LIQUIDITY COVERAGE RATIO: MUNICIPAL SECURITIES ARE HQLA

The National Association of State Treasurers seeks to provide advocacy and support that enables member states to pursue and administer sound financial policies and programs benefiting the citizens of the nation. Membership is composed of all state treasurers or state finance officials with comparable responsibilities from the United States, its commonwealths, territories, and the District of Columbia and through a Corporate Affiliate Program established to build professional relationships and foster cooperation between the public and private sectors. The association serves its members through educational conferences and webinars, a variety of working groups, policy advocacy and publications that provide information about developments in public finance.

Background on LCR Final Rule

On September 3, 2014, the federal banking regulators (the Board of Governors of the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC)) adopted final rules that impose a quantitative liquidity requirement (liquidity coverage ratio, or LCR) intended "to promote the short-term resilience of the liquidity risk profile of large and internationally active banking organizations".[i] The final rules do not apply to community banks. Rather, they apply to "large and internationally active banking organizations," including "generally, bank holding companies, certain savings and loan holding companies, and depository institutions with $250 billion or more in total assets or $10 billion or more in on balance sheet foreign exposure" and to their depository institution subsidiaries with $10 billion or more in total consolidated assets. The LCR requires a financial institution subject to the rule to hold a certain amount of high quality liquid assets (HQLA). Of particular concern, the final rule does not include municipal securities as HQLA.

Federal Reserve Proposed Rule

On May 21, the Federal Reserve Board issued a proposed rule which would amend the Board's LCR rule to include certain municipal securities as high quality liquid assets (HQLA). Specifically, the Federal Reserve proposal would "include as level 2B liquid assets under the LCR general obligation securities of a public sector entity that meet the same criteria as corporate debt securities that are included as level 2B liquid assets, subject to limits that are intended to address the unique structure of the U.S. municipal securities market." However, the OCC and FDIC have not proposed similar changes to the LCR, so if the proposed rule were finalized it would only apply to institutions regulated by the Federal Reserve that are subject to the LCR, largely excluding the institutions primarily regulated by the OCC.

H.R. 2209, Bipartisan LCR Legislation

Representatives Luke Messer (R-IN) and Carolyn Maloney (D-NY) introduced bipartisan legislation (H.R. 2209) that directs the federal banking regulators to amend the LCR to require municipal obligations that are liquid, readily marketable and investment grade to be treated as level 2A (rather than 2B as the Board proposes) liquid assets.

Impact of Excluding Municipal Bonds as HQLA

Municipal bonds are low risk and have limited price volatility, high trading volumes, and are liquid and readily marketable. These are features that are consistent with the HQLA criteria used in the LCR rule. The exclusion of municipal securities from HQLA would increase borrowing costs for municipal issuers, reduce liquidity and increase volatility, and disadvantage U.S. municipalities relative to foreign governments in accessing the U.S. capital markets.

NAST supports efforts, including Representative Luke Messer's bill (H.R. 2209), that would classify municipal securities as HQLA.

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[i] **Liquidity Coverage Ratio; 79 Fed. Reg. 61440 (October 10, 2014).**