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H.R. 2209, To require the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets, and for other purposes

FLOOR SITUATION

On Monday, February 1, 2016, the House will consider H.R. 2209, to require the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets, and for other purposes, under suspension of the rules. H.R. 2209 was introduced on May 1, 2015 by Rep. Luke Messer (R-IN), and was referred to the Committee on Financial Services, which ordered the bill reported by a vote of 56 to 1 on November 4, 2015.

SUMMARY

H.R. 2209 requires the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency (OCC) to treat certain investment grade municipal securities as level 2A High Quality Liquid Assets (HQLA), in order to allow these securities to be counted towards certain[1] institution's liquidity coverage ratio (LCR).

BACKGROUND

Liquidity is a term that can apply to assets, markets, or firms. An asset is liquid if it is easily bought and sold (i.e., converted into cash). Markets are generally considered to be liquid if there are many ready buyers and sellers. Banks hold liquid assets to reliably meet cash flow needs, which may be variable and unpredictable. The cost of holding liquid assets is that they have a lower expected rate of return than less liquid assets. When banks hold more liquid assets, they hold fewer loans, which are generally illiquid.[2] Additionally, the Federal Reserve is authorized to set bank reserve requirements which require banks to hold a certain percentage of its liabilities in cash based upon the entity's transactions.[3]

[1] This includes large banks with more than $250 billion in consolidated assets or $10 billion in foreign assets and any subsidiaries of those institutions with assets of at least $10 billion to treat highly rated municipal bonds as liquid assets.
[2] See CRS Report, "The Liquidity Coverage Ratio (LCR)," September 12, 2014.
[3] See Federal Reserve Website, Reserve Requirements

In response to acute liquidity shortages during the 2008 financial crisis, 27 countries agreed in 2010 to modify the Basel Accords, which are internationally negotiated bank regulatory standards, to increase certain financial institution's liquidity requirements.[4] On September 3, 2014, the OCC, Federal Reserve, and the FDIC issued a final rule that implements the Liquidity Coverage Ratio (LCR) rule consistent with the Basel Committees standards. The final rule is designed to strengthen the liquidity risk management of banks, savings associations, and bank holding companies.

The new LCR rule aims to require banks to hold enough High Quality Liquid Assets (HQLA) to match net cash outflows for 30 days during a hypothetical scenario of market stress where creditors are withdrawing funds. An asset can qualify as a HQLA if it has low risk, has a high likelihood of remaining liquid during a crisis, is actively traded in secondary markets, is not subject to excessive price volatility, can be easily valued, and is accepted by the Federal Reserve as collateral for loans.[5] The rule did not include investment grade municipal securities in the rule's HQLA definition.

According to investors, many municipal securities are considered to be one of the safest available investments, as state and local governments are generally not at risk of default.[6] By excluding municipal securities to qualify for HQLA status under this new rule, state and local governments will face increased borrowing costs for infrastructure construction and maintenance projects. H.R. 2209 classifies investment grade municipal bonds as HQLA in an attempt to ensure low-cost infrastructure financing remains available to state and local governments.

According to the bill sponsor, "By excluding all municipal securities from HQLA eligibility, financial institutions are discouraged from holding municipal debt. This has a real-world impact. It could raise borrowing costs for state and local governments to finance infrastructure projects and force municipalities to reduce, or even stop, projects that are financed with municipal bonds. We can't allow Federal bureaucrats to promote policies that disincentivize investment in our local communities.[7]

COST

The Congressional Budget Office estimates that enacting H.R. 2209 could affect direct spending; therefore, pay-as-you-go procedures do apply. However, CBO estimates that the net cost of the bill would be negligible.

STAFF CONTACT

For questions or further information please contact Robert Goad with the House Republican Policy Committee by email or at 6-1831.

[4] See CRS Report, "The Liquidity Coverage Ratio (LCR)," September 12, 2014.
[5] *Id.*
[6] See New York Times Article, "Municipal Bonds Still Considered Safe, Despite Some Ailing Governments," July 24, 2015.
[7] See Rep. Luke Messer Press Release, "Financial Services Committee passes two Messer bills out of Committee," November 4, 2015.