

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** CS/HB 569

Investment of Public Funds

**SPONSOR(S):** Roberson

**TIED BILLS:**

**IDEN./SIM. BILLS:** SB 732

	REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1)	Insurance, Business & Financial Affairs Policy Committee	17 Y, 0 N, As CS	Barnum	Cooper
2)	General Government Policy Council			
3)	Full Appropriations Council on General Government & Health Care			
4)	Finance & Tax Council			
5)				

**SUMMARY ANALYSIS**

Currently the Chief Financial Officer (CFO) may deposit state funds not required to meet disbursement needs in certificates of deposit in one or more bank or savings and loan association designated as a qualified public depository by the Chief Financial Officer. The principal and interest must be insured by the Federal Deposit Insurance Corporation (FDIC). Local governments have the same option and requirement for FDIC insurance.

Statutory language limits the CFO's options if state-held securities are downgraded below a specified required rating level. This may force liquidation of positively performing securities in an unfavorable market.

Presently, any investment losses from securities or investments are offset against monthly earning. Authority does not exist for the CFO to establish a reserve account against which such losses could be charged.

CS/HB 569 expands the scope of the applicable *Florida Statutes* by providing an option for state and local government funds to be deposited into money market deposit accounts and other financial instruments insured by the FDIC. The magnitude of fiscal impact on state and local governments is indeterminate because the amount of accrued interest will be dependent upon the amount of principal invested, the interest rate being applied, and protocols for crediting interest.

The bill provides the CFO with the discretion to hold certain performing securities if their ratings are downgraded below the statutory required rating level and it is believed that holding such securities is in the interest of the State.

The bill provides the CFO with the authority to establish a reserve account within the State Treasury for investment losses. Such losses could be charged against the account, thereby smoothing losses and reducing the possibility of having negative earnings. In addition, it specifies how the account is to be funded and provides for a maximum reserve balance of \$200 million.

Estimated earnings that could be put in the reserve account during Fiscal Year 2009-2010 are up to \$39,008,311, broken down as follows:

General Revenue	\$ 9,702,933
Trust Funds	\$19,494,977
Treasury Special Purpose Investment Account <sup>1</sup>	\$ 9,810,400

This bill is effective July 1, 2009.

<sup>1</sup> Includes approximately 160 unique account holders associated with state agencies, municipalities, universities, community colleges, and other entities.

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### Current Situation

State and local governments are authorized to deposit funds in excess of those required to meet disbursement needs or expenses in a qualified public depository. The term "qualified public depository" applies only to a bank, savings bank, or savings association which meets specific criteria. The criteria include designation as a qualified public depository by the Chief Financial Officer (CFO).<sup>2,3</sup> By definition, a credit union can not be a qualified public depository.

*Florida Statutes* provide that funds deposited in a qualified public depository can then be placed in certificates of deposit in one or more federally insured bank or savings and loan association.<sup>4</sup> A certificate of deposit is the only financial instrument authorized. The full amount of the principal and accrued interest must be insured by the Federal Deposit Insurance Corporation (FDIC), a federal government corporation created by the Glass-Steagall Act of 1933. FDIC insurance covers funds in deposit accounts, including checking and savings accounts, money market deposit accounts, and certificates of deposit in member banks. Banks are not mandated to be FDIC insured. FDIC insurance does not cover other financial products and services that insured banks may offer such as stocks, bonds, mutual fund shares, life insurance policies, annuities, or municipal securities. The current \$250,000 standard insurance coverage amount is in effect through December 31, 2009. On January 1, 2010, the standard insurance coverage amount will return to \$100,000 for all deposits except IRAs and certain retirement accounts, which will remain insured up to \$250,000.<sup>5</sup>

Promontory Interfinancial Network was founded in 2002 by a former head of the U.S. Office of the Comptroller of the Currency, FDIC Chief of Staff, Vice Chairman of the Board of Governors of the Federal Reserve System, and Presidential Special Advisor and Special Counsel. With a stated goal of developing and providing creative solutions to issues confronting bank management, its current network includes nearly 3,000 members nationwide. Promontory Interfinancial Network offers a suite of services which includes Certificate of Deposit Account Registry Service (CDARS). Using CDARS, financial institutions can offer customers up to \$50 million in FDIC insurance.<sup>6</sup> CDARS is a deposit-placement service designed to allow FDIC-insured depository institutions to accept deposits of more

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<sup>2</sup> s. 280.02(26), F.S.

<sup>3</sup> 69C-2.005, F.A.C.

<sup>4</sup> s. 17.57(7), F.S.

<sup>5</sup> FDIC Financial Institution Letter FIL-102-2008 dated October 3, 2008 on file with the Insurance, Business and Financial Affairs Policy Committee.

<sup>6</sup> <http://www.promnetwork.com> (Last visited March 3, 2009)

than \$100,000 and obtain full coverage for the depositor by spreading the funds among as many separate FDIC insured institutions as necessary so that no institution holds more than \$100,000, including principal plus interest, for each depositor. FDIC has issued an advisory opinion that deposits placed through the CDARS system would be insured on a pass-through basis under the FDIC's rules on the insurance coverage of agency or custodial accounts.<sup>7</sup> Statutory language provides for deposits consistent with FDIC's opinion.<sup>8,9</sup> All FDIC insured banks are not members of the CDARS network. Approximately 98% of Florida Bankers Association members are part of the CDARS network. Banks are charged fees for participation in the CDARS network, however a depositor incurs no fees.

Prior to investment of state funds by the CFO, *Florida Statutes* establish specific security rating criteria which must be met.<sup>10</sup> Once funds are invested, those rating criteria continue to apply. If, as a result of the downgrading of a security's rating, the requirement is no longer satisfied, the downgraded security is sold within 90 days unless it can otherwise be held as part of the 3 percent of total funds which need not meet the rating criteria.<sup>11</sup>

Department of Financial Services has established the Treasury Special Purpose Investment Account, as authorized in s. 17.61, F.S. The original purpose was for investment of university local funds. Its scope has subsequently been expanded.<sup>12</sup> Investment losses from securities or investments are offset against monthly earning. Authority does not exist for the CFO to establish a reserve account against which such losses could be charged.

### Proposed Change

CS/HB 569 expands the options available to the Chief Financial Officer and local governments for deposit of surplus public funds by removing the requirement that funds only be placed in certificates of deposit. The requirement that the principal and any accrued interest be insured by the Federal Deposit Insurance Corporation remains. Replacing "certificate of deposit" with the broader term "financial instrument" allows for the inclusion of other deposit accounts insured by the FDIC. These would include checking and savings accounts, money market deposit accounts and certificates of deposit, as well as other financial instruments which are or may become eligible for insurance by the FDIC.

For money market deposit accounts, a service or product similar to CDARS, known as the Deutsche Bank Insured Deposit Program (Program), has been developed. Deutsche Bank Trust Company Americas, a fully owned subsidiary of Deutsche Bank AB, is the contracting entity and is authorized to act as administrator and intermediary bank for the Program. The Program provides for over \$11 million of FDIC Insurance by allocating deposits to multiple participating program banks.<sup>13</sup> All FDIC insured banks do not participate in the Program. Approximately 5% of Florida Bankers Association members participate in the Deutsche Bank Insured Deposit Program. A depositor incurs no fees for participating in the Program.

CS/HB 569 provides the CFO with the discretion to hold certain securities<sup>14</sup> if their ratings are downgraded below the statutory required rating level and it is believed that holding such securities is in the interest of the State.

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<sup>7</sup> FDIC Advisory Opinion 03-03 dated July 29, 2003 on file with the Insurance, Business and Financial Affairs Policy Committee.

<sup>8</sup> s. 17.57(7), F.S.

<sup>9</sup> s. 218.415(23), F.S.

<sup>10</sup> s. 17.57(2), F.S.

<sup>11</sup> s. 17.57(2)(v), F.S.

<sup>12</sup> Currently it includes approximately 160 unique account holders associated with state agencies, municipalities, universities, community colleges, and other entities.

<sup>13</sup> Evolve Bank & Trust Deutsche Bank Insured Deposit Program Brochure 1-001887 on file with the Insurance, Business and Financial Affairs Policy Committee.

<sup>14</sup> Commercial paper of prime quality, bankers acceptances, corporate obligations or master notes, mortgaged-backed securities, asset-backed securities, obligations guaranteed by the federal government or obligations of United States agencies or instrumentalities, obligations of state and local governments, negotiable certificates, foreign bonds, and corporate convertible debt obligations.

The CFO is authorized to establish a reserve account within the State Treasury for investment losses. Funding may be by placing up to 10 percent of monthly net state treasury earnings in the account. A maximum reserve account balance of \$200 million is established. Investment losses could then be charged against the account, effectively reducing the possibility of having negative earnings and smoothing losses.

**B. SECTION DIRECTORY:**

Section 1. Amends s. 17.57(7), F.S., by expanding the options available for deposit of certain state public funds. It creates s. 17.57(8), F.S. authorizing the CFO to hold performing securities if their ratings are downgraded below the statutory required rating level.

Section 2. Creates s. 17.61(6), F.S., authorizing the CFO to establish a reserve account within the State Treasury for investment losses, specifying funding, and a maximum reserve balance.

Section 3. Amends s. 218.415(23), F.S., by expanding the options available for deposit of certain local government public funds.

Section 4. Provides an effective date of July 1, 2009.

**II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT**

**A. FISCAL IMPACT ON STATE GOVERNMENT:**

1. Revenues:

Indeterminate regarding certificates of deposit and money market deposit accounts. Accrued interest is dependent upon the amount of principal, interest rate, and protocols for crediting interest.

For Fiscal Year 2009-2010, Department of Financial Services (DFS) projects interest earnings of up to \$39,008,311 could be placed in the reserve account within the State Treasury for investment losses as follows:

General Revenue	\$ 9,702,933
Trust Funds	\$19,494,977
Treasury Special Purpose Investment Account	\$ 9,810,400

2. Expenditures:

None.

**B. FISCAL IMPACT ON LOCAL GOVERNMENTS:**

1. Revenues:

Indeterminate regarding certificates of deposit and money market deposit accounts. Accrued interest is dependent upon the amount of principal, interest rate, and protocols for crediting interest.

For Fiscal Year 2009-2010, DFS projects interest earnings of up to \$39,008,311 could be placed in the reserve account for investment losses to include \$9,810,400 from the Treasury Special Purpose Investment Account (SPIA). The SPIA includes unique account holders associated with municipalities, universities, community colleges and other entities.<sup>15</sup>

2. Expenditures:

None.

**C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:**

<sup>15</sup> Complete SPIA listing as of January 30, 2009 on file with the Insurance, Business and Financial Affairs Policy Committee.

None.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Department of Financial Services has noted that the terms “financial instruments” and “financial instrument” may be overly broad and could be interpreted to include instruments other than traditional deposit accounts which might qualify for FDIC insurance now or in the future. For example, there has been discussion at the national level of FDIC acting to guarantee or insure mortgage loans that are in, or at risk of, foreclosure.<sup>16</sup> According to the department, utilization of the terms “deposit accounts” and “deposit account” would provide clarity.

### IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES

At the March 6, 2009 meeting of the Insurance, Business and Financial Affairs Policy Committee two amendments were proposed and adopted.

Amendment 1 provided the Chief Financial Officer (CFO) with the discretion to hold performing securities if their ratings are downgraded below the statutory required rating level, rather than being forced to liquidate them in an unfavorable market.

Amendment 2 provided the CFO authority to establish a reserve account for investment losses. It specifies how the account is to be funded and provides for a maximum reserve balance.

The analysis is drafted to the committee substitute.

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<sup>16</sup> Department of Financial Services Bill Analysis and Financial Impact Statement dated February 18, 2009 on file with the Insurance, Business and Financial Affairs Policy Committee.