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Biggest U.S. Banks Cut Municipal-Bond Holdings as Tax Rates Fall.

- **Shift may mark banks' first retreat from market since 2009**
- **Bank of America, Citigroup, JPMorgan, Wells reduced stakes**

More than a half dozen of the biggest U.S. banks reduced their holdings of state and local government bonds by billions of dollars after the federal government slashed corporate tax rates, making the securities less valuable to one of the market's key buyers.

Bank of America Corp., Citigroup Inc., JPMorgan Chase & Co. and Wells Fargo & Co. together cut their stakes by $7.8 billion during the first three months of 2018, according to quarterly filings with the U.S. Securities and Exchange Commission. State Street Corp., Morgan Stanley and First Republic Bank also reduced their municipal-debt holdings.

The figures show a significant pullback from buyers that had been steadily expanding their ownership of state and local government securities since the end of the recession, helping bolster demand. If the large banks are a guide, the quarter will mark the first time the industry has retreated from the $3.9 trillion market since 2009.

"Definitely the tax change has reduced banks' appetite for municipal bonds, although they'll still be part of the mix going forward," said Alan Schankel, managing director and municipal strategist at Janney Montgomery Scott.

The filings confirm the widespread view among Wall Street analysts that tax-exempt debt would be less alluring to banks after the corporate tax rate was dropped this year to 21 percent from 35 percent. Some of the selling may also have been encouraged by an accounting rule shift that allowed banks to make state and local debt available for sale rather than continuing to hold it to maturity, Tom Kozlik, municipal strategist at PNC Capital Markets, wrote in a report.

The selling may not continue at the same pace since the partial rollback of the Dodd-Frank law this year allows them to use the bonds to satisfy liquidity requirements, giving them an incentive to hold the securities. And the low default rate of municipal bonds will continue to make them a draw to banks that need to manage risk, said Scott Siefers, a bank analyst at Sandler O'Neill & Partners.

"Banks are going to try to prudently manage to maintain high credit quality within the portfolio but to also generate some income as well," Siefers said.

But so far, the corporate tax cut seems to be having the biggest effect. By the end of last year, banks held a record $570 billion of municipal bonds, making them the third largest buyer, according to Federal Reserve figures. While the Fed has yet to release first-quarter data, Barclays Plc analysts estimate that banks decreased their municipal-debt exposure during that time by a combined $15 billion and will continue to pull back, albeit at a slower pace.

Among the biggest banks, JPMorgan reported the largest drop, with its holdings of municipals —

which includes those for trading, available for sale and held to maturity — declining by about $2.9 billion to $54.1 billion as of March 31. Wells Fargo's dropped by $2.1 billion to $59.3 billion during that time. Bank of America and Citigroup cut their stakes by $1.5 billion and $1.3 billion, respectively, the filings show.

Among rivals, State Street's holdings dropped by $1.8 billion, First Republic's by $1.3 billion, Morgan Stanley's by $363 million and Bank of New York Mellon's by $231 million.

Spokespeople for the banks declined to comment on changes in their municipal-debt holdings.

The tax cut made the securities far less valuable than they were previously to businesses. For example, yields on benchmark tax-exempt bonds due in 30 years were 2.9 percent Wednesday. That would have been equivalent to a 4.46 percent taxable yield under previous rates. But now it's about 3.67 percent, less than what they could earn on top-rated corporate debt with similar maturity, according to a Moody's Investors Service index.

Banks' demand for municipal bonds may also be further diminished as the Federal Reserve raises interest rates. Dick Bove, a former banking analyst who now serves as chief strategist at Hilton Capital Management, said tighter monetary policy may make banks extend more capital to making overnight loans, since that could be more of a draw if short-term rates rise faster than long-term ones.

"The yields on long-term securities have not kept pace with the yields on federal funds," Bove said.

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