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 Commerce and Tourism

BILL: SB 558

INTRODUCER: Senator Detert

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

DATE: March 1, 2013 REVISED:

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

I. Summary:

SB 558 amends the Florida Security for Public Deposits Act (the act)[1] which authorizes local and state governments to place public deposits in qualified public depositories (QPD). The state Chief Financial Officer (CFO) is responsible for establishing criteria for financial institutions to be designated QPDs. A QPD is required to secure or collateralize public deposits in accordance with the act. 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 (AAA), which is the highest rating, by a national source.

Due to uncertainties regarding the fiscal condition of the United States (U.S.), consumer confidence, high unemployment, and the global economy, one of the nationally recognized credit rating agencies, Standard and Poor's Ratings Services (Standard & Poor's), downgraded the U.S. long-term sovereign credit rating one level from "AAA" to "AA+."[2] While Moody's Investor Service, Inc., (Moody's) and Fitch, Inc., (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 obligations of the FHLBank, a government-sponsored entity, are 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

[1] Chapter 280, F.S.

[2] Press Release, Standard & Poor's, *United States of America Long-Term Rating Lowered to 'AA+' Due to Political Risks, Rising Debt Burden,; Outlook Negative* (Aug. 5, 2011). *Available at* http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563 (last visited February 27, 2013).

ratings for FHLBank obligations, QPDs could no longer use FHLBank letters of 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 FHLBank obligations below AAA. 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 s. 280.13, F.S.

II. Present Situation:

The Security for Public Deposits Act provides the framework for the protection of public deposits.[3] Under the act, the Chief Financial Officer (CFO) of the State of Florida is responsible for designating financial institutions as qualified public depositories (QPD).[4] To secure the public deposits, a QPD must pledge collateral in accordance with the statute and the CFO's collateral requirements and collateral pledging levels, as established by rule.[5] Eligible collateral that may be pledged includes securities, Federal Home Loan Bank letters of credit, and cash.[6] 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, such as a QPD's insolvency or a determination by the CFO that an immediate danger to public health, safety, or welfare exists.[7] When the CFO has determined that a default or insolvency has occurred the CFO must notify all public depositors and provide instructions on the filing of claims.[8] The losses are to be satisfied, 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. The CFO is to cover any remaining losses by assessment against other QPDs.

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[3] A public deposit refers to moneys of the state, any state university, county, school district, community college district, special district, metropolitan government, 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 savings association and for which the bank, savings bank, or savings association is required to maintain reserves. s. 280.02(23), F.S.

[4] A qualified public depository is a bank, savings bank, or savings association that is organized under the laws of the United States or any state or territory of the United States, has a principal place of business or branch office in this state authorized to receive deposits, has federally-insured deposits, has procedures and practices that accurately report and collateralize public deposits, meets the requirements of the Florida Security for Public Deposits Act, and has been designated as a qualified public depository by the CFO. s. 280.02(26), F.S.

[5] Chapter 69C-2, F.A.C., sets forth the collateral requirements.

[6] Sections 280.02(12) and 280.13, F.S. Other eligible collateral includes obligations of the United States Government, federal agencies, any state, Puerto Rico, political subdivision, or municipality; tax anticipation certificates; public housing obligations; revenue bonds of any state of the United States or of a political subdivision or municipality thereof; corporate bonds; and other securities designated allowable by law.

[7] For a complete list of events that may trigger a demand of payment, see s. 280.041(6), F.S.

[8] Sections 280.08 and 280.085, F.S.

Federal Home Loan Bank Letters of Credit

Congress created the Federal Home Loan Bank (FHLBank) System in 1932. Its mission is to support residential mortgage lending and community investment at a local level.[9] The FHLBank is composed of 12 regional cooperative banks that are entirely owned by their members.[10] Obligations of the FHLBanks are not obligations of the U.S. and are not guaranteed by the federal government or any government agency.[11]

Section 280.13, F.S., provides that an FHLBank letter of credit may be pledged as eligible collateral by a QPD, if, among other things, the obligations of an FHLBank issuing the letter of credit maintain a AAA rating by a nationally recognized source.[12] The long-term debt of the FHLBank is rated by both Standard & Poor's Rating (Standard & Poor's) and Moody's Investor Service (Moody's). On August 15, 2012, Standard & Poor's gave FHLBank's long-term senior debt a credit rating of AA+. The rating is a reflection of the negative outlook on the U.S. government.[13] Moody's has maintained a AAA credit rating of the FHLBank's long-term senior debt. According to the Department of Financial Services, there are currently 17 QPDs that have pledged a total of $1.88 billion in FHLBank letters of credit.[14]

U.S. Credit Ratings

On August 5, 2011, Standard & Poor's lowered the long–term sovereign credit rating for the United States from "AAA" to "AA+."[15] The lowered rating was based on the uncertainty of the political and economic climate. 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 if Congress fails to address the fiscal issues and growing deficit.[16] There is a distinct possibility that all three nationally recognized rating agencies could downgrade the U.S. sovereign rating if concerns about the ongoing issues with U.S. fiscal policy

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9 Federal Home Loan Bank, Office of Finance, *History of Service*, *available at* http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/mission--history-29 (last visited February 27, 2013).

10 Federal Home Loan Bank, *The Federal Home Loan Banks: The Basics, available at:*http://www.fhlbanks.com/assets/pdfs/sidebar/FHLBanks_TheBasics_4_2012.pdf (last visited February 27, 2013).

11 Federal Home Loan Bank, Office of Finance, *Credit Ratings*, *available at* http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/credit-ratings-31 (last visited February 27, 2013).

12 A nationally recognized statistical rating organization (NRSRO) is a credit rating organization, registered with the Securities and Exchange Commission, which provides its opinion on the creditworthiness of an entity and the financial obligations issued by an entity. There are currently ten firms registered as NRSROs: A.M. Best Company, Inc.; DBRS, LTD.; Egan-Jones Rating Company; Fitch, Inc.; Japan Credit Rating, Ltd.; Kroll Bond Rating Agency, Inc.; Moody's Investors Service, Inc.; Rating and Investment Information, Inc.; Realpoint LLC; and Standard & Poor's Rating Services. U.S. Securities and Exchange Commission, Credit Rating Agencies – NRSROs, a*vailable at* http://www.sec.gov/answers/nrsro.htm (last visited February 27, 2013).

13 FHLBank, Office of Finance, *Credit Ratings*.

14 Policy and Research Memorandum from the Department of Financial Services, (October 29, 2012) (on file with the Senate Commerce and Tourism Committee).

15 Press Release, Standard & Poor's, *United States of America Long-Term Rating Lowered to 'AA+' Due to Political Risks, Rising Debt Burden; Outlook Negative* (Aug. 5, 2011), *available at* http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563 (last visited February 27, 2013).

16 Newman, Rick, *What Will Cause the Next U.S. Credit Downgrade*, U.S. News and World Report, (Jan. 3, 2013), *available at* http://www.usnews.com/news/blogs/rick-newman/2013/01/03/what-will-cause-the-next-us-credit-downgrade (last visited February 27, 2013).

are not adequately addressed.[17] The credit rating of the FHLBank is integrally tied to those of the U.S.'s sovereign debt. This is evident by Standard & Poor's downgrade of the FHLBank's credit rating on the heels of the downgrade of the U.S. sovereign debt in August 2011. Standard & Poor's noted "…if we lowered the rating on the U.S., we would likely lower the ratings on [the FHLBank] System debt and the individual FHLBanks 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."[18] If the other nationally recognized rating agencies were to downgrade the U.S sovereign debt, this would eliminate the ability of QPDs to use letters of credit from the FHLBank to meet the requirements of s. 280.13, F.S.

Currently, all FHLBanks, except Seattle, hold an "AA+" credit rating on long-term obligations from Standard and Poor's, which is the same rating as the U.S sovereign rating.[19] All of the FHLBanks currently hold Moody's top credit rating for both short and long-term obligations, which reflects the ratings Moody's holds for the U.S. generally.[20] In 2011, Fitch affirmed the "AAA" rating of the FHLBank System and the U.S. sovereign debt; however, Fitch issued a negative rating outlook on both entities.[21]

III. Effect of Proposed Changes:

Section 1 amends s. 280.13, F.S., to allow QPDs to continue using letters of credit issued by a Federal Home Loan Bank as collateral in the event other major credit rating agencies downgrade their ratings of the FHLBank obligations below AAA. The bill would permit the use of the FHLBank letters of credit if the FHLBank obligations are rated by a nationally recognized source at a rating at least the rating of U.S. sovereign debt.

Section 2 provides this act will take effect July 1, 2013.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

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[17] Lopez, Luciana, *Fitch Backs Away from Downgrade of U.S. Credit Rating*, (Jan. 28, 2013), *available at* http://www.reuters.com/article/2013/01/28/us-usa-rating-fitch-idUSBRE90R0WS20130128 (last visited February 27, 2013).
[18] Standard and Poor's Rating Services, Ratings Direct Federal Home Loan Banks, (Aug. 15, 2012), *available at* http://www.fhlb-of.com/ofweb_userWeb/resources/SandPCreditAnalysis081512.pdf (last visited February 27, 2013).
[19] *Ibid.*
[20] FHLBank, Office of Finance, *Credit Ratings*.
[21] Press Release, Fitch, Inc., *Fitch Revises the Rating Outlook on the Federal Home Loan Banks to Negative* (Nov. 28, 2011), *available at* http://www.reuters.com/article/2011/11/28/idUS226613+28-Nov-2011+BW20111128 (last visited February 27, 2013).

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

SB 558 will assure that QPDs will continue to be able to use FHLBank letters of credit as eligible collateral.

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 FHLBank 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.