Date of Hearing: April 21, 2014

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Roger Dickinson, Chair
AB 1933 (Levine) – As Introduced: February 19, 2014

SUBJECT: Local government: investments

SUMMARY: Allows a local agency to invest up to 30% of their surplus moneys in obligations, issued by the International Bank for Reconstruction and Development (World Bank), International Finance Corporation (IFC), or Inter-America Development Bank (IADB). Specifically, this bill:

1) Provides that investments in specified entities shall be limited to those rated at "AA" or higher credit rating.

2) Specifies that the investments shall have a maximum maturity of five years or less.

EXISTING LAW

1) Defines, a "local agency" to mean a city, district, or other local agency that does not pool money in deposits or investments with other local agencies, other than local agencies that have the same governing body. (Government Code, Section 53600. All further references are to Government Code.)

2) Allows the legislative body of a local agency to invest funds not immediately needed by the agency in a variety of specified financial instruments, including local agency bonds, U.S. Treasury obligations, state obligations, California local agency obligations, U.S. agency obligations, bankers' acceptances, commercial paper, negotiable certificates of deposit, CD placement service, repurchase agreements, reverse repurchase agreements and securities lending agreements, medium-term notes, mutual funds and money market mutual funds, collateralized bank deposits, and mortgage pass-through securities. (Section 53601)

3) Allows the state Treasury to invest in obligations issued, assumed, or guaranteed by the World Bank, the IADB, the Asian Development Bank, the African Development Bank, the IFC, or the Government Development Bank of Puerto Rico. (Section 16430)

4) Provides state retirement system and 1937 Act retirement systems with authority to invest in rated bonds, notes, or other obligations issued, assumed, or unconditionally guaranteed by the African Development Bank, the Asian Development Bank, the Caribbean Development Bank, the IADB, the IFC, the World Bank, the European Bank for Reconstruction and Development, and any other international financial institution that has met the payments of similar bonds, notes, or other obligations when due and in which the United States is a member. (Section 7514.1)

FISCAL EFFECT: Unknown

COMMENTS:

This bill uses the terminology "*United States dollar denominated senior unsecured unsubordinated obligations issued or unconditionally guaranteed…*" What does this mean? Unsubordinated debt refers to loans and debt securities (e.g., bonds, CDs, collateralized securities, etc.) for which the repayment priority outranks other debts owed by the same individual entity (called subordinated debt). Debt in the form of loans or debt securities (e.g. bonds and CDs) are classified as unsubordinated debt if claims on revenues and capital assets by lenders and/or investors take priority over the repayment of other related debt. Related debt with a lower payment priority is called subordinated debt and is, consequently, considered riskier than unsubordinated debt. In most cases, loans are determined to be subordinated or unsubordinated based on the amount and length of time outstanding in comparison with other loans. In the bond markets, unsubordinated and subordinated debt can best be exemplified by the tranches into which collateralized securities are classified based on value and time to maturity. A security's Class A tranche is considered unsubordinated debt because it takes payment priority over Classes B and C, both of which are subordinated debt. This means that obligations on Class A issues of a security will always be fulfilled before those of Class B and C issues.

This bill would allow local agencies to invest in bonds issued, or guaranteed by what are known as "supranationals." Supranationals are international institutions that provide development financing, advisory services and/or financial services to their member countries to achieve the overall goal of improving living standards through sustainable economic growth.

AB 1933 allows investment in instruments issued by three specific entities, known collectively as the "Washington Supras." These Washington Supras are the following three entities:

1) The World Bank (officially called International Bank for Reconstruction and Development, IBRD) is the largest part of the World Bank Group and finances activities by issuing bonds in the capital markets. Established in 1944, it works with member countries to promote equitable and sustainable economic growth, by providing financing and risk management solutions directly to sovereign governments - globally.

2) IFC, part of the World Bank Group, created in 1956, provides investments and advisory services to build the private sector in developing countries.

3) IADB, established in 1959, supports efforts by Latin America and the Caribbean countries to reduce poverty and inequality

These entities finance their activities through the issuance of bonds in the capital markets and income received from interest on loans made to other nations or projects. The World Bank has an AAA credit rating with the current largest shareholder the United States at 15.19%.

The California Association of County Treasurers and Tax Collectors, sponsors of AB 1933 write in support of the bill:

> *The universe of liquid triple-A bond issuers available to local agencies has reduced dramatically in addition to the diminishing supply of government sponsored enterprises (GSE) such as Fannie and Freddie federal agency securities. Government Investment*

Officers need alternative investment options that provide safety and diversification for managed investment pools.

The triple-A supranational, or "supra" sector is an option for portfolio manager that offers high credit quality and a stable return at spreads above US Treasuries. Supranationals are international institutions that provide development financing, advisory services and/or other financial services to their member countries to achieve overall goal of improving living standards through sustainable economic growth.

Previous legislation.

Since 1913, state law has authorized local officials to invest a portion of their temporarily idle funds in a variety of financial instruments. The Legislature has since expanded this list of investment options available to local agencies to invest funds not required for the immediate needs of the local agency. Most recently SB 194 (Governance and Finance Committee), Chapter 382, Statutes of 2011, added the federally chartered branches of foreign banks to the list of financial institutions whose certificates of deposit are eligible for local agencies' investments, and AB 1745 (Committee on Revenue and Taxation), Chapter 340, Statutes of 2007, added registered treasury notes or bonds, including bonds payable solely out of the revenues from a revenue-producing property owned by a state, department, board, agency or authority.

Technical amendments.

Changes proposed via this bill require some additional amendments to correct cross references.

1) Page 7, line 22 delete "(o)" and insert ***"(q)"***

2) Page 8, line 5 delete "(o)" and insert **"(q)"**

3) Page 9, line 20 and line 30: Delete "(o)" and add ***"(q)."***

REGISTERED SUPPORT / OPPOSITION:

Support

California Association of County Treasurers and Tax Collectors (Sponsor)

Opposition

None on file.

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