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[Lawmakers Urge Bank Regulators to Rethink Muni Liquidity Proposal.]

WASHINGTON — Two members of Congress are urging federal regulators to reevaluate a proposal to exclude municipal bonds from qualifying as high quality liquid assets under banking rules designed to ensure banks are equipped to handle severe financial and economic stress.

Reps. Gwen Moore, D- Wis. and Terri Sewell, D- Ala., made the request in a two-page letter sent to Federal Reserve chairman Janet Yellen, Federal Deposit Insurance Corporation chair Martin Gruenberg, and Comptroller of the Currency Thomas Curry on Wednesday. Both women are members of the House Committee on Financial Services, which has jurisdiction over banks and capital markets.

The two lawmakers are the latest to question the decision not to classify munis as HQLA in the rule that the Fed, FDIC, and Comptroller's office proposed in October.

The proposed rule would require large banks to maintain a minimum liquidity coverage ratio, defined as the ratio of HQLA to total net cash outflows. Assets would qualify as HQLA if they could be easily and immediately convertible to cash with little or no loss of value during a period of liquidity stress.

The rules could be finalized as soon as this summer, and become effective Jan. 1. Local government groups, banks, and others have already argued that a failure to include munis will hurt the market by making tax-exempt securities a less attractive investment for banks.

Moore and Sewell wrote that they are "concerned" about the rule as proposed. Including munis as HQLA would actually make the rule stronger by diversifying investments and therefore reducing systemic risk, they argued in the letter argues.

"In fact, during the 2008 financial crises, classes of municipal bonds, specifically highly-rated dollar-denominated general obligation and revenue bonds, exhibited greater price stability than comparably rated corporate bonds," they told the banking regulators. "Presumably, this is due to the low default rate of these securities."

The lawmakers also wrote that munis have a lot in common with the securities already classified as HQLA under the proposal, such as corporate bonds. Munis trade over a real-time reporting system and the muni market includes a diverse range of participants, the letter noted, adding, the Fed already accepts municipal bonds as collateral for overnight lending.

Regulators said that they did not include munis as HQLA because "these assets are not liquid and readily-marketable in U.S and thus do not exhibit liquidity characteristics necessary to be included in HQLA under this proposed rule."

Moore and Sewell urged Yellen, Gruenberg, and Curry to collaborate with the Securities and Exchange Commission and Municipal Securities Rulemaking Board to "further evaluate" the proposal and reach “additional findings.”

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