

August 31, 2009

Maurice L. Pilotte, Acting Chair
Joint Legislative Committee on Administrative Rules
Room 219
25 Capitol Street
Concord, NH 03301-6312

Via Hand Delivery

Re: Response to Preliminary Objection to Final Proposal 2009-64

Dear Representative Pilotte,

By letter dated July 17, 2009, the New Hampshire Banking Department ("Department") was notified of the Joint Legislative Committee on Administrative Rules ("Committee") vote pursuant to RSA 541-A:13, IV to enter a preliminary objection to Final Proposal 2009-64 containing rule Ban 1450 ("Ban 1450"). The vote was taken at the Committee's July 16, 2009 meeting. The Department was present and testified at the meeting. The letter stated that "the objection was based on public testimony addressing the final proposal." Please accept this letter as the Department's response to the Committee's preliminary objection pursuant to RSA 541-A:13, V(c) and Committee Rule 303.06.

With the July 17th correspondence, the Committee included a copy of Ban 1450 as annotated by Committee staff, a copy of the transcript of the relevant portions of the July 16th meeting, and written public testimony from the New Hampshire Municipal Association, the New Hampshire Treasury Department and the Treasurer of the City of Concord.

RSA 541-A:13, IV and Committee Rule 303.01(c) allow the Committee to object to a proposed rule only if the rule is:

- (a) Beyond the authority of the agency;
- (b) Contrary to the intent of the legislature;
- (c) Determined not to be in the public interest; or
- (d) Deemed by the committee to have a substantial economic impact not recognized in the fiscal impact statement.

Specific criteria for objections are contained in Chapter 400 of the Committee rules and the Committee is required to consider and abide by those criteria. Committee rule 303.01(e) requires a motion for a preliminary objection to "identify the rule or rules that are objectionable and the grounds of the objection as explained in Chapter 400 of the Committee's rules. If the rules and the

grounds are sufficiently detailed . . . in public testimony, the motion shall only have to identify the final proposal . . . and state that the motion to object is based upon . . . public testimony.” (emphasis supplied). The public testimony given against proposed Ban 1450 did not address the criteria of Chapter 400 of the Committee rules. Nor was there a finding by the Committee that Ban 1450 fit any of the limited categories for permissible objection under RSA 541-A:13, IV and Committee Rule 303.01(c). The public testimony did not clearly assert nor provide “sufficiently detailed” grounds that Ban 1450 was beyond the authority of the Department, contrary to the intent of the legislature, not in the public interest or has a substantial economic impact not recognized in the fiscal impact statement.¹ Accordingly, the Department questions the Committee’s reliance on public testimony as its basis for a preliminary objection. Nevertheless, without waiving its objections, the Department will attempt to address what it views as the core concerns expressed in opposition to Ban 1450.

A. “Level of Risk” Classification

RSA 386:57, II requires that the bank commissioner adopt rules that “define and classify by risk the nature of securities appropriate for collateral.” Accordingly, in the final proposal, Ban 1450.06 states that “[a]ll collateral enumerated in Ban 1450.04 and Ban 1450.05 shall be identically classified as low risk collateral for public funds on deposit.”

The focus of some commentary was the appropriateness of Ban 1450.06, especially given the current economic climate. The comments suggested that the rule’s language may be unclear and not consistent with the legislative intent of 386:57,II to “classify by risk.” Suggestions to amend the language included the addition of a comparison of the relative risks of the collateral listed and “clarification” regarding the distinction between full faith and credit federal agencies and government sponsored enterprises. The Treasurer, through the Advisory Committee on Collateralization of Public Fund and the rulemaking process submitted suggested edits related to this issue. The Department fully evaluated all comments and suggested edits. Some of the Treasurer’s suggestions have been adopted in the final proposal. In other cases, the suggested additions were redundant (i.e. spelling out U.S. Treasury obligations, NH public obligations, etc. which are all covered by reference to RSA 387:6 in the rule). The remainder of the suggestions were deemed inappropriate for the following reasons.

All of the collateral listed in the rule is the highest level of safety for purposes of risk classification. Further delineating risk within this level will add confusion and not provide any measurable additional security to public funds. Such granular classification may promote unnecessary flight to the perceived least risky collateral, making the cost of the perceived most safe collateral prohibitive. Additionally, Rule 1450, as previously approved by the Committee, has always only had one classification.

The rule could have listed different categories of risk – for example, high, medium, and low. The categories of “high” and “medium,” however, would have been empty and thus superfluous. As suggested by testimony, the rule could distinguish between varying shades of low level risk – low, very low, super low. Such detailed classification is difficult, especially in these changing economic times, and unnecessary to fulfill the intent of the statute. The rule will not be re-written weekly or even monthly to account for changing markets.

Further, RSA 386:57 does not remove the obligations of financial institutions to monitor the value of their collateral. The securities listed were chosen as they are readily identifiable as to value and marketability. Institutions and public entities will contract for the level of collateral and the institution will be obliged to maintain collateral at that level – regardless of the performance of one security or another, the net result should be to collateralize the deposit to the contracted level.

¹ The Staff comments note that Ban 1450.06 “may not be consistent with legislative intent.” The Committee, however, did not base its objection on staff comment nor did the staff or the Committee itself analyze Ban 1450 in light of the required criteria of Part 402 of the Committee rules.

The intent of the statute and therefore the goal of the rule is to list collateral that, on the whole, given the knowledge available at the time of drafting and the law of averages, fits into the category of low risk and is therefore appropriate to collateralize public deposits. By listing only obligations that are low risk, Ban 1450 fulfills the legislative intent. Further delineation within the "low risk" category does not further the intent of the statute nor the safety of public funds.

B. Primary Users of Rule

Comments also focused on who would use the rule, suggesting that towns, cities, counties, school districts and other public entities are in fact the primary users of the rule and thus the rule should provide the "necessary guidance and clarity" many of these public entities need to safeguard public funds. While it may be that public entities look to Ban 1450, by the law's language, the rule is not geared toward public entities. Ban 1450 is for "any bank or association chartered by this state to engage in a banking business" to use to determine which of the institution's securities are appropriate for collateral for public funds. RSA 386:57.

Under 383:9, the bank commissioner has broad supervisory powers, including rulemaking, over banks and financial institutions in this state. The commissioner's broad authority does not extend to towns, cities and other public entities. The commissioner can only draft and enforce rules for and against those within the commissioner's jurisdiction. Public entities are outside of that jurisdiction. To draft a rule for such public entities would be outside the authority of the commissioner.

C. Perfection of Collateral

It was suggested that Ban 1450 detail how to perfect the collateral. Perfection is of concern to and is a matter of due diligence for the secured party, here the public depositor. Such detail is beyond the scope of the commissioner's jurisdiction under 383:9 and 386:57. As discussed above, the commissioner does not have jurisdiction over public entities and thus has no authority to make or enforce rules for and against them. 386:57, II directs the commissioner to draft rules which "define and classify by risk the nature of securities appropriate for collateral." The statute does not direct the commissioner to draft rules regarding the perfection of collateral. In fact, the statute clearly states the opposite. Under 386:57, I "[a]ny such deposit of public funds in any bank or association may be evidenced by an agreement in such form and upon such terms and condition as may be agreed upon by the depositing public authority and such bank or association." By statute, the intricacies of perfection are therefore left to the parties.

D. Collateral Specifics

There were also comments that addressed the collateral level, the appropriateness of specific securities and the perceived absence of certain securities. To a large extent these comments either go to the level of classification addressed above and/or go to policy, which is outside the scope of the Committee. Even so, to further communication and understanding, we offer the following responses.

The inclusion of "Fannie Mae" and "Freddie Mac" obligations was called into question by Committee staff as they are not explicitly guaranteed by the U.S. government. This very issue was the subject of a law review article by Associate Professor, at the Brooklyn Law School, David Reiss. His conclusion was that "Despite the absence of such a legally enforceable claim, as a practical matter, Fannie and Freddie are so deeply enmeshed in the regulatory regimes of other American financial institutions that the federal government has effectively signaled that it would support Fannie and Freddie they were unable to make payments on their obligations."² This conclusion was proved true by recent events which saw the U.S. government step in to help

² "The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam will pick up the Tab," *Georgia Law Review*, Vol. 42: 1019, 1025 (2008).

stabilize Fannie and Freddie. While always possible, it is not a material risk that there are insufficient funds at the Federal government's disposal to satisfy such obligations.

One commentator stated that Ban 1450 fails to list U.S. Treasury Notes, bonds, etc. This is not accurate. Ban 1450 does include such obligations by reference to RSA 387:6 which lists those securities.

Lastly, another commentator expressed a desire to see the rule's language regarding the funds covered by federal deposit insurance struck to allow for perceived greater collateralization. Ban 1450's current language provides a floor, not a ceiling. The parties are free under Ban 1450.03(a) to contract for collateralization "equal to *or in excess of* amount of public funds . . ." (emphasis supplied). The suggested change, therefore, is not necessary.

Ban 1450 was the result of the Department's work in conjunction with the Advisory Committee on Collateralization of Public Funds and careful consideration of all written and oral testimony. In responding to this preliminary objection, the Department has revisited Ban 1450 and the basis therefore. After due consideration, for the above stated reasons, the Department will be making no change to Final Proposal 2009-64 containing rule Ban 1450.

Sincerely,

/s/

Peter C. Hildreth, Commissioner