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Senators Propose Bill to Include Municipal Debt as Liquid Assets.

A group of U.S. senators introduced a bipartisan bill that includes municipal bonds among assets that banks need to hold to weather a financial shock.

Democratic Senators Mark Warner and Chuck Schumer and Republican Mike Rounds introduced a scaled-down version of legislation that passed the House in February that would classify investment grade municipal bonds on par with U.S. agency securities issued by Fannie Mae and Freddie Mac to meet bank liquidity rules.

The Senate measure classifies munis as “Level 2B” assets comparable to certain corporate bonds and stocks.

Level 2B assets are subject to a 50 percent “haircut,” meaning if a bank holds \$1 million of a municipal bond, \$500,000 counts towards its liquidity buffer. The House bill classifies munis as Level 2A assets, which have a 15 percent haircut. Level 2A and 2B assets can make up no more than 40 percent of total “high quality liquid assets,” with Level 2B assets restricted to no more than 15 percent of HQLA.

“As a former governor, I know firsthand how critical it is for states and municipalities to issue bonds that fund their basic operations, including the construction of schools, roads, and local projects,” Warner said in a news release “We must ensure a continued and reliable access to capital markets for our local governments, and this legislation represents a compromise that achieves that while appropriately balancing concerns for the long term stability of our financial system.”

Local-government officials and securities-industry lobbyists turned to Congress after regulators including the Fed adopted rules that would restrict or bar banks from including munis among high quality liquid assets. State treasurers and city finance officers said the new rules, if not changed, will saddle them with higher borrowing costs eliminating incentives banks have to purchase the bonds.

“Having bipartisan, bicameral legislation is an excellent first step,” said Emily Brock, federal liaison for the Government Finance Officers Association. “It shows a commitment on their part for what we municipal securities to be, which is high quality and liquid.”

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by Martin Z Braun

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