Bond Case Briefs

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Congress Passed the Banking Bill. Here's What City Leaders Need to Know.

In the wake of the Great Recession, there was broad consensus that Congress and bank regulators needed to take measures to ensure the largest banks in the country, those deemed systemically important financial institutions (or SIFIs), were safeguarding themselves and the role they play in the national economy from dangerous levels of risk.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Act established a host of regulations for the financial industry and defined SIFIs as banks with more than $50 billion in assets. Consensus split on whether or not $50 billion was a fair threshold for determining whether a bank was "too big to fail," or an arbitrary number that would harm community and regional banks.

This March, the Senate passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155), otherwise known as the Senate Banking Bill. And yesterday (May 23), after an agreement to tackle other banking legislation at a future date, the House passed S. 2155 as is and sent it to the President's desk for him to sign into law. The measure is the most substantive banking bill since Dodd Frank and eases some financial regulations.

The legislation also contains provisions, outlined below, that will help cities served by community banks by providing targeted regulatory relief, and will lower interest rates for municipal bonds by making them more attractive to large institutional investors.

1. Community Banks: By raising the threshold for SIFIs from $50 billion in assets to $250 billion, S. 2155 alleviates stricter regulations for smaller community and regional banks. Many community and regional banks fall within the original range and have been constrained by the accompanying compliance regulations that larger national banks are more easily able to meet.

By alleviating these constraints, community banks will be better able to compete in a market that has recently been marked by consolidations of smaller banks into larger ones. Regulatory relief for community banks will help encourage lending and investment in city economies across the country, spur job creation, provide stronger support for anchor institutions and strengthen local economies in communities that have lagged while the national economy has recovered.

2. HQLA Reclassification for Municipal Bonds: Dodd-Frank also required certain banks to meet a Liquidity Coverage Ratio (LCR) to ensure financial institutions have enough liquid assets to weather periods of financial stress. As part of the requirements, banks needed to retain certain levels of "high quality liquid assets" (HQLA).

Bank regulators failed to include municipal bonds as HQLA when they jointly issued their Final Rule on Liquidity Coverage Ratio in the fall of 2014, despite municipal debt having a near-zero default rate and being as — if not more — stable than other assets included in the final rule. Since 2014, NLC and other state, local and public finance groups have pushed for municipal bonds to be classified as HQLA.

S. 2155 instructs bank regulators to reclassify investment grade municipal bonds that are both market ready and liquid as level 2B "high quality liquid assets" (HQLA). Classification of municipal bonds would make them more attractive to larger financial institutions who would then be able to use municipal bonds to satisfy part of their Liquidity Coverage Ratio (LCR) requirements. This in turn would lower interest rates on municipal debt.

National League of Cities

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