
US Federal Reserve Board, OCC and FDIC Issue Interim Final Rule with Respect to the Treatment of Certain Municipal Obligations as High-Quality Liquid Assets: Sherman & Sterling

The U.S. Board of Governors of the Federal Reserve System, U.S. Office of the Comptroller of the Currency and U.S. Federal Deposit Insurance Corporation jointly issued an interim final rule and request for comment to treat "liquid and readily-marketable," investment grade municipal obligations as level 2B high-quality liquid assets (HQLAs) for purposes of the liquidity coverage ratio rule. The interim final rule implements Section 403 of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which amends Section 18 of the Federal Deposit Insurance Act and requires the Federal Reserve Board, OCC and FDIC to treat qualifying municipal obligations as high-quality liquid assets (i.e., level 2B liquid assets) for purposes of the LCR rule and any other regulation that incorporates the definition of "high-quality liquid asset" or similar term. For purposes of the LCR rule, the term "municipal obligation" is defined to mean "an obligation of a state or any political subdivision thereof or any agency or instrumentality of a state or any political subdivision thereof. In order for a municipal obligation to qualify as a HQLA, it must be liquid and readily-marketable and investment grade at the time of calculation. With respect to the definition of liquid and readily-marketable, the interim final rule harmonizes the definition across the three agencies and adopts the Federal Reserve Board's definition, which defines the term as a security that is traded in an active secondary market with: (i) more than two committed market makers; (ii) a large number of non-market maker participants on both the buying and selling sides of transactions; (iii) timely and observable market prices; and (iv) a high trading volume. Section 403 also provides that the term "investment grade" has the meaning given in 12 C.F.R. Part 1, which requires that the issuer of a security has adequate capacity to meet financial commitments (meaning that the risk of default is low and full and timely repayment is likely) under the security for the projected life of the asset or exposure. In addition, consistent with the EGRRCPA, the Federal Reserve Board is rescinding its 2016 amendments to the LCR rule, which treated a narrower range of municipal obligations as HQLAs. With respect to FDIC- and OCC-regulated financial institutions, municipal obligations were not previously permitted to be treated as HQLAs. The interim final rule will take effect upon its publication in the Federal Register, with comments due within 30 days of publication.

View full text of the interim final rule.

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