

Bond Case Briefs

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Why Do Politicians Care So Much About the Fine Print in Regulators' Liquidity Requirements for Banks?

According to civics textbooks, Congress passes broad laws and leaves it to the regulators to work out the details on how to implement them. But when the regulators craft a rule that could pinch institutions in virtually every congressional district, lawmakers are apt to jump back in.

Hence the unusual bipartisan campaign challenging the Federal Reserve and other bank regulators over the arcane question of just what counts as “level 2A high-quality liquid assets,” or HQLAs, on a bank’s balance sheet.

Under postcrisis rules designed to limit the need for unpopular bailouts, banks are supposed to hold enough liquid assets to fund operations for as long as 30 days in case a new crisis triggers a sudden need for large amounts of cash. Nobody seems to disagree with that goal.

But controversy arose when the regulators ranked different kinds of assets in terms of their value in providing liquidity. They gave the highest weight to cash, Treasuries, and mortgage-backed securities. They want to give less weight to securities issued by municipal governments. “Municipal securities generally are not very liquid,” or easily dumped at a time of stress, Fed Chairwoman Janet Yellen told Congress Feb. 11.

But municipal securities are crucial to funding local governments and infrastructure projects around the country. Issuers worry the regulators’ determination will discourage banks from holding munis, forcing them to pay higher interest rates to keep borrowing. On Feb. 1, the House passed by voice vote a bill overriding the rules and allowing banks to count municipal bonds to meet their liquidity requirements.

It’s less about the safety and soundness of banks and more about the ability of towns and counties in their districts to raise funds—a completely different, albeit understandable, goal.

“Without this fix, critical local infrastructure and other projects could lack the financing they need to go forward, costing us jobs and hurting local communities,” Rep. Carolyn Maloney (D., N.Y.), a leading sponsor of the legislation, said in a statement.

The bill still needs to be considered in the Senate, where the issue came up during Ms. Yellen’s most recent testimony. “This bill would interfere with our supervisory judgments about what constitutes adequate liquidity,” she told lawmakers. But that has nothing to do with building roads.

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