**The Florida Senate**

# BILL ANALYSIS AND FISCAL IMPACT STATEMENT

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

Prepared By: The Professional Staff of the Committee on Appropriations

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| BILL: | CS/SB 564 |
| INTRODUCER: | Banking and Insurance Committee and Senator Richter |
| SUBJECT: | Security for Public Deposits |
| DATE: | April 10, 2014 |
| REVISED: | |

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|---|---|---|---|---|
| 1. | Johnson | Knudson | BI | **Fav/CS** |
| 2. | Betta | DeLoach | AGG | **Favorable** |
| 3. | Betta | Kynoch | AP | **Favorable** |

**Please see Section IX. for Additional Information:**

COMMITTEE SUBSTITUTE - Technical Changes

## I. Summary:


CS/SB 564 amends the Florida Security for Public Deposits Act (act), which authorizes local and state governmental units (public depositors) to place public deposits in qualified public depositories (QPD). 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. The QPDs must secure public deposits in accordance with the act and the collateral requirements and pledging levels established rule of the Chief Financial Officer. The bill provides the following changes to the act:

- Reduces and streamlines reporting requirements.
- Reduces the two highest collateral-pledging levels for public deposits, which would ease the regulatory burden for small and moderate sized QPDs.
- Provides protection from loss for a public depositor that fails to comply with a ministerial reporting requirement if the defaulting or insolvent QPD had classified, reported, and collateralized their account as public deposits.
- Repeals the Qualified Public Depository Oversight Board which has been inactive since holding an initial meeting in December 2001.
- Revises and updates terminology and practices.

The bill has no fiscal impact to state funds.

## II. Present Situation:

### Public Deposit Program

The Florida Security for Public Deposits Act (act) provides the framework for the protection of public deposits.[1] Under the act, the Chief Financial Officer (CFO)[2] of the State of Florida is responsible for designating financial institutions as qualified public depositories (QPD).[3] Unless exempted by the act, all public deposits must be placed in a QPD.[4] Public deposits include, but are not limited to, time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposit.[5] To provide protection of public deposits, each QPD is required to pledge collateral at a level commensurate with the amount of public deposits held and a measure of its financial stability, as determined by the CFO. Eligible collateral includes securities, Federal Home Loan Bank letters of credit, and cash.[6]

On a monthly basis, the QPDs provide the CFO with reports regarding the public deposits held.[7] The CFO determines the financial stability of each QPD based on nationally recognized financial rating services information and established performance guidelines. The most financially stable depositories, as determined through these measures, are required to pledge collateral equal to 25 percent of the public deposits held.[8] The CFO has the authority to require a 125 percent collateral-pledge 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. The least financially stable QPDs must 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 percent of public deposits held into an account designated by the CFO and restrict its public deposits. The Department of Financial Services (DFS) rules set forth collateral requirements and numerical parameters (a quarterly average financial ranking scale of 0 to 100) for the entry, withdrawal, and collateral pledging levels.[9]

The CFO may demand payment under a letter of credit or direct a custodian to deposit or transfer collateral and proceeds of securities not previously credited upon the occurrence of one or more triggering events, such as a QPD's insolvency or a determination by the CFO that an immediate danger to public health, safety, or welfare exists.[10] When the CFO has determined that a default or insolvency has occurred, the CFO must notify all public depositors and provide instructions

[1] Chapter 280, F.S.
[2] The CFO is the agency head of the Department of Financial Services (s. 20.121, F.S.)
[3] A qualified public depository is a bank, savings bank, or savings association that is organized under the laws of the United States or any state or territory of the United States, has a principal place of business or branch office in this state authorized to receive deposits, has federally-insured deposits, has procedures and practices that accurately report and collateralize public deposits, meets the requirements of the act, and has been designated as a qualified public depository by the CFO. (see s. 280.02(26), F.S.)
[4] Section 280.03, F.S.
[5] Section 280.02(23), F.S
[6] Section 280.13, F.S.
[7] Section 280.16, F.S.
[8] Section 280.04, F.S.
[9] See also Rules 69C-2.006 and 69C-2.024, F.A.C.
[10] For a complete list of events that may trigger a demand of payment, see s. 280.041(6), F.S.

on the filing of claims.[11] The losses are satisfied initially through any applicable deposit insurance and then through demanding payment under letters of credit or the sale of collateral pledged or deposited by the defaulting QPD. The CFO covers any remaining losses by assessment against other QPDs.

**Recordkeeping and Reporting Requirements**

Public depositors and QPDs are subject to recordkeeping and reporting requirements. In addition to the monthly report to the CFO regarding deposits held, each QPD must submit federal Call or Thrift Financial Reports and an annual report to the CFO. Each QPD is also required to provide each public depositor specified information to allow a reconciliation of account information.[12]

For each public deposit account, a public depositor is required to execute a form prescribed by the CFO for identification of each public deposit account and obtain acknowledgment of receipt on the form from the QPD at the inception of the account. The public depositor is required to maintain the current public deposit identification and acknowledgment form because the form is mandatory for filing a claim with the CFO upon default or insolvency of a QPD. If a public depositor does not comply with the requirements of governmental units on each public deposit account, the protection form loss provided in s. 280.18, Florida Statutes, is not effective as to that public deposit account. Each public depositor must confirm annually that public deposit information has been provided by each qualified public depository and reconciles with the public depositor's records.[13]

**Qualified Public Depository Oversight Board**

In 2001, the Legislature created the Qualified Public Depository Oversight Board (board).[14] The purpose of the six-member board is to represent the interests of all QPDs in safeguarding the integrity of the program and preventing loss assessments that could be imposed upon the default or insolvency of a QPD.[15] The CFO is required to initiate the selection of board representation on July 31 of each year and as vacancies occur.[16]

## III. Effect of Proposed Changes:

**Definitions**

The bill removes the word "immediately" from the definition of "alternative participation agreement" in s. 280.02(2), 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

[11] Section 280.085, F.S.
[12] Section 280.16(1), F.S.
[13] Section 280.17(5), F.S.
[14] Chapter 2001-230, Laws of Fla.
[15] Section 280.071, F.S.
[16] After categorizing QPDs into three groups according to asset size, the CFO is to identify two QPDs in each grouping that have the greatest shares of contingent liability and notify the six identified QPDs. Each of the six QPDs is to provide to the CFO within 30 days a board member and alternate selection, or if declined, the CFO must notify the Florida Bankers Association, which shall select a member and alternate.

months or longer to withdraw from the program depending on the time needed for certificates of deposits to mature or other contractually required banking services for a public depositor. The CFO also publishes notice in the Florida Administrative Register 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.[17]

The bill amends the definition of the term, "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. 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. [18] However, the most financially stable QPDs, while only required to pledge 25 percent of their "average monthly balance" of public deposits, must include deposit insurance in their collateral calculation. Accordingly, this requirement may negatively affect QPDs with public deposits that are covered by Federal Deposit Insurance Corporation (FDIC) deposit insurance.[19] 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 percent, instead of the act's minimum collateral requirement of $100,000.[20]

The bill amends the term, "capital account," in s. 280.02(6), F.S., to add "tangible equity capital" as an alternative term to reflect the current bank regulatory environment more accurately. 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 the term, "capital account," to remove a reference to the Thrift Financial Report, which was filed previously 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.[21] Subsequently, the Office of the Comptroller of the Currency has assumed primary federal regulatory responsibility over savings banks and savings and loans associations, as well as nationally chartered banks. In addition, effective with the first quarterly report of 2012, savings banks or savings and loans associations no longer use the Thrift Financial Report.[22] Instead, these institutions file the same Consolidated Reports of Condition and Income (call report) referenced in s. 280.16(6), F.S., and filed by all insured commercial banks.

[17] Section 280.11, F.S.
[18] See the act's definition of "average daily balance" in s. 280.02(3), F.S., which excludes deposit insurance in determining collateral amounts at the 125 percent pledging level for newer or less financially stable QPDs.
[19] The FDIC insurance covers all deposit accounts, including checking and savings accounts, money market deposit accounts and certificates of deposit. The standard insurance amount is $250,000 per depositor, per insured bank, for each account ownership category. The FDIC 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 any "political subdivision" of the public unit.
[20] Section 280.04(2)(e), F.S.
[21] 12 U.S.C. s 5412-5413.
[22] Agency Information Collection Activities; Submission for OMB Review; Joint Comment Request, 76 FR 39,981 (July 7, 2011).

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 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 percent. Nonpersonal time deposits are defined, in part, as "[a] time deposit, including a money market deposit accounts (MMDA) or any other savings deposit, representing funds in which any beneficial interest is held by a depositor which is not a natural person."[23] Governmental units are not considered to be natural persons by the Federal Reserve, [24] so a QPD has a 0 percent reserve requirement for a governmental unit's certificates of deposit (CD), savings accounts, or MMDA. The elimination of the reserve requirement provides 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.

**Exemptions from Chapter 280, F.S.**

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."[25] In 1998, this exemption was added to address public deposit accounts of a Florida governmental unit that was required to be collateralized under both state law and federal regulation.[26] However, the U.S. Department of Housing and Urban Development (HUD) requires public housing authorities to collateralize their public deposits with HUD-approved investments, which generally only allow certain eligible collateral such as U.S. Treasury and agency securities.[27] This has resulted in some QPDs having to collateralize local housing authorities' public deposits under both Florida and federal programs. This 1998 provision 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) was sufficient to qualify for this exemption. Accordingly, the DFS has expressed that adding the phrase "pursuant to a collateral requirement" would provide clarification as to the actual intent of the exemption.

**Collateral Pledge Levels**

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

[23] See also 12 C.F.R. s. 204.2(f).
[24] Board of Governors of the Federal Reserve Requirements, 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).
[25] Section 280.03(3)(e), F.S.
[26] Chapter 1998-409, Laws of Fla.
[27] See HUD Public and Indian Housing Notice 02-13; see also Notice PIH 96-33.

public deposits.[28] The DFS recommendation to reduce the program's two highest collateral pledging levels (125 percent and 150 percent) is in response to concerns of the Office of Financial Regulation (OFR) and a number of small and moderate-sized QPDs impacted by these two pledge levels. According to the DFS, the OFR has indicated that the 200 percent pledge level may magnify the difficulties for a struggling bank by either forcing it to return some or all public deposits to its governmental unit customers or by adversely impacting a bank's liquidity. Additionally, the experience of the DFS with QPD failures throughout the public deposit program's history has been that the collateral valuations for failed QPDs has not been impacted by such failures themselves, and that there have not been material, concurrent collateral valuation declines due to any broader financial market disruptions.

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 grounds for suspension or disqualification. Currently, this section and the DFS rule use the term "public depository pledge agreement,"[29] but the DFS renamed this form to "Collateral Control Agreement" in 2001.[30]

Current law requires the CFO to notify all public depositors (who have complied with s. 280.17, F.S.) in the event of a QPD's default or insolvency. The bill provides an exception to this notice requirement in s. 280.085, F.S., if another bank, savings bank, or savings association acquires a defaulting or insolvent QPD's public deposits.

The bill also provides that any bank, savings bank, or savings association that acquires some or all of a defaulted or insolvent QPD is subject to s. 280.10(1), F.S. This change provides certainty that any non-QPD bank that acquires a failed QPD would automatically be subject to the act. 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.

**Reporting Requirements**

The bill also removes the call reporting requirement in s. 280.16(1)(e), F.S. Currently, depository institutions are required under federal law to submit their call reports to the Federal Financial

[28] Email from Logan McFaddin, Director of Legislative Affairs, Department of Financial Services, (February 3, 2014) (on file with Senate Committee on Banking and Insurance).
[29] Rule 69C-2.009(1)(b), F.A.C.; Public Depository Pledge Agreement - Form DI4-1001 (revised March 1997).
[30] Form DFS-J1-1001, Revised June 2001. DFS Collateral Management, at https://apps8.fldfs.com/CAP_Web/PublicDeposits/intro_definitions.aspx (last visited February 7, 2014).

Institutions Examination Council (FFIEC)[31], and these reports are available at the FFIEC's website.[32]

The bill streamlines certain annual reporting requirements for public depositors. 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.

The bill revises s. 280.17, F.S., by creating an exception to the requirements a public depositor must comply with to maintain protection from loss due to a failed QPD. The bill allows a public depositor that fails to comply with form reporting requirements to be eligible for protection from loss from a failed QPD if the QPD classified, reported, and collateralized the account as public deposits. Currently, public depositors are required to submit annually to the CFO a public deposit identification and deposit form, which s. 280.17(8), F.S., currently requires as a condition for protection from loss to public depositors. In the event of a QPD's default or insolvency, the DFS is required to coordinate with the 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."[33] Additionally, the act provides that the CFO must validate claims on public deposits accounts. However, the current form requirement may lead to situations where a governmental unit is denied access to the program's protection simply due to an inadvertent form filing oversight.

**Qualified Public Depository Oversight Board**

The bill repeals the Qualified Public Depository Oversight Board and provides technical, conforming changes relating to the repeal. According to a recent report issued by the Auditor General, the board has been largely inactive since its creation.[34] The report notes that while a board was appointed and an initial meeting was held in December 2001, the DFS 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.

The effective date of the bill is July 1, 2014.

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[31] 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 (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller, of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB), along with advisory state agency representatives.

[32] The FFIEC Central Data Repository's Public Data Distribution Website at https://cdr.ffiec.gov/public/ (last visited February 8, 2014).

[33] Section 280.08, F.S.

[34] Office of the Auditor General, *Operational Audit of the Department of Financial Services Public Deposit Program,* Report No. 2010-049 (Nov. 2009).

## IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

## V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under CS/SB 564, the reduction of the two highest collateral pledge levels may have a positive impact on small and moderate sized qualified-public depositories. Additionally, the streamlining and clarification of reporting and other compliance requirements may result in an indeterminate, minor reduction in administrative costs.

C. Government Sector Impact:

Public depositors that fail to comply with the reporting requirements for identification of their money 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 are subject to the act would no longer be required to request bank account confirmation data from their qualified public depositories. The estimated administrative cost of such requests is negligible.

## VI. Technical Deficiencies:

None.

## VII. Related Issues:

None.

## VIII. Statutes Affected:

This bill substantially amends the following sections of the Florida Statutes: 280.02, 280.03, 280.04, 280.05, 280.051, 280.085, 280.10, 280.11, 280.16, and 280.17.

This bill repeals section 280.071 of the Florida Statutes.

## IX. Additional Information:

A. Committee Substitute – Statement of Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS by Banking and Insurance on February 11, 2014:**
The CS provides technical changes.

B. Amendments:

None.