THE BOND BUYER

# Munis as HQLA comes closer to reality

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LOS ANGELES – The House is set to vote as soon as this coming week on banking legislation that would classify certain municipal bonds as high-quality liquid assets, a provision that market groups have long sought to improve the demand for munis.

House Speaker Paul Ryan, R-Wis., announced on May 8 that the House and Senate had struck a deal in which the House would agree to vote on the Senate's bank "regulatory relief" bill in exchange for the Senate's willingness to take up a package of measures previously approved by the House.

S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, won Senate approval in March with a vote of 67-31. The bill was sponsored by Sen. Mike Crapo, R-Idaho, but had 12 Democrats as co-sponsors. If it becomes law, it will require federal banking regulators to classify readily tradeable, investment-grade municipal securities as high-quality liquid assets under their rules.

The measure is a response to Liquidity Coverage Ratio rules adopted by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corp. in 2014. These rules require banks with at least $250 billion of total assets or consolidated on-balance sheet foreign exposures of at least $10 billion to have a high enough liquidity coverage ratio – the amount of HQLA to total net cash outflows – to deal with periods of financial stress.

Munis didn't make the cut in the HQLA classifications, and many believe that the cost of borrowing has risen in part because banks have less appetite for securities they can't use to satisfy their HQLA requirements.

If the banking bill as written is passed into law, banks would be able to treat some munis as level 2B HQLAs, the same level as for mortgage backed securities. That’s a level down from the 2A HQLA securities the market was hoping munis would be placed into alongside sovereign debt.

House Majority Leader Kevin McCarthy, R-Calif., said May 10 that the banking bill was among several measures that could come up for vote this week. No votes are expected on Monday, but the chamber is taking up legislative business every other day of the week.

While the HQLA measure is considered bipartisan and while the bill got some Democrat support in the Senate, members of the party’s left wing have denounced it as an effort to undo provisions of the Dodd-Frank Act, which was passed in 2010 following the financial crisis. Muni market groups believe the bill has a strong chance to pass and are rallying to push it over the finish line.

“This is very exciting news for issuers of municipal bonds at a critical time in our market,” said Emily Brock, director of the Government Finance Officers Association's federal liaison center.

Bond Dealers of America president Mike Nicholas applauded the forward movement on this issue but said his group will continue pushing for more favorable treatment of munis.

“With this vote, Congress will encourage infrastructure development nationwide and reduce borrowing costs for state and local governments,” Nicholas said. “While the BDA believes municipal bonds deserve the classification of level 2A liquid assets due to the long track record of safe investment, level 2B is a step in the right direction. BDA will continue to aggressively advocate on Capitol Hill for level 2A treatment for municipal bonds.”

Michael Decker, a managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association, noted that the regulators will have work to do if and when the bill becomes law.

“We are pleased and encouraged that Congress appears poised to pass legislation requiring regulators to provide HQLA treatment for many investment-grade municipal securities,” said Decker. “When the legislation is enacted, the next step will be for regulators to amend their Liquidity Coverage Ratio rules to comport with the new law. We look forward to working with regulators on that initiative.”