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Invested in America

October 22, 2012

The Honorable Ben S. Bernanke, Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20051
Docket No. R-1430 / RIN 7100-AD87

The Honorable Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AD95; Attention: Comments, Federal Deposit Insurance Corporation

Mr. Thomas J. Curry, Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2.3
Washington, DC 20219
Docket ID OCC-2012-0008

MEMORANDUM TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL DEPOSIT INSURANCE CORPORATION AND THE OFFICE OF THE COMPTROLLER OF THE CURRENCY (the "Agencies")

Re: Treatment of Unrealized Gains and Losses on US Municipal Debt Securities

The Securities Industry and Financial Markets Association ("SIFMA") is pleased to comment on "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action." SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org. This letter supplements other comments provided by SIFMA on this proposal.

I. Introduction

In June 2012, the Agencies issued the joint notice of proposed rulemaking ("NPR") listed above, that would revise their risk-based and leverage capital requirements consistent with agreements reached by the Basel Committee on Banking Supervision ("BCBS") in "Basel III: A Global Regulatory Framework for More Resilient Banks." This letter will address the NPR in regard to U.S. municipal debt securities, described by the Agencies in the Standardized Approach proposed rule as either "General Obligations" or "Revenue Obligations" of Public Sector Entities ("PSE"), which the Agencies have defined to include a state, county, city, town or other municipal corporation, a public authority, and generally any publicly owned entity that is an instrument of a state or municipal corporation. In the NPR and the corresponding Proposed Rule (released on August 30, 2012), the Agencies discuss the "Treatment of Unrealized Gains and Losses of Certain Debt Securities in Common Equity Tier 1 Capital" and go on to mention U.S. municipal debt securities ("US PSE Debt"), stating:

"The agencies also seek comment on whether unrealized gains and losses on general obligations issued by states or other political subdivisions of the United States should receive similar treatment, even though unrealized gains and losses on these obligations are more likely to result from changes in credit risk and not primarily from fluctuations in a benchmark interest rate."

We respectfully disagree with the Agencies that valuation changes in such securities are "more likely to result from changes in credit risk and not primarily from fluctuations in a benchmark interest rate." To the contrary, one hundred years of data demonstrate that valuation changes in municipal debt securities are primarily driven by fluctuations in benchmark interest rates, and not changes in credit risk.

If the Agencies conclude that Accumulated Other Comprehensive Income ("AOCI") associated with US Government Debt Obligations (i.e., U.S. Treasury Securities) should be excluded from Common Equity Tier 1 Capital ("CET1"), then both U.S. PSE General Obligation Debt and U.S. PSE Revenue Debt with certain credit characteristics should receive the same treatment. The Investment Grade definition, contained in Title 12 Code-of-Federal-Regulations[1] ("CFR") Part 1, which were recently updated in order to meet the ratings removal requirements of Section 939A of the Dodd-Frank Act, and relied upon by the Agencies to bifurcate corporate exposures in the June 2012 joint final rule covering "Risk-Based Capital Guidelines: Market Risk", should be used to define the US PSE Debt that should be eligible to have AOCI excluded from CET1. The Agencies could further narrow the universe of eligible US PSE Debt for this purpose (without regard to whether General Obligation or Revenue Obligation) by subdividing the revised Investment Grade definition, with the strongest credits being defined as Very High Quality ("VHQ"), and only allowing AOCI exclusion from CET1 for US PSE debt which met the VHQ designation (see Appendix A).

Symmetrical treatment for the exclusion of AOCI on CET1 for Government Obligations and VHQ Municipal Bonds is warranted in consideration of the following:

[1] Department of Treasury, Office of the Comptroller of Currency Docket ID OCC–2012–0005. June 2012 Final Rule.

A) Valuation changes on VHQ Municipal Bonds move in line with valuation changes on municipal bonds that have been legally defeased with US Government Obligations (Treasury Securities or SLGS[2]), which are referred to as PreRefunded ("PreRe") Municipal Bonds. Both the market and the Code of Federal Regulations make clear that PreRe Municipal Bonds are treated as US Government risk and not the risk of the municipal issuer. Therefore, if no material spread basis exists between PreRe Municipal Bonds and other VHQ Municipal Bonds, one can infer that any basis that does arise between VHQ Municipal Bonds and on-the-run US Treasuries is not credit risk related.

B) VHQ Municipal Revenue Obligation Bonds demonstrate no material price/valuation deviations from VHQ Municipal General Obligation Bonds. The Agencies should not make any distinction based on Revenue Obligation pledge vs. General Obligation pledge. The distinction should be based on credit quality, as it appears the Agencies intend to prevent credit driven valuation changes from being filtered from CET1. During the 2008 credit crisis, for example, VHQ Municipal Revenue Obligation Bonds displayed less spread variation to VHQ Municipal General Obligation Bonds than the spread variation observed between various off-the-run Treasury Notes and Treasury Bonds of similar maturity.

C) Federal Reserve H.15 data shows that during financial stress of the 1930's and 1970's, valuation changes on VHQ Municipal Bonds were similar to that of US Government Debt Obligations.

D) Despite attempts to sensationalize U.S. Public Sector credit issues in the popular media, over the past 100 years the realized credit losses on all municipal debt has been less than 1%. Given that there are over 78,000 unique US PSE entities, even if one US PSE filed bankruptcy every day for the next year; that would represent a 0.5% annual default rate. Although today's credit evaluation methods cannot be applied to the past 100 years, if we use available NRSRO ratings, which was market practice from the 1920's to 2010, there is no available evidence that a VHQ Municipal Bond ever defaulted.

E) As recently noted[3] by staff of the Federal Reserve Bank of New York, defaults on US PSE debt that would meet the Type I and Investment Grade definition are extraordinarily rare. From 1970 through 2011, the 41-year cumulative total percentage of defaulting US PSE Obligors which would generally meet the Type I and Investment Grade definition was less than a quarter of one-percent.

Supporting evidence for the first four statements is contained in exhibits A, B, C, and D, respectively.

We support the desire to align CET1 with Tangible Common Equity ("TCE"); however, we do not believe this should be achieved by inhibiting municipal government access to bank financing relative to Federal

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[2] SLGs are State and Local Government Series (Federal Regulations ("CFR") Title 31, Part 344). SLGs are non-marketable U.S. Government Obligations used primarily for creating escrows to legally defease the principal and interest of Municipal Bond Obligations.

[3] Jason Appleson, Eric Parsons, and Andrew Haughwout, "The Untold Story of Municipal Bond Defaults," Federal Reserve Bank of New York, August 2012.

government access to bank financing, as both Federal and municipal entities govern and serve public taxpayers. Public policy and national interests, implemented at both the Federal and local level via debt financing, benefit the United States of America as a whole, and finance investment in such important areas as elementary schools, preference for home-ownership, military spending, bridges, water delivery systems, roads and subways, among others. Municipal Bonds issued to finance these national objectives should receive the same AOCI exclusion from CET1.

Individual State laws require that public sector deposit monies held at banks in excess of the FDIC insured amount be collateralized with either U.S. Municipal Securities or US Government Obligations. According to Federal Flow of Funds data, State & Local Governments had $409bn of deposits on June 30, 2012. The ability of a bank to take and collateralize these public sector deposits will be damaged if AOCI associated with Municipal and Government Securities impacts CET1, as the additional regulatory capital required to support the Security position will likely make the business untenable from a regulatory capital perspective.

Even if the future is different from the past 100 years, and the default rate on PSE debt increases materially, PSE debt will not lead to widespread U.S. banking problems like the ones caused by bad real estate debt during the savings and loan[4] crisis or the broader financial crisis of 2008. Banks do not hold enough U.S. PSE debt, nor is there enough in existence, to lead to similar banking system losses. US deposit institutions currently hold $4 trillion of non-GSE mortgages[5] vs. $0.3 trillion of US PSE debt, and US tax law discourages banks from holding most state and local government debt. Since 1952 (earliest Fed data available), US Banks have held on average ten times the amount of non-GSE real estate backed mortgage debt than US PSE debt.

Additionally, consistency should be desired for the treatment of US PSE Debt within the US Agency Basel III Standard Approach NPR, the US Agency Basel III Advanced Approach NPR and the pending US Agency release on the Basel III Liquidity Coverage Ratio NPR. Ultimately, the US Agencies should harmonize the standard risk-weights, LCR eligibility and AOCI exclusion from CET1 for US Debt classes. For instance, all VHQ Municipal Bonds should be eligible for a 20% risk-weight under the standard approach, symmetrical AOCI treatment with US Government Obligations and eligible as liquid collateral for LCR purposes.

Depending on the views of other interested parties, such as foreign governments, state and local governments, and other industry groups, the Agencies should consider excluding AOCI from CET1 for all debt instruments which meet the Type I Security definition as contained in 12 CFR Part § 1.2. Delineating debt securities at the OCC definition of “Type I”, for this purpose, would align with US Congressional preference demonstrated by public laws 73-66 and 106-102, which were implemented via 12 U.S.C. 24 (Seventh).

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[4] Former FDIC and RTC chairman William Seidman, “History of the 1980’s, Lessons for the Future”
[5] Federal Reserve statistical release, Flow of Funds Accounts of the United States.

We appreciate the opportunity to provide the Agencies with these comments. If you have any questions or wish to discuss the above comments further, please do not hesitate to contact us.

Sincerely,

Michael Decker
Managing Director and Co-Head of Municipal Securities

EXHIBIT A

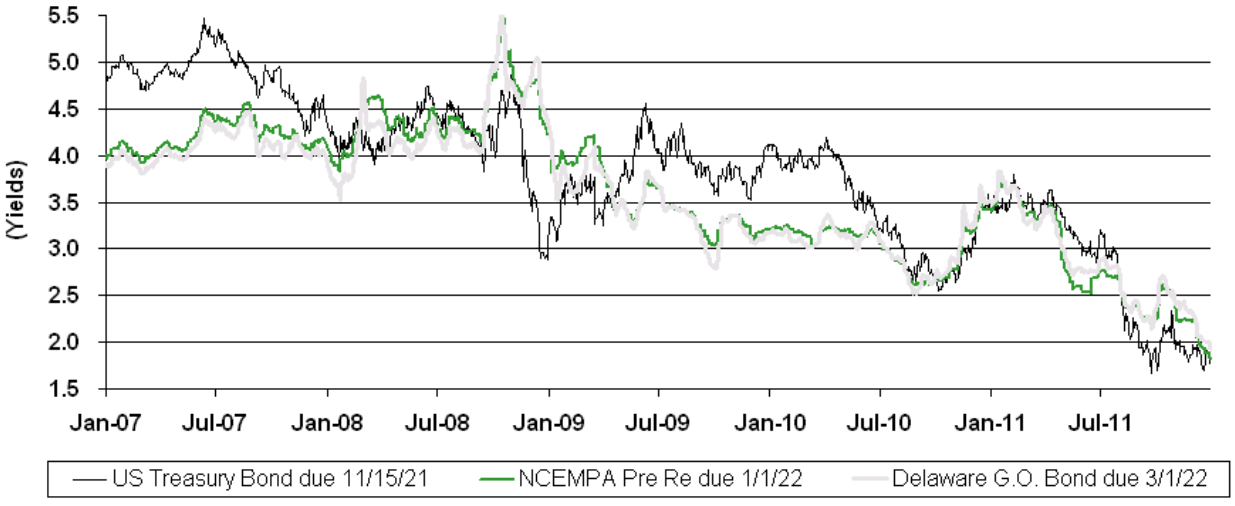
a. Valuation changes on VHQ Municipal Bonds are predominantly attributable to changes in benchmark interest rates and supply vs. demand factors, and not from changes in credit risk.

"The agencies seek comment on alternatives to the proposed treatment of unrealized gains and losses on AFS securities, including an approach where the unrealized gains and losses related to debt securities whose valuations primarily change as a result of fluctuations in a benchmark interest rate would be excluded from a banking organization's regulatory capital"

Valuation changes on VHQ Municipal Bonds generally follow the direction of Treasury Yields (presumed to be Benchmark Interest Rates), except during rapid de-levering periods, such as late 2008 and early 2009. However, these brief distensions are driven by liquidity contractions and not because of a perceived change in the Credit Risk of VHQ Municipal Bonds. This same phenomenon can be observed in the Treasury Market, where off-the-run treasuries widened to on-the-run treasuries and where less liquid US Government Guaranteed paper, such as Israel AID Bonds, widened even further.

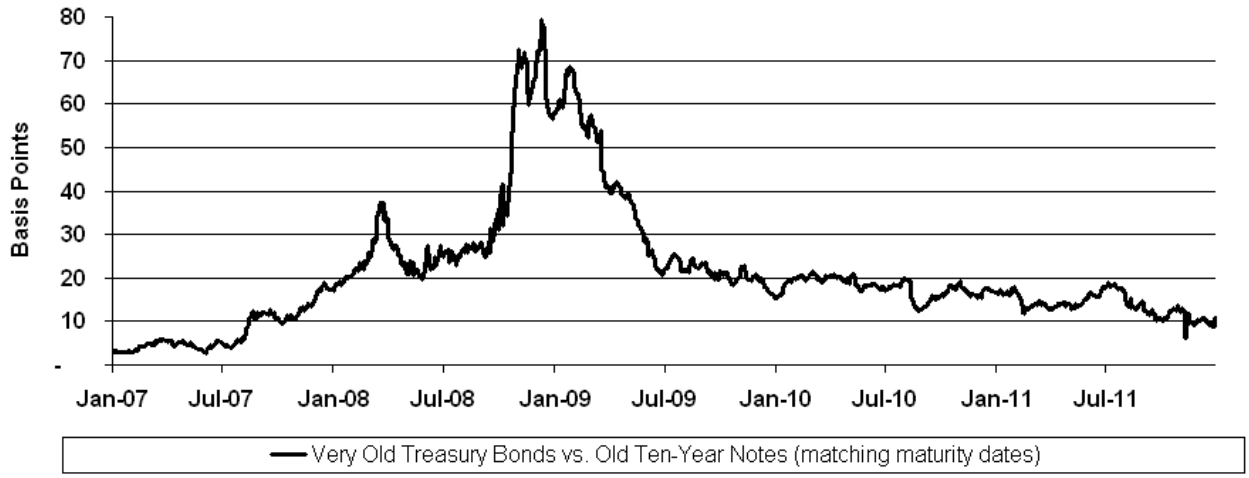
VHQ Municipal Bonds do at times exhibit price and yield volatility versus the Treasury Yield Curve (assuming this is what the Agencies meant when describing "benchmark interest rates"); however, it is easily proven that this volatility does not come from credit risk, as the yields on PreRefunded (US Government Obligation risk and 0% risk weight) municipal bonds tracked yields on VHQ Municipal Bonds. Below is a comparison of three debt instruments:

- US Treasury Bond due 11/15/2021, CUSIP 912810EL8
- North Carolina Eastern Municipal Power Agency ("NCEMPA") CUSIP 658196GA2, legally defeased with US Treasury Collateral in 2003 to a maturity date of January 1, 2022
- General Obligation Bond of the State of Delaware due 3/1/2022



The chart shows that the Delaware General Obligation Bond moves in line with the PreRe NCEMPA Bond. Over the five-year horizon shown above, the average yield on the Treasury Bond was 3.81%, the average yield on PreRe NCEMPA bond 3.59% and on the Delaware State General Obligation Bond 3.55%. During the 4Q of 2008 both the NCEMPA PreRe and the Delaware G.O. Bond lagged the rally in treasury rates, however the Delaware G.O. Bond did not materially deviate from the NCEMPA PreRe. The reason for the very brief distension between VHQ Municipal Bonds and US Government Bonds was not credit related; it was caused by the rapid reduction of financial leverage which existed globally during the month of December 2008.

Furthermore, this same phenomenon was observable in US Government Obligations (shown below), as 20-year old Treasury Bonds widened by 75bp versus just-off-the-run 10-year Treasury notes of the same maturity.



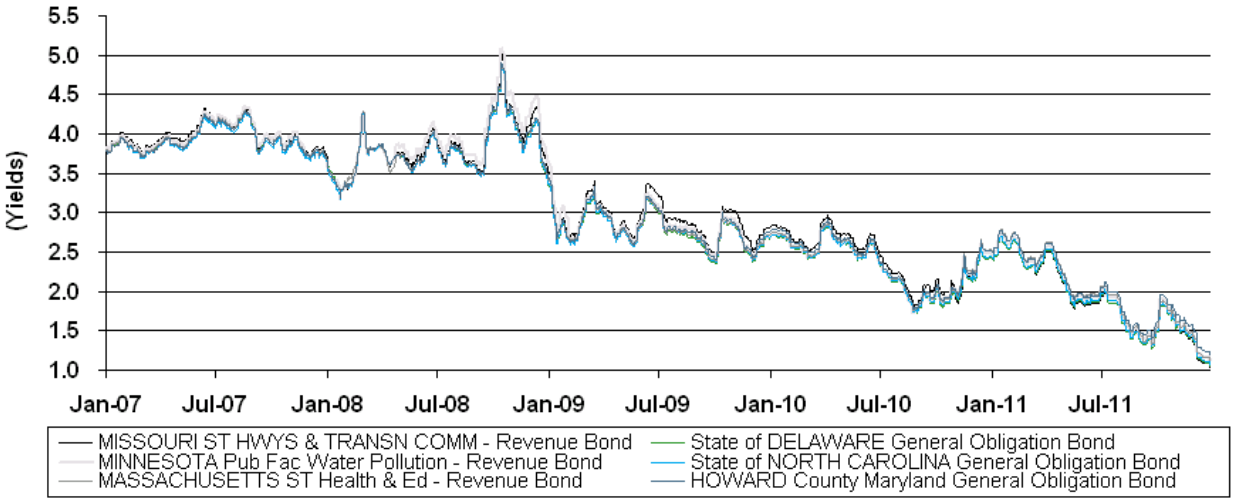
Under the present monetary arrangement (non convertible free floating currency), US Government obligations have no default risk (except for intentional repudiation or Congressional failure to raise the Debt Limit). Therefore, credit risk could not be the cause of an 80bps spread widening between US Government Obligations with the same final maturity, but differing dates of issue. The differential between like-maturity Government Obligations represents a liquidity preference, not a credit concern. The market has demonstrated this, as pre-2008 the spread was less than 10bps, and after going up to 80bps in 2008, has presently returned to 10bps. The same liquidity phenomenon explains the distension of both VHQ Municipal Bonds and pre-re municipal bonds versus on-the-run Treasuries during 2008. Neither very old Treasury Securities nor VHQ Municipal Bonds deviated from on-the-run treasuries because of “credit risk” – they both deviated because of acute liquidity contractions.

EXHIBIT B

b. Valuation changes on VHQ Revenue Obligation Bonds are the same as valuation changes on VHQ General Obligation Bonds.

VHQ Municipal Revenue Bonds demonstrate no material price/valuation deviations from VHQ Municipal General Obligation Bonds. For purposes of AOCI, the Agencies should not make their distinction based on Revenue Obligation Pledge vs. General Obligation Pledge. The distinction should be based on credit quality, as it appears to be the Agencies' intent to prevent valuation changes driven by credit risk changes from being filtered from CET1. During the 4Q of 2008, VHQ Municipal Revenue Bonds displayed less spread volatility compared to VHQ Municipal General Obligation Bonds (see chart below) than recently off-the-run Treasury Notes and 20-year old Treasury Bonds (see top chart on prior page).

The chart below shows the historic yield levels of three VHQ General Obligation Bonds and three VHQ Municipal Revenue Obligation Bonds:



We can observe that the market values of these bonds are materially similar, however the market is also conscious that they are not all backed by the same credit source. State of Delaware General Obligation bonds (AAA/Aaa) will be used as a benchmark for this discussion, since the prior section demonstrated that the market treats them as nearly identical to PreRe Municipal Bonds (US Government Obligation risk). Using daily prices, on December 17th 2008, the Minnesota Water Pollution Control Revenue Bonds reached a peak spread over the Delaware State General Obligations of 36 basis points, i.e., 0.36%. During the 3Q of 2008, the average spread between these two municipal credits was 15 basis points 0.15%. Subsequently, in early 2009, the spread between the two bonds narrowed back, and has been between one and ten basis points each trading day since. This shows us that the mild basis which exists between the VHQ General Obligation Bonds and VHQ Revenue Obligation Bonds is no greater than that which was observed between different US Government Obligations (on-the-run treasuries versus off-the-run treasuries, or active treasury strips versus Israel AID Bonds, for example).

Summary of Bonds shown in chart above, along with their peak widening to Delaware State GO Bonds:

CUSIP	GO/Rev	Description	Maturity	Coupon	PeakSprd(bp)
60636WJG1	Revenue Ob	Missouri State Highway & Transportation Comm	02/01/18	5.00%	**22**
246380B65	General Ob	Delaware State G.O.	03/01/18	5.00%	**0**
604114QQ4	Revenue Ob	Minnesota Pub Fac Water Pollution Control	03/01/18	5.00%	**36**
658256VG4	General Ob	North Carolina State G.O.	04/01/18	5.00%	**4**
57585K3E6	Revenue Ob	Massachusetts St Health & Education Auth	07/01/18	5.00%	**12**
442565QY6	General Ob	Howard County Maryland	08/15/18	5.00%	**16**

EXHIBIT C

c. During severe systematic banking stress & economic stress, such as the 1930's & 1970's, valuation changes on VHQ Municipal Bonds were similar to Treasury Bonds.

Two indices from the Federal Reserve's H.15 release allow us to look at historical financial stress periods:

- Composite Yields on US Treasury Bonds with Maturity over ten years
- Bond Buyer 11 General Obligation Bond Index based on 20-year Municipal Bonds

Great Depression Period: Looking at the 1930's, and assuming a bank acquired 20-year maturity Treasuries and 20-year maturity VHQ Municipal Bonds at the average available yields from January 1926 to December 1928, the table on the following page represents the annual valuation changes, based on annual yield averages.

Yields	1926-'28 Avg	1929	1930	1931	1932	1933	1934	1935	1936	1937
Treasuries	3.45%	3.60%	3.29%	3.34%	3.68%	3.31%	3.12%	2.79%	2.69%	2.74%
Municipals	4.02%	4.28%	4.08%	3.87%	4.33%	4.29%	3.73%	3.00%	2.69%	2.67%

Cumulative Price Change	1929	1930	1931	1932	1933	1934	1935	1936	1937
Treasuries	-2.2%	2.4%	1.6%	-3.3%	2.0%	4.8%	10.1%	11.7%	10.8%
Municipals	-3.5%	-0.8%	2.0%	-4.1%	-3.6%	4.1%	15.3%	20.4%	20.8%

The price changes shown represent the cumulative AOCI impact of the portfolio that was acquired over the three years before 1929. Negative numbers represent OCI losses. Marking the portfolios versus monthly data produces peak losses of 11% for Municipals in May of 1933 and 11% for Treasuries in January of 1932, both of which materially reverted the subsequent month. No reasonable analysis of the yield data from the 1930's can demonstrate that Treasuries have materially less price risk than VHQ municipal bonds, or said in reverse, that VHQ Municipal Bonds created any more valuation risk for banks than Government Securities did during the 1930's.

1970's Stagnation: During 1973-1975, the United States incurred significant economic stress, as Oil prices more than doubled, equities were in a bear market, home prices fell and New York City ran into severe fiscal pressures (municipal issuer with the most outstanding debt at that time). During that period VHQ Municipal Bonds underperformed treasuries in 1974 & 1975, however viewed back from

1972, we see that VHQ Municipal Bonds materially outperformed Treasuries during 1973. VHQ Municipal Bonds were yielding 90% of Treasuries during 1972. When the economy started its downturn in 1973, VHQ Municipal Bonds outperformed treasuries, rallying to 81% of Treasury Yields. Subsequently, VHQ Municipal Bonds backed up to 85% of treasuries in 1974 and 95% of treasuries in 1975 before returning to 90% of treasuries during 1976. Cumulatively, during that period, VHQ Municipal Bonds exhibited no more valuation volatility than Government Obligations.

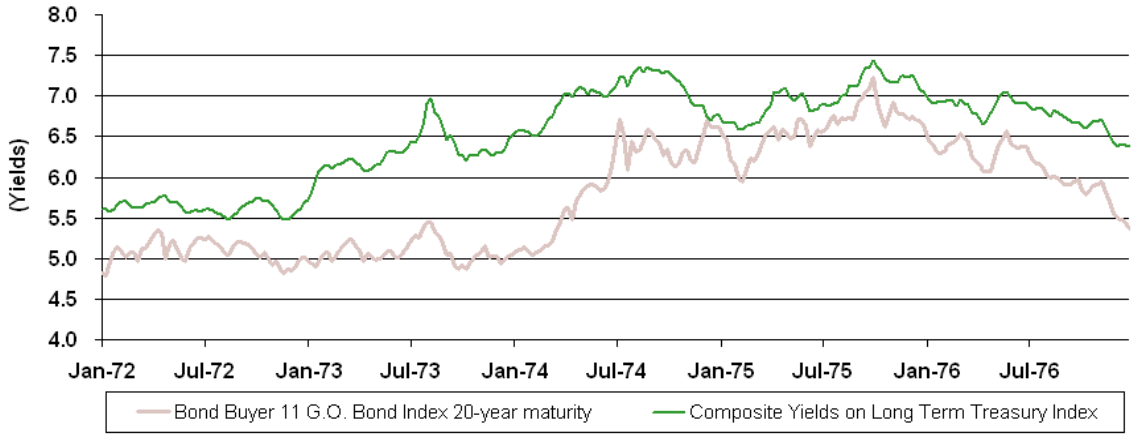


EXHIBIT D

d. Realized Credit losses on all U.S. PSE Obligations since the founding of the Federal Reserve in December 1913 have been trivial. There is no evidence we are aware of that a VHQ U.S. PSE Debt Obligation has ever defaulted.

1929 to 1937 – Great Depression Period: The National Bureau of Economic Research, General Series Number 94, titled "The Postwar Quality of State and Local Debt" by George Hempel, provides significant insight into the credit performance of U.S. PSE Debt Obligations during the Great Depression, and is the source for the content provided in this paragraph. This study shows that from 1929 to 1937, the total ultimate realized credit losses on U.S. PSE Obligations was $100 million on outstanding debt of $17.6 billion, or 0.6% (outstanding debt is taken from 1932). However securities cannot be valued on ultimate realized losses (as they won't occur until the future), the market will value Securities based on fear of potential losses. On that metric, "Credit Risk" needs to reflect the potential universe of market perceived "Default" and the various iterations thereof. On the most expansive measure, the total associated or affiliated indebtedness of state and local units with recorded defaults from 1929-1937 was $2.8bn, or 15% of average total PSE debt outstanding during that period. A second definition of "default" is the total amount of debt that had either delayed interest payments and/or delayed principal payments associated with it, which was $1.35bn, or 7.3% of total outstanding debt. A third definition of "default" is the total dollar amount of the delayed or missed interest and principal payments which was $0.32 billion, or 1.7% of total outstanding debt. The final metric, mentioned initially, was ultimate unrecovered principal and interest, which as $100 million, or 0.6% of outstanding debt. Market psychology for securities valuation would gravitate to the 15% "potential fear" number, which proves that some Municipal Bonds are primarily credit risk driven, however more importantly, also proves that valuations on VHQ Municipal Bonds are not susceptible to being "credit-contaminated" by wide-spread "Default" fears. The historic yield data on VHQ Municipal Bonds from the Great Depression shows that these VHQ Bonds were not materially impacted by the potential for credit losses on other municipal securities. The market was able to discern and evaluate the differences between VHQ Municipal Bonds compared to the entire realm of all Municipal Bonds.

1970 to 2011 – Post U.S. unilateral termination of Bretton Woods system: Relying on municipal market professionals who have been in the business since 1970, along with studies from the NSRO's, there is no known example of a VHQ Municipal Bond defaulting. According to Moody's data, no Municipal Bond carrying ratings better than Aa3 defaulted within 3-years of carrying that rating or better, i.e., none of the 70 defaults on Moody's rated municipal bonds during this period occurred on VHQ Municipal Bonds.

Prominent Municipal "Defaults" over the past 40-years: Below are four of the most notorious municipal credit stories since 1970. Importantly, none of the Bonds that were defaulted on, or close to being defaulted on, were VHQ Municipal Bonds as described in this paper. As reference, none of these PSE entities were rated "Aa3" or better by Moody's at the time of the market became aware of the credit issues:

City of New York (1970's)**:** New York City specific problem related to rolling short-term financing. No principal or interest was lost by public investors in New York City General Obligation Debt. Banks, the State of New York and eventually the Federal government all helped to resolve the issue.

Washington Public Power Supply Nuclear Projects 4 & 5 (1980s)**:** Washington State Court invalidated contracts with local municipalities after the plants were never completed after initial build costs quadrupled and power prices declined. Bond holders recovered 40% of their principal exposure.

Orange County California**:** Losses on an investment portfolio triggered liquidity crises, causing the County to file for bankruptcy; however bondholders lost no principal or interest.

Jefferson County Alabama**:** County failed several times to bring sewer system up to EPA standards. Eventually, Federal Court mandated the County spend an ultimately unaffordable amount of money improving the sewer system. Recovery is still pending.

Appendix A – Defining "Very High Quality"

The Agencies can use the existing definitions contained in *12 CFR Part § 1*, which was updated in June of 2012, to define the boundary of securities that are eligible to have their AOCI excluded from CET1. Per *12 CFR Part § 1;* Type I Securities eligible for purchase by national banks as Investment Securities include U.S. Government Obligations, GSE Obligations, Municipal General Obligations, and certain Municipal Revenue Obligations (along with other Obligations as prescribed by the OCC, such as Canadian Government Debt). The OCC, in order to meet the requirement by Congress for the removal of all NSRO ratings from regulations, recently changed the definition of "Investment-Grade" and "Investment Security" to the following:

12 CFR Part § 1.2 – Definitions

(d) Investment Grade means the issuer of a security has an adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected.

(e) Investment Security means a marketable debt obligation that is Investment Grade and not predominately speculative in nature.

The debt instruments grouped together in the Type I Security definition (versus type II to Type VI or non permissible activities) occurs because of direct Congressional and Presidential passage of The Banking Act of 1933 (Public Law 73-66, 48 stat. 162, enacted June 16, 1933), commonly referred to as Glass-Steagall. Even in the mindset of that environment, which was perhaps similar to the current environment, our predecessors understood monetary system realities along with national interests that necessitated entirely exempting certain classes of debt from new regulations (codified in 12 U.S.C. 24 (Seventh)). That preference for all (and only) Type I Securities, should be continued by excluding their AOCI from impacting CET1.

In order to address the Agencies over-riding preference to prevent valuation changes associated with credit perception from being filtered from CET1, the Agencies could specify that only VHQ Municipal Bonds obtained the symmetrical treatment to Government Obligations in regards to AOCI impact on CET1. Very High Quality can be defined in CFR as follows:

Suggested 12 CFR Part § 1.2 – Additional Definition

*( ) Very High Quality means the issuer of a security has a **very** adequate capacity to meet financial commitments under the security for the projected life of the asset or exposure. An issuer has a **very** adequate capacity to meet financial commitments if the risk of default by the obligor is **very** low and the full and timely repayment of principal and interest is **highly** expected.*

The division point for VHQ would generally correspond to the credit quality groupings described by both the BCBS numerous times and the US Agencies in their NPR's that were released prior to June of 2012 (and post the original '88 Basel Accord). For example see Federal Register / Vol. 73, No. 146 / Tuesday,

July 29, 2008 / Proposed Rules, starting on page 43982, where in Table 3, the first two categories are grouped together.

It's important to note that neither "Investment Grade" nor the proposed "VHQ" definitions are purchase only requirements, but ongoing requirements, subject to review throughout the time the Investment Security is held by the National Bank, per general risk management practices along with OCC requirements (which were recently made more stringent via Final Guidance). In so far as the credit quality of the Municipal Bond declined, so that the bond no longer met the VHQ Municipal Bond definition, the Bond would become ineligible that quarter, and all AOCI associated with the Bond would immediately flow through to CET1. This would prevent Bonds whose valuation became primarily driven by credit from being filtered from CET1.