

Date of Hearing: June 29, 2021

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

SB 239 (Committee on Banking and Financial Institutions) – As Introduced January 21, 2021

**SENATE VOTE:** 38-0

**SUBJECT:** Government finance: surplus investments: savings and loan associations or credit unions

**SUMMARY:** This bill authorizes the State Treasurer's Office (STO) to invest surplus state funds in money market mutual funds, under specified conditions, and reduces, from 110% of the amount deposited, to 100% of the amount deposited, the required value of a Federal Home Loan Bank (FHLB) letter of credit that a credit union or a savings and loan association may use as security for a deposit of state funds by the State Treasurer into that credit union or savings and loan association.

**EXISTING LAW:**

- 1) Defines an eligible bank as a state or national bank located in California, selected by the Treasurer for the safekeeping of money belonging to or in the custody of the state, as specified. Provides that an eligible bank is eligible to receive deposits only to the extent that it furnishes security, as specified, but provides that security is not required for any portion of any deposit that is insured under any law of the United States (Government Code Sections 16500 and 16520). Contains a series of requirements applicable to security that is used by an eligible bank to collateralize deposits that are not insured under a law of the United States (Government Code Sections 16521 through 16533).
- 2) Defines eligible savings and loan associations and eligible credit unions in a nearly identical manner as eligible banks, provides that eligible savings and loan associations and eligible credit unions are eligible to receive deposits only to the extent that they furnish security, as specified, but provides that security is not required for any portion of any deposit that is insured under any law of the United States (Government Code Sections 16600 and 16610). Contains a series of requirements applicable to security that is used by an eligible savings and loan association or eligible credit union to collateralize deposits that are not insured under a law of the United States (Government Code Sections 16601 through 16622).
- 3) Generally requires banks, credit unions, and savings and loan associations to collateralize state deposits in an amount at least 10% greater than that which is deposited (Government Code Section 16511 and 16521), but provides an exception for banks, which provides that if a letter of credit from a FHLB is used as security for a state deposit in an eligible bank, the letter of credit must be in an amount equal to at least 100% of the amount deposited with the bank (Government Code Section 16522).
- 4) Lists twenty-one different types of eligible securities for the investment by the State Treasurer of surplus state and local moneys held in the Pooled Money Investment Account (PMIA), as specified (Government Code Section 16430).

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

**COMMENTS:**

**1) Background on the PMIA.**

The PMIA is the account through which the STO 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). 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.

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.

This bill allows the STO to invest PMIA funds into money market mutual funds. A money market mutual fund invests in liquid and short-term instruments such as cash equivalent securities and US Treasurers with short-term maturity. Generally, these funds are considered low risk. This bill also contains some limitations on these investments, including that the financial institution issuing shares has at least five years of experience and has assets under management in excess of \$10 billion and does not impose a commission on the purchase or sale of fund shares by the state.

**2) Background on state collateral**

Generally, any California institution that accepts a deposit of state funds must pledge collateral in order to protect taxpayer money.<sup>1</sup> STO staff calculate the collateral requirement for each participating financial institutions and makes sure the funds on deposit are collateralized appropriately.

Collateralization requirements are detailed in state law, and over time the Legislature has modified these requirements in response to feedback from the STO and industry partners. In 2017, SB 363 (Committee on Banking and Financial Institutions), Chapter 516, Statutes of 2017, modified the collateral requirements by reducing, from 110% of the amount deposited, to 100% of the amount deposited, the required value of a FHLB letter of credit that a bank may use as security for demand and time deposits made by the STO. FHLB letters of credit have high credit quality, maintain face values that do not fluctuate with the market, can be

---

<sup>1</sup> For a list of collateralization requirements, see <https://www.treasurer.ca.gov/inside/divisions/ctsm/accounts.asp>

paid quickly and directly to beneficiaries on presentment, and are not subject to call provisions. Many public entities prefer letters of credit to direct issue securities because the value of the former does not fluctuate with the market, while the value of the latter is more volatile. However, SB 363 inadvertently failed to amend a parallel code section applicable to credit unions and savings and loan associations. Thus, these depositories are still subject to the 110% requirement when they use FHLB letters of credit to collateralize deposits of state funds. This bill corrects that error.

### 3) **Arguments in support**

This bill is sponsored by State Treasurer Fiona Ma. In arguing for the PMIA-related change, the Treasurer Ma notes:

Allowing my office to invest in money market funds that are exclusively invested eligible securities will expand the pool of investment options available to my office without diminishing the safety and soundness of those investments. These highly liquid money market mutual funds would also help my office manage the large swings in cash flow that have come with being one of the largest economies in the world.

Arguing in sport for the FHLB-related change, Treasurer Ma notes that “this action will ensure that collateral requirements applicable to FHLB letters of credit are consistent and equitable among all depository institutions that do business with the state.”

### 4) **A note of caution from local government officials**

This bill makes two reasonable and low-risk changes to state law related to the STO’s performance of its duties. However, fiscal management practices such as collateralization requirements can raise important questions about how state or local governments manage and protect taxpayer dollars. The California Association of County Treasurers and Tax Collectors (CACTTC) writes that while the organization has no objections to this bill, the organization would not support any proposal to reduce collateral requirements for FHLB-issued letters of credit for deposits that include funds held by county treasurers:

The neutrality of CACTTC on SB 239 should in no way be construed or interpreted to imply that CACTTC would support any future proposal to reduce collateral requirements for Federal Home Loan Bank of San Francisco issued letters of credit on bank, savings and loan association or credit union deposits, when engaging in depository transactions that include funds held by County Treasurers. CACTTC would strenuously object to any such proposal to reduce collateral requirements as currently codified in Government Code Section 53652 (c).

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

California State Treasurer

### **Opposition**

None on file.

**Analysis Prepared by:** Luke Reidenbach / B. & F. / (916) 319-3081