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Yellen: Fed Working on Identifying Munis as HQLA.

WASHINGTON – The Federal Reserve is working to identify municipal securities that could be treated as high-quality liquid assets under rules requiring banks to maintain liquidity coverage ratios, Fed chairwoman Janet Yellen told members of a House committee.

“We’re working very expeditiously on that, and hope to be able to identify some of those bonds that would qualify for … different LCR treatment,” Yellen told members of the House Financial Services Committee at a hearing on Wednesday. “We’re in discussions with the other banking agencies.”

Yellen was asked about the Fed’s progress by Rep. Gwen Moore, D-Wis., who along with other House members, sent at least two letters last year, urging the Fed to reconsider excluding munis as HQLA under rules that require large financial institutions to maintain minimum liquidity coverage ratios so they can better handle financial stress.

The liquidity rules apply to U.S. banks and other financial institutions with at least $250 billion of total assets or consolidated on-balance sheet foreign exposures of at least $10 billion.

An LCR is defined as the ratio of HQLA to total net cash outflows. Assets would qualify as HQLA if they could be easily and quickly convertible to cash with or no loss of value during a period of liquidity stress.

Bank regulators failed to include munis as HQLA in the rules, contending are not liquid or easily marketable. They also said banks don’t hold munis for liquidity.

But muni market participants, Moore, Sen. Chuck Schumer, D-N.Y., and other lawmakers have fought the exclusion, arguing that investment-grade munis have lower default rates than corporate bonds and are very marketable. They also have warned that the exclusion will raise borrowing costs for issuers, as well as decrease liquidity and increase volatility in the muni market.

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