including an asset class's risk profile and characteristics of the market for the asset class (*e.g.,* the existence of active sale or repurchase markets at all times, significant diversity in market participants, and high trading volume). In addition, the agencies developed certain other criteria, such as operational requirements, that assets must meet for inclusion as eligible HQLA.[7]

The LCR rule divides HQLA into three categories of assets: Level 1, level 2A, and level 2B liquid assets. Specifically, level 1 liquid assets, which are the highest quality and most liquid assets, are limited to balances held at a Federal Reserve Bank and foreign central bank withdrawable reserves, all securities issued or unconditionally guaranteed as to timely payment of principal and interest by the U.S. Government, and certain highly liquid, high-credit-quality securities issued by or unconditionally guaranteed as to timely payment of principal and interest by a sovereign entity, certain international organizations, or certain multilateral development banks. Level 1 liquid assets may be included in a covered company's HQLA amount without limitation and without haircut.

Level 2A and 2B liquid assets have characteristics that are associated with being relatively stable and significant sources of liquidity, but not to the same degree as level 1 liquid assets. All level 2 liquid assets, including all level 2B liquid assets, must be liquid and readily marketable as defined in the LCR rule to be included as HQLA.[8] Level 2A liquid assets include certain obligations issued or guaranteed by a U.S. government-sponsored enterprise (GSE) and certain obligations issued or guaranteed by a sovereign entity or a multilateral development bank that are not eligible to be treated as level 1 liquid assets. Under the LCR rule, level 2A liquid assets are subject to a 15 percent haircut, and the aggregate amount of level 2A and level 2B liquid assets is limited to no more than 40 percent of a covered company's HQLA amount, as calculated under 12 CFR 249.21. Level 2B liquid assets, which are liquid assets that generally exhibit more volatility than level 2A liquid assets, are subject to a 50 percent haircut and may not exceed 15 percent of a covered company's HQLA amount. Under the LCR rule, level 2B liquid assets include certain corporate debt securities and certain common equity shares of publicly traded companies.

Other classes of assets, such as debt securities issued or guaranteed by a public sector entity (municipal securities), are not treated as HQLA under the LCR rule. The LCR rule defines a public sector entity to include any state, local authority, or other governmental subdivision below the U.S. sovereign entity level.[9] The **SUPPLEMENTARY INFORMATION** section to the LCR rule published October 10, 2014, stated that ''[w]ith respect to municipal securities, the agencies have observed that the liquidity characteristics of municipal securities range significantly, and overall many municipal securities are not 'liquid and readily-marketable' in U.S. markets as defined in § ____.3 of the final rule.'' [10] Accordingly, the agencies did not include U.S. municipal securities as HQLA in the LCR rule. However, the Board continued to study the question of whether at least some U.S. municipal securities should be included as HQLA under some circumstances, and subsequently issued the proposed rule.

The proposed rule would have included as level 2B liquid assets under the LCR rule certain U.S. general obligation municipal securities that meet similar criteria as corporate debt securities that are included as level 2B liquid assets. The proposed rule also would have contained several criteria and limitations designed to ensure that U.S. general obligation municipal securities included as HQLA would be sufficiently liquid in times of stress. The proposed rule would have applied to all Board-regulated institutions that are subject to the LCR rule: (1) Bank holding companies, savings and loan holding companies without significant commercial or insurance operations, and state member banks that, in each case, have $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure; [11] (2) state member banks with $10 billion or more in total consolidated assets that are consolidated subsidiaries of bank holding companies subject to the LCR described in (1); (3) nonbank financial companies designated by the Council for Board supervision to which the Board has applied the LCR rule by separate rule or order; and (4) bank holding companies and certain savings and loan holding companies, in each case with $50 billion or more in total consolidated assets, but that do not meet the thresholds described in (1) through (3), which are subject to the Board's modified liquidity coverage ratio rule (together, Board-regulated covered companies).

The proposed rule and the final rule permit U.S. general obligation municipal securities that meet certain criteria to be counted as HQLA for purposes of the LCR rule, subject to certain limits.[12] Neither the proposed rule nor the final rule limit in any way, however, the amount or types of municipal securities that a Board-regulated covered company may hold for purposes other than complying with the LCR rule.

B. Overview of the Final Rule and Significant Changes From the Proposed Rule

The final rule amends the LCR rule to include certain U.S. municipal securities as HQLA. The final rule includes U.S. general obligation municipal securities as level 2B liquid assets if they meet certain criteria, some of which have been adjusted from the criteria in the proposed rule based on comments received. To qualify as HQLA under the final rule, the securities must be general obligations of public sector entities, which includes bonds or similar obligations that are backed by the full faith and credit of the public sector entities. U.S. municipal securities must also be ''investment grade'' under 12 CFR part 1 as of the calculation

each case, have $50 billion or more in consolidated assets but that do not meet the thresholds described in (1) through (3), which are subject to the modified liquidity coverage ratio rule (collectively, covered companies). At this time, General Electric Capital Corporation is the only nonbank financial company designated by the Council for Board supervision to which the Board has applied the LCR rule. 80 FR 4411 (July 24, 2015).

[7] The LCR rule defines eligible HQLA as those high-quality liquid assets that meet the requirements set forth in 12 CFR 249.22.

[8] The liquid and readily marketable standard is defined in 12 CFR 249.3 and is discussed in section II.B.2 of the **SUPPLEMENTARY INFORMATION** section to the LCR rule published October 10, 2014. 79 FR 61440, 61451–52 (October 10, 2014).

[9] 12 CFR 249.3.

[10] 79 FR 61440, 61463.

[11] On-balance sheet foreign exposure equals total cross-border claims less claims with a head office or guarantor located in another country plus redistributed guaranteed amounts to the country of the head office or guarantor plus local country claims on local residents plus revaluation gains on foreign exchange and derivative transaction products, calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) 009 Country Exposure Report. 12 CFR 249.1(b)(1)(ii).

[12] A Board-regulated covered company that holds these securities in its consolidated subsidiaries, including those consolidated securities that are not regulated by the Board, may count the securities as HQLA for purposes of the LCR rule in accordance with 12 CFR 249.22(b)(3) and (4).

date,[13] and must be issued by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during a period of significant stress. Under the final rule, U.S. municipal securities generally do not qualify as level 2B liquid assets if they are obligations of a financial sector entity or a consolidated subsidiary of a financial sector entity. This approach is consistent with the requirements imposed on corporate debt securities and publicly traded common equity shares that are included as level 2B liquid assets. Unlike the proposed rule and the LCR rule's treatment of other level 2B liquid assets, however, U.S. municipal securities that are insured by a bond insurer may count as level 2B liquid assets, so long as the underlying U.S. municipal security would otherwise qualify as HQLA without the insurance.

The proposed rule would have limited the amount of U.S. general obligation municipal securities a Board-regulated covered company could include in its HQLA amount based on the total amount of outstanding securities with the same CUSIP number and the average daily trading volume of U.S. general obligation municipal securities issued by a particular U.S. municipal issuer. The proposed rule would also have limited the percentage of the institution's total HQLA amount that could be comprised of U.S. municipal securities. Commenters opposed these limitations, arguing that U.S. municipal securities have similar risks and liquidity characteristics as other assets included in the HQLA amount that are not subject to these limitations. Instead of these limitations, commenters argued that the credit and liquidity characteristics of a U.S municipal security, such as credit quality, source of repayment, CUSIP size, and issuer size, should be considered in determining whether the security may be included in a company's HQLA amount. After considering comments on the proposed rule, the Board is retaining two and eliminating one of these proposed limitations in the final rule.

[13] 12 CFR 1.2(d). In accordance with section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376, 1887 (2010) section 939A, codified at 15 U.S.C. 78o–7, the final rule does not rely on credit ratings as a standard of credit-worthiness. Rather, the final rule relies on an assessment by the Board-regulated covered company of the capacity of the issuer of the U.S. municipal security to meet its financial commitments.

II. Inclusion of U.S. Municipal Securities as HQLA

The Board received 13 comments on the proposed rule from state and local government officials, trade organizations, public interest groups, and other interested parties. In addition, Board staff held meetings with members of the public, summaries of which are available on the Board's public Web site.[14] Although most commenters generally supported allowing Board-regulated covered companies to include certain liquid U.S. municipal securities as HQLA, they objected to the criteria and limitations on U.S. municipal securities in the proposed rule, stating that they would be overly restrictive. One commenter asserted that the cumulative impact of the restrictions imposed on U.S. municipal securities includable as HQLA would essentially negate the ability of a Board-regulated covered company to include U.S. municipal securities as HQLA. Another commenter suggested that the definition of HQLA is too narrow and concentrated on certain instruments, such as cash and U.S. Treasury securities, which could lead to market distortions such as constrictions in HQLA supply during times of financial stress as banks seek the same sources of HQLA. Although the criteria and limitations in the final rule will exclude certain U.S. municipal securities, these criteria and limitations are designed to include in the HQLA amount only those securities that have liquidity characteristics comparable to other level 2B liquid assets. In addition, the final rule expands the assets that Board-regulated covered companies may include as HQLA, which mitigates potential market distortions caused by the correlated market behavior discussed by the commenter.

One commenter opposed the inclusion of any U.S. municipal securities as HQLA because that commenter believed that U.S. municipal securities would be illiquid during periods of significant stress, which would weaken the effectiveness of the LCR Rule. Under the final rule, the criteria that must be met by, and limitations applied to, the U.S. municipal securities that are included in a Board-regulated covered company's HQLA amount ensures that those securities have a high potential to generate liquidity through monetization (sale or secured borrowing) during a period of significant stress. Thus, the effectiveness of the LCR rule will not be compromised by their inclusion as HQLA.

[14] *See http://www.federalreserve.gov/newsevents/reform_systemic.htm.*

Many commenters also expressed a desire for the OCC and the FDIC to issue rules similar to the Board's proposed rule, in order to promote consistency in the regulation of banking organizations and to allow institutions not regulated by the Board to include U.S. municipal securities as HQLA. The final rule would apply only to Board-regulated covered companies.

A. Criteria for Inclusion of U.S. Municipal Securities as Level 2B Liquid Assets

Under the proposed rule, U.S. municipal securities would have been included as level 2B liquid assets. Commenters argued that U.S. municipal securities instead should be included as level 2A liquid assets because they have exhibited limited price volatility, particularly during the 2007–2009 financial crisis, high trading volumes, and deep and stable secured funding markets. Commenters also contended that many U.S. municipal securities are more liquid and more secure than foreign sovereign securities that may be counted as level 2A liquid assets under the LCR rule and other assets that are level 2B liquid assets, such as corporate bonds. Some commenters highlighted the difference between the treatment of certain U.S. municipal securities under the proposed rule and the treatment under the liquidity coverage ratio standard established by the Basel Committee on Banking Supervision (Basel III Liquidity Framework),[15] which includes municipal securities as level 2A liquid assets. A commenter expressed concern that the rule would create an international inconsistency that would disadvantage U.S. state and local government issuers due to the different treatment of municipal securities in the United States as compared to other jurisdictions.

Certain U.S. municipal securities may be more liquid than some securities that can be included as level 2A liquid assets under the LCR rule. However U.S. municipal securities as a class of assets are less liquid than the asset classes included as level 2A liquid assets under the LCR rule. For example, the daily trading volume of securities issued or guaranteed by U.S. GSEs far exceeds that of U.S. municipal securities. The LCR rule differs from the Basel III Liquidity Framework in the treatment of municipal securities because of

[15] Basel Committee on Banking Supervision, ''Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools'' (January 2013), available at *http://www.bis.org/publ/bcbs238.htm.*

differences in the regulation and structure of the U.S. municipal securities compared to municipal securities markets in foreign jurisdictions.

The proposed rule would have required U.S. municipal securities to be ''liquid and readily marketable,'' as that term is defined in the LCR rule [16] for other level 2B liquid assets. To be liquid and readily marketable, a security must be traded in an active secondary market with more than two committed market makers, a large number of non-market maker participants on both the buying and selling sides of transactions, timely and observable market prices, and a high trading volume. Commenters asserted that most U.S. municipal securities would not meet the conditions specified in the LCR rule to be considered liquid and readily marketable, and therefore would not qualify as level 2B liquid assets under the proposed rule.

Consistent with the LCR rule's treatment of corporate securities, the final rule maintains that a U.S. municipal security may only be included as a level 2B liquid asset if it meets the liquid and readily marketable standard in the LCR rule. The final rule retains this requirement because it will aid in improving a Board-regulated covered company's resilience to liquidity risk by ensuring that U.S. municipal securities included as level 2B liquid assets are traded in deep, active markets, so a company can monetize them easily, even during periods of significant stress. This criterion applies equally to corporate debt securities, and is successfully being implemented by firms for purposes of the LCR. There is no special difficulty in applying this same criterion in the same manner to U.S. municipal securities.

Permitting certain U.S. municipal securities to be included as level 2B liquid assets recognizes that these securities, while not as liquid as a category as other types of HQLA, can serve as highly liquid assets within certain limits and if certain conditions are met.

1. U.S. General Obligation Municipal Securities

Under the proposed rule, 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, which includes bonds or similar obligations that are backed by the full faith and credit of the issuing public sector entity. A revenue bond, which is an obligation that a public sector entity has committed to repay with proceeds from a specified revenue source, such as a project or utility system, rather than from general tax funds, would not have qualified as a level 2B liquid asset.

Commenters argued that revenue bonds have similar liquidity and volatility characteristics to general obligation bonds and therefore should not be treated differently under the final rule. Some commenters stated that the inclusion of revenue bonds would expand the universe of HQLA-eligible municipal bonds without impairing the objectives of the LCR rule. In addition, commenters contended that many revenue bonds are not dependent on a single project as a source of repayment, but are secured by multiple sources of repayment, such as revenues of multiple public entities, pools of assets backed by the full faith and credit of other public entities, or by other sources of tax revenues. One commenter argued that the value of corporate bonds, which are level 2B liquid assets, are tied to uncertain corporate revenues, which is similar to revenue bonds being tied to revenues of a specific project or projects.

An asset's credit quality is an important factor in its liquidity because market participants tend to be more willing to purchase higher credit quality assets, especially during stressed market conditions. During a period of significant stress, the credit quality of revenue bonds tends to deteriorate more significantly than general obligation bonds, and thus, the liquidity of revenue bonds is not as reliable as that of general obligation bonds during a period of market stress.[17] Revenue derived from one or more sources may fall dramatically as domestic consumption declines during a stress, and as the risk of default of any associated revenue bond increases, revenue bonds may experience significant price declines and become less liquid. On the other hand, general obligation bonds are less likely to experience significant price declines during a period of significant stress because they are backed by the general taxing authority of the issuing municipality and, therefore, are less likely to default in times of stress. In fact, historically, there have been a significantly higher number of defaults on revenue bonds than general obligation bonds.

Another commenter argued that revenue bonds should be included as HQLA because revenue bonds receive preferential treatment under chapter 9 of the U.S. Bankruptcy Code. Several commenters requested that the inclusion of U.S. municipal securities as HQLA be based on the issuer's total amount of outstanding debt and the issuer's credit rating, rather than support from the general taxing authority of the municipality. One commenter argued that the term ''general obligation'' is not universally understood and does not necessarily imply a greater level of security than the term ''revenue obligation.''

A revenue bond's treatment in bankruptcy, though a relevant consideration to its liquidity profile, does not necessarily indicate that the bond has sufficient liquidity for inclusion in a Board-regulated covered company's HQLA amount. During a period of significant stress, probability of default is considered along with the magnitude of the expected loss upon a default. As discussed above, without general taxing authority support, the market would likely be more concerned about the probability of default for a revenue bond as compared to a general obligation bond. Similarly, the total amount of outstanding debt supporting a municipal project is not necessarily a reliable indicator of the liquidity of a U.S. revenue bond supporting that project. For example, liquidity could disappear if the specified revenue source of a revenue bond were found to be insufficient to meet its obligation, regardless of the total amount of the revenue bond outstanding. The final rule clarifies that the term ''general obligation'' means a bond or similar obligation that is backed by the full faith and credit of a public sector entity.

The Board will continue to monitor the liquidity characteristics of revenue bonds and consider whether certain revenue bonds should be included as HQLA.

2. Investment Grade U.S. General Obligation Municipal Securities

Consistent with the requirements applied to corporate debt securities that are included as level 2B liquid assets, the proposed rule would have required that U.S. municipal securities be ''investment grade'' under 12 CFR part 1 as of the calculation date.[18] Commenters requested that all U.S. municipal securities that meet the investment grade standard qualify as

[16] *See supra* note 9.

[17] The Board has also recognized that general obligation bonds have a higher credit quality than revenue bonds in its risk-based capital rules, which assign a 50 percent risk weight to revenue bonds and a 20 percent risk weight to general obligations of U.S. public sector entities. *See* 12 CFR 217.32(e)(1).

[18] *See supra* footnote 13.

HQLA regardless of other limitations set forth in the proposed rule, arguing that not including these high-credit-quality securities would increase borrowing costs for state and local governments to finance public infrastructure projects. Commenters also asked for clarity on the definition of ''investment grade,'' stating that without clearer guidance a Board-regulated covered company could interpret ''investment grade'' to include U.S. municipal securities that have low credit quality, inclusion of which in a Board-regulated covered company's HQLA amount would not improve the liquidity risk profile of the firm. One commenter suggested that a municipal security should be included in HQLA on the basis of the issuer's credit rating.

The investment grade criterion helps to ensure that only U.S. municipal securities with high credit quality are included in a Board-regulated covered company's HQLA amount. This criterion requires an issuer of a U.S. general obligation municipal security to have adequate capacity to meet its financial commitments under the security for the projected life of the security, which is met by showing a low risk of default and an expectation of the timely repayment of principal and interest.[19] While higher credit quality is associated with greater liquidity, in the absence of other distinguishing factors, a security's credit quality alone does not guarantee its liquidity. Therefore, the final rule will permit Board-regulated covered companies to include investment grade U.S. municipal securities as HQLA only if they meet the additional criteria for inclusion as level 2B liquid assets and subject to the limitations discussed below.

3. Proven Record as a Reliable Source of Liquidity

Consistent with the requirements for corporate debt securities included as level 2B liquid assets under the LCR rule, the proposed rule would have required that U.S. general obligation municipal securities included as level 2B liquid assets be issued by an entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during a period of significant stress. Under the proposed rule, a Board-regulated covered company would have been required to demonstrate this record of liquidity reliability and lower volatility during periods of significant stress by showing that 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 calendar-day period of significant stress, or 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.

Commenters argued that this standard would severely limit the number of U.S. municipal securities that would qualify for inclusion as HQLA based on the historical performance of U.S. municipal securities in times of stress. The final rule maintains the requirement that U.S. municipal securities must have a proven record as a reliable source of liquidity to qualify as level 2B liquid assets. The percentage decline in value (20 percent) and percentage increase in haircut (20 percent) used to determine compliance with this criterion are the same as those applicable to corporate debt securities included as level 2B liquid assets under the LCR rule.[20] This criterion is meant to exclude volatile U.S. municipal securities, which may not hold their value during a period of significant stress. Inclusion of volatile U.S. municipal securities may result in an overestimation of the HQLA amount available to a Board-regulated covered company during a period of significant stress. U.S. municipal securities that meet this criterion have demonstrated an ability to maintain relatively stable prices, and are more likely to be able to be rapidly monetized by a Board-regulated covered company during a period of significant stress.

Commenters expressed concern that it would be difficult to demonstrate compliance with this requirement without specific examples of a stress scenario and quantitative, measurable standards for such an assessment. As discussed in the Supplementary Information section to the LCR rule published October 10, 2014, a Board-regulated covered company may demonstrate a historical record that meets this criterion through reference to historical market prices and available funding haircuts of the U.S. general obligation municipal security during periods of significant stress, such as the 2007–2009 financial crisis.[21] Board-regulated covered companies should also consider other periods of systemic and idiosyncratic stress to determine if the asset under consideration has proven to be a reliable source of liquidity.

4. Not an Obligation of a Financial Sector Entity or Its Consolidated Subsidiaries

The proposed rule would have excluded U.S. general obligation municipal securities that are obligations of a financial sector entity or a consolidated subsidiary of a financial sector entity, as defined under the LCR Rule.[22] This requirement would have excluded U.S. general obligation municipal securities that received a guarantee from a financial sector entity, including a U.S. municipal security that was insured by a bond insurer that was a financial sector entity. This criterion was intended to exclude U.S. general obligation municipal securities that are valued, in part, based on guarantees provided by financial sector entities, because these guarantees could exhibit similar risks and correlation with Board-regulated covered companies (wrong-way risk) during a period of significant stress. Inclusion may result in an overestimation of the HQLA amount that would be available to the Board-regulated covered company during such period of significant stress.

Commenters argued that an insured U.S. municipal security should not be considered an obligation of a financial sector entity because the primary obligation of the security is that of the issuer, not the insurer. Commenters also expressed concern that insured U.S. general obligation municipal securities would receive punitive treatment on the basis of the insurance regardless of the liquidity of the underlying U.S. general obligation municipal security, which may otherwise qualify as HQLA. Commenters further argued that insured U.S. general obligation municipal securities do not represent the type of highly correlated wrong-way risk that is present when a financial institution holds the debt of another financial

[19] In 2012, the Board issued guidance on the investment grade standard. *See Supervision and Regulation Letter 12–15 (November 15, 2012)*, available at *http://www.federalreserve.gov/bankinforeg/srletters/sr1215.htm.*

[20] Under the LCR rule, equity securities included as level 2B liquid assets have a similar criteria. However, the covered company would be required to demonstrate that the market price of the security or equivalent securities of the issuer declined by no more than 40 percent during a 30 calendar-day period of significant stress, or that the market haircut demanded by counterparties to securities borrowing and lending transactions that are collateralized by the publicly traded common equity shares or equivalent securities of the issuer increased by no more than 40 percentage points, during a 30 calendar-day period of significant stress.

[21] 79 FR 61440, 61459 (October 10, 2014).

[22] The LCR rule defines a financial sector entity to include a regulated financial company, investment company, non-regulated fund, pension fund, investment adviser, or a company that the Board has determined should be treated the same as the foregoing for the purposes of the LCR rule. 12 CFR 249.3.

institution and, since the 2007–2009 financial crisis, bond insurers have modified their risk profiles to limit such wrong-way risk.

Commenters stated that insurance not only provides an additional layer of credit protection, but also provides additional benefits because insurers promote increased transparency, engage in due diligence and credit monitoring, and actively participate in bond restructurings following a default, all of which increase the price stability and liquidity of insured bonds. One commenter suggested modifying the proposed rule to allow bonds insured by U.S. regulated financial guarantors who only insure U.S. municipal securities, because these insurers have less exposure to the broader financial markets.

In response to comments, the final rule adopts a different approach to U.S. general obligation municipal securities that are insured than in the proposed rule. Under the final rule, a Board-regulated 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 level 2B liquid assets without taking into consideration the insurance. This revision is based on further research showing that the market for insured U.S. municipal securities are primarily derived from underlying U.S. municipal securities' liquidity characteristics and not the presence of the insurance, which limits the presence of wrong-way risk. In this way, the requirements in the final rule will help to ensure that an insured U.S. general obligation municipal security would remain liquid regardless of the financial health of the insurer.

B. Quantitative Limitations on a Company's Inclusion of U.S. General Obligation Municipal Securities in Its HQLA Amount

The proposed rule would have limited the amount of U.S. general obligation municipal securities with the same CUSIP number that a Board-regulated covered company could include in its HQLA amount. It would also have limited the amount of a particular U.S. municipal security that a Board-regulated covered company could include in its HQLA amount based on the average daily trading volume of U.S. general obligation municipal securities issued by the U.S. municipality. In addition, the proposed rule would have limited the overall amount of municipal securities that a Board-regulated covered company could include in its HQLA amount to 5 percent of the institution's total HQLA amount. Commenters opposed these limitations, arguing that U.S. municipal securities have similar risks and liquidity characteristics as other assets included in the HQLA amount that are not subject to these limitations. The final rule will retain two and eliminate one of the proposed limitations.

1. Limitation on the Inclusion of U.S. General Obligation Municipal Securities With the Same CUSIP Number in the HQLA Amount

As stated above, the proposed rule would have permitted a Board-regulated covered company to include U.S. general obligation municipal securities as eligible HQLA only to the extent the fair value of the institutions' securities with the same CUSIP number do not exceed 25 percent of the total amount of outstanding securities with the same CUSIP number.

Commenters opposed this limitation, arguing that it would exclude a large portion of the outstanding U.S. general obligation municipal securities from eligible HQLA, and that the limitation was unnecessary to ensure the liquidity of a Board-regulated covered company's HQLA, in light of the proposed rule's other requirements. Commenters emphasized that, due to the structure of the U.S. municipal security market, this limitation would reduce a Board-regulated covered company's ability to invest in U.S. municipal securities and would incentivize them to hold smaller, less liquid blocks of U.S. municipal securities. A commenter stated that applying a limitation at the CUSIP number level would be more limiting than one at the issuer level because single securities issuances with the same CUSIP level are typically smaller in size than an issuer's outstanding debt.

Several commenters noted that U.S. municipal securities generally are not traded or evaluated according to their CUSIP number, as bond issuances are often structured to include many CUSIP numbers identifying issuances with varying maturities and coupon payment schedules, but which are treated similarly in the U.S. municipal securities markets. For example, a very large issuer of U.S. municipal securities may have several hundred individual issuances outstanding, each with different CUSIP numbers. A commenter noted that the number of CUSIPs does not affect the liquidity of a particular security or negatively impact the price stability of U.S. municipal securities. Due to this structure, some commenters suggested that the 25 percent cap could more readily be applied to outstanding U.S. municipal securities of a single issuing entity, rather than to outstanding securities with the same CUSIP number. One commenter expressed concern that a 25 percent cap on securities with the same CUSIP number would cause Board-regulated covered companies to hold smaller positions in individual issuances of U.S. municipal securities rather than large blocks of securities that are more liquid and more frequently traded by institutional investors. Another commenter requested that the Board clarify whether 25 percent of the total amount of outstanding securities with the same CUSIP number could be included as level 2B liquid assets if a company owned more than 25 percent of the outstanding securities.

In response to concerns expressed by certain commenters, the final rule eliminates the 25 percent limitation on the total amount of outstanding securities with the same CUSIP number that could be included as level 2B liquid assets. As indicated in the proposed rule, a Board-regulated covered company that holds a high percentage of an issuance of outstanding municipal securities with the same CUSIP number faces a concentration risk and, therefore, may be unable to readily monetize such positions during a financial stress. This concentration risk is exacerbated in the U.S. municipal securities markets where municipal securities issuances are often structured to include many CUSIP numbers identifying issuances with varying maturities and coupon payments. However, as commenters indicated, the proposed 25 percent limitation would have prevented Board-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. To avoid excluding these highly liquid securities, the 25 percent limitation is not a requirement under the final rule. To the extent these securities are not liquid and, more generally, to address the elevated liquidity risk presented by the structure of the U.S. municipal securities market, the final rule would retain the other limitations on the inclusion of U.S. general obligation municipal securities in a Board-regulated covered company's HQLA amount, as discussed below.

2. Limitation on the Inclusion of the U.S. General Obligation Municipal Securities of a Single Issuer in the HQLA Amount

The proposed rule would have limited the amount of securities issued by a single public sector entity that a company may include as eligible HQLA to two times the average daily trading volume, as measured over the previous four quarters, of all U.S. general obligation municipal securities issued by that public sector entity. As discussed in the Supplementary Information section to the proposed rule, this limitation was designed to ensure U.S. general obligation municipal securities are only included as eligible HQLA to the extent that the market has capacity to absorb an increased supply of such securities.

Many commenters expressed concern regarding this requirement, cautioning that this limitation would put too much emphasis on trading volumes as a measure of liquidity and too little emphasis on the historical price risk of U.S. municipal securities. Some commenters asserted that trading volume, in isolation, is not a reliable indicator of U.S. municipal securities' future liquidity in times of stress. Commenters asserted that trading volumes in the U.S. municipal securities market are often low during times of financial strength, as many investors purchase such securities as ''buy-and-hold'' investments, and therefore past trading volumes during non-stressed periods do not necessarily correlate with a U.S. municipal security's liquidity during periods of significant stress. One commenter asserted that U.S. municipal securities have similar liquidity characteristics as other level 2B liquid assets that are not subject to similar limitations.

As discussed in the **SUPPLEMENTARY INFORMATION** section to the proposed rule, the Board 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. The Board did not include the volume of U.S. municipal securities that are purchased and held for long periods in this analysis because doing so would have assumed that theoretical capacity and demand would exist in periods of significant stress, and would have increased liquidity risk by permitting firms to include an amount of U.S. municipal securities in their HQLA amount that may not be readily monetized in periods of stress. Based on the Board's analysis, two times the average daily trading volume of all U.S. general obligation municipal securities issued by a public sector entity could likely be absorbed by the market within a 30 calendar-day period of significant stress without materially disrupting the functioning of the market. This requirement complements the other criteria and limitations in the final rule and ensures that U.S. general obligation securities that are included as eligible HQLA remain relatively liquid and have buyers and sellers during periods of significant stress.

Commenters also expressed concern that this limitation would pose operational difficulties for Board-regulated covered companies because a system to monitor daily trading volumes of individual municipal issuers' securities does not currently exist. Although it does not appear that an automated system to monitor daily trading volume is available, data on the trading of an individual municipal issuers' securities is publicly available, so Board-regulated covered companies should be able to access data on the daily trading volumes of individual municipal issuers and monitor such trading volumes with limited operational difficulties.

For these reasons, the final rule retains the limitation on the inclusion of U.S. general obligation municipal securities of a single issuer as eligible HQLA. In addition, the Board is clarifying in the final rule that a Board-regulated covered company that owns more than two times the average daily trading volume of all U.S. general obligation municipal securities issued by a public sector entity may include up to two times the average daily trading volume of such securities as eligible HQLA.

3. Limitation on the Amount of U.S. General Obligation Municipal Securities That Can Be Included in the HQLA Amount

The proposed rule would have limited the amount of U.S. general obligation municipal securities that may be included in a Board-regulated covered company's HQLA amount to no more than 5 percent of the HQLA amount. Commenters disagreed with this limitation, contending that U.S. municipal securities are safer and more liquid than some other types of HQLA assets that have no such concentration limitation. A commenter argued that limiting the amount of U.S. municipal securities to 5 percent of the HQLA amount would discourage banks from investing in U.S. municipal securities, would increase funding costs for state and local entities, and would unnecessarily constrict the supply of HQLA. Another commenter suggested that the preexisting limitations in the LCR rule regarding the percentage of HQLA assets that can be level 2 liquid assets would ensure sufficient diversification in HQLA assets.

The final rule maintains the 5 percent limitation on the amount of U.S. municipal securities that can be included in a Board-regulated covered company's HQLA amount, but, as noted, does not include the proposed 25 percent limitation on the total amount of outstanding securities with the same CUSIP number. As discussed above, while the 25 percent limitation effectively could have barred a Board-regulated covered company from including certain municipal securities, and particularly small issuances, in its HQLA amount, the 5 percent limitation should not prevent a Board-regulated covered company from including any particular issuance of municipal securities in its HQLA amount. Rather, the 5 percent limitation will act as a backstop to address the overall liquidity risk presented by the structure of the U.S. municipal securities market, including the large diversity of issuers and sizes of issuances, by ensuring that a Board-regulated covered company's HQLA amount is not overly concentrated in and reliant on U.S. municipal securities. The 5 percent limitation is in addition to the 40 percent limitation on the aggregate amount of level 2A and level 2B liquid assets and the 15 percent limitation on level 2B liquid assets that can be included in a Board-regulated covered company's HQLA amount. It also complements the two times trading volume limitation on U.S. general obligation municipal securities described above, which pertains to individual issuers. Consistent with the LCR rule's limitations on level 2A and level 2B liquid assets, this 5 percent limitation applies both on 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.[23]

The final rule would not, however, limit the amount of U.S. municipal securities a firm may hold for purposes other than complying with the LCR rule.

C. HQLA Calculation

Section 249.21 of the LCR rule provides instructions for calculating a Board-regulated covered company's

[23] *See* 12 CFR 249.21(g).

HQLA amount, which includes the calculation of the required haircuts and caps for level 2 liquid assets. The final rule implements the 5 percent limitation for U.S. general obligation municipal securities by adding the limitation to the calculation in § 249.21 of the LCR rule. Specifically, the final rule amends the calculations of the unadjusted excess HQLA amount and the adjusted excess HQLA amount in the LCR rule [24] and adds four new calculations: the public sector entity security liquid asset amount, the public sector entity security cap excess amount, the adjusted public sector entity security liquid asset amount, and 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. The method of calculating the public sector entity security cap excess amount is set forth in § 249.21(f) of the final rule. Under this section, the public sector entity security cap excess amount is calculated as the greater of (1) the public sector entity security liquid asset amount minus the level 2 cap excess amount minus level 2B cap excess amount minus 0.0526 (or 5/95, which is the ratio of the maximum allowable public sector entity security liquid assets to the level 1 liquid assets and other level 2 liquid assets) times the total of (i) the level 1 liquid asset amount, plus (ii) the level 2A liquid asset amount, plus (iii) the level 2B liquid asset amount, minus (iv) the public sector entity security liquid asset amount; or (2) zero.

Under the final rule, the adjusted excess HQLA amount equals the sum of the adjusted level 2 cap excess amount, the adjusted level 2B cap excess amount, and the adjusted public sector entity cap excess amount. The method of calculating the adjusted public sector entity security cap excess amount is set forth in § 249.21(k) of the final rule. The adjusted public sector entity security cap excess amount is calculated as the greater of: (1) 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, which is 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 (i) the adjusted level 1 liquid asset amount, plus (ii) the adjusted level 2A liquid asset amount, plus (iii) the adjusted level 2B liquid asset amount, minus (iv) the adjusted public sector entity security liquid asset amount; or (2) zero.

The **SUPPLEMENTARY INFORMATION** section to the LCR rule included an example calculation of the HQLA amount.[25] The following is an example calculation of the HQLA amount under the final rule, which is similar to the calculation in the LCR rule, but includes the public sector entity security liquid asset amount, the public sector entity security cap excess amount, the adjusted public sector entity security liquid asset, and the adjusted public sector entity security cap excess amount. Note that the given liquid asset amounts and adjusted liquid asset amounts already reflect the level 2A and 2B haircuts.

(a) Calculate the liquid asset amounts (12 CFR 249.21(b))

The following values are given:

Fair value of all level 1 liquid assets that are eligible HQLA: 17

Covered company's reserve balance requirement: 2

Level 1 liquid asset amount (12 CFR 249.21(b)(1)): 15

Level 2A liquid asset amount: 25

Level 2B liquid asset amount: 140

Of Which, Public sector entity security liquid asset amount: 15

(b) Calculate unadjusted excess HQLA amount (12 CFR 249.21(c))

Step 1: Calculate the level 2 cap excess amount (12 CFR 249.21(d)):

Level 2 cap excess amount = Max (level 2A liquid asset amount + level 2B liquid asset amount − 0.6667*level 1 liquid asset amount, 0)

= Max (25 + 140 − 0.6667*15, 0)

= Max (165 − 10.00, 0)

= Max (155.00, 0)

= 155.00

Step 2: Calculate the level 2B cap excess amount (12 CFR 249.21(e)).

Level 2B cap excess amount = Max (level 2B liquid asset amount − level 2 cap excess amount − 0.1765*(level 1 liquid asset amount + level 2A liquid asset amount), 0)

= Max (140 − 155.00 − 0.1765*(15 + 25), 0)

= Max (− 15 − 7.06, 0)

= Max (− 22.06, 0)

= 0

Step 3: Calculate the public sector entity security cap excess amount (§ 249.21(f) of the final rule).

Public sector entity security cap excess amount = Max (public sector entity security liquid asset amount − level 2 cap excess amount − level 2B cap excess amount − 0.0526*(level 1 liquid asset amount + level 2A liquid asset amount + level 2B liquid asset amount − public sector entity security liquid asset amount), 0)

= Max (15 − 155.00 − 0 − 0.0526*(15 + 25 + 140 − 20), 0)

= Max (− 140 − 8.42, 0)

= Max (− 148.42, 0)

= 0

Step 4: Calculate the unadjusted excess HQLA amount (12 CFR 249.21(c)).

Unadjusted excess HQLA amount = Level 2 cap excess amount + level 2B cap excess amount + public sector entity security cap excess amount

= 155.00 + 0 + 0

= 155

(c) Calculate the adjusted liquid asset amounts, based upon the unwind of certain transactions involving the exchange of eligible HQLA or cash (12 CFR 249.21(g)).

The following values are given:

Adjusted level 1 liquid asset amount: 110

Adjusted level 2A liquid asset amount: 50

Adjusted level 2B liquid asset amount: 20

Of Which, Adjusted public sector entity security liquid asset amount: 20

(d) Calculate adjusted excess HQLA amount (12 CFR 249.21(h)).

Step 1: Calculate the adjusted level 2 cap excess amount (12 CFR 249.21(i)).

Adjusted level 2 cap excess amount = Max (adjusted level 2A liquid asset amount + adjusted level 2B liquid asset amount − 0.6667*adjusted level 1 liquid asset amount, 0)

= Max (50 + 20 − 0.6667*110, 0)

= Max (70 − 73.34, 0)

= Max (− 3.34, 0)

= 0

Step 2: Calculate the adjusted level 2B cap excess amount (12 CFR 249.21(j)).

Adjusted level 2B cap excess amount = Max (adjusted level 2B liquid asset amount − adjusted level 2 cap excess amount − 0.1765*(adjusted level 1 liquid asset amount + adjusted level 2A liquid asset amount, 0)

= Max (20 − 0 − 0.1765*(110 + 50), 0)

= Max (20 − 28.24, 0)

= Max (− 8.24, 0)

= 0

Step 3: Calculate the adjusted public sector entity security cap excess amount (§ 249.21(k) of the final rule).

Adjusted public sector entity security cap excess amount = Max(adjusted

[24] *See* 12 CFR 249.21(c) and (f).

[25] *See* 79 FR 61440, 61474–75.

public sector entity security liquid asset amount − adjusted level 2 cap excess amount − adjusted level 2B cap excess amount − 0.0526*(adjusted level 1 liquid asset amount + adjusted level 2A liquid asset amount + adjusted level 2B liquid asset amount − adjusted public sector entity security liquid asset amount, 0)
= Max (20 − 0 − 0 − 0.0526*(110 + 50 + 20 − 20), 0)
= Max (20 − 8.42, 0)
= Max (11.58, 0)
= 11.58

Step 4: Calculate the adjusted excess HQLA amount (12 CFR 249.21(h)).

Adjusted excess HQLA amount = Adjusted level 2 cap excess amount + adjusted level 2B cap excess amount + adjusted public sector entity security cap excess amount
= 0 + 0 + 11.58
= 11.58

(e) Determine the HQLA amount (12 CFR 249.21(a)).

HQLA Amount = Level 1 liquid asset amount + level 2A liquid asset amount + level 2B liquid asset amount − Max (unadjusted excess HQLA amount, adjusted excess HQLA amount)
= 15 + 25 + 140 − Max (155, 11.58)
= 180 − 155
= 25

III. Plain Language

Section 722 of the Gramm-Leach Bliley Act[26] requires the Board to use plain language in all proposed and final rules published after January 1, 2000. The Board sought to present the proposed rule in a simple and straightforward manner and did not receive any comments on the use of plain language.

IV. Regulatory Flexibility Act

The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (the ''RFA''), generally requires that an agency prepare and make available for public comment an initial Regulatory Flexibility Act analysis in connection with a notice of proposed rulemaking.[27] The Board solicited public comment on this rule in a notice of proposed rulemaking and has since considered the potential impact of this final rule on small entities in accordance with section 604 of the RFA. The Board received no public comments related to the initial Regulatory Flexibility Act analysis in the proposed rule from the Chief Council for Advocacy of the Small Business Administration or from the general public. Based on the Board's analysis, and for the reasons stated below, the Board believes that the final rule will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration, a ''small entity'' includes a depository institution, bank holding company, or savings and loan holding company with total assets of $550 million or less (a small banking organization). As of December 31, 2015, there were approximately 606 small state member banks, 3,268 small bank holding companies, and 166 small savings and loan holding companies.

As discussed above, the final rule would amend the LCR rule to include certain high-quality U.S. general obligation municipal securities as HQLA for the purposes of the LCR rule. The final rule does not apply to ''small entities'' and applies only to Board-regulated institutions subject to the LCR rule: (1) Bank holding companies, certain savings and loan holding companies, and state member banks that, in each case, have $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure; (2) state member banks with $10 billion or more in total consolidated assets that are consolidated subsidiaries of bank holding companies subject to the LCR rule; (3) nonbank financial companies designated by the Council for Board supervision to which the Board has applied the LCR rule by separate rule or order; and (4) bank holding companies and certain savings and loan holding companies with $50 billion or more in total consolidated assets, but that do not meet the thresholds in (1) through (3), which are subject to the modified LCR rule. Companies that are subject to the final rule therefore substantially exceed the $550 million asset threshold at which a banking entity is considered a ''small entity'' under SBA regulations.

No small top-tier bank holding company, top-tier savings and loan holding company, or state member bank would be subject to the rule, so there would be no additional projected compliance requirements imposed on small bank holding companies, small savings and loan holding companies, or small state member banks.

The Board believes that the final rule will not have a significant impact on small banking organizations supervised by the Board and therefore believes that there are no significant alternatives to the rule that would reduce the economic impact on small banking organizations supervised by the Board.

V. Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3521) (PRA), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Board reviewed the final rule under the authority delegated to the Board by the OMB and determined that it would not introduce any new collection of information pursuant to the PRA.

VI. Riegle Community Development and Regulatory Improvement Act of 1994

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (RCDRIA) requires a federal banking agency, in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, to consider any administrative burdens that such regulations would place on depository institutions, and the benefits of such regulations, consistent with the principles of safety and soundness and the public interest.[28] In addition, new regulations that impose additional reporting disclosures or other new requirements on insured depository institutions generally must take effect on the first day of a calendar quarter which begins on or after the date on which the regulations are published in final form.[29] Section 302 of the RCDRIA does not apply to this final rule because the final rule does not prescribe additional reporting, disclosures, or other new requirements on insured depository institutions. As discussed in detail above in the **SUPPLEMENTARY INFORMATION** section, the final rule instead expands the types of assets for which Board-regulated covered companies may include as HQLA under the LCR rule. Nevertheless, the final rule becomes effective on July 1, 2016, the first day of a calendar quarter.

List of Subjects in 12 CFR Part 249

Administrative practice and procedure; Banks, banking; Federal Reserve System; Holding companies;

[26] Public Law 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809.

[27] *See* 5 U.S.C. 603(a).

[28] *See* Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994, 12 U.S.C. 4802.

[29] 12 U.S.C. 4802(b).

Liquidity; Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons stated in the **SUPPLEMENTARY INFORMATION**, the Board amends part 249 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 249—LIQUIDITY RISK MEASUREMENT STANDARDS (REGULATION WW)

■ 1. The authority citation for part 249 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481–486, 1467a(g)(1), 1818, 1828, 1831p–1, 1831o–1, 1844(b), 5365, 5366, 5368.

■ 2. Amend § 249.3 by adding a definition for ''General obligation'' in alphabetical order to read as follows:

§ 249.3 Definitions.

* * * * *

General obligation means a bond or similar obligation that is backed by the full faith and credit of a public sector entity.

* * * * *

■ 3. Amend § 249.20 by redesignating paragraph (c)(2) as paragraph (c)(3) and adding paragraph (c)(2) to read as follows:

§ 249.20 High-quality liquid asset criteria.

* * * * *

(c) * * *

(2) A general obligation security issued by, or guaranteed as to the timely payment of principal and interest by, a public sector entity where the security is:

(i) Investment grade under 12 CFR part 1 as of the calculation date;

(ii) Issued or guaranteed by a public sector entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions, as demonstrated by:

(A) The market price of the security or equivalent securities of the issuer declining by no more than 20 percent during a 30 calendar-day period of significant stress; or

(B) The market haircut demanded by counterparties to secured lending and secured funding transactions that are collateralized by the security or equivalent securities of the issuer increasing by no more than 20 percentage points during a 30 calendar-day period of significant stress; and

(iii) Not an obligation of a financial sector entity and not an obligation of a consolidated subsidiary of a financial sector entity, except that a security will not be disqualified as a level 2B liquid asset solely because it is guaranteed by a financial sector entity or a consolidated subsidiary of a financial sector entity if the security would, if not guaranteed, meet the criteria in paragraphs (c)(2)(i) and (ii) of this section.

* * * * *

■ 4. Amend § 249.21 by:

■ a. Adding paragraph (b)(4);

■ b. Removing the period at the end of paragraph (c)(2) and adding in its place ''; *plus*'';

■ c. Adding paragraph (c)(3);

■ d. Redesignating paragraphs (f) through (i) as paragraphs (g) through (j), respectively, and adding paragraph (f);

■ e. Adding paragraph (g)(4) to newly redesignated paragraph (g);

■ f. Removing the period at the of newly redesignated paragraph (h)(2) and adding in its place ''; *plus'';* and

■ g. Adding paragraph (h)(3) to newly redesignated paragraph (h) and paragraph (k).

The additions and revisions read as follows:

§ 249.21 High-quality liquid asset amount.

* * * * *

(b) * * *

(4) *Public sector entity security liquid asset amount.* The public sector entity security liquid asset amount equals 50 percent of the fair value of all general obligation securities issued by, or guaranteed as to the timely payment of principal and interest by, a public sector entity that are eligible HQLA.

(c) * * *

(3) The public sector entity security cap excess amount.

* * * * *

(f) *Calculation of the public sector entity security cap excess amount.* As of the calculation date, the public security entity security cap excess amount equals the greater of:

(1) The public sector entity security liquid asset amount minus the level 2 cap excess amount minus level 2B cap excess amount minus 0.0526 times the total of:

(i) The level 1 liquid asset amount; plus

(ii) The level 2A liquid asset amount; plus

(iii) The level 2B liquid asset amount; minus

(iv) The public sector entity security liquid asset amount; and

(2) 0.

(g) * * *

(4) *Adjusted public sector entity security liquid asset amount.* A Board-regulated institution's adjusted public sector entity security liquid asset amount equals 50 percent of the fair value of all general obligation securities issued by, or guaranteed as to the timely payment of principal and interest by, a public sector entity that would be eligible HQLA and would be held by the Board-regulated institution upon the unwind of any secured funding transaction (other than a collateralized deposit), secured lending transaction, asset exchange, or collateralized derivatives transaction that matures within 30 calendar days of the calculation date where the Board-regulated institution will provide an asset that is eligible HQLA and the counterparty will provide an asset that will be eligible HQLA.

(h) * * *

(3) The adjusted public sector entity security cap excess amount.

* * * * *

(k) *Calculation of the adjusted public sector entity security cap excess amount.* As of the calculation date, the adjusted public sector entity security cap excess amount equals the greater of:

(1) 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 times the total of:

(i) The adjusted level 1 liquid asset amount; *plus*

(ii) The adjusted level 2A liquid asset amount; *plus*

(iii) The adjusted level 2B liquid asset amount; *minus*

(iv) The adjusted public sector entity security liquid asset amount; and

(2) 0.

■ 5. Amend § 249.22 by redesignating paragraph (c) as paragraph (d) and adding paragraph (c) to read as follows:

§ 249.22 Requirements for eligible high-quality liquid assets.

* * * * *

(c) *Securities of public sector entities as eligible HQLA.* A Board-regulated institution may include as eligible HQLA a general obligation security issued by, or guaranteed as to the timely payment of principal and interest by, a public sector entity to the extent that the fair value of the aggregate amount of securities of a single public sector entity issuer included as eligible HQLA is no greater than two times the average daily trading volume during the previous four quarters of all general obligation securities issued by that public sector entity.

* * * * *

By order of the Board of Governors of the Federal Reserve System, March 31, 2016.

Robert deV. Frierson,

Secretary of the Board.

[FR Doc. 2016–07716 Filed 4–8–16; 8:45 am]

BILLING CODE 6210–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2015–4076; Directorate Identifier 2015–NE–30–AD; Amendment 39–18483; AD 2016–08–07]

RIN 2120–AA64

Airworthiness Directives; Rolls-Royce plc Turbofan Engines

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: We are adopting a new airworthiness directive (AD) for certain Rolls-Royce plc (RR) RB211–22B and RB211–524 turbofan engines with low-pressure turbine (LPT) support roller bearing, part number (P/N) LK30313 or P/N UL29651, installed. This AD requires removal of certain LPT support roller bearings installed in RR RB211–22B and RB211–524 engines. This AD was prompted by a report of a breach of the turbine casing and release of engine debris through a hole in the engine nacelle. We are issuing this AD to prevent failure of the LPT support roller bearing, loss of radial position following LPT blade failure, uncontained part release, damage to the engine, and damage to the airplane.

DATES: This AD becomes effective May 16, 2016.

ADDRESSES: See the **FOR FURTHER INFORMATION CONTACT** section.

Examining the AD Docket

You may examine the AD docket on the Internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2015–4076; or in person at the Docket Management Facility between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this AD, the mandatory continuing airworthiness information (MCAI), the regulatory evaluation, any comments received, and other information. The address for the Docket Office (phone: 800–647–5527) is Document Management Facility, U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590.

FOR FURTHER INFORMATION CONTACT: Brian Kierstead, Aerospace Engineer, Engine Certification Office, FAA, Engine & Propeller Directorate, 1200 District Avenue, Burlington, MA 01803; phone: 781–238–7772; fax: 781–238–7199; email: *brian.kierstead@faa.gov.*

SUPPLEMENTARY INFORMATION:

Discussion

We issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 by adding an AD that would apply to the specified products. The NPRM was published in the **Federal Register** on December 9, 2015 (80 FR 76402). The NPRM proposed to correct an unsafe condition for the specified products. The MCAI states:

> An RB211–524G2–T engine experienced an in-service event that resulted in breach of a turbine casing and some release of core engine debris through a hole in the engine nacelle. The investigation of the event determined the primary cause to have been fracture and release of a Low Pressure (LP) turbine stage 2 blade. The blade release caused secondary damage to the LP turbine, producing significant out-of-balance forces. The event engine was fitted with an LP turbine support bearing where the roller retention cage is constructed from two halves that are riveted together. The LP turbine imbalance resulted in an overload of the LP turbine support bearing and caused separation of the riveted, two –piece roller retention cage. Radial location of the LP turbine shaft was lost, allowing further progression of the event that resulted in a breach of the IP turbine casing.

You may obtain further information by examining the MCAI in the AD docket on the Internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2015–4076.

Comments

We gave the public the opportunity to participate in developing this AD. We considered the comments received.

Support for the NPRM (80 FR 76402, December 9, 2015)

Boeing concurred with the NPRM.

Request To Change Compliance

Orbital ATK and Lockheed Martin requested that the compliance time be based on LPT blade cycles instead of calendar time. Orbital ATK cites correspondence with the U.S. Rolls-Royce representative who recommends a 15,000 cycles-since-new (CSN) duration for the LPT blade design life. Since there is no calendar time driving the unsafe condition, Orbital ATK believes this is a good mitigation factor for low utilization rate operators. Orbital ATK believes that routine borescope inspections of the LPT blades and removal of the engine prior to reaching an LPT blade limit of 15,000 CSN offers an equivalent level of safety.

We partially agree. We agree that the failure mode of the bearing support is not a time-based dependency. However, a compliance time of 24 months is specified to allow for a shop visit interval. We have determined that removal of the LPT support roller bearing addresses the unsafe condition. Operators with unique circumstances may apply for an alternative method of compliance using the procedures listed in this AD. We did not change this AD.

Request To Change Costs of Compliance

Lockheed Martin requested an adjustment to the estimated costs of compliance. The costs to low utilization operators would be significantly increased by imposing an unscheduled shop visit and/or unscheduled engine removal. Another possible contributor for increased costs is the lack of an approved repair station within the United States.

We partially agree. We disagree that no repair stations exist within the U.S. that may perform the work required by this AD. We agree that this AD may drive low utilization operators to the shop faster. Operators with unique circumstances may apply for an alternative method of compliance using the procedures listed in this AD. We did not change this AD.

Conclusion

We reviewed the available data, including the comments received, and determined that air safety and the public interest require adopting this AD as proposed.

Costs of Compliance

We estimate that this AD affects 9 engines installed on airplanes of U.S. registry. We also estimate it will take 0 hours to comply with this AD. Removing the LPT support roller bearing is required during a shop visit; therefore, no additional time is needed for removal. Required parts cost about $8,184 per engine. The average labor rate is $85 per hour. Based on these figures, we estimate the cost of this AD on U.S. operators to be $73,656.

Authority for This Rulemaking

Title 49 of the United States Code specifies the FAA's authority to issue rules on aviation safety. Subtitle I, section 106, describes the authority of the FAA Administrator. ''Subtitle VII: Aviation Programs,'' describes in more