HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	HB 145	**FINAL HOUSE FLOOR ACTION:**	
SPONSOR(S):	Santiago	116 **Y's**	0 **N's**
COMPANION BILLS:	(SB 558)	**GOVERNOR'S ACTION:**	Approved

SUMMARY ANALYSIS

HB 145 passed the House on April 30, 2013 as SB 558.

Qualified public depositories (QPDs) are banks, savings banks, or savings associations that are qualified to accept public deposits from state and local governments. In addition to other requirements, QPDs must meet a collateral requirement by pledging, depositing, or issuing eligible collateral to the Chief Financial Officer or to the CFO's designee in some instances. QPDs are permitted to use Federal Home Loan Bank (FHLB) letters of credit to meet this collateral requirement, as long as obligations issued by the FHLB remain triple-A rated by a nationally recognized source.

The bill allows QPDs to continue securing and retaining FHLB letters of credit as eligible collateral in the event the other major credit agencies downgrade their ratings of FHLB obligations below triple-A. The bill permits QPDS to use FHLB letters of credit if no longer triple-A rated, if FHLB obligations are rated by a nationally recognized source at not lower than its rating of the long-term sovereign credit of the U.S.

The bill may have a positive impact on the private sector, and it is not likely that the bill will have a fiscal impact on state or local government.

The bill was approved by the Governor on June 7, 2013, ch. 2013-129, L.O.F., and will become effective on July 1, 2013.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Current Situation

Chapter 280, Florida Statutes, is the Florida Security for Public Deposits Act (Act), which authorizes state and local governments to deposit funds in excess of amounts required to meet disbursement needs or expenses in a qualified public depository (QPD), which is a bank, savings bank, or savings association that meets specific criteria. Qualified public depositories must secure public deposits in accordance with the act and the collateral requirements and pledging levels as set forth by rule of the Chief Financial Officer (CFO).[1] Qualified public depositories may meet this collateral requirement by pledging, depositing, or issuing eligible collateral to the CFO, or to a CFO's designee in some instances. Eligible collateral consists of securities, Federal Home Loan Bank (FHLB) letters of credit, and cash, as designated by the act.[2] The Department of Financial Services, as headed by the CFO, administers a collateral management program which ensures compliance with the Act.[3]

The Act's collateral requirements protect public deposits against loss in the event of certain triggering events, most notably, a QPD's insolvency or default.[4] Losses are satisfied first through the standard maximum federal deposit insurance of $250,000, and then through the CFO's demand for payment under letters of credit or the sale of collateral pledged or deposited by the defaulting QPD.[5] Any remaining shortfall would then be covered by the CFO's authority to impose assessments against the other QPDs.[6]

Federal Home Loan Bank Letters of Credit

Congress created the Federal Home Loan Bank (FHLB) System in 1932. Its mission is to support residential mortgage lending and community investment at a local level.[7] The FHLB System is composed of 12 regional cooperative banks that are entirely owned by their members.[8] Obligations of the FHLB are not obligations of the U.S. and are not guaranteed by the federal government or any government agency.[9]

Under the Act, QPDs are permitted to use FHLB letters of credit as a collateral option, if certain requirements are met.[10] Unlike the other eligible collateral types, FHLB letters of credit do not involve a custodial arrangement and instead name the CFO as a beneficiary.[11] According to the Florida Bankers Association, FHLB letters of credit are stable, irrevocable, and cost-efficient. Additionally, the use of FHLB letters of credit provide operational efficiencies to the CFO who can directly make a demand on the FHLB letters of credit in the event of a QPD's default, without having to sell and transfer pledged

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[1] *See* chapter 280, F.S., and chapter 69C-2, F.A.C.
[2] Sections 280.02(12) and 280.13, F.S.
[3] More information about the Bureau of Collateral Management can be found at: https://apps8.fldfs.com/cap_web/ (last accessed February 26, 2013).
[4] Section 280.041(6), F.S.
[5] Section 280.08(3)(a), F.S.
[6] Section 280.08(3)(b), F.S.
[7] Federal Home Loan Bank, Office of Finance, *History of Service, available at* http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/mission--history-29 (last accessed May 8, 2013)
[8] Federal Home Loan Bank, *The Federal Home Loan Banks: The Basics*, http://www.fhlbanks.com/assets/pdfs/sidebar/FHLBanks_TheBasics_4_2012.pdf (last accessed May 8, 2013).
[9] Federal Home Loan Bank, Office of Finance, *Credit Ratings*, http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/credit-ratings-31 (last accessed May 8, 2013).
[10] Section 280.13(5), F.S.
[11] Section 280.13(5)(b)4., F.S.

securities.[12] As of October 29, 2012, 17 QPDs have pledged a total of $1.88 billion in FLHB letters of credit as collateral.[13]

One prerequisite for QPDs to use FHLB letters of credit is that obligations issued by the FHLB remain triple-A rated by a nationally recognized source.[14] Currently, FHLB letters of credit are the only eligible collateral type that the act imposes a credit rating requirement, even though other eligible collateral forms, such as Treasury bonds and other federal agency obligations, receive credit ratings.

Credit Ratings

According to Standard & Poor's (S&P), a nationally recognized source and one of the "Big Three" credit rating agencies (the other two being Moody's and Fitch Ratings):

> Credit ratings are forward-looking opinions about credit risk…[and] the ability and willingness of an issuer…to meet its financial obligations in full and on time. Credit ratings can also speak to the credit quality of an individual debt issue…and the relative likelihood that the issue may default…Each agency applies its own methodology in measuring creditworthiness and using a specific rating scale to publish its ratings opinions. Typically, ratings are expressed as letter grades that range, for example, from 'AAA' to "D" to communicate the agency's opinion of relative level of credit risk.[15]

On August 5, 2011, S&P issued an unprecedented downgrade of the U.S.'s sovereign long-term credit rating from triple-A (the highest credit rating available) to AA+ (very strong capacity to meet financial commitments). Standard & Poor's attributed its downgrade to its negative outlook of the current debate and uncertainty surrounding U.S. fiscal and economic policy.[16] Due to the FHLB System's status as a government-sponsored enterprise, its credit ratings are integrally tied to those of the U.S. Accordingly, S&P similarly lowered its credit ratings on 10 of 12 FHLBs from triple-A to AA+:

> The downgrades reflect the interplay between the sovereign rating and the entities' stand-alone credit profiles. The ratings continue to reflect our opinion that there is a very high likelihood the U.S. government would provide timely and sufficient extraordinary support to these entities in the event of financial distress.[17]

However, Moody's gave its highest ratings to long-term debt (Aaa) and short-term debt (Prime-1) issued by the FHLBs,[18] and Fitch Ratings affirmed its triple-A rating of several FHLBs.[19] In addition, both Moody's and Fitch Ratings have maintained their triple-A ratings of U.S. long-term sovereign debt, although subject to a negative outlook based on concerns over the federal deficit.[20]

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[12] Florida Bankers Association's analysis of HB 145, on file with the Insurance & Banking Subcommittee.
[13] Policy & Research Memorandum from the Department of Financial Services, on file with the Insurance & Banking Subcommittee.
[14] Section 280.13(5)(c), F.S.
[15] Standard & Poor's Credit Ratings Definitions & FAQs, at http://www.standardandpoors.com/ratings/definitions-and-faqs/en/us (last accessed February 26, 2013).
[16] *United States of America Long-Term Rating Lowered to 'AA+' Due to Political Risks, Rising Debt Burden; Outlook Negative*, S&P's press release, August 5, 2011, http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563 (last accessed February 26, 2013).
[17] *Credit Matters: Special Report on the U.S. Rating Downgrade and Its Global Effects*, Standard & Poor's CreditWeek, Vol. 31, No. 31, Page 19 (August 17, 2011). A copy of the article is available online at: www.standardandpoors.com/spf/swf/creditweek/data/document.pdf
[18] Federal Home Loan Banks, Office of Finance: Credit Ratings: http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/credit-ratings-31 (last accessed February 26, 2013).
[19] "Fitch Affirms Several Federal Home Loan Banks' 'AAA' Rating and Stable Outlook," at http://www.reuters.com/article/2011/08/16/idUS209276+16-Aug-2011+BW20110816 (last accessed February 26, 2013).
[20] "Fitch Backs Away from Downgrade of U.S. Credit Rating," at http://www.reuters.com/article/2013/01/28/us-usa-rating-fitch-idUSBRE90R0WS20130128 (last accessed February 26, 2013).

In the event all nationally recognized sources downgrade their ratings of FHLB obligations below triple-A, current law would not permit QPDs to use FHLB letters of credit as eligible collateral. Consequently, QPDs would have to turn to other assets (such as Treasury notes and Fannie Mae securities) as replacement collateral, which could affect their liquidity and lending ability.

Effect of the Bill

This bill enables QPDs to continue using FHLB letters of credit as eligible collateral, in the event the other major credit agencies downgrade their ratings of FHLB obligations below triple-A. The bill permits the use of FHLB letters of credit as eligible collateral, if no longer triple-A rated, if FHLB obligations are rated by a nationally recognized source at not lower than its rating of the long-term sovereign credit of the U.S.

The bill provides an effective date of July 1, 2013.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

See Fiscal Comments.

D. FISCAL COMMENTS:

The ability to continue using FHLB letters of credit as eligible collateral may be beneficial to QPDs, as FHLB letters of credit are stable, irrevocable, and cost-efficient. Additionally, there are operational efficiencies to the CFO who can directly make a demand on the FHLB letters of credit in the event of a QPD's default without having to sell and transfer pledged securities.