Banking and Finance Law Daily Wrap Up,PRUDENTIAL REGULATION—Fed proposes letting state, municipal bonds count toward liquidity needs,(May 21, 2015)

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The largest financial institutions supervised by the Federal Reserve Board would be allowed to rely on high-quality state and municipal government bonds to partially satisfy their liquidity obligations under a proposed amendment to Reg. WW—Liquidity Risk Measurement Standards (12 CFR Part 249). The Fed, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency adopted liquidity coverage rules in September 2014 (see *Banking and Finance Law Daily*, Sept. 3, 2014), and the exclusion of state and municipal bonds became controversial almost immediately.

Liquidity coverage. The liquidity coverage rules apply to banking organizations that have $250 billion or more in total assets or $10 billion or more in on-balance sheet foreign exposures. Covered organizations' subsidiaries that have assets of $10 billion or more also are covered. Smaller bank and thrift holding companies that have $50 billion in total assets are covered by a less strict liquidity coverage ratio requirement. Each covered institution must hold high-quality, liquid assets—assets that can be converted easily and quickly into cash—in an amount at least equal to its projected net cash outflow during a 30-day stress period.

Expanded HQLA. The rules adopted by the three agencies excluded state and municipal bonds from being considered high-quality liquid assets (HQLA). According to the Fed, the proposal would allow investment grade general obligation bonds to be counted as HQLA if the bonds are issued or guaranteed by "a public sector entity whose obligations have a proven record as a reliable source of liquidity in repurchase or sales markets during stressed market conditions."

Neither revenue bonds nor obligations of a "financial sector entity" would be included in HQLA. The latter exclusion currently would apply to general obligation bonds insured by a bond insurer, as the Fed believes the insurance could distort the valuation of the bonds.

State and municipal bonds would be counted as level 2B HQLA, which is the lowest of the three categories set by the rules. This categorization would make them comparable to corporate bonds, which were included as HQLA in the original rule. The proposal includes limits on the amount of bonds that could be included in a covered financial institution's HQLA.

Calls for change. Pressure for the inclusion of state and municipal bonds quickly followed the agencies' rule adoptions. Within three weeks, Sen. Charles Schumer (D-NY) was warning that excluding the bonds from the liquidity coverage ratio would slow state and local infrastructure development across the nation (see *Banking and Finance Law Daily*, Sept. 24, 2014). A

bipartisan bill was introduced in the House of Representatives by Reps. Carolyn Maloney (D-NY) and Luke Messer (R-Ind) to force all three regulators to change their rules (see *Banking and Finance Law Daily*, May 6, 2015).