Bond Case Briefs

Municipal Finance Law Since 1971

WSJ: Fed to Consider Including Municipal Bonds in New Bank Safeguards.

Reconsideration Would Come Amid Broad Pushback From States, Treasurers to Muni-Bond Exclusion

WASHINGTON—The Federal Reserve, under pressure from lawmakers and state officials, is considering allowing banks to use certain types of municipal debt to satisfy a new postcrisis financing rule, according to a person familiar with the process.

On Wednesday, U.S. regulators are expected to finalize safeguards requiring that banks hold enough liquid assets—such as cash or those easily convertible to cash—to fund their operations for 30 days if other sources of funding aren't available. Municipal securities issued by states and localities wouldn't count as "high-quality liquid assets" under the rule, meaning such securities wouldn't qualify for use under the new funding requirements.

States and localities have warned that excluding their securities could cause banks to retreat from a $3.7 trillion market in which they have increasingly become an important player, which could driving up borrowing costs to finance roads, schools and bridges. Banks have nearly doubled their ownership in municipal securities over the past decade to more than 11%, according to Fed data.

The Fed is now considering providing some relief in the coming months and may allow banks to include some types of municipal bonds as part of the new safeguards, the person said. The regulator is scrutinizing whether to eventually include more-frequently traded municipal securities but is trying to find a way of distinguishing which bonds it will accept, the person said. There are roughly 60,000 borrowers in the enormous municipal market but only a relatively small number—from large states and cities such as California and New York—see their bonds frequently traded, according to industry experts.

It is unclear if the Fed could act unilaterally to alter the rules, which are being written jointly with the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency.

The rules being finalized Wednesday are intended to prevent a repeat of the 2008 financial crisis when financial markets froze due to a lack of liquidity. Regulators want banks to have enough ready cash on hand so they can finance themselves if markets freeze as they did in the last meltdown. Among those assets that will qualify under the rule as "liquid" are Treasurys and highly rated debt issued by some foreign governments.

In their October proposal, the Fed, OCC and FDIC said they didn't include municipal bonds because "these assets are not liquid and readily marketable in the U.S." The regulators added that securities sold by "public-sector entities generally have low average daily trading volumes."

THE WALL STREET JOURNAL
By ANDREW ACKERMAN
Aug. 28, 2014 2:22 p.m. ET