



Cracking the (California) Code





SPEAKER
PRESENTATION

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Review of the California Government Code



Important Codes Related to Government Investments

California Government Code (Code)

- Investment Surplus (53600-53610)
- Deposit of Funds (53630-53686)

A screenshot of the California Legislative Information website. The header includes the California state seal and the text "California LEGISLATIVE INFORMATION". Navigation links include "skip to content", "home", "accessibility", "FAQ", "feedback", and "login". A "Quick Search" box is present with a "Bill Number" dropdown and a "go" button. Below the header is a navigation bar with links: "Home", "Bill Information", "California Law", "Publications", "Other Resources", "My Subscriptions", and "My Favorites". The main content area is titled "California Law >> >> Code Section Group". It features a search bar with "Code:" and "Section:" dropdowns, and a "Search" button. Below the search bar are tabs for "Code Search" and "Text Search". The "Code Search" tab is active, displaying a hierarchical list of the California Government Code. The list includes: "GOVERNMENT CODE - GOV", "TITLE 5. LOCAL AGENCIES [50001 - 57650] (Title 5 added by Stats. 1949, Ch. 81.)", "DIVISION 2. CITIES, COUNTIES, AND OTHER AGENCIES [53000 - 56821] (Division 2 added by Stats. 1949, Ch. 81.)", "PART 1. POWERS AND DUTIES COMMON TO CITIES, COUNTIES, AND OTHER AGENCIES [53000 - 54999.7] (Part 1 added by Stats. 1949, Ch. 81.)", "CHAPTER 4. Financial Affairs [53600 - 53997] (Chapter 4 added by Stats. 1949, Ch. 81.)", and "ARTICLE 1. Investment of Surplus [53600 - 53610] (Article 1 added by Stats. 1949, Ch. 81.)". The article text for "53600. As used in this article, 'local agency' means county, city, city and county, including a chartered city or county, school district, community college district, public district, county board of education, county superintendent of schools, or any public or municipal corporation. (Amended by Stats. 1987, Ch. 887, Sec. 2.)" is visible. Below this, the text for "53600.3. Except as provided in subdivision (a) of Section 27000.3, all governing bodies of local agencies or persons authorized to make investment decisions on behalf of those local agencies investing public funds pursuant to this chapter are trustees and therefore fiduciaries subject to the prudent investor standard. When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency. Within the limitations of this section and considering individual investments as part of an overall strategy, investments may be acquired as authorized by law." is displayed.



Who Do the Codes Apply to?

53600 defines a “local agency” as any:

- County
- City
- City and County
- Public District
- Public or Municipal Corporation
- School District
- Community College District
- County Board of Education
- County Superintendent of Schools

} Typically required to invest
through County Treasury



Standard of Prudence (53600.3)

- Code defines the standard of prudence for public funds to be the **Prudent Investor Standard**, which states:

“When investing, reinvesting, purchasing, acquiring, exchanging, selling, or managing public funds, a trustee shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency.”

- Members of council/board and anyone authorized to make investment decisions are considered trustees and fiduciaries subject to this standard of prudence
- Permits investments to be acquired
- Consider investments as part of overall strategy/portfolio



Objectives (53600.5)

1

Safeguard
Principal



2

Meet Liquidity
Needs



3

Achieve
a Return





Application of 53601

Agency types:

- Cities, districts, and local agencies who do not pool money in deposits or investments with other local agencies with different governing bodies

Fund types:

- Sinking funds or moneys in treasury not immediately required

Delivery of securities:

- Must be in agency's name and delivered to the agency or a third-party custodian

Application of percentage limits:

- Date of purchase

Maximum maturity:

- Five years unless otherwise stated or council/board has approved longer-term investments at least 90-days in advance

Applying the Code



Investment Universe vs. California Government Code

Securities	1 Day	180 Days	270 Days	1 Year	5 Years	Over 5 Years
U.S. Treasuries		✓ Permitted				Requires Approval
Federal Agencies		✓ Permitted				Requires Approval
Municipal Securities		✓ Permitted				Requires Approval
Negotiable Certificates of Deposit		✓ Permitted				Requires Approval
Commercial Paper		✓ Permitted			X Prohibited	
Bankers' Acceptances	✓ Permitted				X Prohibited	
Medium-Term Corporate Notes		✓ Permitted				X Prohibited
Asset-Backed Securities (ABS)		✓ Permitted				X Prohibited
Supranationals		✓ Permitted				X Prohibited
Repurchase Agreements		✓ Permitted			X Prohibited	
Money Market Funds/Bond Mutual Funds	✓ Permitted				X Prohibited	
Local Government Investment Pools	✓ Permitted				X Prohibited	
Foreign Sovereign						X Prohibited
Fixed-Income ETFs						X Prohibited
High-Yield Bonds						X Prohibited
Private Placements						X Prohibited
Convertibles						X Prohibited
Non-U.S. Dollar Investment Grade						X Prohibited
Emerging Markets Debt						X Prohibited
Bank Loans						X Prohibited
Domestic Equities (Large, Mid, Small Cap)						X Prohibited
International Equities (Large, Mid, Small Cap)						X Prohibited
Emerging Markets						X Prohibited
Preferred Stock						X Prohibited
Equity Mutual Funds and ETFs						X Prohibited
Commodities						X Prohibited
Real Estate						X Prohibited
Hedge Funds						X Prohibited
Private Equity						X Prohibited
Venture Capital						X Prohibited
Tangible Assets						X Prohibited
Complex Derivatives, Futures and Options						X Prohibited



Permitted Investments – Government Sector

- U.S. Treasuries (b)
- Federal Agencies (f)
- Local agency's own bonds (a)
- State of California bonds (c)
- California local agency bonds (e)
- Bonds issued by 49 other states (d)
- Supranationals (q)
 - Issued or unconditionally guaranteed by the International Bank for Reconstruction and Development, International Finance Corporation, or Inter-American Development Bank
 - 30% of portfolio
 - 5-year maximum maturity
 - AA or better by an NRSRO



Permitted Investments – Non-Government Sector

- Bankers' acceptances (g)
 - 40% of portfolio
 - 180 day maximum maturity

- Commercial paper (h)
 - 25% of portfolio
 - 270 day maximum maturity
 - 10% of the outstanding CP of any single issuer
 - Credit criteria

- Negotiable CDs (i)
 - Issued by nationally or state-chartered bank, savings association, federal association, state or federal credit union, or by a federally- or state-licensed bank branch of a foreign bank
 - 30% of portfolio
 - Conflict of interest limitation



Permitted Investments – Non-Government Sector

- Repurchase and reverse repurchase agreements (j)
 - 1 year/92 day maximum maturity
 - Counterparty, collateral, and other requirements
- Medium-term notes (k)
 - 30% of portfolio
 - 5-year maximum maturity
 - Issued by corporations organized and operating in U.S. or depository institutions licensed by U.S. or any state and operating in U.S.
 - A or better
- Mortgage- or asset-backed securities (o)
 - 20% of portfolio
 - 5-year maximum maturity
 - AA or better by an NRSRO



Permitted Investments – Pooled

Shares of beneficial interest issued by a diversified management company (I)

- Money market mutual funds (2)
 - 20% of portfolio
 - AAA by two or more NRSROs OR Advisor requirements
 - Net asset value (NAV) may be stable or variable depending on type of fund (government vs. prime, retail vs. institutional)
- Mutual funds (1)
 - 20% of portfolio, no more than 10% in any one fund
 - AAA by two or more NRSROs OR Advisor requirements
 - Variable NAV
 - Underlying investments must be same as California Government Code Section 53601



Key Elements of Money Market Reform

After the 2008-2009 financial crisis, the Securities and Exchange Commission (SEC) tightened certain risk-limiting provisions of the regulations that govern money market funds by adopting significant changes to Rule 2a7.

	Prime Fund Government securities, commercial paper, certificates of deposit, corporate notes and other debt investments	Government Fund 99.5% of total assets in cash, government securities or repos
Retail Fund Limited to “natural persons”	<ul style="list-style-type: none">• Constant NAV• Gates• Liquidity Fees	<ul style="list-style-type: none">• Constant NAV• Optional Gates• Optional Liquidity Fees
Institutional Fund	<ul style="list-style-type: none">• Variable NAV• Gates• Liquidity Fees	<ul style="list-style-type: none">• Constant NAV• Optional Gates• Optional Liquidity Fees



Permitted Investments – Pooled (cont'd)

- Shares of beneficial interest issued by a joint powers authority (p)
 - Local government investment pools (LGIPs)
 - Adviser requirements
- State of California's Local Agency Investment Fund (LAIF) (16429.1)
- County Treasurers' pools (53684)





Permitted Investments (53635)

- For agencies that pool money with other local agencies that have different governing bodies
- Difference from 53601
 - 40% of portfolio in commercial paper
 - 10% of portfolio in commercial paper of any one issuer



Key History of Changes 2001-2007

2001

SB 68 designated money in the **LAIF** as non-state money

2004

SB 787 replaced references to specific rating agencies with **“NRSRO”**

2005

AB 969 added authorization for the formation and use of **joint powers authorities** for investment purposes

2007

AB 2011 added 2 new Code sections, explicitly allowing use of **CD placement services** through January 1, 2012





Key History of Changes 2008-2017

2008

AB 1745 allowed **municipal bonds** from any of the other 49 states



2015

AB 1933 permitted local agencies to invest in the **senior debt obligations of three specific U.S. Instrumentalities**: IBRD, IFC, and IADB.

2017

SB-974 clarified that a **required rating is for the entire category** and not for a specific rating.





2020 Proposed California Code Changes

AB 857: Public Banks

- Allows local governments to form public banks
- Proponents of the bill argue that a network of public banks would utilize taxpayer money in support of public policy priorities such as:
 - Affordable housing
 - Clean energy
 - Small business lending
 - Alternatives to payday loans
- Until now, the only public bank operating in the U.S. has been the Bank of North Dakota
- Takes effect **January 1, 2020**

Source: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB857.





Authorized Securities Dealers (53601.5)

- Direct issuers
- Broker-dealer registered with California
- Member of a federally regulated securities exchange (i.e., FINRA)
- National or state-chartered bank
- Savings or federal association
- Primary dealers

The screenshot shows the Federal Reserve Bank of New York website. The top navigation bar includes links for Museum & Gold Tour, Regional Economy, Data & Statistics, Careers, Blog, and Press Center. The main header reads "FEDERAL RESERVE BANK of NEW YORK" with the tagline "Serving the Second 1". Below this are four columns: "About the New York Fed", "Markets & Policy Implementation", "Economic Research", and "Financial Institution Supervision". The "Markets & Policy Implementation" section is active, showing a breadcrumb trail: "home > markets & policy implementation > counterparties >". The "Primary Dealers" section is highlighted, with a description: "Primary dealers are trading counterparties of the New York Fed in its implementation of monetary policy. They are also expected to make markets for the New York Fed on behalf of its official accountholders as needed, and to bid on a pro-rata basis in all Treasury auctions at reasonably competitive prices." Below this is a "LIST OF PRIMARY DEALERS" section with a sub-header "CURRENT LIST, ADDITIONS, REMOVALS & NAME CHANGES". A table lists the primary dealers in two columns.

PRIMARY DEALERS	ADDITIONS AND REMOVALS	NAME CHANGES
Amherst Pierpont Securities LLC		J.P. Morgan Securities LLC
Bank of Nova Scotia, New York Agency		Mizuho Securities USA LLC
BMO Capital Markets Corp.		Morgan Stanley & Co. LLC
BNP Paribas Securities Corp.		NatWest Markets Securities Inc.
Barclays Capital Inc.		Nomura Securities International, Inc.
BofA Securities, Inc.		RBC Capital Markets, LLC
Cantor Fitzgerald & Co.		Societe Generale, New York Branch
Citigroup Global Markets Inc.		TD Securities (USA) LLC
Credit Suisse AG, New York Branch		UBS Securities LLC
Daiwa Capital Markets America Inc.		Wells Fargo Securities, LLC
Deutsche Bank Securities Inc.		
Goldman Sachs & Co. LLC		
HSBC Securities (USA) Inc.		
Jefferies LLC		

Source: <https://www.newyorkfed.org/markets/primarydealers#primary-dealers>.





Prohibited Investments (53601.6)

- Inverse floaters
- Range notes
- Mortgage-derived, interest-only strips
- Security that could result in zero interest accrual if held to maturity
 - Exempts mutual funds





Deposit Placement Services (53601.8)

- 30% of portfolio
- Depository institution must have branch in California and be one of these types of financial institutions:
 - Nationally or state-chartered commercial bank
 - Savings bank
 - Savings and loan association
 - Credit union
- Must be FDIC- or NCUA-insured





Other Permissions

1

Can purchase investments through primary or secondary markets (53603)

2

May sell or exchange investments prior to maturity (53604)

3

May sell to raise cash for agency's expenditures (53605)





Delegation of Authority (53607)

- Council/board may delegate to Treasurer for one-year period
- Must be renewed annually
- Must make monthly report of transactions when authority is delegated
 - **Commonly missed reporting requirement**





Reporting Requirements (53646)

- Quarterly reporting requirements are optional
- If providing quarterly reports, they must:
 - Be submitted within 30 days after quarter end
 - Include: investment type, issuer, maturity date, par amount, purchase price, description of funds being managed by an outside party, market value and source for any securities managed by an outside party that is not a local agency or LAIF
 - State that the portfolio is in compliance with the Policy or manner in which it is out of compliance
 - State the ability of the agency to meet its pool's expenditure requirements for the next six months or explain why it cannot



Reporting Requirements (53646)

Excerpt of IEUA Monthly Report

	Settlement Date	Security Length	Credit Rating @ Purchase		CHANGES IN Credit Rating		Par Amount	Cost Basis Amount	Term (Days)	June Value	% Coupon	% Yield to Maturity	Maturity Date	Market Value
			S&P	Moody's	S&P	Moody's								
Total Cash, Bank Deposits and Bank Investment Accounts							\$447,303	\$447,303		\$447,303				\$447,303
Repurchase & Pooled Investment Accounts							\$64,128,312	\$64,128,312		\$64,128,312		0.023280976		\$64,128,312
Brokered Certificates of Deposit (CDs)														
Bank of Nova Scotia Houston	06/07/18	718	A-1	P-1			\$1,410,000	\$1,409,464	729	\$1,409,746	3.08%	3.10%	06/05/20	\$1,421,827
Bank of Montreal Chicago	08/03/18	720	A+	Aa2			1,400,000	1,400,000	731	1,400,000	3.19%	3.23%	08/03/20	1,409,736
Synchrony Bank	10/02/15	1800	N/R	N/R			240,000	240,000	1827	240,000	2.25%	2.25%	10/02/20	240,158
Royal Bank of Canada NY	06/08/18	1079	AA-	Aa2			815,000	815,000	1095	815,000	3.24%	3.24%	06/07/21	831,107
Subtotal Brokered CDs							\$3,865,000	\$3,864,464		\$3,864,746		3.12%		\$3,902,818

Investment Type

Brokered
Certificates of
Deposit (CDs)

Issuer

Bank of Montreal
Chicago

Par Amount

\$1,400,000

Maturity Date

08/03/20

Market Value

\$1,409,736





Reporting Requirements (53646)

IEUA Monthly Report Agency Liquidity

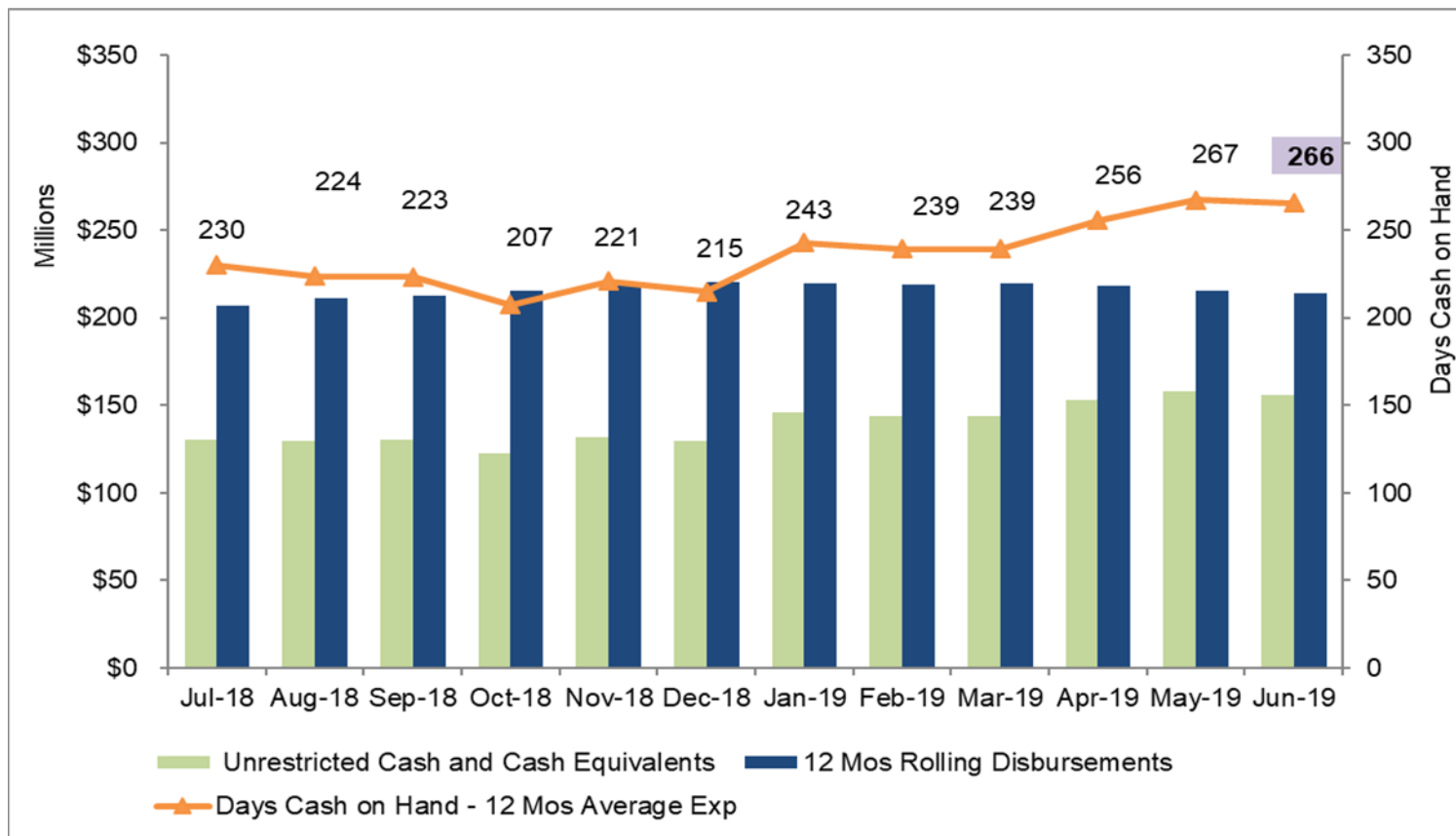
Description	May (\$ million)	June (\$ million)	Change (\$ million)
Investment Portfolio	\$154.7	\$155.5	\$0.8
Cash and Restricted Deposits	\$98.8	\$101.1	\$2.3
Total Investments, Cash, and Restricted Deposits	\$253.5	\$256.6	\$3.1
Investment Portfolio Yield	2.53%	2.54%	0.02%
Weighted Average Duration (Years)	1.02	1.00	(0.02)
Average Cash on Hand (Days)	267	266	(1)





Reporting Requirements (53646)

IEUA Monthly Report Days Cash on Hand – 12 Month Rolling Average





Investment Policies (53646)

Local agencies

- May annually render a statement of investment policy to council/board/oversight committee, which shall be considered at a public meeting by the council/board
- Any change in the Policy shall be **considered** by the council/board at a public meeting

Counties

- May annually render to the board of supervisors/oversight committee a statement of investment policy, which board shall review and approve at a public meeting
- Any change in the Policy shall be **reviewed and approved** by the board at a public meeting



IEUA Investment Policy Statement vs. California Code

Sector Type	IEUA IPS	CA State Code	Currently Utilized?
U.S. Treasuries	✓	✓	✓
Federal Agencies	✓	✓	✓
Municipal Securities	✓	✓	✓
Supranationals	✓	✓	✗
Repurchase Agreements	✓	✓	✓
Bankers' Acceptances	✓	✓	✗
Negotiable Certificates of Deposit	✓	✓	✓
Commercial Paper	✓	✓	✓
Medium-Term Corporate Notes	✓	✓	✓
Asset-Backed Securities	✓	✓	✗
Money Market Funds/Bond Mutual Funds	✓	✓	✓
Local Government Investment Pools	✓	✓	✓

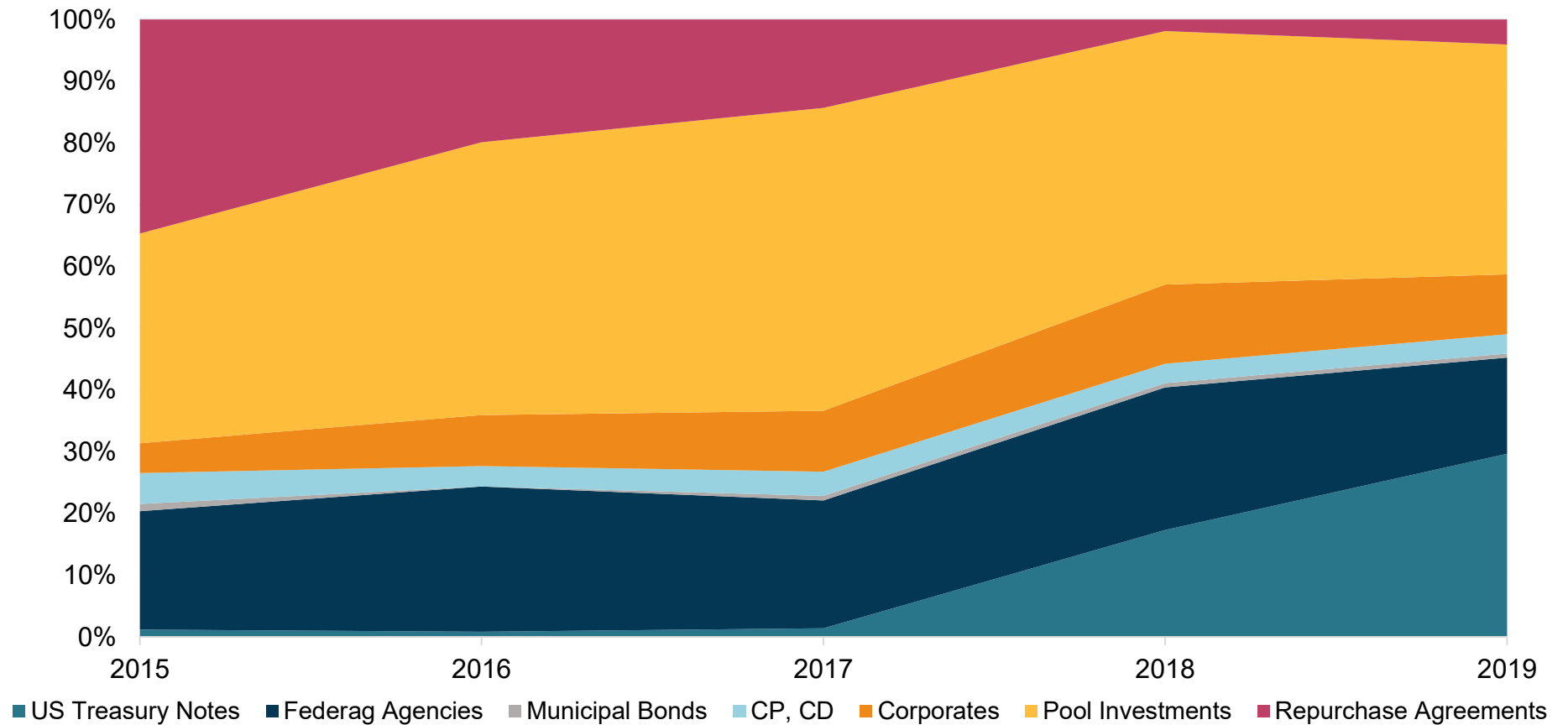
Source: <http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=gov&codebody=&hits=20> & IEUA Investment Policy Statement as of February 2018.





IEUA Historical Sector Allocation

IEUA Investment Portfolio Composition



Source: IEUA. Portfolio data as of June 30 of each year. Pool investments include CAMP, LAIF, & CalTRUST holdings.



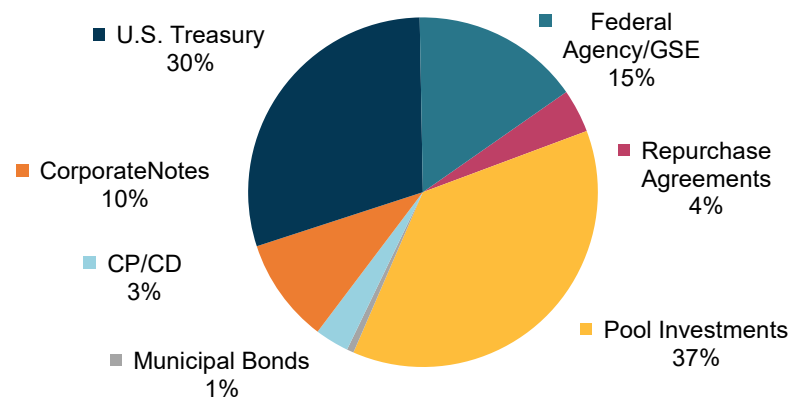


IEUA Portfolio Snapshot

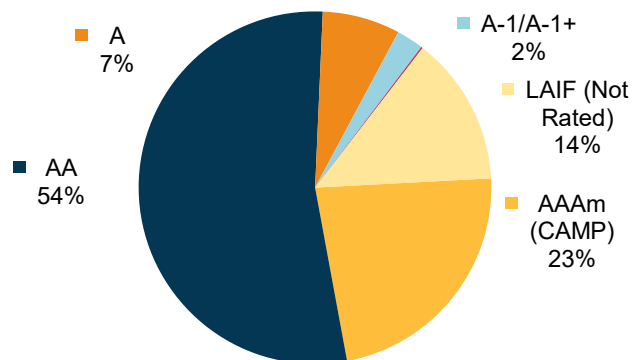
IEUA Portfolio Statistics

Total Market Value	\$155,460,560
Effective Duration	1.62 Years
YTM at Cost	2.33%
Average Credit Quality	AA

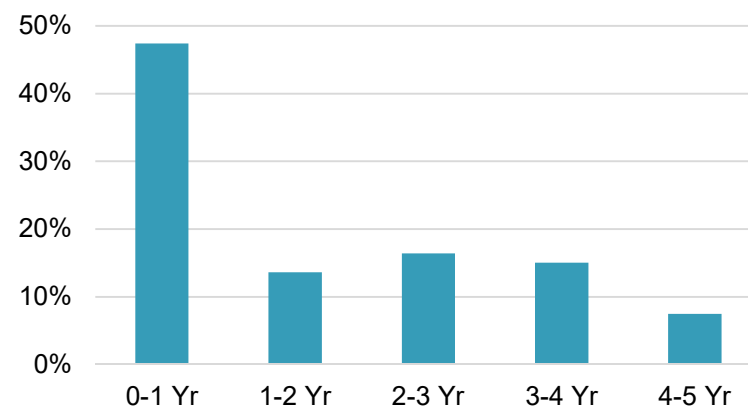
Sector Allocation



Credity Quality - S&P



Duration Distribution



Source: IEUA portfolio data as of June 30, 2019. Pool investments include CAMP and LAIF holdings.





Permitted Investments by State: How does CA Compare?

Permitted Investments by State	CA	High DEGREE OF LENIENCY Low		
		AZ	WA	CT
U.S. Treasuries	100% ✓	100% ✓	100% ✓	100% ✓
Federal Agencies	100% ✓	100% ✓	100% ✓	100% ✓
Municipal Securities	100% ✓	100% ✓	100% ✓	100% ✓
Supranationals	30% ✓	100% ✓	100% ✓	100% ✓
Repurchase Agreements	20% ✓	100% ✓	✗	100% ✓
Bankers' Acceptances	40% ✓	✗	40% ✓	✗
Negotiable Certificates of Deposit	30% ✓	100% ✓	✗	✗
Commercial Paper	25% ✓	100% ✓	25% ¹ ✓	✗
Medium-Term Corporate Notes	30% ✓	100% ✓		✗
Asset-Backed Securities	20% ✓	✗	✗	✗
Money Market Funds/Bond Mutual Funds	20% ✓	100% ✓	✗	100% ✓
Local Government Investment Pools	100% ✓	100% ✓	100% ✓	100% ✓

Source: <http://www.leginfo.ca.gov/cgi-bin/calawquery?codesection=gov&codebody=&hits=20>, <http://www.azleg.state.az.us/ArizonaRevisedStatutes.asp?Title=35>, <http://app.leg.wa.gov/RCW/default.aspx?cite=39.59.040>, & https://www.cga.ct.gov/current/pub/chap_112.htm#sec_7-400.

1. WA Revised Statutes impose a 25% aggregate limit on commercial paper and corporate notes.





Key Takeaways

- California Government Code is inherently risk averse.
- The Code is designed to protect public portfolios while providing flexibility to invest according to your agency's unique goals and objectives.
- The Code changes periodically and your agency's needs may change over time – review your investment policy and investments regularly to stay up-to-date and ensure the policies and practices continue to best serve your agency.



Resources

California

California Government Code



California Municipal Treasurers Association



California Debt and Investment Advisory
Commission Local Agency Investment
Guidelines



National

Association of Public Treasurers



Government Finance Officers Association



CFA Institute





Questions Welcome

If you have additional questions, please email them to meachams@pfm.com
and cvalencie@ieua.org.

Thank you for joining us today!





Disclaimer

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Appendix



History of Changes 2001-2005

2001

- SB 68 designated money in the Local Agency Investment Fund (LAIF) as non-state money

2002

- AB 609:
 - Clarified which agencies fall under 53601 (all local agencies that are not counties) and 53635 (applies only to counties and certain pools)
 - Simplified definition of Federal Agencies by eliminating references to specific Agencies
- Changed sliding scale of permitted commercial paper allocation to static 25%
- Added Fitch to the list of rating agencies providing ratings for commercial paper
- Eliminated distinction between pre- and post-December 1994 investments for repurchase and reverse repurchase agreements and securities lending
- Added Community Redevelopment Act rating of satisfactory for depositories to be eligible to receive funds
- LAIF's deposit limit goes from \$30 million to \$40 million

2004

- SB 787 replacing references to specific rating agencies with "nationally recognized statistical-rating organization (NRSRO)"
- AB 2853 made the submission of investment policies and quarterly reports optional and therefore not a reimbursable mandate

2005

- AB 969 added 2 new sections, 6509.7 and 53601(p), that provide specific criteria and authorization for the formation and use of joint powers authorities for pooling funds for investment purposes





History of Changes 2007-2014

2007	<ul style="list-style-type: none">• AB 2011 added 2 new Code sections, 53601.8 and 53635.8, explicitly allowing use of CD placement services through January 1, 2012
2008	<ul style="list-style-type: none">• AB 1745 added a new section, 53601(d), that allows municipal bonds from any of the other 49 states
2009	<ul style="list-style-type: none">• LAIF's deposit limit goes from \$40 million to \$50 million
2011	<ul style="list-style-type: none">• SB 1344 removed January 1, 2012 sunset date for eligibility of CD placement services
2012	<ul style="list-style-type: none">• SB 194 added federally-licensed branch of a foreign bank to list of eligible issuers for negotiable CDs
2014	<ul style="list-style-type: none">• AB 279 added two sections each for 53601.8 and 53635.8:<ul style="list-style-type: none">– Section 1 of 53601.8 and Section 3 of 53635.8, which took effect January 1, 2014 and set to expire December 31, 2016, expanded the types of deposits that local agencies can invest in using a deposit placement service. Added a 10% limit for any one placement service.– Section 2 of 53601.8 and Section 4 of 53635.8, which was scheduled to take effect January 1, 2017, would revert the Code back to prior language, again limiting deposits to CDs. No expiration date was defined.



Recent Changes to Code

2015

- AB 1933 added section 53601(q) that permits local agencies to invest in the senior debt obligations of three specific U.S. Instrumentalities: the International Bank for Reconstruction and Development, International Finance Corporation, and the Inter-American Development Bank.

2016

- AB 283 extended the dates established in AB 279.
 - Section 1 of 53601.8 and Section 3 of 53635.8 sunset dates were extended from January 1, 2017 to January 1, 2021. Eliminated the combined 30% holding limits for placement service CDs and negotiable CDs. Eliminated the 10% limits for any one placement service.
 - Section 2 of 53601.8 and Section 4 of 53635.8 are scheduled to take effect January 1, 2021 and will last indefinitely.

2017

- SB-974 clarified the Code's rating requirements such that a required rating is for the entire category and not for a specific rating.

2019

- AB 1770 revised language in section 53601(o) to permit the purchase of ABS with a maximum remaining maturity of 5 years and eliminate the requirement that securities be rated "A" or better by an NRSRO.

