
Volcker Rule Shift Lets Banks Continue Muni Bond Speculation.

U.S. financial regulations that curb banks' ability to speculate with their own money included an exemption for the $3.7 trillion municipal bond market after issuers complained the rules could increase borrowing costs.

The Volcker Rule, issued today by regulators, allows banks to invest in securities issued by states, localities and government agencies. A draft version would have barred the practice with debt sold by agencies and authorities. The Municipal Securities Rulemaking Board has estimated that such issuers account for about 40 percent of municipal bonds.

The change is a victory for borrowers and municipal securities dealers that pressed regulators to broaden the exemption. Without it, agencies that sell bonds for public works projects said they might have faced higher borrowing costs by eliminating banks as investors.

"That was a potential problem that has been avoided," said Matt Fabian, an analyst who tracks tax-exempt securities for Municipal Market Advisors, which is based in Concord, Massachusetts.

The ban on most types of proprietary trading — banks using their own money to speculate in securities markets — is part of the Dodd-Frank Act, approved by Congress in 2010 in response to the credit crisis. The limits are intended to prevent another taxpayer-funded bailout. The rules exempt securities that pose less risk than corporate stocks and bonds.

Regulators' Proposal

Agencies that run water, mass transit systems and school districts often sell municipal debt. In 2011, regulators proposed barring bank investments in such debt. The step drew opposition from bond underwriters as well as government officials, who argued that investments in such securities pose little risk to banks.

Wall Street banks have been closing proprietary trading units in preparation for the rules, and the Federal Reserve gave them until mid-2015 to comply.

Bond underwriter trade groups applauded the decision to allow them to keep investing in municipal securities.

"Had all municipal bonds not been excluded from the rule, the result would have been a more difficult environment for communities raising capital and decreased liquidity in the municipal market," said Kenneth Bentsen, president of the New York-based Securities Industry and Financial Markets Association, which represents banks, in a statement.

By William Selway and Darrell Preston December 10, 2013

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