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U.S. Cities Criticize Treatment of Munis in Bank Liquidity Plan.

(Reuters) – Leaders of U.S. cities and states criticized bank regulators' proposal to block banks from counting municipal debt toward buffers of easy-to-sell assets they will have to hold in case of a credit crunch.

The proposed rules, which require banks to hold enough liquid assets to meet cash needs for 30 days, are a key portion of an international plan to make banks safer after the 2007-2009 financial crisis.

The idea is that, in a crunch, banks should have enough government debt and other assets on hand to cope with customer withdrawals and to post collateral.

In October, the Federal Reserve, Office of the Comptroller of the Currency and Federal Deposit Insurance Corp proposed implementing much tougher rules for U.S. banks than required under the Basel III international agreement.

Those included prohibiting municipal bonds from being counted toward the liquid asset buffer. The comment period on the proposed rules ends on Friday.

That decision "will rob financial institutions of a very safe source of liquidity and prevent institutions from using municipal bonds to diversify their portfolios," Janet Cowell, North Carolina's treasurer, wrote in a comment letter on the proposed rule.

"This will increase borrowing costs, leading to increased taxes and rates for citizens and delayed or foregone capital projects," Cowell said.

Several cities and towns in North Carolina filed similar comments, as did leaders from Houston; Junction City, Kansas; and Washington County, Pennsylvania.

Ratings agency Fitch said on Thursday that U.S. banks held about $404 billion in outstanding municipal securities and loans, and the proposed rules could cause them to reduce those holdings.

"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 agency said.

The proposed liquidity rules are meant to respond to experiences during the crisis, when some banks had significant assets but did not have enough cash on hand to survive runs.

Banks with $250 billion or more in assets, such as JPMorgan Chase & Co and Goldman Sachs Group Inc, must meet the full requirement, while mid-sized banks face a less stringent liquidity requirement.

Regulators want U.S. banks to meet the new requirements two years before most foreign banks must comply, and they also excluded covered bonds and private-label mortgage securities from the liquid asset buffer.

Further, they created a new method for calculating how much liquid assets banks need that would likely mean U.S. banks would have to hold more than foreign banks would.

In comment letters filed with the regulators, several big banks said these extra requirements go too far.

“The U.S. proposal includes a number of new operational requirements … that introduce uncertainties and unnecessary burdens,” wrote Gregory Hackworth, Bank of America Corp’s treasurer.

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WASHINGTON Fri Jan 31, 2014 5:52pm EST