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House OKs Bill To Equalize Muni Bonds In Liquidity Rules.

Law360, Washington (October 3, 2017, 6:41 PM EDT) — The U.S. House of Representatives passed a bipartisan bill Tuesday that would spread a Federal Reserve rule on the treatment of municipal securities across the financial industry.

Rep. Luke Messer's Municipal Finance Support Act of 2017, which passed on a voice vote Tuesday, would mandate that banks treat otherwise qualified municipal debt as part of their calculations of high-qualified liquid assets under the liquidity coverage rule. That corrects what Messer, R-Ind., called an unintended effect of the liquidity coverage rule that raised borrowing costs for municipalities and put domestic municipal securities against similar foreign municipal securities.

"Frankly, they messed up," Messer said, referring to a prohibition on the treatment of municipal securities as high quality liquid assets.

Messer and others said the legislation is needed to correct a problem with the calculation of the liquidity coverage ratio, a measure of assets that can be easily converted into cash should a financial institution face a sudden cash crunch.

The original liquidity coverage ratio rules by the Fed and other agencies did not allow banks to include municipal securities in their measures of high-quality liquid assets over concerns that those securities would not be as easily sold as corporate debt, Treasury securities or other assets that were included.

After an outcry from municipalities, legislators and others, the Fed revisited the issue in 2016. Its final rule allowed all the banks it regulates with $50 billion or more in assets, plus any nonbank firms designated as systemically important financial institutions, to include debt issued by local governments in their calculations.

The Federal Reserve's final rule is similar to Messer's bill, but the Office for the Comptroller of the Currency and the Federal Deposit Insurance Corporation did not issue updates to their 2014 rule since the Fed changed its high-qualified liquid asset calculations. The bill passed by the House Tuesday would require the regulating agencies to treat all municipal securities that would otherwise meet the rule's HQLA qualifications the same as other financial instruments.

Rep. Bill Huizenga, R-Mich., and others said the continued exclusion of municipal securities from the liquidity coverage calculation would hurt municipalities because their otherwise high-quality securities would be less attractive to financial institutions.

"Excluding municipal securities from treatment as HQLAs will result in higher borrowing costs for municipalities in times of financial strain for state and local governments," Huizenga said.

Rep. Maxine Waters, D-Calif., one of the Democratic backers of the bill, noted that not every town across the country would benefit from the change, but "for those who do, I think it is important for us to recognize that when we have the opportunity to come together to make borrowing easier for municipalities."

Waters noted that the bill would correct a regulatory split for municipal securities, where the governing law would change depending on the institution.

Messer's bill, which had Republican and Democratic backing, would also require that the Federal Reserve, the FDIC and the comptroller of the currency all issue new regulations to handle the change.

Under the new rule, qualifying municipal securities would have to be treated as at least Level 2B liquid assets, which corresponds to as much of a 50 percent "haircut" on the asset's face value in the calculation.

A similar bill is being considered by the U.S. Senate Banking Committee.

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