

Date of Hearing: April 15, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 2618 (Chen) – As Amended March 21, 2024

SUBJECT: Surplus funds: investment

SUMMARY: This bill makes permanent the temporary authority for a local agency to invest up to 50% (rather than 30%) of its surplus funds in deposits at a commercial bank, savings bank, savings and loan association, or credit union under specified conditions.

EXISTING LAW:

- 1) Authorizes a local agency, until January 1, 2026, to invest a portion of its surplus funds in deposits at a commercial bank, savings bank, savings and loan association, or credit union that uses a private sector entity that assists in the placement of deposits, provided that the purchases of deposits, in total, do not exceed 50% of the agency's funds. Beginning on January 1, 2026, the purchase of deposits shall not exceed 30%.
- 2) Provides that the following conditions apply for a local agency to invest its surplus funds in deposits:
 - a) The local agency shall choose a nationally or state-chartered commercial bank, savings bank, savings and loan association, or credit union in California to invest the funds, which shall be known as the "selected" depository institution;
 - b) The selected depository institution may use a private sector entity to help place local agency deposits with one or more commercial banks, savings banks, savings and loan associations, or credit unions that are located in the United States and within the network used by the private sector entity for this purpose;
 - c) Any private sector entity used by a selected depository institution to help place its local agency deposits shall maintain policies and procedures that require the following:
 - i) The full amount of each deposit placed, including interest, shall at all times be insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA); and,
 - ii) Every depository institution where funds are placed shall be capitalized at a sufficient level to receive deposits pursuant to FDIC or NCUA.
 - d) The selected depository institution shall serve as a custodian for each deposit; and,
 - e) On the same date the local agency's funds are deposited, the selected depository institution shall receive an amount of insured deposits from other financial institutions that, in total, are equal to, or greater than, the full amount of the principal that the local agency initially deposited through the selected depository institution for investment.

FISCAL EFFECT: Unknown. This bill is keyed Nonfiscal by Legislative Counsel.

COMMENTS:

1) **Purpose.**

According to the author:

Depository institutions that use reciprocal deposits as a means to collateralize against local agency deposits are community banks operating within the geographical region of the local agency. This measure will maintain flexibility for local agencies and banks as they work together in managing local agency funds and in serving their communities.

2) **Background.**

State law authorizes local officials to invest a portion of local governments' temporarily idle funds in a variety of financial instruments. Specifically, local officials may deposit money in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies located in the State of California. These public deposits are subject to restrictions, including a requirement that deposits must be insured by the FDIC or, to the extent not insured, collateralized with certain types of securities in specified amounts. FDIC insurance usually covers only \$250,000 per depositor per institution. As a result, to secure large public deposits, depository institutions must hold significant amounts of collateral.

Deposit placement services emerged in the early 2000s as a mechanism for a depository institution to accept a deposit from a local government of greater than the FDIC-insured amount. Generally, deposit placement services will work with a local agency's initial selected bank to transfer the local agency's money in \$250,000 increments to other banks. At the same time, that same service works with other accountholders and member banks to place deposits of a similar aggregate amount back in that selected bank. Thus, the local agency's deposits are fully federally insured, despite being in excess of the \$250,000 insured limit, while the local depository institution receives the full deposit.

The success of deposit placement services, and the FDIC's acceptance of them, have led local financial institutions to seek larger deposits from local governments. These deposits, also called brokered deposits or reciprocal deposits, allow for more taxpayer funds can be injected into the local banking system, rather than being invested in government bonds or other debt securities outside of the local banking system.

3) **Not all local agencies are covered by AB 2618.**

Under existing law, counties may pool monies from other agencies with separate governing bodies, including special districts and school districts. Previous legislative efforts to expand the local reciprocal deposit program generated concern among county treasurers who manage funds not just on behalf of the county, but these other local agencies. In previous legislative discussions, the California Association of County Treasurers and Tax Collectors (CACTTC) expressed concern about tracking the deposits of participating local agencies and the

possibility of deposit placing services making an error, thereby putting the deposits of local agencies in jeopardy if a bank were to fail.

Given these concerns, AB 925 (McCarty), Chapter 619, Statutes of 2019, which temporarily increased the allowable share of surplus funds that can be invested in reciprocal deposits from 30% to 50%, was amended late in the legislative process to exclude local agencies that pool investments with other local agencies. AB 2618 continues that approach and applies only to the local agencies that do not pool investments with other local agencies.

4) Double-referred.

This bill is also referred to the Assembly Local Government Committee. While this committee is hearing AB 2618 as the committee of second referral, for scheduling purposes the order of the hearing was switched.

5) Previous legislation.

- a) AB 925 (McCarty), Chapter 619, Statutes of 2019, increased the cap on the amount of surplus funds that certain local agencies can invest in placement service deposits from 30% to 50%, with a sunset date of January 1, 2026.
- b) AB 283 (Dababneh), Chapter 181, Statutes of 2015 deleted the 10% per placement agency cap added by AB 279 and extended the sunset date on local agencies' ability to invest in non-CD deposits at depository institutions that use private sector placement agencies to January 1, 2021.
- c) AB 279 (Dickinson), Chapter 228, Statutes of 2013, until January 1, 2017, authorized local agencies to invest surplus funds in deposits other than CDs at depository institutions that use a private sector entity to assist in the placement of deposits, but capped the amount that any local agency could invest in non-CD deposits placed by any single placement service at 10%.
- d) SB 1344 (Kehoe), Chapter 112, Statutes of 2010 deleted the sunset date contained in AB 2011, thus permanently extending the ability of local agencies to use private sector, CD placement services.
- e) AB 2011 (Vargas), Chapter 459, Statutes of 2006, until January 1, 2012, authorized local agencies to invest up to 30% of surplus funds in a private sector, CD placement service.

6) Support

AB 2618 is supported by the California Bankers Association, California Credit Union League, and the California Community Banking Network, who write:

Until January 1, 2026, Government Code Section 53601.8 allows, but does not mandate, a local agency to deposit up to 50 percent of their overall surplus funds with a depository institution that uses reciprocal deposits as a means of collateralization.

These local agency funds may be deposited into a certificate of deposit or a demand deposit account. Using reciprocal deposits allows the depository institution to accept a deposit from a local agency exceeding the Federal Deposit Insurance Corporation or National Credit Union Association standard insurance limit of \$250,000 (per depositor) while maintaining full insurance coverage over the entirety of the local agency's deposit.

Unless the sunset date is removed, on January 1, 2026, the maximum 50 percent of local agency funds that may be placed using reciprocal deposits will be reduced to 30 percent. If local agency surplus funds exceed the 30 percent threshold, local agencies may be forced to consider more expensive investment options that offer restricted access to those funds in the event of a liquidity crisis. Allowing local agencies to invest surplus funds in community banks helps ensure that these funds are redeployed into the community through small business and consumer lending.

REGISTERED SUPPORT / OPPOSITION:**Support**

California Bankers Association
California Credit Union League
California Community Banking Network

Opposition

None on file.

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