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FISCAL IMPACT REPORT

ORIGINAL DATE 02/24/09

SPONSOR Gutierrez LAST UPDATED _____ HB 643

SHORT TITLE Public Money Investments in Banks SB _____

ANALYST White

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	NFI			

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Treasurer's Office (STO)
 New Mexico Municipal League
 Higher Education Department (HED)
 Regulation and Licensing Department (RLD)
 Department of Finance and Administration (DFA)

Responses Not Received From

New Mexico Association of Counties

SUMMARY

Synopsis of Bill

House Bill 643 amends collateral requirements for the State Treasurer as well as county treasurers, municipal treasurers, treasurers of public schools, colleges, universities, and all other subdivisions of the state for certificate of deposit investments (CDs) with New Mexico financial institutions. Under current statute if the State Treasurer's Office (STO) were to place public funds in CDs at a New Mexico bank in excess of the amount insured by the Federal Deposit Insurance Corporation (FDIC), which has been temporarily increased to \$250,000 from \$100,000, the bank would have to pledge collateral in the form of highly rated financial instruments such as treasury bills. If this legislation were enacted, New Mexico banks would no longer be required to pledge collateral if they were able to send deposits in excess of the FDIC insurance to other banks in exchange for "an amount of deposits from customers of other federally insured financial institutions, wherever located equal to or greater than the amount of funds" initially deposited in the New Mexico bank.

FISCAL IMPLICATIONS

This bill only proposes to change the collateral requirements for placing public funds in New Mexico financial institution and therefore should have no fiscal impact to the state.

SIGNIFICANT ISSUES

This legislation was brought forth in reference to the newly created Certificate of Deposit Account Registry Service (CDARS). Under the proposed legislation if a financial institution were to use CDARS for its public fund deposits in excess of those insured by the FDIC they would not be required to pledge collateral and therefore have more capital on hand to make loans. The State Treasurer's Office describes the CDARS program as follows.

State Treasurer's Office (STO):

The CDARS program works as follows, using a \$10 million certificate of deposit (CD) as an example: When a public entity (*Depositor*) places an interest-bearing deposit in a federally-insured financial institution (*Relationship Institution*) in the state, the first \$250,000 of this deposit is covered by FDIC and will remain in the *Relationship Institution*. Through the CDARS network, the remaining \$9,750,000 is placed in deposits, in increments up to a maximum of \$250,000, at 39 or more individual, federally insured financial institutions (*Issuing Institutions*) throughout the country who participate in CDARS. The use of CDARS then guarantees that if any of the *Issuing Institutions* nationwide holding the deposits fail, the New Mexico public funds deposits will have full FDIC coverage and the public entity *Depositor* will recover that portion of its original deposit. The other side of this transaction is that an equal amount (\$9,750,000) of deposits from other *Issuing Institutions* nationwide, participating in CDARS will be deposited in that New Mexico financial institution (*Relationship Institution*) (that originally accepted the \$10 million public funds deposit) in 39 separate interest-bearing accounts of \$250,000 each, fully covered by FDIC. All FDIC-insured deposits on both sides of the transaction will be fully covered if any of the participating banks fail.

A portion of the CDARS promotional literature describes the very complex nature of the scheme used to deploy CD money to participating institutions nationwide, to obtain full FDIC coverage:

*“The agreement states that the **Relationship Institution** will act as the **Depositor’s** agent in placing funds in CDs with the **Issuing Institutions**. It indicates that: the **Relationship Institution** will act as the **Depositor’s** custodian with respect to the CDs and has entered into an agreement with the Bank of New York (“BNY”) to act as the **Relationship Institution’s** sub-custodian with respect to the CDs for which the **Relationship Institution** is acting as the **Depositor’s** custodian; each CD for which the **Relationship Institution** is acting as the **Depositor’s** custodian will be recorded on the **Issuing Institution’s** records in the name of the sub-custodian, BNY; the CD will be recorded on BNY’s records in the **Relationship Institution’s** records in the **Depositor’s** name.”*

Financial institution representatives have explained that the use of CDARS is less expensive than traditional securities or surety bonds pledged as collateral on public funds deposits. Banks and other financial institutions will then have less capital committed for collateral requirements.

Given the current global financial climate, it may be onerous to drastically alter collateral requirements related to public funds. This bill would require STO to monitor the creditworthiness of banks not just here in New Mexico but potentially all over the country.

STO has also voiced significant concern over the use of the CDARS program. Of particular concern is that fees related to the participation in CDARS are unclear. STO even went so far as to directly contact CDARS staff to inquire about the fees related to the program “but did not get a clear response.” STO also made inquiries through the National Association of State Treasurers regarding the CDARS program. Sixteen State Treasurers responded, nine of which use the CDARS program.

State Treasurer’s Office (STO):

Ohio. The following comments are from the Ohio State Treasurer’s Office: “It’s our understanding that it is the FDIC’s opinion that deposits placed using the CDARS approach would qualify for FDIC insurance. (<http://www.fdic.gov/regulations/laws/rules/4000-10220.html>.) However, it’s interesting that the FDIC website also carries a September 2005 presentation by George Pennacchi, Department of Finance, University of Illinois, entitled “Deposit Insurance, Bank Regulation and Financial System Risks,” in which Professor Pennacchi states that CDARS is one of several “recent examples of excessive expansion of the safety net”. http://www.fdic.gov/bank/analytical/cfr/2005/sept/cfrfall_2005_Pennacchi.ppt This commentary leads one to believe that there may be questions that the FDIC, from a systemic standpoint, is allowing more risk than the Bank Insurance Fund is able to support.”

Alabama. The Alabama State Treasurer’s Office had the following comments on CDARS legislation: “My comments about CDARS in relation to Alabama - I do not think that legislation should be changed to allow one company to broker CD's - IF the legislators choose to allow public deposits to be held outside the State without the security of our collateral pool, then the public depositor should be allowed to broker his CD on his own without having to go through CDARS. CDARS is a good program for private deposits, but I would expect that a public depositor would prefer to have collateral in hand or a collateral pool securing the deposit, versus waiting on FDIC to liquidate the assets. We would not place State funds outside the State in a bank; however, there may be other public depositors that would be interested.”

Maine. Dave Lemoine, State Treasurer of Maine had the following comments: “We do not use CDARS as we have seen a short collateralization gap between the time we wire the funds and the time that the CDARS are in place. I have been unwilling to expose us to uncollateralized deposits, even if each individual exposure may be of short (1-2 day) duration.”

ADMINISTRATIVE IMPLICATIONS

STO reports that the enactment of this legislation would significantly affect its collateral management by dramatically increasing the number of financial institutions it would have to monitor. Because of the substantial amount of institutions nationwide who would qualify for this program this bill “would have a negative impact on the Investment division of the State Treasurer’s Office.”

TECHNICAL ISSUES

State Treasurer’s Office (STO):

Because CDARS would place deposits of New Mexico public funds in out of state banks, it appears to be in conflict with the New Mexico Constitution and the State Treasurer’s Investment Policy. See the two paragraphs below.

There is a section of the New Mexico Constitution that appears to prohibit depositing public monies in financial institutions outside the state. Article XIII, Section 4 reads in part, ***“All public money not invested in interest-bearing securities shall be deposited in national banks in this state, in banks or trust companies incorporated under the laws of the state, in federal savings and loan associations in this state, in savings and loan associations incorporated under the laws of this state whose deposits are insured by an agency of the United States and in credit unions incorporated under the laws of this state or the United States to the extent that such deposits of public money in credit unions are insured by an agency of the United States, and the interest derived there from shall be applied in the manner prescribed by law. The conditions of such deposits shall be provided by law.”*** In this language, ***“interest-bearing securities”*** is interpreted as investment securities other than certificates of deposit. Therefore, money not invested in interest bearing securities must be deposited in financial institutions located inside the state, as specified.

The State Treasurer’s Investment Policy restricts state funds deposits to banks, savings and loan associations and credit unions located within the state. Section VI.F.2.(f) of the policy states, ***“Deposits are allowed in certified and designated New Mexico financial institutions whose deposits are insured by an agency of the United States.”***

OTHER SUBSTANTIVE ISSUES

Regulation and Licensing Department – Financial Institutions Division (RLD):

In a situation where the local bank or savings and loan decides to place all or some portion of a deposit of public funds with another insured financial institution, HB 643 provides no guidance on how to determine whether a deposit received from a customer of another federally insured financial institution is to be counted towards the requirement that local bank or savings and loan receive “an amount of deposits from customers of other federally insured financial institutions, wherever located equal to or greater than the amount of funds” initially deposited by the public entity (an “offsetting deposit”).

HB 643 does not set any time limits for when the local bank or savings and loan must receive an offsetting deposit. If the bank or savings and loan can show that many of its existing customers who hold certificates of deposit or other forms of deposit also are customers of other “federally insured financial institutions” will those existing deposits be counted as “offsetting deposits”?

HB 643 states that an “offsetting deposit” must be from a customer of another “federally insured financial institution.” It does not specify that this other institution be a depository institution. Since a securities brokerage firm normally carries insurance from the Securities Investors Protection Corporation (similar to FDIC insurance), would brokerage firms count as “other federally insured financial institutions” thereby making deposits

from any of the bank's (or savings and loan's) customers who have accounts at any such brokerage firm count towards the "offsetting deposit"?

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Deposits of public funds in excess of those insured by the FDIC would still have to be collateralized by recipient financial institutions and those institutions would not be able to exchange those deposits with other federally insured financial institutions throughout the country.

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