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State, Local Groups - Make Muni HQLA Case.

WASHINGTON – Eight state and local groups are urging federal banking regulators to classify investment-grade munis with demonstrated liquidity as high-quality liquid assets.

The National Governors Association, National Conference of State Legislators, Council of State Governments, National Association of Counties, National League of Cities, U.S. Conference of Mayors, Government Finance Officers Association, and International City/County Management Association all put their signatures to an Oct. 16 letter asking that high-quality marketable muni bonds count as HQLA under a new liquidity coverage ratio rule adopted last month.

That rule, a joint effort by the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency, requires the largest banks to hold a certain amount of high-quality, easily-marketable securities that could be converted to cash in a fiscal crisis. HQLA are categorized on the basis of risk and liquidity. Level 1 assets are viewed as the most liquid and least risky, and Level 2a and 2b considered less liquid but still readily marketable.

Corporate bonds, U.S. Treasuries, and foreign sovereign debt are included in the rule's HQLA list, while munis are not. While the Fed has acknowledged that some munis could qualify and that members of its staff are working on an amendment to include some as HQLA, regulators have expressed doubt about how liquid munis really are and have argued that banks don't hold them for liquidity purposes. Though some analyst have said the market can adjust to the new rule, market participants remain concerned that it will inhibit banks' appetite when it becomes effective Jan. 1, driving up costs for issuers.

The state and local group letter stopped short of suggesting specific issuer size parameters as the Securities Industry and Financial Markets Association suggested did in its own letter, which proposed that the investment grade bonds of issuers and obligors with at least $100 million of marketable securities outstanding should qualify as HQLA. But the issuer groups still made the case that munis should be able to qualify as level 2a HQLA and suggested that large volume issuers whose bonds who display low price volatility should qualify.

"Municipal securities are and continue to be among the safest for investors and are highly tradeable," the groups wrote. "The final rule should reflect the strength, integrity and value of municipal securities by identifying them as HQLA."

Any amendment proposal produced by the Fed staff would need to be approved by the regulators before it could take effect.

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