

# **Bond Case Briefs**

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## **Fitch: Proposed HQLA Rules May Affect Muni Market Liquidity.**

NEW YORK — The proposed high quality liquid asset (HQLA) rule could negatively affect liquidity in the municipal bond market. The U.S. Office of the Comptroller of the Currency, the U.S. Federal Reserve System, and the U.S. Federal Deposit Insurance Company proposed the rule to implement a quantitative liquidity requirement consistent with the liquidity ratio standard established by the Basel Committee on Banking Supervision. If implemented as currently written, it will exclude municipal bonds from the definition of HQLA used in calculating a bank's liquidity coverage ratio.

As of the Fed's third quarter 2013 Financial Accounts of the United States release, U.S.-chartered depository institutions held approximately \$404 billion of the current \$3.69 trillion outstanding municipal securities and loans. Fitch believes that the proposed HQLA definitions may cause banks to begin reducing their holdings in municipal bonds and reinvesting in securities that can be counted as HQLA. Due to the fact that municipal bonds would not count as HQLA, it would be more expensive for banks to hold municipal bonds on their balance sheets and therefore banks that also serve as dealers may become hesitant to provide liquidity in the secondary market using proprietary capital, increasing liquidity risk for municipal bond holders.

The full impact of HQLA remains unclear at this point and the 'Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring' rule is open for public comment until Jan. 31, 2014. Fitch will continue to monitor regulatory updates with regard to HQLA and provide comments as revisions to the rule are released.

The proposal's intent is to strengthen the banking industry by imposing a standard for the liquidity risk profile of certain internationally active banking organizations. In order to comply with the new standards, these banks would hold a combination of liquid assets designated as level 1, 2A, or 2B, sufficient to withstand a 30- or 21-day liquidity stress scenario (depending on the size of total assets of the bank).

January 30, 2014