F I S C A L   I M P A C T   R E P O R T

		ORIGINAL DATE	1/27/06		
SPONSOR	Varela	**LAST UPDATED**	2/9/06	**HB**	596/aHAFC
SHORT TITLE	TREASURER REPURCHASE AGREEMENTS INVESTMENTS			**SB**	
				ANALYST	Schardin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY06	FY07	FY08		
	195.3		Recurring	General Fund
	159.8		Recurring	Self-Earning Accounts
	264.0		Recurring	LGIP Partici-pants

(Parenthesis ( ) Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY06	FY07	FY08	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		28.5	28.5	57.0	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates SB 84.
Relates to HB 326 and SB 722.

SOURCES OF INFORMATION
LFC Files
New Mexico Municipal League (NMML)

Responses Received From
Department of Finance and Administration (DFA)
Attorney General's Office (AGO)
State Treasurer's Office (STO)

SUMMARY

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee amendment to House Bill 596 makes a technical correction to current statute on page 7, line 13.

In addition, the amendment restricts STO investments in mutual funds to shares of an open-ended diversified investment company that is registered with the SEC, complies with diversification, quality and maturity rules applicable to money market mutual funds, and assesses no fees pursuant to rule 12b-1 of the securities and exchange commission, no sales load on the purchase of shares, and no contingent deferred sales charge.

These amendments bring House Bill 596 into conformity with Section 3 of House Bill 326 and Senate Bill 722.

Synopsis of Original Bill

House Bill 596 amends Section 6-10-10 NMSA 1978 to allow the state treasurer to accept U.S. agency obligations as collateral on repurchase agreements and to allow the treasurer to enter tri-party repurchase agreements.

The bill also amends Section 6-10-10.1 NMSA 1978 to require that the short-term investment fund (normally referred to as the local government investment pool or LGIP) obtain and maintain a credit rating of "AA" or better from a nationally recognized statistical rating organization. If the LGIP receives a rating lower than "AA," the treasurer will be required to immediately submit a plan to the state board of finance to bring the rating back to "AA" or higher.

Because the bill contains no effective date, this analysis assumes it will be effective 90 days after adjournment on May 17, 2006.

FISCAL IMPLICATIONS

Amending statute to allow U.S. agency securities as repo collateral will increase return on term repos by 10 to 20 basis points and increase return on overnight repos by 2 to 4 basis points. This amendment will increase earnings by about $547.5 thousand in FY07 (see table below).

Amending statute to allow tri-party repos will increase return on overnight repos by about 2.2 basis points. This amendment will increase revenue by about $71.5 thousand in FY07.

These additional earnings will be distributed to the state general fund ($195.3 thousand), self earning accounts ($159.8 thousand), and LGIP participants ($264.0 thousand).

A rating organization such as Standard and Poor's will charge the State Treasurer's Office an advisor fee of about $16 thousand per year to monitor the fund, plus a fee of 1/8 of one basis point (0.00125 percent) of the portfolio balance. Assuming an LGIP balance of $1 billion, these fees will be about $28.5 thousand per year. The bill contains no appropriation for this fee.

Fiscal Impact of Amending Repurchase Agreement Restrictions
(Dollars in Thousands)

	FY07
Allow federal agency obligations as repo collateral	
10 to 20 basis point increase on Term Repos (assume 15 bp)	$ 450.0
2 to 4 basis point increase on Overnight Repos (assume 3 bp)	$ 97.5
Allow tri-party repos	
2.2 basis point increase on Overnight Repos	$ 71.5
TOTAL REVENUE	**$ 619.0**
DISTRIBUTION OF REVENUE	
State General Fund	$ 195.3
Self-Earning Accounts	$ 159.8
LGIP	$ 264.0

Assumptions: (based on Dec. 2005 consensus estimate)
55% of STO general fund goes to state general fund and 45% goes to self-earning accounts

Expected STO General Fund Overnight Repo Balance	$250,000
Expected STO General Fund Term Repo Balance	$150,000
Expected LGIP Overnight Repo Balance	$ 75,000
Expected LGIP Term Repo Balance	$150,000

SIGNIFICANT ISSUES

The amendments in House Bill 596 were recommended by Barbara Fava of Public Financial Management, with whom the LFC contracted regarding STO reforms.

Section 6-10-10(J) NMSA 1978 currently requires collateral on repurchase agreements to be fully secured obligations of the United States, which effectively restricts collateral to treasury securities. Relaxing collateral requirements to allow U.S. agency obligations would make it easier for brokers to collateralize these contracts and will significantly broaden the pool of securities available. This will improve return without adding risk to the treasurer's portfolio and bring the STO in line with standard industry practice.

Section 6-10-10(L) NMSA 1978 currently requires that collateral securities for repurchase agreements be physically delivered to the state's fiscal agent or designee. This requirement prohibits the use of tri-party agreements, in which a third-party custodial bank holds collateral securities for the state and its repo counterparty. This arrangement is less costly because the third-party custodian merely moves the collateral balance from one account to another rather than physically delivering the collateral. Allowing tri-party agreements would improve return without adding risk to the treasurer's portfolio and bring the STO in line with standard industry practice.

Section 6-10-10.1 NMSA 1978 would be amended to require that the LGIP maintain a rating of at least "AA," as determined by a nationally recognized statistical rating organization such as Standard and Poor's. The LGIP will be rated each fiscal year and at other times as directed by the state board of finance. With this amendment, a rating organization will monitor the pool on a weekly basis and require that any imprudent actions be amended quickly. This monitoring will help restore confidence in the LGIP, which provides an important and unique service to local governments and tribal entities.

PERFORMANCE IMPLICATIONS

Allowing U.S. agency securities as repurchase agreement collateral and tri-party repurchase agreements will increase STO earnings without adding risk to the portfolio. See fiscal implications.

ADMINISTRATIVE IMPLICATIONS

DFA notes that using tri-party agreements will require the state to enter sub-custodial contracts with third-party custodial banks. It is unclear which state agency would manage these contracts. This process would require at least 1 FTE for a short period of time to set up the contracts. Ongoing maintenance of these contracts could occur with the STO's current resources.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 596 duplicates Senate Bill 84. It also relates to Senate Bill 722 and the House Government and Urban Affairs Committee substitute for House Bill 326. These bills contain the provisions of House Bill 596 but also contain several additional provisions related to the powers and duties of the State Board of Finance and State Treasurer campaign contributions.

TECHNICAL ISSUES

The AGO notes that on page 14, lines 4 through 8, the bill requires the treasurer to immediately submit a plan to the BOF if the LGIP rating falls below AA. However, it is unclear whether the BOF must approve the treasurer's plan or if the plan is submitted merely to notify the BOF.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Earnings on the treasurer's portfolio will continue to be lower than possible due to outdated restrictions. Confidence in the LGIP may not recover fully from recent scandal.

SS/nt:yr