Date of Hearing: April 22, 2019

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Monique Limón, Chair
AB 945 (McCarty) – As Introduced February 20, 2019

SUBJECT: Local government: financial affairs: surplus funds

SUMMARY: Increases the amount of surplus funds that a local agency can invest in certain deposits.

Specifically, **this bill**:

1) Deletes the January 1, 2021, sunset date in existing law which allows a local agency to invest up to 30% 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 to assist in the placement of deposits.

2) Increases the amount of surplus funds a local agency can invest in these deposits from 30% to 50%.

EXISTING LAW:

1) Authorizes a local agency, until January 1, 2021, 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 30% of the agency's funds.

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: None

COMMENTS:

1) PURPOSE

The author states:

> AB 945 will provide for greater opportunities for investments in our communities by allowing, but not requiring, local agencies to invest more of their surplus funds with local banks and credit unions. Those financial institutions will then have more capital to use for small business loans and other financial instruments, which will in turn provide a multiplier-effect of economic growth in our communities.

2) BACKGROUND

State law authorizes local officials to invest a portion of local governments' temporarily idle funds in a variety of financial instruments. California law allows local officials to deposit money in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies 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. Deposit placement services interface with depository institutions (not directly with customers) to split up and spread out large deposits across multiple institutions. This service allows the local government's full deposit to be insured by the FDIC (or NCUA in the case of credit unions), which incentivizes local community banks and credit unions to seek larger deposits from local government customers. The service also provides a way for the depository institution to avoid purchasing costly collateral by splitting the deposit across multiple institutions and keeping the full amount of the deposit insured by the FDIC or NCUA.

By incentivizing local community depository institutions to compete for local government deposits, 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. Local government customers include county treasurers, city treasurers, and financial managers at special districts (e.g., school districts, water districts, mosquito abatement districts, etc.) and joint powers authorities. The amount of surplus funds that these entities invest can range from a few thousand dollars to multiple billions of dollars.

3) EXPECTED IMPACT

If this bill is enacted, it is likely that local government entities will increase the amount that they deposit with local financial institutions. Nothing in this bill requires a local government to change their investment strategy. Rather, the bill provides the local government with an additional option that may better meet the government's priorities related to liquidity, return, and cost of administration, without compromising the safety of principal.

Local government deposits can serve as a stable and low-cost funding source for community banks and credit unions to originate loans. To the extent that a local banking system needs additional liquidity, these deposits may help to increase credit availability for consumers and businesses in a given area.

One potential side effect of this bill is related to liquidity management of county investment pools. County treasurers manage the funds not only of counties, but also manage an investment pool that cities and special districts can invest in. To the extent that local governments decide to shift their investments away from a county-managed pool and into the local banking system, county treasurers may need to rebalance their investment portfolios to ensure adequate liquidity for pool participants. In other words, county treasurers may need to hold a smaller portion of longer-term, higher-returning securities in their portfolios, in order to meet the immediate cash needs of pool participants.

4) DOUBLE-REFERRED

This bill was also referred to the Assembly Local Government Committee, which passed the bill on an 8-0 vote.

5) ARGUMENTS IN SUPPORT

A coalition of financial institutions writes:

> Typically, 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. Unfortunately, the current law percentage limitation prevents banks and local agencies from using reciprocal deposits beyond 30% of surplus funds. The law's inflexibility limits how local agencies and banks work together in managing local agency funds and the manner in which they serve their communities. Measure AB 945 increases the statutory cap while maintaining a local agency's discretion in securing collateral.

6) ARGUMENTS IN OPPOSITION

The California Association of Treasurers and Tax Collectors writes:

> Increasing the authority to invest 50% of the treasury pool into one type of deposit would create new and unfair pressures on pool participants, to the extent a single participant's funds are needed but unavailable.

REGISTERED SUPPORT / OPPOSITION:

Support

American Riviera Bank
Association Of California Water Agencies
California Bankers Association
California Community Banking Network
California Credit Union League
Central Valley Community Bank
Five Star Bank
Fresno First Bank
Pinnacle Bank

Opposition

California Association Of County Treasurers & Tax Collectors (unless amended)

Analysis Prepared by: Michael Burdick / B. & F. / (916) 319-3081