

Date of Hearing: April 15, 2021

ASSEMBLY COMMITTEE ON BANKING AND FINANCE  
Timothy Grayson, Chair  
AB 869 (Bloom) – As Amended April 7, 2021

**SUBJECT:** State funds: investments

**SUMMARY:** Authorizes the Treasurer to invest up to one percent of Pooled Money Investment Account (PMIA) funds in sovereign debt instruments, as specified.

Specifically, **this bill:**

- 1) Adds the following class of securities to the list of eligible securities for the investment of surplus moneys: bonds, notes, warrants, and other securities that are the direct obligations of the government of a foreign country, if the securities meet the following conditions:
  - a) Are not in default,
  - b) Are rated investment grade by a nationally recognized ratings agency,
  - c) The issuing country is deemed an advanced economy by the International Monetary Fund,
  - d) Are US Dollar denominated with a maximum maturity of five years or less, and eligible for purchase and sale within the United States, and
- 2) Restricts the combined par value of all of the investments described in #1 to a maximum of one percent of the total par value of PMIA assets.
- 3) Requires the issuing country to submit to the federal jurisdiction of the courts of the United States and to the state jurisdiction of the California courts when disputes arise related to the investments.

**EXISTING LAW:**

- 1) Lists eligible securities for the investment of surplus moneys. Eligible securities include (1) U.S. Government securities; (2) securities of federally sponsored agencies; (3) domestic corporate bonds; (4) interest-bearing time deposits in California banks, savings and loan associations and credit unions; and (5) prime-rated commercial paper (Gov Code Sec. 16430).
- 2) Creates the Pooled Money Investment Board, consisting of the Controller, Treasurer, and Director of Finance, to designate at least once a month the amount of money available to invest in securities or in deposits in banks and savings and loans associations or in loans to the General Fund and the type of investment or deposit (Gov Code Sec. 16480.1).
- 3) Authorizes the State Treasurer to invest and reinvest any securities described in Existing Law Number 1 or in loans to General Fund. The State Treasurer may hire or engage the services of an investment analyst to assist in these decisions (Gov Code Sec. 16480.4).

- 4) States that it is the intent that money available for investment or deposit be invested in such a way as to realize the maximum return consist with safe and prudent treasury management (Gov Code Sec. 16480.22).
- 5) Specifies the collateralization requirements for state deposit (Gov Code Secs. 16520 through 16533). Authorizes the use of bonds of the nation of Israel as collateral (Gov Code Secs. 16522 and 16612).

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

**COMMENTS:**

1) PURPOSE.

According to the State Treasurer's Office (STO), who is a sponsor of this bill:

California's PMIA, which combines temporarily idle state funds from the state's General Fund, Surplus Money Investment Fund and the Local Agency Investment Fund, is constrained by statute and policy to a limited array of investment choices. My office invests these funds pursuant to statute and an investment policy that favors safety and liquidity over yield or return. A broader array of safe investment alternatives would enhance competition and enable the Treasury to run more effectively. In recent years Ohio, Illinois, Indiana, Louisiana, Oklahoma, Georgia, Colorado, and Arizona (among others) have introduced similar legislation to AB 869 and all these states have had success with their new policies, gaining diversification without sacrificing safety. In addition, the bill would accomplish the mission of bringing statutes governing investments into better alignment with statutes governing state collateral.

2) THE PMIA

The PMIA is the account through which the State Treasurer invests cash surpluses to manage the state's cash flow. The PMIA is governed by the Pooled Money Investment Board (Board), and the PMIA includes General Fund dollars, other state agency funds (the Surplus Money Investment Fund), and the cash from some participating cities (the Local Agency Investment Fund).

By law, PMIA monies can only be invested in certain categories of investments, including: (1) U.S. Government securities; (2) securities of federally sponsored agencies; (3) domestic corporate bonds; (4) interest-bearing time deposits in California banks, savings and loan associations and credit unions; and (5) prime-rated commercial paper. Typically, the investment strategy is to choose safe investment instruments with short-term maturity schedules. Over time, the average yields on these investments have varied significantly. For example, average yields exceed 10% in the 1980s, but fell to nearly zero following the 2008 crisis.

While PMIA investments typically see small returns, the PMIA's balance has significantly increased as California's cash flow has improved. For example, the average quarterly balance of the PMIA in 2015-16 was \$68.43 billion. By 2019-20, that average grew to \$97.90 billion.

### 3) BALANCING RISKS AND RETURN

The key question before this committee is whether or not introducing sovereign debt into the PMIA investment strategy introduces too much risk to a fund whose purpose is to ensure adequate cash flow for the state government and for participating local governments.

Sovereign debt is not a risk-free investment. In addition to a higher risk of default, political instability can cause sovereign bonds to lose value, and sovereign debt is subject to currency risks if the currency in which the bond was issued depreciates relative to the dollar.

Moreover, sovereign debt purchases may involve state policymakers in geopolitical debates, which may cause disruption to the management of PMIA. In some cases, that disruption may be calls to divest from a certain country over foreign affairs or other practices, such as recent initiatives to divest from Turkish debt in response to their role in the Armenian genocide.<sup>1</sup> In other cases, the STO may be asked to invest in certain countries as a show of support, like the ongoing “Invest in Israel” program.<sup>2</sup> The merits and effectiveness of these efforts are not the purview of this analysis; rather, they are used as examples of how sovereign debt can be the source of debate and advocacy unrelated to the financial goals of the PMIA.

### 4) STATE COLLATERAL AND SOVEREIGN DEBT

Generally, any California institution that accepts a deposit of state funds must pledge collateral in order to protect taxpayer money.<sup>3</sup> STO staff calculate the collateral requirement for each participating financial institutions and makes sure the funds on deposit are collateralized appropriately.

While the STO is currently prohibited from investing surplus cash in sovereign debt, the STO allows for a narrow use of sovereign debt as collateral for certain state deposits. Specifically, Government Code Sections 16522 and 16612 allow for bonds from the nation of Israel only to be used as collateral in certain scenarios. Thus, this bill’s provisions are not completely unprecedented, but they are broader than what is currently allowed for collateralization.

### 5) PROVIDING STO WITH FLEXIBILTIIY AND AUTONOMY

The STO argues this bill will give staff additional flexibility to choose the appropriate investment strategy for the PMIA. While the PMIA has performed well in recent years, conditions may change in future years and this bill will allow for additional investment options.

Despite the concerns about introducing sovereign debt into the PMIA portfolio, STO staff have been good stewards of the PMIA thus far. Moreover, this bill contains a number of guardrails that limit the type of sovereign debt that can be purchased.

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<sup>1</sup> AB 1320 (Nazarian), Chapter 569, Statutes of 2019, which requires California public pension systems to divest from Turkish sovereign debt, under certain conditions.

<sup>2</sup> <https://www.israelbonds.com/Home.aspx>

<sup>3</sup> For a list of collateralization requirements, see <https://www.treasurer.ca.gov/inside/divisions/ctsm/d/accounts.asp>

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California State Treasurer (Sponsor)

**Opposition**

None

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