# Bond Case Briefs

*Municipal Finance Law Since 1971*

---

## Fight Among Regulators Over Municipal Bonds Could Mean No New School for Your Kid.

WASHINGTON • States and cities have griped for months that a rule designed to make big banks safer will prompt a Wall Street exodus from the $3.7 trillion municipal bond market. While the Federal Reserve wants to make changes, two key regulators are standing in the way.

At issue is a measure approved in September that requires banks to hold a chunk of assets that could be easily converted into cash during a crisis. While munis weren't considered liquid enough to make the cut, Fed officials have been convinced after aggressive lobbying by lenders and local governments, said three people with knowledge of the matter.

The problem: The Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency remain unconvinced, the people said. With the largest U.S. banks accounting for about 12 percent of investments in munis, politicians are concerned that unless the rule is revised, it will become more expensive to build bridges, roads and schools.

This will have "real price and yield impacts," James McIntire, the treasurer of Washington state, said in an interview. "To drive up the cost of our debt issuance for no quantifiable reason would be a mistake."

The September rule was among several measures adopted by regulators to prevent a repeat of the 2008 financial meltdown, when markets froze and some banks needed a government bailout to stay afloat. It requires lenders to hold enough assets that are deemed high-quality — such as Treasuries, highly-rated corporate bonds and even the debt of foreign governments — to be able to endure a 30-day squeeze.

Many bonds backing infrastructure projects are bought and sold infrequently. Still, Fed officials have privately advocated that banks shouldn't face restrictions on holding munis that trade more often, said the people who asked not to be named because discussions between the agencies are private.

So far, regulators at the FDIC and OCC say they haven't seen enough evidence to bring them around to the Fed's point of view, according to the people. The rule, which banks must fully comply with by 2017, can't be changed without their consent.

Spokesmen for the Fed, FDIC and OCC declined to comment.

Sen. Charles Schumer, D-New York, has been a vocal critic of the decision regulators made on munis. At a September hearing, he told representatives from the Fed, FDIC and OCC that the rule would undermine "the lifeblood of development in this country." Schumer has since continued to make his case behind the scenes in private conversations with regulators, said a person with knowledge of the discussions.

"Many municipal bonds are highly liquid and they should count as such," Schumer said in a statement. “Creating a disincentive for banks to hold these bonds could slow or even stop major infrastructure projects in their tracks.”

While Wall Street generates revenue underwriting munis, banks also have been the biggest purchasers of the bonds in recent years, adding $200 billion to their holdings since 2010, Fed data shows. The buying has boosted prices at a time when some investors are selling because of concerns that as interest rates rise, some issuers may struggle to pay their debt.

One argument in favor of letting banks continue their buying is that borrowers in the muni market typically default less frequently than corporate issuers. Rep. Michael Capuano, D-Mass., made that point to Fed Chair Janet Yellen last month, saying at a hearing that curtailing muni investments was akin to telling lenders that their money would only be safe if it’s stuffed under a mattress.

Yellen’s response: “It’s not a question of safe; it’s a question of liquid and how rapidly these assets can be converted into cash.”

March 18, 2015 4:00 pm • By JESSE HAMILTON and CHEYENNE HOPKINS

Bloomberg News

*With assistance from William Selway in Washington.*

Copyright © 2025 Bond Case Briefs | bondcasebriefs.com