

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 1670

SPONSOR: Banking and Insurance Committee and Senator Constantine

SUBJECT: Security for Public Deposits

DATE: April 2, 2001 REVISED: \_\_\_\_\_

|    | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION       |
|----|---------|----------------|-----------|--------------|
| 1. | Johnson | Deffenbaugh    | BI        | Favorable/CS |
| 2. | _____   | _____          | GO        | _____        |
| 3. | _____   | _____          | AGG       | _____        |
| 4. | _____   | _____          | AP        | _____        |
| 5. | _____   | _____          | _____     | _____        |
| 6. | _____   | _____          | _____     | _____        |

## I. Summary:

The Treasurer is responsible for keeping all state funds and securities and investing excess funds in qualified public depositories. The Treasurer is also responsible for establishing qualifications in order to designate banks and savings and loan associations as qualified public depositories, pursuant to ch. 280, F.S. A qualified public depository is required to collateralize a specified portion of the public monies on deposit so that the designated portion of the public deposits is immediately available should the need arise.

The committee substitute eliminates the advisory committee to the qualified public deposit program and establishes the Qualified Public Depository Oversight Board comprised of six members. The board would represent the interests of all qualified public depositories in safeguarding the integrity of the program and preventing the realization of loss assessments. The Treasurer would select two members that represent public depositories in each of the three asset groups. Any additional expenses of the public deposit program not covered by the resources of the program would be paid in the same manner as loss assessments on qualified public depositories, as provided in s. 280.08, F.S.

The committee substitute authorizes the use of Federal Home Loan Bank letters of credit as eligible collateral, if certain requirements are met.

The committee substitute authorizes the Treasurer to establish special requirements for a qualified public depository in order to protect the integrity of the public deposit program. The Treasurer would be required to notify the custodian of collateral of any change in the Uniform Commercial laws in Florida which affects the requirements for a perfected security interest in collateral. The custodian has 180 days from such notice to withdraw, if the required collateral services cannot be provided.

The committee substitute also requires a qualified public depository to pledge, deposit, or issue additional eligible collateral between filing periods of monthly reports within 2 business days when notified by the Treasurer that the current market value of the collateral does not meet the required collateral. A qualified public depository is prohibited from acting as its own custodian.

Violations subject to administrative penalties are revised to include failure to maintain required collateral rather than failure to pledge sufficient collateral and the Treasurer is authorized to issue a cease and desist order if a qualified public depository deposits or arranges for the issuance of unacceptable collateral.

This committee substitute substantially amends the following sections of the Florida Statutes: 280.02, 280.04, 280.041, 280.05, 280.051, 280.054, 280.055, 280.07, 280.08, 280.09, 280.10, 280.11, 280.13, and 280.16. The bill creates section 280.071, Florida Statutes.

## **II. Present Situation:**

The Cabinet office of the Treasurer is established in s. 4, Art. IV, Fla. Constitution. The Treasurer is directed to keep all state funds and securities and to disburse state monies only upon the order of the Comptroller. Section 20.13, F.S., designates the Treasurer as the Insurance Commissioner, Treasurer, and State Fire Marshal and names the Treasurer as the head of the Department of Insurance. The law also directs the Treasurer to administer the Government Employees Deferred Compensation Plan through the Division of the Treasury, ch. 18, F.S., delineates many of the duties of the Treasurer. The Treasurer is required to invest monies in excess of those needed to pay the immediate debts of the state. These excess funds include monies from the General Revenue Fund, trust accounts, and various other accounts of state agencies and other public and quasi-public entities. The law authorizes the Treasurer to charge a fee for managing excess state monies.

Pursuant to s. 18.10(2), F.S., the Treasurer is directed to invest these excess funds in qualified public depositories that will pay rates established by the Treasurer at levels not less than the prevailing rate for United States Treasury securities with a corresponding maturity. In the event additional money is available and qualified public depositories are unwilling to accept such money and pay the rates established by the Treasurer, then the Treasurer is authorized to invest the money in specific investment products.

The law also directs that the Treasurer establish qualifications in order to designate banks and savings and loan associations as qualified public depositories. Chapter 280, F.S., outlines the procedures a financial institution must follow in order to be designated as a qualified public depository.

In order to qualify as a qualified public depository, a financial institution must provide specific information to the Department of Insurance describing the assets of the institution. A qualified public depository is also required to collateralize a specified portion of the public monies on deposit so that the designated portion of the public deposits is immediately available should the need arise. The percentage of public funds that a financial institution must collateralize varies depending upon the assets of the institution and other factors.

Effective January 1, 1997, the Federal Department of Treasury established new regulations governing book-entry securities for Federal Reserve Banks. These regulations changed the procedures relative to acting as custodians of the Treasury and agency book-entry securities pledged as collateral for state and local deposits or in conjunction with the exercise of trust powers. These changes required the Treasurer to enter into custody agreements with the Federal Reserve Banks using their form that included unacceptable provisions, e.g., liability for the state and waiver of sovereign rights. The Federal Reserve Banks are not subject to the provisions of the Uniform Commercial Code. In the past, the federal Treasury had signed the forms prescribed by the Treasurer. As of January 2, 1998, a Federal Reserve Bank no longer acts as a custodian pursuant to these agreements and safekeeping receipts previously executed. Since that time, the Treasurer's Office has been in negotiations with the Federal Reserve Banks.

### III. Effect of Proposed Changes:

**Section 1.** Amends s. 280.02, F.S., to revise and add definitions. The term, "Alternative participation agreement," is defined to mean an agreement to restrictions which a qualified public depository must complete as an alternative to withdrawing immediately from the public depository program due to the public depository's financial agreement.

The definition of the term, "Eligible collateral," is expanded to include Federal Home Loan Bank letters of credit and cash.

"Market value" is defined to mean the value of collateral calculated pursuant to s. 280.04, F.S.

"Oversight board" is defined to mean the Qualified Public Depository Board created under s. 280.071, F.S., for the purpose of safeguarding the integrity of the public deposits program and preventing the realization of loss assessments through standards, policies, and recommendations for action made to the Treasurer.

The term, "Public deposit program," is revised to mean the Florida Security for Public Deposits Act set forth in this chapter and any rules adopted under ch. 280, F.S.

The term, "Triggering event," is revised to authorize the Treasurer to demand payment under letters of credit.

**Section 2.** Amends s. 280.04, F.S., relating to collateral for public deposits, to revise the collateral deposit requirements for a qualified public depository, to require collateral as required in special instructions from the Treasurer in order to protect the integrity of the program. The deadline for a qualified public depository to meet additional collateral requirements of subsection (4) is changed from 48 hours to 2 business days. Each qualified public depository is also required to report its required collateral on the month the report is required under s. 280.16, F.S., and must simultaneously pledge, deposit, or issue eligible collateral as needed.

In regards to the valuation of collateral, each qualified public depository would be required to report any material declines in value that occur prior to the date of the submission of the monthly report required under s. 280.16, F.S., to the Treasurer. Also, a qualified public depository would

be authorized to use 100 percent of the maximum amount available under Federal Home Loan Bank letters of credit as market for the valuation of collateral.

A qualified public depository would be required to pledge, deposit, or issue additional eligible collateral between filing periods of the monthly report when notified by the Treasurer that the current market value of the collateral did not meet the required collateral. This additional collateral would be required within 2 business days after the Treasurer's notification. In the event a qualified public depository failed to meet the required collateral, it could be required to return public deposits to governmental units and be suspended, disqualified or subjected to administrative penalties, as provided in ss. 280.051 and 280.054, F.S.

The Treasurer would be authorized to adopt rules for the establishment of required collateral, collateral pledging levels, required collateral calculations, and market value, and that clarify related terms.

**Section 3.** Amends s. 280.041, F.S., to establish collateral arrangements that may be used by a qualified public depository or an operating subsidiary to meet the required collateral. The regular custody arrangement would require the pledging of the collateral with a custodian. Federal Home Loan Bank letters of credit arrangements are authorized as eligible collateral and requirements are established for such collateral.

A qualified public depository would be prohibited from acting as its own custodian. If the custodian fails to meet certain reporting or records requests, the qualified public depository would be prohibited from using the custodian for a 1-year period.

The Federal Reserve Bank custody arrangement would require the pledging of collateral to the Treasurer. However, the Federal Reserve Bank agreement could not subject the Treasurer to any costs or indemnification requirements.

The Treasurer's custody arrangement would require collateral to be deposited in the Treasurer's name. The collateral would be held in a custodial account established in the Treasurer's name at a designated custodian.

The Federal Home Loan Bank letter of credit arrangement would require the collateral to be issued with the Treasurer as the beneficiary. A depository would be required to abide by the following provisions:

- The letter of credit must meet the definition of eligible collateral;
- In the event any of the triggering events occurs, the Treasurer may demand payment under the letter of credit and funds received due to triggering events may be deposited in the Treasury Cash Deposit Trust Fund for purposes of eligible collateral;
- The letters of credit must meet the requirements of s. 280.13, F.S., and must be delivered to the Treasurer and all transactions involving the letters of credit require the Treasurer's approval;
- The qualified public depository is responsible for all costs necessary to use or confirm the letters of credit issued on behalf of the Treasurer;

- In the event of litigation, the qualified public depository must be subject to jurisdiction of the courts of this state or the courts of the United States;
- Any information or documents electronically transmitted to the Treasurer have the same enforceability as a signed letter;
- The depository must submit proof that authorized individuals executed the letters of credit on its behalf; and
- The depository must agree by resolution of its board of directors that these letters of credit have been formally accepted and constitute official records of the depository.

The triggering events that would authorize the Treasurer to demand payment under a letter of credit or direct a custodian to deposit or transfer collateral and proceeds would be expanded to include: 1) the Federal Home Loan Board or the qualified public depository gives notice that a letter of credit will not be extended or renewed and other eligible collateral has not been deposited; and 2) the depository is involved in a merger, acquisition, consolidation, or other organizational change fails to notify the Treasurer or to ensure that required collateral is properly maintained by the depository holding the Florida public deposits.

**Section 4.** Amends s. 280.05, F.S., to eliminate the advisory committee and to create the Qualified Public Depository Oversight Board (“Oversight Board”). The Treasurer would be required to identify representative qualified public depositories and furnish notification for the selection of the Oversight Board. The Treasurer would also be required to provide data for the Oversight Board duties, to assist the board in establishing standards for qualified public depositories and custodians, evaluating requests for exceptions to standards and alternative participation agreements, and reviewing and recommending action concerning a violation committed by a qualified public depository. The Treasurer may review, implement, monitor, evaluate, and modify all or any part of the standards, policies, or recommendations of the Oversight Board.

The Treasurer would be authorized to issue notice to a qualified public depository that the use of a custodian would be disallowed if the custodian has failed to follow the terms of a collateral agreement. The Treasurer would also be authorized to demand payment under letters of credit for any triggering events listed in s. 280.041, F.S., and deposit the funds into the Public Deposits Trust Fund for purposes of paying losses to public depositors. The Treasurer would be authorized to deposit administrative penalties into the Treasurer’s Administrative and Investment Trust Fund and to deposit eligible collateral into the Treasury Cash Deposit Trust Fund.

**Section 5.** Amends s. 280.051, F.S., to revise the grounds for suspending or disqualifying a qualified public depository to include failure to maintain required collateral rather than failure to pledge sufficient collateral to cover public deposits.

**Section 6.** Amends s. 280.054, F.S., to revise the grounds for administrative penalties and disqualification to include failure to provide required collateral using eligible collateral and prescribed collateral agreements or withdrawing collateral without the Treasurer’s approval. A qualified public depository would be subject to an administrative penalty in an amount not exceeding the greater of \$1,000 or 10 percent of the amount of withdrawal, not exceeding \$10,000 for either of these violations.

**Section 7.** Amends s. 280.055, F.S., to clarify that the Treasurer may issue a cease and desist order and a corrective order upon determining that a qualified public depository deposits or arranges for the issuance of unacceptable collateral, in addition to the “pledging” as provided in current law.

**Section 8.** Amends s. 280.07, F.S., to change the title of the section from “Mutual Responsibility” to “Mutual Responsibility and Contingent Liability,” to more clearly reflect the provisions of this section. This section provides that any entity designated as a qualified public depository and is not insolvent is required to guarantee public depositors against loss caused by the default or insolvency of other qualified public depositories.

**Section 9.** Creates s. 280.071, F.S., to establish the Qualified Public Depository Oversight Board (“Board”). The Board would consist of six members and six alternate members who represent the interests of the qualified public depositories in safeguarding the integrity of the program and preventing the realization of loss assessments.

On July 31 of each year, as vacancies occur, the Treasurer, in order to initiate the selection of the Board representation, must identify the two qualified public depositories in each of the three asset groups which have the greatest shares of contingent liabilities and send notification to the six qualified public depositories that have been identified. An “eligible qualified public depository” is defined to mean a qualified public depository that is in compliance with all of the provisions of the chapter and cannot be suspended, disqualified, or withdrawn from, or under an alternative participation agreement.

Each of the six representatives must select a member and an alternative of the Board and notify the Treasurer of the selection within 30 days after the Treasurer’s notification. If the qualified public depository selected by the Treasurer declines to participate, the Florida Bankers Association must select a member and an alternative member within 30 days to represent that average asset category. The Board members and alternate board members are subject to the approval of the Treasurer. The alternate member must serve in the event the Board member is unable to perform the duties. Each Board member must serve until a successor is selected.

The duties of the members of the Board include: 1) having resources available for review of qualified public depository issues, 2) possessing knowledge and experience in financial analysis, accounting, banking, risk management, or investment management. His or her representative qualified public depository must pay expenses incurred by the board members in carrying out their duties.

Policies and procedures for organizing, communicating, and conducting Board meetings are prescribed. In the absence of a quorum, the Treasurer or his representative must vote as a member.

The Board is charged with establishing standards for reporting requirements, custodian characteristic requirements and adherence to collateral agreement terms, collateral eligibility and restrictions, conditions for suspension and disqualification, penalties and fines, and corrective actions and administrative orders. The Board is also responsible for recommending to the Treasurer the approval or rejection of requests for exceptions that do not meet established

standards. The Board must approve or reject alternative participation agreements referred by the Treasurer. The Board is also responsible for reviewing program violations and recommending that the Treasurer impose penalties and fines or issue corrective actions and administrative orders. The Board would also be authorized to assess qualified public depositories for the implementation of standards established by the Board which exceed the funding of the program in the same manner as the loss assessments, as provided s. 280.08, F.S.

All official actions of the Board regarding the establishment of standards, decisions regarding exceptions and alternative participation agreements and recommendations concerning violations must be communicated to the Treasurer in writing and are subject to the approval of the Treasurer.

The Treasurer is authorized to adopt rules establishing forms and procedures for the selection of members and alternate members of the Board and governing functions.

**Section 10.** Amends s. 280.08, F.S., to revise procedures for determining the loss to public depositors in the event a default or insolvency occurs to incorporate the use of letters of credit. The loss to any public depositors would continue to be satisfied first through any applicable deposit insurance, then through demanding payment under letters of credit or the sale of collateral, instead of securities, pledged.

**Section 11.** Amends s. 280.09, F.S., relating to the Public Deposits Trust Fund to incorporate the acceptance of letters of credit and to allow for the draw on letters of credit held as collateral. A cross-reference is updated.

**Section 12.** Amends s. 280.10, F.S., to clarify the current provisions that the public deposits and associated collateral of qualified public depository that is merged with, acquired by, or consolidated with another financial institution would be public deposits of the resulting institution. If the resulting institution does not want to participate in the public deposit program, it must provide written notice of intent to withdraw and a proposed effective date of withdrawal, which must be 180 days after the effective date of the acquisition, merger, or consolidation. The Treasurer must initiate a mandatory withdrawal of the resulting institution, if the resulting institution does not provide certain documents or does not meet the program requirements. Procedures for the disposition of Florida public deposits or collateral are provided.

**Section 13.** Amends s. 280.11, F.S., to correct a cross-reference.

**Section 14.** Amends s. 280.13, F.S., to include letters of credit issued by the Federal Home Loan Bank as eligible collateral if certain conditions are met, including the delivery of the letter of credit to the Treasurer and designating the Treasurer as the beneficiary.

**Section 15.** Amends s. 280.16, F.S., to require the collateral control agreements and letters of credit to be made under oath.

**Section 16.** Provides that except as otherwise expressly provided in this act, this act takes effect October 1, 2001.

**IV. Constitutional Issues:****A. Municipality/County Mandates Restrictions:**

None.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

**V. Economic Impact and Fiscal Note:****A. Tax/Fee Issues:**

The Qualified Public Depository Oversight Board would be authorized to assess qualified public depositories for the implementation of standards established by the board which exceed the resources of the public deposit program. Assessments would be made in the same manner as the loss assessments, as provided in s. 280.08, F.S. Typical expenses may include audits or examinations.

**B. Private Sector Impact:**

The bill creates the Qualified Public Depository Oversight Board, which is comprised of members representing qualified public depositories. This board would allow banks and savings associations that have the greatest contingent liability in the program to have the greatest impact on the program standards, exceptions, violations, and other areas. These areas influence the potential for assessments on the qualified public depositories. The qualified public depository that a member represents would incur expenses of the board. These expenses would include members' time, research resources, travel, and meeting expenses.

The use of Federal Home Loan Bank letters of credit would allow banks and savings associations to select a collateral type that will not affect the regulatory liquidity calculations. Banks and savings associations will incur a fee in using this type of collateral.

**C. Government Sector Impact:**

None.

**VI. Technical Deficiencies:**

None.



**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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