HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	HB 7009	**FINAL HOUSE FLOOR ACTION:**	
SPONSOR(S):	Insurance & Banking Subcommittee; Moraitis, Jr. and others	116 **Y's**	0 **N's**
COMPANION BILLS:	CS/SB 564	**GOVERNOR'S ACTION:**	Approved

SUMMARY ANALYSIS

HB 7009 passed the House on March 27, 2014, and subsequently passed the Senate on April 24, 2014.

Chapter 280, Florida Statutes, is the Florida Security for Public Deposits Act (Act), which authorizes state and local governments to deposit public deposits with qualified public depositories (QPDs). Public deposits are funds in excess of amounts required to meet disbursement needs or expenses, and QPDs are banks, savings banks, or savings associations that meet specific criteria under the Act. QPDs must secure public deposits in accordance with the Act and the collateral requirements and pledging levels as set forth by rule of the Chief Financial Officer (CFO). QPDs may meet these collateral requirements by pledging, depositing, or issuing eligible collateral to the CFO, based on their financial condition and public deposit volume. The Department of Financial Services, as headed by the CFO, administers a collateral management program which ensures compliance with the Act.

The bill makes the following changes to the Act:

- Provides several clarifying changes to reflect the current banking industry and regulatory environment;
- Minimizes regulatory burden on QPDs and streamlines compliance requirements;
- Clarifies regulatory requirements for failed QPDs and their acquiring institutions;
- Adjusts the two highest collateral pledge levels to ease regulatory burden for small and moderate-sized QPDs;
- Repeals the Qualified Public Depository Oversight Board, which has been largely inactive since its creation in 2001;
- Eases an existing ministerial notice requirement for public depositors, so that they are still protected from loss arising from a QPD's failure; and
- Makes a number of technical, conforming changes throughout the Act.

The bill may have a positive impact on the private sector, and it is not likely that the bill will have a fiscal impact on state or local government.

The bill was approved by the Governor on June 13, 2014, ch. 2014-145, L.O.F., and will become effective July 1, 2014.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Security for Public Deposits Act

Chapter 280, Florida Statutes, is the Florida Security for Public Deposits Act (the Act). Public deposits are moneys of enumerated state and local governments, and include time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposits, but do not include moneys in deposit notes, securities, mutual funds, and similar investments.[1] Unless exempted, all public deposits must be made in a qualified public depository (QPD).[2] A qualified public depository is any bank, savings bank, or savings association[3] that meets certain requirements of the Act, such as having deposit insurance under the Federal Deposit Insurance Act and receiving designation by the Chief Financial Officer (CFO) as a qualified public depository.[4]

Currently, there are 167 active QPDs in this state.[5] The Department of Financial Services (DFS), through its Division of Treasury and Bureau of Collateral Management, administers the Act's reporting and collateral pledging requirements through its uniform, statewide Public Deposits Program and Collateral Administration Section.[6] QPDs must comply with monthly, quarterly, and annual reporting requirements under the Act. In addition, the Act gives the CFO authority to take action against noncompliant QPDs, as well as financial institutions that accept public deposits without a certificate of qualification from the CFO.

Collateral Requirements & Pledging Levels

Before a QPD accepts or retains a public deposit, it must deposit eligible collateral with an approved custodian in an amount determined according to statutory guidelines and DFS rules.[7] The Act's collateral requirements protect public deposits (both principal and accrued interest) against loss in the event of certain triggering events, most notably, a QPD's insolvency or default.[8] Losses are satisfied first through the standard maximum federal deposit insurance of $250,000,[9] and then through the CFO's demand for payment under letters of credit or the sale of collateral pledged or deposited by the defaulting QPD. Any remaining shortfall would then be covered by the CFO's authority to impose assessments against the other solvent QPDs, who must agree to share mutual responsibility and contingent liability as a condition of acting as a QPD.[10] The DFS has administered the program for over thirty years with no losses ever realized by participating governmental units.[11]

Each QPD is required to secure public deposits by pledging collateral at a level commensurate with the volume of its public deposits (which are reported monthly, quarterly, and annually to the CFO) and its financial condition. A QPD's financial condition is determined by considering factors such as nationally

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[1] Section 280.02(23), F.S. "Public depositors" are the official custodians for a governmental unit who is responsible for handling public deposits, and the enumerated state and local entities listed in the definition in "public deposit" parallel the definition of "governmental unit" (with the exception of state universities, which is addressed in this bill).
[2] Section 280.03(1)(b) and (3), F.S.
[3] Although the Act does not define either "savings association" or "savings bank," state and federal banking laws define "savings association" to include savings banks. Section 665.0211, F.S.; 12 U.S.C. § 1813(3).
[4] Section 280.02(26), F.S.; Rule 69C-2.005, Florida Administrative Code.
[5] DFS Collateral Management, Active Qualified Public Depository List, at: https://apps8.fldfs.com/CAP_Web/PublicDeposits/ActiveQPDDisplayList.aspx (last accessed December 17, 2013).
[6] *Id.*
[7] Section 280.04(2), F.S.; Chapter 69C-2, Florida Administrative Code (Procedures for Administering the Florida Security for Public Deposits Act).
[8] Section 280.041(6), F.S.
[9] With the enactment of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act on July 21, 2010, the standard maximum deposit insurance amount was permanently raised to $250,000. *See* 12 U.S.C. § 1821(a)(1)(E). Depository institutions engaged in the business of receiving deposits other than trust funds may apply for FDIC insurance. 12 U.S.C. § 1815(a)(1).
[10] Section 280.07, F.S.
[11] DFS bill analysis (dated December 23, 2013), on file with the Insurance & Banking Subcommittee staff.

recognized financial rating services information and established financial performance guidelines.[12] DFS rules set forth collateral requirements and numerical parameters (a quarterly average financial ranking scale of 0 to 100) for the entry, withdrawal, collateral pledging levels.[13]

The most financially stable QPDs are only required to pledge 25% of the average monthly balance of their public deposits.[14] Meanwhile, collateral pledging levels increase to 50%, 125%, and 200% of a QPD's public deposits as its financial condition ranking decreases. The CFO has authority to require a 125% collateral pledging level for any QPD with a decreased capital account, a violation of the Act, or evidence of factors such as unsound management practices or unstable market conditions that may affect the QPD's solvency.[15] The least financially stable QPDs must either withdraw from the public deposits program and return public deposits in an orderly fashion, or enter into an alternative deposit agreement and deposit collateral amounts equal to 200% of public deposits held into an account designated by the CFO and restrict its public deposits.[16]

The DFS has indicated that the two highest collateral pledge levels (125% and 200%) have raised regulatory and industry concerns for several small to moderately-sized QPDs.[17] In some instances, the 200% pledge level can exacerbate a struggling institution's condition by forcing it to either adversely affect its liquidity and cash reserves by having to seek additional collateral assets such as securities or letters of credit, or be forced to withdraw from the program and return public deposits. The latter option can trigger a loss of confidence within the QPD's community and possibly a "run" on the QPD's deposits, and thus further impact the QPD's safety and soundness.

QPD Oversight Board

The 2001 amendments to the Act created a six-member Qualified Public Depository Oversight Board (Board) for the purpose of safeguarding the integrity of the Public Deposits Program and preventing the need for loss assessments that could be imposed on all QPDs upon the default or insolvency of any one QPD.[18] The Act gives the CFO authority to identify representative QPDs for potential board member selection and to provide data to the board in order for it to fulfill its duties.[19] Board members are authorized to establish standards in matters regarding financial condition, collateral pledge levels, and so forth; make recommendations to the CFO for exceptions to such standards; issuing decisions on alternative participation agreements referred by the CFO, make recommendations for penalties and corrective actions for program violations; study program areas referred by the CFO; and making assessments on QPDs for the costs of implementing standards when the costs exceed the program's resources.[20] Official actions of the Board are subject to the CFO's approval and existing resources.[21]

However, since the Board's inception, the Board has convened only once. According to the Auditor General's 2011 operational audit:

> While a Board was appointed and an initial meeting was held in December 2001, Bureau staff stated that the Board members had questioned the liability of the represented QPDs in carrying out decisions affecting competitor QPDs and voiced their reluctance to participate in making recommendations as part of their responsibility. Subsequent to this initial meeting, no further Board meetings have taken place.

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[12] Currently, the DFS uses FIS and IDC rating services: https://apps8.fldfs.com/CAP_Web/PublicDeposits/intro_major.aspx
[13] Section 280.04(1), F.S.; see also Rules 69C-2.006 and 69C-2.024, Fla. Admin. Code.
[14] Section 280.04(2)(b), F.S.
[15] Rule 69C-2.010(6), Fla. Admin. Code.
[16] Sections 280.02(2) and 280.11, F.S. and Rule 69C-2.024(3)(b), Fla. Admin. Code.
[17] According to the DFS, only 2.1% of all program collateral is pledged at the two highest levels. E-mail from the DFS (received December 16, 2013), on file with the Insurance & Banking Subcommittee staff.
[18] Chapter 2001-230, Laws of Florida; Section 280.071, F.S.
[19] Section 280.05(1-2), F.S.
[20] Section 280.071(10), F.S.
[21] Section 280.071(11), F.S.

The Auditor General recommended that the DFS pursue legislative changes in order to effectuate the reestablishment of an active Board.[22] In its follow-up audit, the Auditor General recommended that the DFS pursue its stated legislative goal to establish an advisory committee in lieu of an oversight board.[23]

Effect of the Bill

Section 1. Definitions in the Act

The bill updates several definitions in s. 280.12, F.S.:

Currently, a QPD with a financial condition ranking of 15 or less must either "immediately" withdraw from the public deposits program or enter into a restricted alternative participation agreement. In practice, however, a QPD can take several months or longer to withdraw from the program, depending on the time needed for certificates of deposits to mature or for other contractually required banking services for a public depositor. The Division of Treasury also publishes notice in the Florida Administrative Register regarding the names of any QPD that elects to withdraw from the program as a safeguard to allow any unidentified public depositors of such QPD to withdraw their public deposits.[24] As such, the bill removes the word "immediately" from the definition of "alternative participation agreement" in s. 280.12(2), F.S.

Currently, a QPD's collateral requirement involves several factors, but is typically a function of its average daily balance, or *uninsured* public deposits multiplied by its collateral pledging level.[25] However, the most financially stable QPDs, while only required to pledge 25% of its "average *monthly* balance" of public deposits, must include deposit insurance in their collateral calculation. Accordingly, this requirement can negatively impact QPDs with public deposits that are substantially or completely covered by FDIC deposit insurance.[26] For example, a QPD that has averaged $4 million in gross public deposits (with all such deposits covered by FDIC insurance), has a collateral requirement of $1 million (i.e., $4 million average monthly balance times 25%), instead of the Act's minimum collateral requirement of $100,000.[27] As such, the bill amends the definition of "average *monthly* balance" in s. 280.02(4), F.S., to remove the qualifier "before deducting deposit insurance" from the calculation of a QPD's average monthly balance of public deposits held during any 12 calendar months.

The bill amends the current defined term "capital account" in s. 280.04(6), F.S., to add "tangible equity capital" as an alternative term to reflect the current bank regulatory environment more accurately.[28] Tangible equity reflects the total equity capital of a QPD, minus intangible assets such as goodwill, and is calculated from an institution's quarterly call report (also known as reports of condition and income). The bill also amends "capital account" to remove reference to the Thrift Financial Report, which was previously filed by savings banks and savings and loan associations. With the enactment of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Office of Thrift Supervision (formerly the primary federal regulator for savings banks and savings and loans associations), was merged into other federal banking agencies on July 21, 2011.[29] Since then, the Office of the Comptroller of the Currency has assumed primary federal regulatory responsibility over savings banks and savings and loans associations

[22] Auditor General Report No. 2010-049 (November 2009).
[23] Auditor General Report No. 2012-008 (September 2011).
[24] E-mail from the DFS (received December 4, 2013), on file with the Insurance & Banking Subcommittee staff.
[25] See the Act's definition of "average *daily* balance" in s. 280.04(3), F.S., which excludes deposit insurance in determining collateral amounts at the 125% pledging level for newer or less financially stable QPDs.
[26] *Id.*
[27] Section 280.04(2)(e), F.S.
[28] E-mail from the DFS (received December 16, 2013), on file with the Insurance & Banking Subcommittee staff. For example, the Florida Financial Institutions Codes (chs. 655-667, F.S.), define "capital accounts" as "the aggregate value of unimpaired capital stock based on the par value of the shares, plus any unimpaired surplus and undivided profits or retained earnings of a financial institution. For the purposes of determining insolvency or imminent insolvency, the term does not include allowances for loan or lease loss reserves, intangible assets, subordinated debt, deferred tax assets, or similar assets." Section 655.005(1)(d), F.S.
[29] 12 U.S.C. §§ 5412-5413.

in addition to nationally-chartered banks. Also, effective with the first quarterly report of 2012, the Thrift Financial Report is no longer used by savings banks or savings and loans associations.[30] These institutions now file the same Consolidated Reports of Condition and Income (call report) referenced in s. 280.16(6), F.S., that are filed by all insured commercial banks.

The bill adds "state university" to the list of state and local entities that define "governmental unit" in s. 280.02(14), F.S., which comprises the list of entities whose public moneys are entitled to the Act's protection. This creates consistency with the definition of "public deposit," which are the public moneys of enumerated state and local entities, including state universities.[31]

The bill eliminates the definition of "oversight board," due to the bill's repeal of the QPD Oversight Board provision in the Act (s. 280.071, F.S.).

The bill eliminates a clause within the definition of "public deposit" regarding a requirement of banks, savings banks, and savings association to maintain reserves. Reserve requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities, and are determined in accordance with the Federal Reserve's Regulation D.[32] This reserve requirement is no longer needed within the definition of "public deposit," as the Federal Reserve no longer requires depository institutions to maintain reserves against certain types of bank accounts, whether such accounts involve public deposits or not. Since December 27, 1990, the reserve requirement for "nonpersonal time deposits" has been 0%. Nonpersonal time deposits are defined, in part, as "[a] time deposit, including an MMDA or any other savings deposit, representing funds in which any beneficial interest is held by a depositor which is not a natural person."[33] Governmental units are not considered to be natural persons by the Federal Reserve,[34] so a QPD has a 0% reserve requirement for a governmental unit's certificates of deposit ("CD"), savings accounts, or money market deposit accounts ("MMDA"). According to the DFS, eliminating the reserve requirement will provide consistency with the Act's current definition of "public deposit" which includes nonnegotiable CDs, as well as clarity that it includes public moneys held in savings accounts and MMDAs.[35]

Section 2. Public deposits to be secured; clarification of exemption

Current law exempts a number of moneys and public deposits from the requirements and protections of the Act. One exemption involves public deposits "which are fully secured under federal regulations."[36] This exemption was added in 1998 to address public deposit accounts of a Florida governmental unit that was required to be collateralized under both state law and federal regulation. However, public housing authorities are required by the U.S. Department of Housing and Urban Development (HUD) to have their public deposits collateralized with only HUD-approved investments, which generally only allow certain eligible collateral such as U.S. Treasury and agency securities.[37] This has resulted in some QPDs having to collateralize local housing authorities' public deposits under both Florida and federal programs. The "fully secured under federal regulations" language was added in 1998 to provide relief to these QPDs and in anticipation of other federal regulatory agencies adding collateralization requirements. However, this 1998 language has created ambiguity among the industry about whether depositing public funds with any depository institution, whether a QPD or not, with FDIC deposit insurance (a matter of federal regulation)

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[30] Agency Information Collection Activities; Submission for OMB Review; Joint Comment Request, 76 FR 39,981 (July 7, 2011).
[31] Section 280.02(23), F.S.
[32] Board of Governors of the Federal Reserve Requirements, "Reserve Requirements," at http://www.federalreserve.gov/monetarypolicy/reservereq.htm (last accessed December 18, 2013). Regulation D is codified at C.F.R. Title 12, Chapter II, Subchapter A, Part 204.
[33] *Id.* See also 12 C.F.R. §204.2(f).
[34] Regulation D defines "natural person" as either an individual or a sole proprietorship, and does not include a corporation owned by an individual, a partnership or other association. 12 C.F.R. §204.2(g).
[35] E-mail from the DFS (received December 4, 2013), on file with the Insurance & Banking Subcommittee staff.
[36] Section 280.03(3)(e), F.S.
[37] *See* HUD Public and Indian Housing Notice 02-13; *see also* Notice PIH 96-33.

was sufficient to qualify for this exemption. Accordingly, the bill adds the phrase "pursuant to a collateral requirement" to clarify the actual intent of the exemption.

Section 3. Reduction of pledge levels

The bill reduces the numerical parameters for the current 125% and 200% pledge levels to 110% and 150%, respectively, in s. 280.04, F.S. The DFS has indicated that if these adjustments were adopted, Florida would still have the highest pledge level (150%) among the states with centrally administered public deposit programs,[38] thus ensuring the safety of public deposits.

Sections 4 and 6. Powers and duties of the CFO; repeal of the QPD Oversight Board.

The bill repeals s. 280.071, F.S., regarding the QPD Oversight Board, and s. 280.05, F.S., which gives the CFO authority over the Board.

Section 5. Grounds for suspension or disqualification of a QPD

The bill amends s. 280.051, F.S., to make conforming changes to the current definition of capital accounts (which the bill renames as "tangible equity capital"), and clarifies that failure to execute a "collateral control agreement" prior to the use of a custodian is a ground for suspension or disqualification. Currently, this statute and DFS rule use the term "public depository pledge agreement,"[39] but the DFS renamed this form to "Collateral Control Agreement" in 2001.[40]

Sections 7 and 8. Defaulted or insolvent QPDs

Current law requires the CFO to notify all public depositors (who have complied with s. 280.17, F.S.) in the event of any QPD's default or insolvency. The bill provides an exception to this notice requirement in s. 280.085, F.S., when a defaulting or insolvent QPD's public deposits are acquired by another bank, savings bank, or savings association. This is because the vast majority of bank failures result in another insured depository institution acquiring all deposited funds (insured and uninsured) and thus eliminates any risk of loss to depositors.[41]

Current law provides that in the event that a QPD is merged into, acquired by, or consolidated with a non-QPD bank, savings bank, or savings association, the resulting institution automatically becomes a QPD and assumes the former institution's contingent liability and public deposits, and must provide notice to the CFO regarding its decision to remain or withdraw in the program within specified time limits.[42] The bill provides that any bank, savings bank, or savings association that acquires some or all of a defaulted or insolvent QPD is also subject to this requirement. This language provides clarity that any non-QPD bank that acquires a failed QPD is automatically be subject to the Act

Section 9. Withdrawal from the public deposits program

The bill corrects a cross-reference in s. 280.11(3), F.S. (regarding a QPD's mandated withdrawal from the public deposits program), which currently references a non-existent s. 280.05(1)(b), F.S. The bill provides

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[38] E-mail from the DFS (received November 20, 2013), on file with the Insurance & Banking Subcommittee staff.
[39] Rule 69C-2.009(1)(b), Fla. Admin. Code; Public Depository Pledge Agreement - Form DI4-1001 (revised March 1997).
[40] Form DFS-J1-1001, Revised June 2001. DFS Collateral Management, at https://apps8.fldfs.com/CAP_Web/PublicDeposits/intro_definitions.aspx (last accessed Dec. 9, 2013).
[41] E-mail from the DFS (received December 16, 2013), on file with the Insurance & Banking Subcommittee staff. According to information provided by the DFS (received November 30, 2013), 32 QPDs have failed since February 2009. However, all of them have been acquired by other institutions. Once any failed bank is formally closed by its primary bank regulator and resolved by the Federal Deposit Insurance Corporation (acting as a receiver or a conservator), the FDIC conducts an inventory and evaluation of the failed bank to determine appropriate resolution options to offer to potential bidders. For more information on bank failures and resolution structures, see "Anatomy of a Bank Failure," by Ragalevsky and Ricardi, *The Banking Law Journal* (Dec. 2009).
[42] Section 280.10, F.S.

that a QPD which is required to withdraw from the public deposits program pursuant to s. 280.05(17), F.S., which will refer to the CFO's authority to suspend or disqualify any QPD in violation of the Act.[43]

Section 10. Reporting requirements of QPDs

The bill also removes the requirement in s. 280.16(1)(e), F.S., that QPDs submit their call reports to the CFO. This is because depository institutions are already required under federal law to submit their call reports to the Federal Financial Institutions Examination Council (FFIEC)[44], and all call reports are already publicly available through the FFIEC's website.[45]

Section 11. Requirements for public depositors; notice to public depositors and governmental units; loss of protection

The bill streamlines certain annual reporting requirements for public depositors. Currently, public depositors are required to confirm certain public deposit information (account numbers, federal employer identification number, etc.) with the CFO. The bill eliminates the requirement in s. 280.17(5), F.S., for public depositors to obtain confirmation directly from their QPDs for purposes of preparing annual reports to the CFO.

Currently, every public depositor is required to submit to the CFO an annual public deposit identification and deposit form[46] as a condition for protection from loss to public depositors.[47] However, in the event of a QPD's default or insolvency, it is already required to coordinate with the Office of Financial Regulation (OFR) or the receiver of the QPD (generally, the FDIC) to "ascertain the amount of funds of each public depositor on deposit at such depository and the amount of deposit insurance applicable to such deposits."[48] Additionally, the Act provides that the CFO must validate claims on public deposit accounts. Therefore, the DFS is already required to validate claims of loss by coordinating with OFR and/or the FDIC, independent of the existence or utilization by a public depositor of the ID and Acknowledgment form.

The current requirement for the form may lead to situations where a governmental unit is deprived of the program's protection, simply due to an inadvertent oversight to file this form or may have otherwise reported the information to the DFS outside of the form. Accordingly, the bill provides that this ministerial reporting requirement for public depositors, while still required, should not prove fatal to a public depositor if the QPD has otherwise classified, reported, and collateralized the public deposit account.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

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[43] Currently, this provision is s. 280.05(20), F.S., but is renumbered to s. 280.05(17) by the bill.

[44] 12 U.S.C. § 324 (State member banks); 12 U.S.C. §1817 (State nonmember banks); 12 U.S.C. §161 (National banks); and 12 U.S.C. §1464 (Savings associations). The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau, along with advisory state agency representatives. "About the FFIEC," at http://www.ffiec.gov/about.htm (last accessed December 18, 2013).

[45] The FFIEC Central Data Repository's Public Data Distribution website, at https://cdr.ffiec.gov/public/ (last accessed Dec. 9, 2013).

[46] Section 280.17(6), F.S. This form has been adopted by DFS rule. Form DFS-J1-1295(June 1998).

[47] Section 280.17(8), F.S.

[48] Section 280.08(2), F.S.

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill's reduction of the two highest collateral pledge levels may have a positive impact on small and moderate sized QPDs. Additionally, the bill's clarifications of reporting and other compliance requirements may have an indeterminate positive effect on the private sector.

D. FISCAL COMMENTS:

The DFS reports that the bill will not have any fiscal impact, and programming changes to their Collateral Administration Program computer system should be absorbed with existing information technology resources.[49]

Public depositors that fail to comply with the reporting requirements for identification of their moneys as public deposits would not lose their protection from loss, if a failed qualified public depository had nonetheless classified, reported, and collateralized the money as public deposits. Local governments and other units of Florida government that participate in the public deposits program would no longer be required to request bank account confirmation data from their QPDs. The estimated administrative cost of such requests is negligible.

[49] E-mail from the DFS (received December 16, 2013), on file with the Insurance & Banking Subcommittee staff.