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FISCAL IMPACT REPORT

SPONSOR Varela DATE TYPED 03/11/05 HB 388/a HBIC

SHORT TITLE Broaden Scope For Securities Lenders SB _____

ANALYST Padilla-Jackson

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
	NFI			

(Parenthesis () Indicate Revenue Decreases)

Duplicates SB49

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Treasurer (STO)

State Board of Finance (SBF)

Attorney General (AG)

SUMMARY

Synopsis of HBIC Amendment

House Bill 388 has been amended by the House Business and Industry Committee. The amended House Bill 388 would withdraw the proposed changes to section 6-10-21 NMSA in the original bill. According to the Board of Finance, the inclusion of this section in the bill was a drafting error and did not pertain to the intent of this legislation, which is to allow the state's investing agencies the option to use the state's custodial bank as a securities lending agent.

The AGO provided the following comments on proposed amendments:

This amendment remedies what would have been an apparently unintended consequence of Section 2 of the bill had the amendment not been made. As the title to the bill indicates, Section 1 of the bill removes the "third party" requirement applicable to financial institutions acting as custodians for State investments—including the State's custody bank, who is responsible for matters related to investment transactions of the various investing agencies of the State along with safe-

keeping securities owned or held by those agencies—thus allowing the custody bank and other custodians to hold securities that are the subject matter of a transaction in which they are acting as a securities lending agent.

Section 6-10-21, the section that was being amended in Section 2, however, involves a different type of custodial bank. Section 6-10-21 applies to financial institutions holding collateral that section 6-10-16 mandates be pledged by “depository” banks who hold cash for the State and its political subdivisions. Thus, removal of the “third party” requirement in section 6-10-21 does not facilitate securities lending transactions. Rather, it would remove a protection current law provides in the context of this completely different type of custody relationship, and would allow a depository bank holding public money to hold its own collateral pledged to safeguard those funds. This floor amendment restores that protection.

Synopsis of Original Bill

House Bill 388 broadens the range of financial institutions that may serve as either securities lenders or that may perform custodial functions for state investment agencies. The bill eliminates the requirement that institutions providing custodial services must be a third party, allowing the state’s custodial bank to perform securities lending services. Securities lending services entail a market transaction where the state agency temporarily lends a small portion of its securities to a broker/dealer, on a collateralized basis, generally in exchange for cash. The bill also eases requirements to allow non-New Mexico banks to perform custodial functions.

Significant Issues

According to STO, passage of this bill will allow for various structures of custody arrangements to be used by the state, providing the state more vendors qualified to compete for state business.

PERFORMANCE IMPLICATIONS

According to STO the State Board of Finance, House Bill 388 will simplify internal investment processes for all state investment agencies. (See Administrative Implications).

FISCAL IMPLICATIONS

There are no direct fiscal impacts of the amended or the original bill. That said, broadening the list of eligible banks that can perform securities lending or that may perform custodial functions could potentially increase competition for the provision of these services and thus lower the cost of service for the investment agency. Similarly, according to PERA, by adding an additional service the custodial bank can provide, the state may be able to negotiate a lower price for both custody services and securities lending services.

ADMINISTRATIVE IMPLICATIONS

House Bill 388 eliminates administrative inefficiency by keeping the state custodial bank, which currently resides out of state, from having to enter into a subcontract with the fiscal agent bank, which is chartered in New Mexico, to provide custodial services. According to the State Board of Finance, there are only about 5 to 10 major banks in the United States that can perform custodial securities for big clients such as New Mexico, none of which reside in New Mexico. As an

example of this, the State Board of Finance provided the table below showing the list of banks responding to the request for proposals for custodial bank services. None of the five banks that responded were New Mexico banks.

OTHER SUBSTANTIVE ISSUES

Both the State Investment Council and the PERA sent e-mails in support of this bill. The following are comments from those e-mails:

State Investment Council

The State Investment Council (SIC) is in favor of Senate Bill 49. SIC notes that the bill would “allow straight-forward contracting arrangements, with the State Board of Finance to contract separately and directly, for fiscal agent services and custody service” and “would allow a more competitive process for requesting and selecting securities lending services”.

PERA

The Public Employees Retirement Association supports the Securities Lending options that will be available to PERA with the passage of Senate Bill 49.

NM STATE BOARD OF FINANCE
CUSTODY BANK SERVICES - REQUEST FOR PROPOSALS
NO: 30-341-40-12283
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OFFEROR
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