

Senate Bill No. 998

Updates and clarifications to California Government Code effective January 1st, 2021

At Chandler Asset Management, we believe it is imperative that every California Local Agency review their investment policy on an annual basis. This includes an analysis of liquidity needs, risk tolerance, return objectives and ensuring the policy conforms to current best practices. This year, the annual review process takes on a heightened importance as California Government Code (“CGC”) is expanding.

Effective January 1st, 2021, local agencies, inclusive of Indian Tribes, will be authorized to augment their investment policy to incorporate the following per the passing of Senate Bill 998:

- For Local Agencies with more than \$100,000,000 of investable assets under management, SB 998 increases the allowable limit for investments in commercial paper from 25% to 40%;
- Local Agencies (other than a county or a city & county) are limited to investing no more than 10% of its combined investments in the commercial paper and the medium-term notes of any single issuer;
- Federally recognized California Indian Tribes may invest in joint powers investment pools; and
- Local Agencies are authorized to invest in securities issued by, or backed by, the United States Government that could result in zero or negative interest accrual if held to maturity.

Source: California Government Code and Senate Bill 998

An important note relative to the provisions of Senate Bill 998 is the sunset provision. The authorization to invest in commercial paper up to 40% of investable assets and the ability to invest in zero or negative interest investments **will expire on January 1st, 2026.**

COMMERCIAL PAPER

As of the publishing of this white paper, local agencies (except counties) are prohibited from investing more than 25% of their investable assets in commercial paper, and from purchasing more than 10% of the outstanding commercial paper of any single issuer. Senate Bill 998 increases the limitation to 40% of investable assets in commercial paper for those local agencies with more than \$100 million of investable assets until January 1st, 2026. The Bill also closes a loophole capping the total investments in one issuer. The Bill combines the issuer limitation of a local agency’s investments in commercial paper and medium-term notes to 10% of any single issuer. In practice, the 10% change is likely to be immaterial for most investors subject to CGC due to the underlying focus on risk management creating a deterrent to concentrated risk in any single issuer. These stipulations are predicated at the time of purchase.

Portfolio allocations in commercial paper as well as medium term corporate notes can be strategically applied to provide portfolio diversification. Commercial paper is unsecured debt of corporations similar to medium term corporate notes, but with a shorter maturity that is rarely longer than 270 days. This change to CGC also coincides with a recent change to the definition of a “Qualified Institutional Buyer” by the Securities and Exchange Commission going into effect at the end of 2020. In summation, public agencies with \$100 million or more of investable assets could be considered a “Qualified Institutional

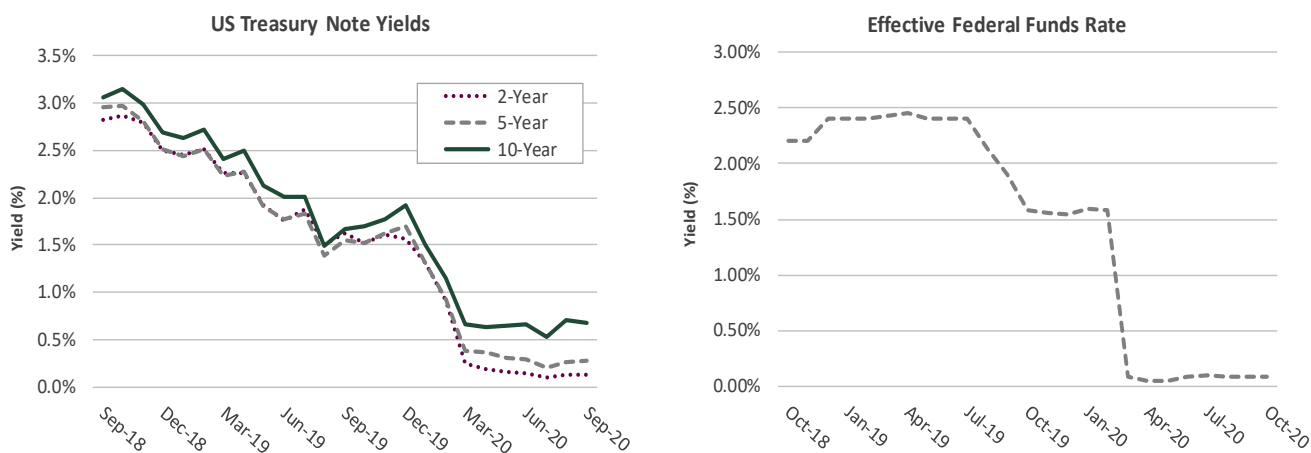
Buyer”, thus providing a wider range of commercial paper available for investment. To address the SEC’s change to the definition of a qualified investor, Chandler will be hosting a webinar in November 2020 detailing the changes and a subsequent white paper with more details.

PARTICIPATION IN INVESTMENT POOLS BY INDIAN TRIBES

In 2011, AB 307 recognized California Indian Tribes as public agencies, and authorized Indian Tribes to enter into joint power agreements without restriction. However, joint power authority code language that predates AB 307, precluded Indian Tribes from participating in and investing in joint powers investment pools. SB 998 clarifies conflicting language in code, thus allowing Indian Tribes to participate in and invest in joint powers investment pools subject to the terms and conditions established by the joint powers authority.

ZERO OR NEGATIVE INTEREST INVESTMENTS

In March 2020, the Federal Open Market Committee (FOMC) lowered the Federal Funds rate to the 0-0.25% range in response to the COVID-19 pandemic. This action, along with global pressures related to the economic concerns of the COVID-19 pandemic saw interest rates drop to historically low levels.



Source: Bloomberg

Furthermore, on September 16th, 2020 the FOMC provided forward guidance that the Federal Funds rate will remain at the 0-0.25% range until 2023. With the expectation that interest rates will be at historically low levels for an extended period, the concerns that interest rates in the United States could drop into negative territory has increased. Nevertheless, multiple members of the FOMC Board of Governors have indicated they do not believe a “negative interest rate policy” is the appropriate course of action. Our recent whitepaper published in September 2019, **“Negative Yields – And Why They’re Unlikely to Happen in the US”**, (click title for article) aligns with the comments from multiple governors of the FOMC. In addition, concerns about negative interest rates persists due to the adoption and continued utilization of a negative interest rate policy by central banks in Japan and Europe.

G7 Rates as of October 1, 2020

G7 Bond	2-Year Yield	10-Year Yield
US	0.129	0.679
Japan	-0.127	0.011
Germany	-0.711	-0.536
France	-0.668	-0.259
UK	-0.049	0.233
Canada	0.242	0.551
Italy	-0.254	0.820

Source: Bloomberg. 2-year yield and 10-year yield as of 10/1/2020.

Current language in California Government Code does not permit investment in negative yielding securities, as such, SB 998 permits local agencies to invest in securities backed by the US Government with zero or negative yields. US government backed securities are considered the safest and most liquid investment in the world. This adjustment to code allows Local Agencies to invest in negative yield investments should US government backed securities revert to negative rates due to market forces or by a change in policy by the FOMC.

IN SUMMARY

Senate Bill No. 998 updates, clarifies and strengthens California Government Code related to the investment in commercial paper up to 40% for cities with more than \$100 million of investable assets; establishes a single issuer limit of combined investment in corporate bonds and commercial paper to 10% for cities and special districts; corrects language permitting Indian Tribes to invest in joint powers investment pools; and allows Local Agencies to invest in zero or negative interest accrual U.S. Government Securities. These changes are effective as of January 1st, 2021.



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Questions?

Please contact Chandler at info@chandlerasset.com, or toll free at 800-317-4747 with any questions or to learn about investment management solutions for public entity investment programs.

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