

Date of Hearing: May 1, 2024

**ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT**

Juan Carrillo, Chair

AB 2618 (Chen) – As Amended March 21, 2024

**SUBJECT:** Surplus funds: investment.

**SUMMARY:** Makes permanent the temporary authority for a local agency, until January 1, 2026, to invest up to 50% (rather than 30%) of its surplus funds in deposits at a commercial bank, savings bank, savings and loan association, or credit union under specified conditions.

**EXISTING LAW:**

- 1) Authorizes a local agency, until January 1, 2026, to invest a portion of its surplus funds in deposits at a commercial bank, savings bank, savings and loan association, or credit union that uses a private sector entity that assists in the placement of deposits, provided that the purchases of deposits, in total, do not exceed 50% of the agency's funds. Beginning on January 1, 2026, the purchase of deposits shall not exceed 30% [Government Code (GC) § 53601.8].
- 2) Provides that the following conditions apply for a local agency to invest its surplus funds in specified deposits (GC 53601.8):
  - a) The local agency shall choose a nationally or state-chartered commercial bank, savings bank, savings and loan association, or credit union in California to invest the funds, which shall be known as the "selected" depository institution.
  - b) The selected depository institution may use a private sector entity to help place local agency deposits with one or more commercial banks, savings banks, savings and loan associations, or credit unions that are located in the United States and within the network used by the private sector entity for this purpose.
  - c) The selected depository institution shall request that the local agency inform it of depository institutions at which the local agency has other deposits, and the selected depository institution shall provide that information to the private sector entity.
  - d) Any private sector entity used by a selected depository institution to help place its local agency deposits shall maintain policies and procedures that require the following:
    - i) The full amount of each deposit placed, including interest, shall at all times be insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA).
    - ii) Every depository institution where funds are placed shall be capitalized at a sufficient level to receive deposits pursuant to FDIC or NCUA.
    - iii) At the time of the local agency's investment with a selected depository institution and no less than monthly thereafter, the private sector entity shall ensure that the local

- agency is provided with an inventory of all depository institutions in which deposits have been placed on the local agency's behalf, that are within the private sector entity's network.
- iv) Within its network, the private sector entity shall ensure that it does not place additional deposits from a particular local agency with any depository institution identified pursuant to c) above, as holding that local agency's deposits if those additional deposits would result in that local agency's total amount on deposit at that depository institution exceeding the FDIC or the NCUA insurance limit.
  - e) If a selected depository uses two or more private sector entities to assist in the placement of a local agency's deposits, the selected depository shall ensure that it does not place additional deposits from a particular local agency with a depository institution if those additional deposits would result in that local agency's total amount on deposit at that depository institution exceeding the FDIC or the NCUA insurance limit.
  - f) The selected depository institution shall serve as a custodian for each deposit.
  - g) On the same date the local agency's funds are deposited, the selected depository institution shall receive an amount of insured deposits from other financial institutions that, in total, are equal to, or greater than, the full amount of the principal that the local agency initially deposited through the selected depository institution for investment.
  - h) Notwithstanding subdivisions (a) to (g), inclusive, a credit union shall not act as a selected depository institution under this section unless both of the following conditions are satisfied:
    - i) The credit union offers federal depository insurance through the NCUA.
    - ii) The credit union is in possession of written guidance or other written communication from the NCUA authorizing participation of federally insured credit unions in one or more deposit placement services and affirming that the moneys held by those credit unions while participating in a deposit placement service will at all times be insured by the federal government.

**FISCAL EFFECT:** None.

**COMMENTS:**

- 1) **Bill Summary and Author's Statement.** This bill makes permanent the temporary authority for a local agency, until January 1, 2026, to invest up to 50% (rather than 30%) of its surplus funds in deposits at a commercial bank, savings bank, savings and loan association, or credit union under specified conditions. The California Bankers Association is the sponsor of this bill.

According to the author, "Depository institutions that use reciprocal deposits as a means to collateralize against local agency deposits are community banks operating within the geographical region of the local agency. This measure will maintain flexibility for local agencies and banks as they work together in managing local agency funds and in serving

their communities. By keeping these funds in the community, rather than forcing local agencies to invest in the stock market, banks and credit unions can lend back into the community and local agencies have quick access to the funds in the event of a liquidity crisis.”

- 2) **Surplus Investments.** Since 1913, state law has authorized local officials to invest a portion of local agencies’ temporarily idle funds in a variety of financial instruments. Originally, state law limited the instruments to government bonds, but over time the laws governing local agency investments have been amended to keep pace with changing investment opportunities and current market offerings.

California law allows local officials to deposit money in state or national banks, savings associations, federal associations, credit unions, or federally insured industrial loan companies in the State of California. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, state law outlines local agencies’ investment objectives, also known as the prudent investor standard. The primary objective is to safeguard the principal of the funds under the local agency’s control. The secondary objective is to meet the liquidity needs of the depositor. The final objective is to achieve a return on the funds under its control.

State law limits the percentage that local agencies can invest in many types of investments. This encourages local agencies to diversify their investment portfolios, which limits the risk to the local agency if any investment does not have the expected return. Local agencies make investments with different maturity dates, which refer to the date when the borrower must make the final payment due on an investment.

- 3) **Deposits.** Public deposits are subject to restrictions, including a requirement that deposits must be insured by the FDIC or, to the extent not insured, collateralized with certain types of securities in specified amounts. FDIC insurance usually covers only \$250,000 per depositor per institution. As a result, to secure large public deposits, depository institutions must hold significant amounts of collateral. Deposit placement services emerged in the early 2000s as a mechanism for a depository institution to accept a deposit from a local government of greater than the FDIC-insured amount.

Generally, deposit placement services will work with a local agency’s initial selected bank to transfer the local agency’s money in \$250,000 increments to other banks. At the same time, that same service works with other accountholders and member banks to place deposits of a similar aggregate amount back in that selected bank. Thus, the local agency’s deposits are fully federally insured, despite being in excess of the \$250,000 insured limit, while the local depository institution receives the full deposit.

The success of deposit placement services, and the FDIC’s acceptance of them, have led local financial institutions to seek larger deposits from local governments. These deposits, also called brokered deposits or reciprocal deposits, allow more taxpayer funds to be injected into the local banking system, rather than being invested in government bonds or other debt securities outside of the local banking system.

- 4) **Previous Legislation.** AB 2011 (Vargas), Chapter 459, Statutes of 2006, until January 1, 2012, authorized local agencies to invest up to 30% of surplus funds in a private sector, certificate of deposit (CD) placement service.

SB 1344 (Kehoe), Chapter 112, Statutes of 2010, deleted the sunset date contained in AB 2011, thus permanently extending the ability of local agencies to use private sector, CD placement services.

AB 279 (Dickinson), Chapter 228, Statutes of 2013, until January 1, 2017, authorized local agencies to invest surplus funds in deposits other than CDs at depository institutions that use a private sector entity to assist in the placement of deposits, but capped the amount that any local agency could invest in non-CD deposits placed by any single placement service at 10%.

AB 283 (Dababneh), Chapter 181, Statutes of 2015 deleted the 10% per placement agency cap added by AB 279 and extended the sunset date on local agencies' ability to invest in non-CD deposits at depository institutions that use private sector placement agencies to January 1, 2021.

AB 945 (McCarty), Chapter 619, Statutes of 2019, increased, until January 1, 2026, from 30% to 50%, the maximum allowable percentage of a local agency's surplus funds that the local agency may invest in depository institutions that use a private sector entity to assist in the placement of deposits.

- 5) **Arguments in Support.** According to the California Bankers Association, the sponsor of this bill, and a coalition of supporters, "Until January 1, 2026, Government Code Section 53601.8 allows, but does not mandate, a local agency to deposit up to 50 percent of their overall surplus funds with a depository institution that uses reciprocal deposits as a means of collateralization. These local agency funds may be deposited into a certificate of deposit or a demand deposit account. Using reciprocal deposits allows the depository institution to accept a deposit from a local agency exceeding the Federal Deposit Insurance Corporation or National Credit Union Association standard insurance limit of \$250,000 (per depositor) while maintaining full insurance coverage over the entirety of the local agency's deposit.

"Unless the sunset date is removed, on January 1, 2026, the maximum 50 percent of local agency funds that may be placed using reciprocal deposits will be reduced to 30 percent. Depository institutions that use reciprocal deposits as a means to collateralize against local agency deposits are community banks and credit unions operating within the geographical region of the local agency. This measure maintains flexibility for local agencies and banks as they work together in managing local agency funds and in serving their communities."

- 6) **Arguments in Opposition.** None on file.
- 7) **Double-Referral.** This bill was double-referred to the Assembly Banking and Finance Committee, where it passed on 9-0 vote on April 15, 2024.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California Bankers Association [SPONSOR]

California Community Banking Network

California Credit Union League

**Opposition**

None on file

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