
Key Regulator Shows No Sign on Budging on Muni Bank Rule.

(Reuters) – A key U.S. regulator said on Wednesday it supports banks making prudent investments in the U.S. municipal bond market but showed no indication it would soften its stance on refusing to allow banks to include muni bonds as liquid assets.

Regulators in September issued rules that banks must hold enough easy-to-sell assets in case of a crisis. Municipal bonds, used by U.S. localities to fund infrastructure investments and other spending, were not included in the buffer.

Since then towns and cities have lobbied regulators to change the rules, fearing that exclusion of muni bonds from capital requirements would discourage banks from holding the bonds and drive up their borrowing costs.

"The agency considers bank investments in municipal securities a prudent activity when part of a safe and sound investment strategy," the Office of the Comptroller of the Currency (OCC) said in a statement.

The OCC issued the statement after a Bloomberg report said the OCC and the Federal Deposit Insurance Corporation (FDIC) were refusing to budge on the issue. The Fed has publicly said it wants to amend the rule to include munis.

A rule change, however, would require agreement of the other two bank regulators, the OCC and the FDIC. While the Fed is open to a change, the OCC is most opposed to amending the rule, while the FDIC holds a middle ground, with more of a "wait-and-see" approach, a regulatory source said.

The OCC and the Federal Reserve declined to comment. The FDIC did not immediately return a request for comment.

The OCC pointed out that bank ownership of muni bonds had increased since the so-called Liquidity Coverage Ratio Rule became final in October of last year.

Retail investors are the largest holders in the $3.7 trillion municipal bond market. In the second quarter, households held 40 percent of all outstanding municipal bonds, $1.5 trillion, while banks held $458 billion, or around 12 percent according to Federal Reserve data.

U.S. states and cities wrote a letter urging regulators to allow banks to treat municipal bonds as liquid assets in October, arguing that munis are among the safest investments and "highly tradeable".

The letter was signed by 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, International City/County Management Association and the Government Finance Officers Association.

BY EDWARD KRUDY

NEW YORK, March 18, 2015

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