

HOUSE BILL REPORT

ESB 6349

As Passed House - Amended:
March 4, 2016

Title: An act relating to public funds and deposits.

Brief Description: Concerning public funds and deposits.

Sponsors: Senators Benton and Mullet; by request of State Treasurer.

Brief History:

Committee Activity:

Business & Financial Services: 2/24/16 [DP].

Floor Activity:

Passed House - Amended: 3/4/16, 93-4.

**Brief Summary of Engrossed Bill
(As Amended by House)**

- Changes the definitions of certain terms related to the Public Deposit Protection Commission and public depositories.
- Makes related changes and clarifications concerning public depositories.
- Eliminates provisions authorizing the State of Washington or any local government to invest in any manner that is authorized for the state or other local governments.
- Preserves the authority of the state or local governments to make investments that law specifically provides for those entities.
- Requires that state or local government investments in commercial paper or corporate notes comply with policies adopted by the Washington State Investment Board.
- Eliminates the authority of the State of Washington and local governments to invest in certain mortgage-related and financial institution-related debt.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Majority Report: Do pass. Signed by 11 members: Representatives Kirby, Chair; Stanford, Vice Chair; Vick, Ranking Minority Member; McCabe, Assistant Ranking Minority Member; Barkis, Blake, Dye, Hurst, Kochmar, Ryu and Santos.

Staff: Peter Clodfelter (786-7127).

Background:

Public Funds and Public Depositaries.

Public funds may generally only be deposited in financial institutions that the Public Deposit Protection Commission (Commission) has approved as public depositaries. Established in 1969, the Commission is comprised of the Governor, the Lieutenant Governor, and the State Treasurer. The State Treasurer chairs the Commission and provides administrative support.

The Commission is responsible for protecting all public funds deposited in public depositaries. A public depositary is a financial institution that does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under Washington law, that has been approved by the Commission to hold public deposits, and that has segregated for the benefit of the Commission eligible collateral having a value of not less than the financial institution's maximum liability. Financial institutions are defined as any national or state-chartered commercial bank or trust company, savings bank, or savings association, or branch or branches thereof, located in Washington. Pursuant to authorization added in 2010 and 2012, state and federal credit unions may act as limited public depositaries of funds for public agencies, up to the maximum amount insured by the National Credit Union Share Insurance Fund, which is currently \$250,000.

Public funds are those moneys belonging to or held for the state, its political subdivisions, municipal corporations, agencies, courts, boards, commissions, or committees, and includes moneys held in trust. All public funds deposited in public depositaries, including investment deposits and accrued interest on such investment deposits, must be protected against loss. Investment deposits are time deposits, money market deposit accounts, and savings deposits of public funds available for investment. Time deposits must bear interest at a rate not in excess of the maximum rate permitted by any applicable government regulation.

The eligible collateral that every public depositary must at all times maintain pursuant to a depositary pledge agreement with the Commission and a trustee must be segregated by deposit with the public depositary's trustee and must be clearly designated as security for the benefit of public depositors. A trustee is a third-party safekeeping agent that has completed a depositary pledge agreement with a public depositary and the Commission. Such a third-party safekeeping agent may be the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank of Seattle, or such other third-party safekeeping agent approved by the Commission.

Eligible collateral that the Commission may accept is defined as specific classes of securities:

- certificates, notes, or bonds of the United States;
- state, county, municipal, or school district bonds or warrants of taxing districts of any state in the United States;

- bonds, notes, letters of credit, or other securities or evidence of indebtedness constituting the direct and general obligation of a federal home loan bank or federal reserve bank;
- revenue bonds of Washington or any authority, board, commission, committee, or similar agency of Washington, and any municipality or taxing district of this state;
- direct and general obligation bonds and warrants of any city, town, county, school district, port district, or other political subdivision of any state, having the power to levy general taxes, which are payable from general ad valorem taxes;
- bonds issued by public utility districts; and
- bonds of any city of the State of Washington for the payment of which the entire revenues of the city's water system, power and light system, or both, less maintenance and operating costs, are irrevocably pledged, even though such bonds are not general obligations of such city.

The Commission may determine by rule or resolution whether any security is or will remain eligible as collateral when it is desirable or necessary to do so in the Commission's judgment.

The Director of the Department of Revenue must notify the Commission quarterly of the names and addresses of any financial institutions that have claimed exemption from the payment of any sales or compensating use or ad valorem taxes under Washington law.

Authorized Investments of Public Funds.

The Washington Constitution generally prohibits the state and local governments from investing in private enterprises through vehicles such as stocks and bonds. Unless specifically exempted from these provisions, the investment of state funds is therefore effectively limited to government securities and certificates of deposit. The local government prohibition contains more specificity, which the courts have interpreted to apply equally to the state:

ARTICLE 8, SECTION 7 CREDIT NOT TO BE LOANED. No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.

The voters adopted amendments to the Washington Constitution in 1966, 1968, 1985, and 2000, to allow stock investments by the K-12 Common School Permanent Fund, public employee retirement funds, workers' compensation funds, and funds held in trust for the benefit of persons with disabilities. Over time, the provisions have been interpreted to allow some transactions with private financial institutions, such as banks.

In a 1993 opinion, the Attorney General advised that in narrow circumstances certain types of corporate debt acquired in the secondary market, such as commercial paper, may not be a constitutionally prohibited investment in stock or bonds. The opinion reasoned that some forms of corporate debt were considered distinct from bonds when the Washington Constitution was drafted, and their purchase creates no public ownership of a private entity as owning stock would.

The Washington State Investment Board adopts and regularly reviews guidelines that must be followed by the State Treasurer and local governments that wish to invest in commercial paper. The current policy was adopted in September 2015, and includes requirements that the maturities of the paper not exceed 270 days, have high credit ratings, not exceed 25 percent of the assets of a portfolio (nor more than 5 percent from a single issuer), and be purchased in the secondary market.

Different local governmental entities and special districts are authorized to invest funds in many separate chapters and sections of the laws of Washington. For example, housing authorities are authorized by statute to invest in any investments permitted for savings banks, which include stock in small business investment companies, obligations of supranational entities including the International Bank for Reconstruction and Development, the Inter-American Development Bank, and the Asian, African, and other multilateral development banks that the United States government participates in, bankers' acceptances, bills of exchange, promissory notes secured by the pledge of investments otherwise permitted for purchase by the savings bank, loans to corporations, preferred stock, corporate bonds, or other corporate debt.

In contrast, excess and inactive funds in the treasury of a code or non-code city may be invested in United States bonds or certificates of indebtedness, bonds or warrants of the state, general obligation or utility revenue bonds or warrants, bonds or warrants of a local improvement district, or other investments authorized by law for any other taxing district. Similarly the state and local governments are authorized to invest in any investments authorized by law for the state or any local government of the state other than a metropolitan municipal corporation.

Summary of Bill:

Public Funds and Public Depositaries.

When the Commission accepts a letter of credit from a federal bank or a federal reserve bank as eligible collateral from a public depository, the letter of credit is not subject to a completed depository pledge agreement and, accordingly, the Commission must act as the safekeeping agent of the letter of credit rather than a trustee.

The definition of "public depository" is amended to harmonize the definition with the separate authorization for credit unions to act as public depositaries in a limited scope. The requirement that the Director of the Department of Revenue must notify the Commission quarterly of the names and addresses of any financial institutions that have claimed exemption from the payment of any sales or compensating use or ad valorem taxes under Washington law is removed.

It is provided that investment deposits do not include time deposits represented by a transferable or negotiable certificate, instrument, passbook, or statement, or by book entry or otherwise.

The definition of "trustee" is amended so that eligible trustees include all federal home loan banks or other third-party safekeeping agents approved by the Commission, instead of

specifically the Federal Reserve Bank of San Francisco and the Federal Home Loan Bank of Seattle or other third-party safekeeping agents approved by the Commission.

A reference to an obsolete federal agency is removed.

The requirement that time deposits must bear interest at a rate not in excess of the maximum rate permitted by any applicable government regulation is removed.

Authorized Investments of Public Funds.

The State Treasurer and higher education institutions are broadly authorized to invest in: bonds of the State of Washington and local government bonds with one of the three highest credit ratings of a nationally recognized rating agency; general obligation bonds of another state or local governments of another state with similarly high credit ratings; registered warrants of a local government in the same county as the government making the investment; certificates, notes, or bonds of the United States, any corporation wholly owned by the United States, or obligations issued or guaranteed by supranational institutions that have the United States as its largest shareholder; and bankers' acceptances, commercial paper, or corporate notes purchased on the secondary market.

Local governments are similarly authorized, but may invest in Washington and local government bonds without one of the three highest rating of a nationally recognized rating agency. Commercial paper and corporate notes must adhere to the Washington State Investment Board investment policies to be eligible for local government, the State Treasurer, or higher education institutions investment.

The investment authority granted to higher education institutions does not limit the authority already provided in the laws pertaining to the University of Washington, Washington State University, regional universities, The Evergreen State College, and community and technical colleges.

Money market funds and certain types of mutual funds are eliminated from the definitions in the general laws authorizing investment of public funds, and changes are made to the definition of "state" for the chapter to mean any state in the United States other than the State of Washington. The authority for the state and local governments to invest in any investments authorized by law for the state or any other local government is also eliminated. Local government authority to make investments specifically authorized for those entities is not limited by the repeal.

Authority for the State of Washington and any subdivision or local government to invest in debt secured by mortgages insured by the Federal Housing Administrator, or in bonds of the Home Owner's Loan Corporation is eliminated.

Authority for the State of Washington and any subdivision or local government to invest in notes, bonds, or debentures of savings and loan associations, banks, mutual savings banks, savings and loan service corporations, and corporate mortgage companies is eliminated.

The Higher Education Facilities Authority is granted the authority to invest funds held in reserve that are not required for immediate disbursement.

The authority of the State Finance Committee to administer and adopt rules relating to the investment of local government funds laws is repealed.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) None.

(Opposed) None.

Persons Testifying: None.

Persons Signed In To Testify But Not Testifying: None.