The Office Of State Treasurer
Denise L. Nappier

News

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FEDERAL RESERVE EASES NEW RULE, ALLOWS BANKS TO HOLD MORE MUNICIPAL BONDS

TREASURER NAPPIER JOINS IN CALLS FOR FURTHER REFORMS

HARTFORD, CT – The Federal Reserve's decision to expand the eligibility of municipal bonds that can be held by large banks to meet certain liquidity requirements will result in increased demand for the State's and other municipal bonds, according to State Treasurer Denise L. Nappier.

"Expanding the eligibility of municipal bonds for this purpose lowers the cost for state and local governments to borrow for critical infrastructure projects such as school construction and affordable housing that create jobs and help grow the State's economy," said Treasurer Nappier.

The final regulations, however, stopped short of allowing certain high quality municipal bonds to qualify for an even higher status in a bank's liquidity portfolio. In addition, the regulations did not qualify revenue bonds as permissible securities for banks, but the Federal Reserve said it will continue to monitor the liquidity characteristics of revenue bonds and consider whether certain revenue bonds should be included in the future.

Treasurer Nappier said, "I argued and continue to firmly believe that certain types of revenue bonds, such as those secured by a stream of tax revenues or a pool of loans to municipal entities, should clearly be qualified. I am confident that the Fed's study will bear this out."

In 2014, several bank regulators issued new rules requiring that the nation's largest banks maintain adequate liquid assets on their books to ensure that the banks have enough cash should there be another financial meltdown as experienced in 2008. However, these initial requirements did not allow the banks to hold bonds issued by state and local governments for this purpose, but did allow the banks to hold bonds issued by corporations and other countries.

Following an outcry from State and local governments, including Treasurer Nappier, one bank regulator, the Federal Reserve, proposed revised regulations last summer that would allow certain municipal bonds be held by large banks to be part of their liquidity pools. In

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response to comments submitted by Treasurer Nappier and others, the Federal Reserve issued final regulations last Friday that further expanded the eligibility of municipal bonds.

The final Federal Reserve rule allows insured municipal bonds where the payment of principal and interest is guaranteed by a bond insurance company and that otherwise meet the credit rating criteria to be eligible, and removes a limitation on a bank holding more than 25 percent of a particular type of bond due in the same year from the same bond issue, both suggestions offered by Treasurer Nappier.

The Federal Reserve System regulations only apply to a few of the very largest banks governed by the Federal Reserve. Treasurer Nappier also has submitted comments to the Comptroller of the Currency and the Federal Deposit Insurance Corporation that also adopted new bank liquidity requirements that would apply more broadly, but exclude municipal securities, and she has signed onto letters with other state treasurers through the National Association of State Treasurers urging action on this matter.

"While the latest Fed action was a positive step, our work is far from done. I will continue to fight to ensure that municipal securities are treated the same as bonds issued by corporations and other countries by all bank regulators," said Treasurer Nappier. "To do otherwise would jeopardize the ability of our state and its towns -- as well as all government issuers throughout the country -- to issue bonds at reasonable cost for critical infrastructure improvements."

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