Legislation Text

File #: 160287, **Version:** 0

Calling upon the United States Senate to approve H.R. 2209, recently approved on February 1, 2016 by the House of Representatives, to require the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets by amending the rule entitled "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule"

WHEREAS, The third installment of the Basel Accords was developed in response to the deficiencies in financial regulation revealed by the financial crisis of 2007-08. Basel III is intended to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage; and

WHEREAS, The Liquidity Coverage Ratio ("LCR") was introduced by the Basel Committee on Banking Supervision to require large banks and bank holding companies to hold a sufficient quantity of liquid assets to enable them to survive a bank "run" lasting roughly 30 days. Each covered bank and bank holding company must estimate the volume of short-term liabilities that might "run" in a 30-day crisis period and each covered institution must hold enough high quality liquid assets (HQLA) so that the bank or bank holding company could sell these assets and use the proceeds to replace the funding shortfall caused by the "run"; and

WHEREAS, The Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (Federal banking agencies) have promulgated regulations to implement the Basel III LCR rule. Under these interagency rules, HQLA is divided into three categories (Level 1, Level 2A, and Level 2B). The regulations provide that across the categories, the combination of Level 2A and 2B assets cannot exceed 40% of a covered financial institution's HQLA with 2B assets limited to a maximum of 15% of the institution's HQLA; and

WHEREAS, On September 3, 2014, Federal banking agencies issued a final rule that implements the LCR consistent with the Basel Committee's policy directive and completely excludes municipal bonds from qualifying as HQLA; and

WHEREAS, On April 1, 2016, responding to a high volume of public comments critical of the exclusion of municipal bonds, the Federal Reserve issued a modification to the final rule, which applies only to the large bank holding companies it regulated, and which now allows those bank holding companies to count a small minority of state or municipal bonds as HQLA; and

WHEREAS, The other two Federal banking agencies, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have not issued any modifications to the final rule for the institutions they govern, with the result that the final rule continues to exclude virtually all municipal bonds from treatment as HQLA such that a bank's municipal bond holdings can not count toward satisfying a bank's LCR requirement; and

WHEREAS, The exclusion of most state and municipal bonds from being classed as HQLA simply cannot be justified. The Basel III framework promulgated by the Basel Committee on Banking Supervision (the "Basel Committee"), on which the final rule is largely based, included in the definition of HQLAs securities of "public sector entities," which would include municipal securities; and

WHEREAS, Under the terms of the final rule itself, there are many liquid investment grade state and municipal bond issues that meet the specific characteristics specified in the rule for Level 2A and Level 2B HQLA assets in the final rule but the rule nevertheless excludes them; and

WHEREAS, In addition, numerous state and municipal bonds issues are more liquid than some investment grade corporate bonds, and therefore better suited for HQLA than corporate bonds which classed as HQLA by the final rule; and

WHEREAS, A report published by BNY Mellon Wealth Management, citing dta from Moody's, compares the cumulative default rates through 2012 on both corporate debt and Municipal Securities and clearly shows that for similarly rated securities, Municipal Securities have a lower default rate than corporate debt. For example, three years after being rated A, Municipal Securities had a cumulative default rate of 0.01%, or one in ten thousand. By contrast, 41 out of ten thousand corporate bonds defaulted. This lower default rate of Municipal Securities relative to corporate debt can be seen across the rating spectrum; and

WHEREAS, Many foreign countries implementing the Basel LCR regulation specifically allow their version of domestic state and municipal bonds to qualify as HQLA. There is simply no reason why high quality liquid bonds issued by US states and municipalities should receive a lower standing than foreign sovereign debt with equivalent (or even lesser) credit quality and market liquidity; and

WHEREAS, The exclusion of state and municipal bonds from the definition of HQLA will have a profoundly negative impact on the market for Philadelphia's municipal securities and on the City's and School District's ability to cost-effectively finance much-needed public infrastructure; and

WHEREAS, By excluding municipal bonds from the definition of HQLAs, the final rule will cause banks to make fewer investments in Municipal Securities. This will weaken the overall demand for, and decrease liquidity of, Municipal Securities. Consequently, municipal borrowing costs will increase; and

WHEREAS, The final rule will reduce the amount of bank capacity available to fund credit and liquidity support for municipal variable rate bond programs. Municipalities are typically required to obtain letters of credit or liquidity facilities from banks to support their variable rate bonds in the event that such bonds are unable to be remarketed. Under the Proposed Rule, the Municipal Securities associated with such letters of credit and liquidity facilities will not be able to be counted as HQLAs to meet the Liquidity Coverage Ratio. As a result, banks will reduce the amount of such letters of credit and liquidity facilities. The consequence will be increased costs to municipalities to obtain such letters of credit and liquidity facilities. Similarly the reduction in the availability of such letters of credit and liquidity facilities will limit municipalities' ability to issue variable rate bonds. This will also increase municipalities' overall borrowing costs because such variable rate programs effectively reduce municipalities' borrowing costs; and

WHEREAS, Given the size of the City's capital program and the concomitant financing needs, the City has a compelling interest in the proper functioning of the municipal securities market. The City is one of the largest issuers of municipal bonds in the United States. The City, through its general obligation bonds and bonds of City-related issuers, is planning to issue $300 million in municipal bonds over the next five years to finance the City's infrastructure projects; and

WHEREAS, The City is currently planning over $9 billion in capital spending over the course of its five-year financial plan. Increased debt service costs will result in a reduction in the ability of the City to maintain the current level of its capital program, impeding the City's successful implementation of its Rebuilding Community Infrastructure and Philadelphia Energy Campaign initiatives to transform the city's infrastructure throughout every neighborhood in the City; and

WHEREAS, Alternatively, increasing debt service cost but maintaining public infrastructure investment would result in reduced availability of funding for necessary public services. Therefore, keeping these non-discretionary debt service costs as low as possible is crucial to the City's ongoing fiscal health and its ability to continue delivering the wide range of services that it provides for its residents; and

WHEREAS, On February 1, 2016, the United States House of Representatives approved H.R. 2209, introduced by Representative Luke Messer, which amends the Federal Deposit Insurance Act to require the Federal banking agencies to treat certain municipal securities that are liquid, readily marketable, and investment grade as high quality level 2A liquid assets by amending the rule entitled "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule." This legislation is currently pending before the United States Senate; now, therefore, be it

RESOLVED, That this Council calls upon the United States Senate to approve H.R. 2209, recently approved on February 1, 2016 by the House of Representatives, to require the appropriate Federal banking agencies to treat certain municipal obligations as level 2A liquid assets by amending the rule entitled "Liquidity Coverage Ratio: Liquidity Risk Measurement Standards; Final Rule".

FURTHER RESOLVED, That Engrossed copies of this resolution be presented to the leadership of the Senate and the House of Representatives of the United States, both U.S. Senators of the Commonwealth of Pennsylvania and the Congressional delegation of the Commonwealth of Pennsylvania, as evidence of the sincere sentiments of this legislative body.