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.)

Prepared By: Governmental Oversight and Productivity Committee

BILL: SB 1998

SPONSOR: Senator Alexander

SUBJECT: Investment of Public Funds

DATE: April 15, 2005 REVISED: _____ _____ _____ _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	**Favorable**
2.	Wilson	Wilson	GO	**Favorable**
3.			WM	
4.				
5.				
6.				

I. Summary:

The bill would allow banks and savings associations that serve as qualified public depositories for state and local governments to accept public deposits in amounts greater than $100,000 that would maintain full Federal Deposit Insurance Corporation coverage, if the following conditions were met:

- The funds must be initially deposited through a qualified public depository, as defined in s. 280.02, F.S., selected by the Chief Financial Officer or unit of local government;
- The selected depository must arrange for deposit of the funds in certificates of deposit in one or more federally insured banks or savings and loans associations, wherever located, in the account of the state or unit of local government;
- The full amount of principle and accrued interest of each certificate of deposit must be insured by the Federal Deposit Insurance Corporation;
- The selected depository is to act as custodian for the state or unit of local government with respect to such certificates of deposit issued for its account; and
- At the same time the state's funds are deposited and the certificates of deposit are issued, the selected depository receives an amount of deposits from customers of other federally insured financial institutions, wherever located, equal to or greater than the amount of the funds initially invested by the Chief Financial Officer or unit of local government through the selected depository;

This bill substantially amends the following sections of the Florida Statutes: 17.57 and 218.415.

II. Present Situation:

The Chief Financial Officer is required to invest monies in excess of those needed to pay the immediate debts of the state. Pursuant to s. 17.57, F.S., the Chief Financial Officer (CFO) invests these excess funds in qualified public depositories that will pay rates established by the CFO of 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 CFO, then the CFO is authorized to invest the money in specific investment products.

Section 280.02, F.S., defines a "public deposit" as the moneys of the state or any county, school district, community college district, special district, metropolitan government, or municipality, including agencies, boards, bureaus, commissions, and institutions of any of the foregoing, or of any court, and includes the moneys of all county officers, including constitutional officers, that are placed on deposit in a bank, savings bank, or savings association and for which the bank, savings bank, or savings association is required to maintain reserves. A public deposit includes, but is not limited to, time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposit.

Qualified Public Depositories

The law also directs that the Chief Financial Officer establish qualifications in order to designate banks and savings and loan associations as qualified public depositories. The Division of Treasury of the Department of Financial Services administers the provisions of ch. 280, F.S., which delineates the procedures a financial institution must follow in order to be designated as a qualified public depository. A "qualified public depository" is any bank, savings bank, or savings association that: is organized and exists under the laws of the United States, the laws of this state or any other state or territory of the United States; has its principal place of business in this state or has a branch office in this state which is authorized under the laws of this state or the United States to receive deposits in this state; has deposit insurance under the provision of the Federal Deposit Insurance Act, as amended, 12 U.S.C. ss. 1811 et seq; has procedures and practices for accurate identification, classification, reporting, and collateralization of public deposits; meets all the requirements of chapter 280, F.S., and; has been designated by the CFO as a qualified public depository.[1]

Collateral for Public Deposits

The Chief Financial Officer determines the collateral requirements and collateral pledging level for each qualified public depository pursuant to rules adopted by the Department of Financial Services. 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 percentage of public funds that a financial institution must collateralize varies depending upon the assets of the institution and other factors. A qualified public depository may not accept

[1] Section 280.02, F.S.

or retain any public deposit which is required to be secure unless it has been deposited with the CFO eligible collateral within specific parameters, including minimum required collateral of $100,000. Almost all states require public deposits in excess of the Federal Deposit Insurance Corporation's limit of $100,000 be secured by pledged collateral from depository institutions. State and local governmental units and the qualified public depositories must monitor and periodically adjust the book value of the collateral to reflect its market value to ensure that the public depositories maintain the appropriate amount of collateral. A qualified public depository may be required to return public deposits to governmental units and be suspended, disqualified or subject to administrative penalty, as provided in ss. 280.051 or 280.054, F.S., for failure to maintain required collateral.

Public Deposits Secured

All public deposits are considered secure, as provided in chapter 280, F.S., when public depositors comply with the provisions of the chapter. Public deposits are to be made in a qualified public depository unless exempted by law. Presently, public funds cannot be deposited directly or indirectly in negotiable certificates of deposit. The following deposits are exempt from requirements of and protection under chapter 280, F.S.,: public deposits deposited in a bank or savings association by a trust department or trust company which are fully secured under trust business laws; moneys of the System Trust Fund, as defined in s. 121.021 (36), F.S.; public deposits held outside the country; wire transfers and transfers of funds solely for the purpose of paying registrars and paying agents; and public deposits which are fully secured under federal regulations.

Federal Deposit Insurance Corporation (FDIC)

The FDIC's regulations (12 C.F.R. s. 330.15) govern the insurance coverage of "public unit" accounts. For deposit insurance purposes, the term "public unit" includes a state, county, municipality, or "political subdivision." This regulation provides that the "official custodian" of the funds belonging to the public unit be insured as the depositor.

The insurance coverage of public unit accounts is contingent upon the type of deposit and the location of the insured depository institution. All "time and savings deposits" owned by a public unit and held by the same official custodian in an insured depository institution within the state in which the public unit is located are insured up to $100,000. Separately, all "demand deposits" owned by a public unit and held by the same official custodian in an insured depository institution within the state in which the public unit is located are insured up to $100,000.

The insurance coverage of public unit accounts is different if the depository institution is located outside the state in which the public unit is located. In that case, all deposits owned by the public unit and held by the same official custodian are added together and insured up to $100,000. Time and savings deposits are not insured separately from demand deposits. Deposit insurance coverage cannot be increased by unbundling funds among several official custodians who lack plenary authority over such funds. Likewise, coverage cannot be increased by dividing funds among several accounts controlled by the same official custodian for the same public unit.

Certificate of Deposit Account Registry Service

The Certificate of Deposit Account Registry Service (CDARS) is a deposit placement service operated by Promontory Registry Service that allows Federal Deposit Insurance Corporation (FDIC) insured institutions to accept deposits greater than $100,000, including principal plus interest, and up to $10 million for a single depositor or customer, while still maintaining FDIC insurance on that deposit. Once a depositor places the money in the institution, certificates of deposit (CD's) of up to $100,000 are issued to other network banks located in the United States. These banks then issue CD's of the same amount back to the bank where the original deposit was made. As a result, the money comes back to the state and the local bank has the benefit of using the full amount of the deposit for lending. The system is based on a reciprocal relationship between network banks, but the customer maintains a single relationship with the original bank in which the funds were deposited. Currently, there are over 600 network banks nationwide and 23 network banks in Florida. To become a member bank, the bank must be well capitalized and have FDIC insurance.

The CDARS program allows for deposits into qualified public depositories up to $10 million while maintaining FDIC insurance on the deposit, thus eliminating the need for qualified public depositories to deposit certain eligible collateral with the Division of Treasury. In a letter dated July 29, 2003, the Federal Deposit Insurance Corporation opined that deposits placed through the CDARS deposit-placement service system would be insured on a pass-through deposit insurance basis under the FDIC's rules on the insurance coverage of agency or custodial accounts. The FDIC also noted that if the same depositor or principal had an ownership interest in other deposits at the same issuing institution, those deposits would be added to the ownership interests in deposits held in the same ownership capacity placed through the CDARS system and insured up to a limit of $100,000.

How CDARS Works

Public funds are deposited in a relationship bank. While the lump sum deposit remains in the bank, dollar-for-dollar FDIC coverage in CD's in an amount up to $100,000 is exchanged with at least 11 member banks around the country through matches made at the Bank of New York, which acts as a clearinghouse for the CDARS program. For a financial institution to accept public deposits in Florida, it must be a qualified public depository as defined under s. 280.02, F.S. If the depositor seeks to withdraw its deposit early, the relationship bank, or the bank where the deposit is originally made, has two options:

- It can offer a loan to the depositor against the total deposit to avoid the early termination fee; or
- The relationship bank may call in the CD's from the member banks and pay the fee (50 percent of the interest earned on the CD) to the member bank that is losing the funds due to the early termination of the CD. The relationship bank determines whether to pass the fee to the depositor.

The depositor can recover the full amount of these deposits. If the relationship bank should fail, the FDIC would take over the relationship bank and hold the CD's until they mature. If a member bank fails, the FDIC would go to the Bank of New York and seize the CD's issued by

the failed member bank and either sell the bank and its liabilities, or sell the CD's in bulk as demand CD's.

The governmental unit depositing funds into a single qualified public depository is considered having a deposit in that qualified public depository alone. Governmental units receive a single statement listing all the banks in which their money has been deposited through CDARS, as well as the interest earnings. Currently, 16 states are using the CDARS system, including Georgia, Illinois, Pennsylvania, Missouri, and Tennessee.

III. Effect of Proposed Changes:

Section 1 amends s. 17.57, F.S., to authorize the use of the "CDARS" program in law. Presently, in order for a qualified public depository to accept deposits above the $100,000 Federal Deposit Insurance Corporation insured limit, the qualified public depository must purchase permissible collateral to guarantee deposits in excess of $100,000. The bill would allow qualified public depositories to implement the CDARS program and significantly reduce their pledging of collateral if the following conditions are met:

- The funds are initially deposited through a qualified public depository, as defined in s. 280.02, F.S., selected by the Chief Financial Officer;
- The selected depository arranges for deposit of the funds in certificates of deposit in one or more federally insured banks or savings and loans associations, wherever located, in the account of the state;
- The full amount of principal and accrued interest of each certificate of deposit must be insured by the Federal Deposit Insurance Corporation;
- The selected depository acts as custodian for the state with respect to such certificates of deposit issued for its account; and
- At the same time the state's funds are deposited and the certificates of deposit are issued, the selected depository receives an amount of deposits from customers of other federally insured financial institutions, wherever located, equal to or greater than the amount of the funds initially invested by the Chief Financial Officer through the selected depository.

This language would allow qualified public depositories to accept deposits greater than $100,000 that would be covered by the Federal Deposit Insurance Corporation. As a result, collateral pledging requirements for public deposits would be reduced for qualified public deposits participating in this program.

Section 2 authorizes a unit of local government to deposit any portion of surplus public funds under identical conditions described in section 1 of the bill.

Section 3 provides that this act will take effect July 1, 2005.

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:

None.

B. Private Sector Impact:

Pledging requirements for public deposits would be reduced for qualified public deposits participating in the CDARS network. Banks participating in the CDARS network would pay a transaction fee for funds placed through CDARS.

C. Government Sector Impact:

Proponents of the bill state that the rate of return on these public deposits is expected to be higher than returns on other deposits. The higher rate of return is expected due to the result of increased competition for the deposits and because the bank would not incur the expense associated with pledging collateral.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Summary of Amendments:

None.