

DATE: July 5, 2013

TO: The Honorable Senate President pro Tem Darrell Steinberg;
The Honorable Speaker John A. Perez

CC: League of California Cities;
California Association of County Treasurer-Tax Collectors

FROM: Michelle Durgy, Chief Investment Officer, City and County of San Francisco;
California Municipal Treasurers Association;
California Society of Municipal Finance Officers

RE: LETTER OF CONCERN: Assembly Bill 279 (Dickinson) Financial Affairs

We are writing to you to express our concern over the proposed legislation, **Assembly Bill 279 (Dickinson)** Financial Affairs. As stated in the Legislative Analysis of the bill provided by Kathleen O'Malley on April 8, 2013, the bill seeks to "expand" the current law, California Government Code, Sections 53601.8 and 53635.8 to allow municipalities to use a placement service for "deposits" and not merely certificates of deposit as the law currently allows. The changes, as proposed, seek to effect greater deposits in local banking institutions and credit unions by providing 100% Federal Depository Insurance Corporation (FDIC) or National Credit Union Association (NCUA) insurance for the entire deposits. The bill further seeks to fix the Congress' decision not to extend the Transaction Account Guarantee (TAG) program past December 31, 2012, which previously provided full FDIC insurance coverage on all non-interest bearing accounts. With the termination of the TAG program, local banks and credit unions saw outflows of several billion dollars over the past two quarters from their institutions and into money market funds and other short-term instruments.

The bill also has the added benefit of encouraging greater deposits in local banking institutions and credit unions. The benefit is that larger deposits lead to more lending of small business and mortgage loans and in turn, these spur economic growth in the local communities. While current bill expands permissible investments to include FDIC- and NCUA-insured cash accounts,

these Federally Insured Cash Accounts (FICAs) are being marketed as providing a liquid and insured investment vehicle to government entities. The reality is that these investments are not the liquid instruments they purport to be.

These investments are being marketed as demand deposit accounts (DDAs) and Money Market Demand Accounts (MMDAs), which by definition have the following features:

- No maturity period (or maturity period of less than seven days)
- Payable on demand (or on less than seven days' notice)
- May not be interest-bearing
- No limit on the number of withdrawals or transfers an account holder may make
- No eligibility requirements

MMDAs only:

- Bank must reserve the right to require at least seven days' notice of intent to withdraw funds (in practice, this right is rarely, if ever, exercised)
- Allow no more than six transfers or withdrawals per calendar month or statement cycle of at least four weeks for the purpose of transferring funds to another of the depositor's accounts at the same institution or making third-party payments by means of preauthorized, automatic, or telephonic transfers

(Federal Reserve Consumer Compliance Handbook, Regs. Q and D, January 2006, p. 2)

In practice, these FICAs as they are currently structured, do not meet these criteria. Therefore, a moral hazard exists where the public fund investor has the expectation that these accounts provide a reasonable alternative to the TAG program, where same day liquidity is received on an insured deposit.

Unfortunately, this is not the case. This position is further supported by Standard and Poor's Ratings Services, which categorizes deposits in FICA as part of the "limited liquidity/illiquid basket [for Principal Stability Fund Ratings] because these deposits (and other pooled deposit programs) are nonmarketable securities, may impose fees for early withdrawal, and may have a delay in receiving monies from FDIC." (see "Principal Stability Fund Ratings Criteria,"

published Feb. 2, 2007, and "Principal Stability Fund Ratings Criteria Updated," published March 10, 2009, both on RatingsDirect).

We are deeply concerned about the potential for misleading marketing practices behind these products and the confusion of the public sector investment community. Should this bill pass, we will be undertaking substantial educational efforts to inform the community as to the risks associated with these products.

You may contact us further to discuss these concerns at michelle.durgy@sfgov.org and pauline.marx@sfgov.org.

Sincerely,

Michelle Durgy
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President, California Municipal Treasurers Association

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