Date of Hearing: April 30, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 2481 (Morrell) – As Amended: March 29, 2012

SUBJECT: Financial Institutions.

SUMMARY: Allows the Treasurer to receive letters of credit issued by any Federal Home Loan Bank (FHL Bank) as security for demand and time deposits.

EXISTING LAW requires the Treasurer to receive as security for demand and time deposits, letters of credit issued by the FHL Bank of San Francisco that includes the following terms: the treasurer shall be the beneficiary of the letter of credit and the letter of credit shall be clean and irrevocable. [Government Code, Section 16522]

FISCAL EFFECT: None.

COMMENTS:

AB 2481 makes a clarifying change to current allow specifying that the Treasurer can receive letters of credit issued by any FHL Bank as security rather than just the FHL Bank of San Francisco. This bill will address a problem if a bank is headquartered in another state but wants to issue a letter of credit to the FHL Bank of San Francisco, it can do so under this measure.

According to the sponsor, the California Bankers Association, "*This provision will allow depository institutions that are not chartered or domiciled in California to use these letters of credit to secure public deposits, thus allowing California to expand its access to these reliable and stable sources of collateral and potentially increase competition for its deposits among depository institutions. FHL Bank letters of credit provide the following benefits when used as collateral for public deposits:*

- *No Market Risk- the value of letters of credit do not fluctuate based on market conditions, consequently, loss of value is never a concern for the beneficiary, of an federal home loan bank letter of credit.*

- *Irrevocable and unconditional- FHL Bank letters of credit are irrevocable once issued, which guarantees that they will be available to be drawn upon during the state term.*

- *No liquidity risk-funds are payable upon demand and can be assessed quickly in times of need.*

- *No Costs to Draw- no third party custodians are required which results in increased cost savings and operational efficiencies for California as the beneficiary of the collateral."*

FHL BANKS

Currently, 12 FHL Banks are established. They are in: San Francisco, California; Seattle, Washington; Dallas, Texas; Atlanta, Georgia; Des Moines, Iowa; Chicago, Illinois; Boston, Massachusetts; New York, New York; Pittsburgh, Pennsylvania; Cincinnati, Ohio; Topeka, Kansas; and, Indianapolis, Indiana. The FHL Banks are cooperative banks that U.S. lending institutions use to finance housing and economic development in their communities. Created by Congress, the FHL Banks have been the largest source of funding for community lending for eight decades.

Financial institutions rely on the FHL Bank system as a stable source of funds through all market cycles. FHL Banks are regionally focused and controlled. This structure allows each FHL Bank to be responsive to the specific community credit needs throughout its region, while the 12 FHL Banks collectively use their combined size and strength to obtain funding at the lowest possible cost for their members. This cooperative structure means that the lender member owners can advance credit to communities at competitive prices.

More than 8,000 lenders are members of the FHL Bank System, representing approximately 80 percent of the insured lending institutions in the country. Community banks, thrifts, commercial banks, credit unions, community development financial institutions, and insurance companies and state housing finance agencies are all eligible for membership in the System. Members have branches throughout the 50 states and the U.S. territories. Members range from some of the largest financial institutions in the world to banks with just a single branch. To become a member of an FHL Bank, a financial institution must purchase stock in the FHL Bank system. The stock is held at par value and not traded. The FHL Banks are entirely privately owned by these member-owners. FHL Banks do not have the pressure for high rates of return as do publicly traded companies.

The primary purpose of the FHL Banks is to provide their members with liquidity. Liquidity funding addresses a key risk of bank management, the unexpected need to fund new assets and deposit withdrawals. Financial institutions are limited in how they can meet liquidity needs. They can raise new deposits, cut expenses, sell assets, limit new lending, or access credit markets. It takes time to attract deposits and it can be prohibitively expensive. Smaller institutions especially rely almost entirely on their local customers to do so. The FHL Bank system is the only source of credit market access for the majority of their members. Most community institutions do not have the ability to access the credit markets on their own.

The regulator charged with overseeing the FHL Banks is the Federal Housing Finance Agency (FHFA), created by Congress in the Housing and Economic Recovery Act of 2008.

AB 2805 (Papan, Statutes of 2000) allowed the Treasurer to receive letters of credit from the FHL Bank of San Francisco. The measure stated only the FHL Bank of San Francisco, not specifically to limit the use of the letters of credit, but simply because it was assumed that California state or licensed' banks would be members of the Home Loan District servicing California, San Francisco. Several banks are headquartered elsewhere, so the FHL Bank of San Francisco is not available to that bank if the headquarter is elsewhere out of the San Francisco district.

Federal Home Loan Banks are jointly and severally liable for their combined obligations. If any individual Bank would not be able to pay a creditor, the other eleven Banks are required to step in and cover that debt. This provides another level of safety and leads to prudent borrowing throughout the FHL Bank System. In 2001, the Government Accountability Office noted, "Joint and several liability for the payment of consolidated obligations gives investors' confidence that System debt will be paid."

A letter of credit is a letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase.

PREVIOUS LEGISLATION

AB 2805 ((Papan) Chapter 913, Statutes of 2000) added specified letters of credit issued by the Federal Home Loan Bank of San Francisco to the list of securities that may be received as security for demand and time deposits of state funds.

REGISTERED SUPPORT / OPPOSITION:

Support

California Bankers Association (CBA) - Sponsor

Opposition

None on file.

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