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

ORIGINAL DATE 2/02/07
SPONSOR Campos, J. **LAST UPDATED** 3/15/07 **HB** 471/aHFl/aSFC

SHORT TITLE Establish Linked Deposit System **SB**

ANALYST Schardin

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
	($176.4)	($352.8)	Recurring	General Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Duplicates SB 578

SOURCES OF INFORMATION
LFC Files

Responses Received From
Department of Finance and Administration (DFA)
State Treasurer's Office (STO)
Economic Development Department (EDD)
Regulation and Licensing Department (RLD)

SUMMARY

Synopsis of SFC Amendment

The Senate Floor Amendment to House Bill 471 changes the definition of a "financially at risk rural community" to include municipalities with populations up to 3,500. The original bill required a community's population to be less than 2,600 to participate. EDD expects this amendment will allow about 10 to 15 additional communities to participate in the linked deposit program.

The amendment increases duties of the director of RLD's financial institutions division by requiring that director to promulgate rules regarding verification criteria to determine that a participating institution is meeting the banking service needs of its community.

The amendment also states that a depository institution qualified to participate in the linked deposit program must be open five days per week, rather than eight hours per day and five days per week.

Finally, the amendment makes it clear that the treasurer will be authorized to accept a rate of return up to 1 percent below the market rate on linked deposits, but is not required to do so.

Synopsis of HFl Amendment

The House Floor Amendment to House Bill 471 makes a technical correction. It amends the statutory reference for new material found in Section 1 of the bill so that the new section will be compiled as Section 6-10-24.2 rather than 6-1-24.2.

Synopsis of Original Bill

House Bill 471 creates the linked deposit program, which would allow the State Treasurer to invest up to 14 percent, not to exceed $49 million, of state deposits in qualified depository institutions located in financially at risk rural communities. No more than $10 million could be deposited in any one qualified depository institution. The State Treasurer will be authorized to accept a rate of return on such deposits that is up to 1 percent below the market rate set by the state board of finance.

Qualified depository institutions are defined as insured banks, trust institutions or credit unions. To qualify as a financially at risk rural community a community must have no more than one insured bank, thrift institution, or credit union; a population less than 2,600; and either a population that declined between the last two decennial censuses or a median household income less than 80 percent of the state median.

The bill states that the director of the financial institutions division of RLD will be authorized to make regulations and orders regarding eligibility criteria for qualified depository institutions and application procedures for participation in the program.

The effective date of these provisions is July 1, 2007.

FISCAL IMPLICATIONS

EDD and DFA believe it will take about three years for enough financial institutions in New Mexico to participate in the linked deposit program to exhaust the $49 million cap. It is estimated that STO will deposit 1/3 of the allowed $49 million in qualified depository institutions in FY08, 2/3 of the maximum in FY09, and the full $49 million in FY10 and beyond.

The bill states that the treasurer may accept a rate of return that is up to 1 percent below the market rate (which is set by the State Board of Finance). That Board of Finance interest rate is the rate earned by the State Treasurer's CD portfolio. From FY00 to FY06, the rate of return on the treasurer's CD portfolio was 8 basis points below the average return on the total portfolio. Assuming that the rate of return on linked deposit program investments will be 108 basis points below what would otherwise be earned on the STO portfolio, interest earnings will be $176.4 thousand lower in FY08, $352.8 thousand lower in FY09, and $529.2 thousand lower in FY10 and beyond. This fiscal impact estimate is rough as it depends on participation in the program as well as the amount by which STO rate of return is lower due to the program.

STO assumes that lost interest earnings will accrue only to the general fund. However, interest could be lost to local governments participating in the local government investment pool (LGIP), the state's permanent funds, and the state's self-earning accounts (see Technical Issues).

SIGNIFICANT ISSUES

This bill follows a recommendation made by the Rural Bank Task Force in summer 2006 after Wells Fargo announced it was closing the only banks located in Roy, Vaughn and Wagon Mound. Later, First National Bank announced it would open branches in Roy and Wagon Mound, while Everyone's Federal Credit Union opened a branch in Vaughn.

Proponents of the bill believe allowing state deposits in qualified financial institutions will prevent closure of banks from leaving New Mexico's small communities without any banking services. EDD states that closure of a small community's only bank can dramatically hasten a local economy's decline.

DFA asserts that the deposits authorized by this bill will not be high-risk investments because participating depository institutions will have to follow surety requirements established in statute and will be required by statute to meet collateral requirements established by the State Board of Finance. However, LFC believes that since some rural banks may be required to provide only 50 percent collateral, investment in them does increase STO portfolio risk somewhat.

The State Treasurer is charged to invest state balances in a manner that preserves investment principal, provides adequate liquidity for state expenditure needs, and provides the maximum return possible while ensuring safety and liquidity.

STO is currently authorized to deposit up to $350 million in general fund balances in certificates of deposit (CDs) at New Mexico financial institutions at a rate of return set by the State Board of Finance. This CD program is currently the only economic development oriented investment currently made by STO. The bill would add a second economic development arena to state treasurer investments.

STO reports that any financial institutions participating in this new program will need to comply with the state board of finance collateral policy.

PERFORMANCE IMPLICATIONS

STO recently adopted a general fund performance benchmark that is a weighted average of 15 percent zero to one year treasuries, 70 percent one to five year federal agency securities, and 15 percent one to five year federal agency securities (option only). If the treasurer chooses to deposit up to $49 million in financial institutions that qualify for the linked deposit at a rate of return 1 percent below the market rate set by the state board of finance, overall returns will be lower and it will be more difficult to meet or exceed this benchmark.

ADMINISTRATIVE IMPLICATIONS

The director of the financial institutions division of RLD will be authorized to make regulations to implement the linked deposit program including eligibility criteria and application procedures.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 471 as amended duplicates the Senate Finance Committee substitute for Senate Bill 578 as amended.

TECHNICAL ISSUES

RLD believes the statutory reference to Section 6-10-15 NMSA 1978 on page 2, line 13 of the bill should be amended to reference Section 6-10-10 NMSA 1978. While Section 6-10-15 NMSA 1978 pertains to collateral requirements for a bank or savings and loan associations to qualify to hold deposits of the state treasurer, Section 6-10-10(A) NMSA 1978 reads,

> "A. Upon the certification or designation of a bank, savings and loan association or credit union whose deposits are insured by an agency of the United States to receive public money on deposit, the state treasurer and county or municipal treasurers who have on hand any public money by virtue of their offices shall make deposit of that money in banks and savings and loan associations, and may make deposit of that money in credit unions whose deposits are insured by an agency of the United States, designated by the authority authorized by law to so designate to receive the deposits of all money thereafter received or collected by the treasurers."

Because trust institutions are prohibited from accepting deposits unless they are departments of insured banks (Section 58-1-76 NMSA 1978), RLD recommends amending page 2, lines 11 though 13 to read, "'qualified depository institution' means an insured bank, trust department of an insured bank or credit union qualified pursuant to Section 6-10-10(A) NMSA 1978."

The definition of "state deposits" as any public funds under control of the state treasurer or the state treasurer's designee is vague and should be clarified. The state treasurer accepts deposits from the general fund, the state's self-earning accounts, local governments, and the state's permanent funds. This definition will determine which types of deposits can be invested in rural banks, and subsequently, will determine the funds to which the fiscal impact of the bill will accrue.

SS/nt