

ECONOMIC UPDATE

Supplemental Report—Collateral Opinion from AG

Market Snapshot—10:00am

3 month T-Bill	0.49
6 month T-Bill	0.62
12 month T-Bill	0.80
2 year Treasury Note	1.19
5 year Treasury Note	1.89
10 year Treasury Note	2.44
30 year Treasury Bond	3.05

Upcoming Economic Data

Monday— February 6

Gallup Consumer Spending

Tuesday— February 7

Redbook

NFIB Small Business Optimism

Consumer Credit

Wednesday— February 8

MBA Mortgage Applications

Thursday - February 9

Claims

Wholesale Trade

Friday - February 10

Import-Export Prices

Consumer Sentiment

Rig Count

There have been several questions regarding the recent Attorney General Opinion KP-0128 and these comments are to address those questions at this point in time. The primary focus for many is the Opinion's statements on letters of credits as used for bank collateral. The Opinion is not definitive in its findings but important none the less.

Attorney General Opinion KP-0128 is raising questions raised in the past; primarily, whether and to what extent the LOC is authorized as collateral. The Opinion focuses on wording of the Act as to whether FHLB is actually an obligation of the US, its agencies or instrumentalities. The question arises because the Act appears to say that the FHLB LOC is an obligation of the US. (*US Obligations, including letters of credit, ...*)

Although the Opinion hedges because of the absence of clear case law, clearly it references the fact that FHLB, and each of its regional banks, depend for their credit basis on "secured advances" from "privately owned" and "privately capitalized" institutions not the US. That, in and of itself, would argue strongly against it being any obligation of the US.

What the opinion does not address but what has been known since its inclusion is that FHLB is privately owned with ownership from the regional member banks. FHLB is a *banker's bank* meaning it is owned by its member banks. In essence then, the bank putting up a LOC from FHLB is ultimately collateralizing public deposits with their own (and admittedly other banks) credit. We simply do not know the extent to which the 'other' banks would or could stand up and support a troubled bank in this situation if they were ever called upon to be used.

The FHLB will state and relies, at least verbally, on its *direct credit line to the US Treasury* but further examination has shown that this is a very tenuous and fragile line – certainly not a direct one that could be used since it is not a US obligation. In light of the bank regulations issued over the past few years one would have to assume that direct support from the Treasury for any bank failing its liquidity and leverage ratios would not be looked on favorably by the Treasury. The other questions raised in the Opinion are a bit clearer. Clearly public entities can use time and demand deposits in banks in Texas.

Since the Opinion does not clearly *opine* on the LOC collateral question and the fact that many banks are trying to utilize the LOC as collateral (for good reason under the new bank regulations), my best guess is that we will see some legislation put forth in 2017 which will either clarify or take the LOC out of the "obligations of the US" space and simply add LOC to the "eligible securities" list in the PFCA. Once the argument is considered however this may entail quite an argument.

Specifically the new regulations are why we have advised some of our clients with fewer bank choices to add the LOC to their collateral list on RFPs simply to assure that they will at least receive bank proposals, but, we have even more strongly recommended that each public entity stress that preference will be given to pledged securities. The best route to take now is to utilize a sweep to a \$1 NAV money market fund to minimize or eliminate the collateral needed at any bank. This structure additionally materially reduces/eliminates the regulatory fee that is being charged.

We hope this brings some clarity. We will stay on top of the issue.

TRIVIA OF THE DAY

Q: Which President was the first to campaign by telephone?

A. William McKinley

QUOTES OF THE DAY

"No one's ever achieved financial fitness with a January resolution that's abandoned by February."

- Suze Orman