The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Banking and Insurance

BILL: SB 558

INTRODUCER: Senator Detert

SUBJECT: Letters of Credit Issued by a Federal Home Loan Bank

DATE: February 8, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Burgess	BI	**Pre-meeting**
2.			CM	
3.			JU	
4.				
5.				
6.				

I. Summary:

The Chief Financial Officer (CFO), as the head of the Department of Financial Services (DFS), is responsible for keeping all state funds and securities and investing excess funds in qualified public depositories (QPD). The CFO also establishes qualifications for designating banks and savings and loan associations as QPDs. A QPD is required to collateralize a specified portion of the public monies on deposit so that the designated portion of the public deposits is immediately available should the need arise. Various types of securities are eligible to be pledged as collateral, including letters of credit issued by a Federal Home Loan Bank (FHLBank) that are triple A-rated, which is the highest rating, by a national source (credit rating agency).

Due to uncertainties regarding the fiscal condition of the United States, consumer confidence, high unemployment, and the global economy, one of the nationally recognized credit rating agencies, Standard and Poor's (S&P), downgraded the U.S. long-term sovereign credit rating one level from "AAA" to "AA+".[1] While Moody's and Fitch have not downgraded the U.S. sovereign rating, they have both issued short term negative outlooks for the U.S. and have indicated that they may downgrade the U.S. from its top credit rating if Congress fails to address the fiscal issues. Although debt of the FHLBank, as a government-sponsored entity, is not guaranteed by the U.S. government, credit rating agencies state that there is financial dependence between the U.S. government and the FHLBank. Thus, a lower U.S. sovereign rating would likely impact the rating of the FHLBank. In the event the two other rating agencies also downgrade their credit ratings for FHLB obligations, QPDs could no longer use FHLB letters of

[1] "United States of America Long-Term Rating Lowered To 'AA+' Due To Political Risks, Rising Debt Burden; Outlook Negative", Standard & Poor's, press release. August 5, 2011. Available at: http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563. (Last accessed February 14, 2013.)

credit as eligible collateral under current law. This would require QPDs to use other assets as replacement collateral, which in turn could affect their liquidity and lending ability.

The bill would allow QPDs to continue using letters of credit of a FHLBank as eligible collateral in the event the other major credit agencies downgrade their ratings of a FHLBank obligations below triple-A. The bill would permit QPDs to use letters of credit of an FHLBank, if obligations of the FHLBank are rated by a nationally recognized source at not lower than its rating of the long-term sovereign credit of the U.S.

This bill substantially amends the following section of the Florida Statutes: 280.13.

II. Present Situation:

Florida Qualified Public Depository Program

The Florida Security for Public Deposits Act (act)[2] delineates the powers and duties of the CFO and the requirements that must be met by QPDs and public depositors.[3] To provide protection of public deposits, each QPD is required to pledge collateral at a level commensurate with the amount of public deposits[4] held and a measure of its financial stability, as determined by the CFO. The CFO may demand payment under a letter of credit or direct a custodian to deposit or transfer collateral and proceeds of securities not previously credited upon the occurrence of one or more triggering events as provided for in law.[5] The act provides that when the CFO determines that a QPD default or insolvency has occurred, the loss to public depositors is to be satisfied, insofar as possible, first through any applicable deposit insurance and then through demanding payment under letters of credit or the sale of collateral pledged or deposited by the defaulting QPD.[6] The CFO is to provide coverage of any remaining loss by use of amounts assessed and collected from the other QPDs.

Collateral Requirements for Public Deposits

The CFO determines the financial stability of each QPD based on nationally recognized financial rating services information and established performance guidelines.[7] Contingent on the financial stability of the QPD, the amount of pledged collateral[8] could be 25 percent to 200 percent of the

[2] Chapter 280, F.S.
[3] A public depositor is the official custodian of funds for a governmental unit who is responsible for handling public deposits.
[4] A public deposit is defined as the moneys of the State or of any State university, county, school district, community college, special district, metropolitan governments, or municipality, including agencies, boards, bureaus, commissions, and institutions of any of the foregoing, or of any court, and includes the moneys of all county officers, including constitutional officers, that are placed on deposit in a bank, savings bank, or saving association and for which the bank, savings bank, or savings association is required to maintain reserves.
[5] Examples of triggering events include those instances in which the CFO determines that an immediate danger to the public health, safety, or welfare exists; the QPD defaults or becomes insolvent; the QPD fails to pay an administrative penalty; the QPD fails to meet financial condition standards; and the QPD pledges, deposits, or has issued insufficient or unacceptable collateral to meet required collateral within the required time. [Section 280.041(6), F.S.]
[6] Section 280.08, F.S.
[7] Section 280.04, F.S.
[8] Eligible collateral includes obligations of the United States Government, federal agencies, and any state or political subdivision or municipality; Federal Home Loan Bank letters of credit; tax anticipation certificates; public housing authority

public deposits held. The act allows the pledging of letters of credit of the FHLBank if the obligations of the FHLBank remain "triple-A" rating by at least one nationally recognized source (i.e., Standard & Poor's, Moody's, or Fitch rating agencies). According to DFS, the Florida Qualified Public Depository program currently has 17 QPDs that have pledged a total of $1.88 billion in Federal Home Loan Bank letters of credit.[9]

Federal Home Loan Bank System

The Federal Home Loan Bank System (FHLBank) is a government-sponsored enterprise chartered by Congress in 1932. Its purpose is to support residential mortgage lending and community investment at the local level. Each financial depository member is a shareholder in one or more of 12 regional FHLBanks, which are privately capitalized, separate corporate entities managed within a framework established by the Federal Housing Finance Agency. Although the debt issued by the FHLBank is not guaranteed by the U.S. Government, credit rating agencies[10] assume a high dependence and support between the FHLBank and the U.S. government. Long-term senior debt of an FHLBank is rated by Moody's (Aaa) and Standard & Poor's (AA+).[11]

Current U.S. Credit Outlook

Uncertainties remain regarding the fiscal condition of the United States, consumer confidence, high unemployment, and the global economy. As a result of these concerns, S&P downgraded the U.S. long-term sovereign credit rating from "AAA" to "AA+" in 2011.[12] While Moody's and Fitch have not downgraded the U.S. sovereign rating, they have both announced that their short-term outlook for the U.S. is negative and they may downgrade the U.S. from its top credit rating if Congress fails to address the fiscal issues and growing deficit.[13] Accordingly, there is a distinct possibility that all three nationally recognized rating agencies could downgrade the U.S. sovereign credit rating in the near future if the U.S. fiscal issues are not adequately addressed. The credit rating of the FHLBank is integrally tied to those of the United States sovereign debt. For example, the credit ratings of the FHLBank were downgraded to AA+ when the U.S. sovereign debt was downgraded by Standard and Poor's in August 2011. Standard and Poor's

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obligations; revenue bonds of any state of the United States or political subdivision or municipality; corporate bonds; and other securities designated allowable by law, Section 280.13, F.S.

[9] Department of Financial Services, Policy and Research Memorandum," FHLBank LOCs and Requirements under Section 280.13(5)(c), F.S.," dated October 29, 2012. On file with the Senate Banking and Insurance Committee staff.

[10] A credit rating agency provides its opinion on the creditworthiness of an entity and the financial obligations issued by an entity. A credit rating agency may register as an "Nationally Recognized Statistical Rating Organizations" (NRSROs) with respect to up to five classes of credit that include financial institutions, insurance companies, issuers of government securities. Ten rating agencies are registered as NRSROs with the Securities and Exchange Commission. (A.M. Best Company, Inc., DBRS Ltd., Egan-Jones Rating Company, Fitch, Inc., Japan Credit Rating Agency, Ltd., Kroll Bond Rating Agency, Inc., Moody's Investors Service, Inc., Rating and Investment Information, Inc., Realpoint LLC, and Standard & Poor's Ratings Services). Available at: http://www.sec.gov/answers/nrso.htm. (Last accessed February 17, 2013.)

[11] FHLBank Office of Finance, *Credit Ratings.* http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/credit-ratings-31.

[12] "United States of America Long-Term Rating Lowered To 'AA+' Due To Political Risks, Rising Debt Burden; Outlook Negative", Standard & Poor's, press release. August 5, 2011. Available at: http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563. (Last accessed February 18, 2013.)

[13] What Will Cause the Next U.S. Credit Downgrade? U.S. News, January 3, 2013. Available at: http://www.usnews.com/news/blogs/rick-newman/2013/01/03/what-will-cause-the-next-us-credit-downgrade. (Last accessed February 17, 2013)

noted, "… if we lowered the rating on the U.S., we would likely lower the ratings on the (FHLBank) system debt and the individual FHLBs according to our GRE (government-related entity) criteria, since we do not believe an institution that receives support should be rated above the institution that supports it, except in very unique situations."[14] If the other Moody's and Fitch ultimately downgrade the U.S. sovereign debt, this would eliminate the ability of QPDs to use letters of credit of the FHLBank to meet the requirements of s. 280.13, F.S.

As would be expected, none of the FHLBanks hold a long-term triple-A credit rating from Standard and Poor's, thereby reflecting the U.S. downgrade. Currently, all FHLBanks (with the exception of Seattle) hold the same credit rating as the U.S. (AA+).[15] All of the FHLBanks currently hold Moody's top credit rating for both the short and long-term (Aaa/P-1), which reflects the ratings Moody's holds for the U.S. generally.[16] In 2011, Fitch affirmed the AAA rating of the FHLBank and the U.S. sovereign debt; however, Fitch issued a negative rating outlook on the FHLBank and the U.S. sovereignty credit.[17]

III. Effect of Proposed Changes:

Section 1 amends s. 280.13, F.S., relating to eligible collateral, to allow QPDs to continue using letters of credit issued by FHLBank collateral, in the event the other credit rating agencies downgrade their ratings of FHLB obligations below triple-A. The bill would permit the use of FHLBank letters of credit if the obligations of the FHLBank are rated by a nationally recognized source at not lower than its rating of the long-term sovereign credit of the U.S.
Section 2 provides this act would take effect July 1, 2013.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

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[14] Standard and Poor's Ratings Direct, Federal Home Loan Banks, August 15, 2012. http://www.fhlb-of.com/ofweb_userWeb/resources/SandPCreditAnalysis081512.pdf (Last accessed on February 9, 2013.)
[15] All FHLBanks do hold Standard and Poor's top credit rating in the short-term (A-1+).
[16] "Combine Financial Report – Q2 2012", FHLBanks – Office of Finance, Page 36. Available at: http://www.fhlb-of.com/ofweb_userWeb/resources/12Q2end.pdf. Since January 2012, there has been no rating action taken with regard to the FHLBanks or their consolidated obligations. Last accessed on February 17, 2013.)
[17] "Fitch Revises the Rating Outlook on the Federal Home Loan Banks to Negative," Reuters, November 28, 2011. Available at: http://www.reuters.com/article/2011/11/28/idUS226613+28-Nov-2011+BW20111128. (Last accessed February 17, 2013.)

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The ability to continue using FHLBank letters of credit as eligible collateral may be beneficial to QPDs, as these letters of credit are stable, irrevocable, and cost-efficient.

This change in letters of credit as eligible collateral would eliminate any potential disruption to banks and savings associations that use FHLBank letters of credit as collateral should the long-term sovereign credit rating of the United States drop below triple-A.

C. Government Sector Impact:

The letters of credit issued by the FHLBank provide operational and cost 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. The Department of Financial Services does not anticipate that the bill will have a fiscal impact.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.