TREASURY AND PUBLIC DEPOSITS

UNC School of Government

Cash Management and Investment of Public Funds

October 22, 2015

Chandler Francis, CTP
Treasury Manager
Raleigh, NC

TOPICS TO COVER

- Collateralization of Public Deposits
- Safekeeping of Securities
- Electronic Payments
- Fraud

COLLATERALIZATION OF PUBLIC DEPOSITS

Agenda

- Definitions
- Statutory Requirements
- Required Participants
- FDIC Insurance
- Methods of Collateralization
- Monitoring and Reporting
- Responsibilities
- Collateralization and Capitalization
- Resources

What is Collateralization?

- Financial institutions in North Carolina serving as official depositories for public funds, as well as the public depositors of those funds, are subject to statutory and regulatory requirements regarding the collateralization of certain public deposits.

Definitions

- **Public Depositor/ Unit**
  - State, County, Municipality, or Political Subdivision of the Unit, or an Indian Tribe
- **Public Deposits/ Funds**
  - Funds Deposited into accounts in the name of the Public Unit
- **Official Custodian**
  - Officer, employee, or agent of the Public Unit having custody of public funds and lawfully depositing these funds in an insured institution.
  - Plenary authority over funds (possession as well as authority to open accounts, make deposits and make withdrawals)

Statutory and Regulatory Requirements

- NC General Statutes authorize and require the State Treasurer & the Local Government Commission to prescribe such rules as may be necessary to regulate the collateralization of certain public deposits in North Carolina banks and savings institutions.

- These rules are codified in the North Carolina Administrative Code – Title 20, Chapter 7.

Other Requirements

- US Code 12 C.F.R. 330.15 governs the insurance coverage of public unit accounts

- Statement No. 40 of the Governmental Standards Board requires disclosure of:

  - Any conditions of under-collateralization, as of balance sheet date

  - Any significant violations of collateral requirements

Statutory References and Participants

The State Treasurer	G.S. 147-69 & 79
The NC State Bar	G.S. 84-34.1
University Medical Schools	G.S. 116-6.1(g)(7) & 36.1(h)
Local School Admin Units	G.S. 115C-443 and 444
Community Colleges	G.S. 115D-55(b) & 56(b)
Local ABC Boards	G.S. 18B-702(d)
Local Governmental Units	G.S. 159-30 and 31

- participation and inclusion in collateralization must be referenced in General Statutes (i.e. charter schools)

Local Governmental Units

- Cities and Towns
- Counties
- Public and Regional Hospitals
- Public Airports
- Public Libraries
- Public Housing Authorities**
- Area Mental Health Centers
- District Health Departments
- District Water and Sewer Authorities
- Councils of Government

Clerks of Superior Court

- Funds are considered public deposits
- Not subject to collateralization policies of Department of State Treasurer
- Subject to collateralization rules administered by Administrative Office of the Courts

FDIC Insurance for *Public Units*

- $250,000 coverage on combined Demand Deposits per custodian
  - Non-interest bearing
  - INTEREST BEARING (July 2011)
- $250,000 coverage on combined Time and Savings Deposits per custodian
  - NOW Accounts
  - Money Markets
  - Certificates of Deposit
- Deposits must be maintained in a **NC bank***
  - *for full "dual" coverage
- Funds over these totals must be collateralized

Custodian

- Government Deposits are designated and insured "by custodian" rather than "by depositor"
- Defined as:
  - Officer, employee, or agent of a public unit having official custody of public funds and lawfully depositing the funds in an insured institution.
- Each custodian receives the coverage (unless both are required for the transaction / dual signatures)

*From www.fdic.gov/deposit/deposits/FactSheet.html

Pledging Deposits

- Dedicated Method
  - Public Housing Agencies
  - County Clerks of Court
- Pooling Method
- Selection of Method is Depository's Choice

Dedicated Method

- Securities pledged to the agency or unit
- Separate escrow accounts for each public depositor
- Agency must monitor market values
- Less involvement from State Treasurer’s office

Pooling Method

- Deposits are secured through a single escrow account
- Established with the State Treasurer
- Works best for depositories with large number of public deposits
- Limits dealings to DST for collateralization process

Monitoring Responsibilities

- Dedicated Method
  - Public Depositor
- Pooling Method
  - State Treasurer
  - Financial Institutions Reporting Requirements
  - State and Local Government List

Pledging Collateral

- FDIC requires a security agreement
- Escrow Agent Agreements
  - Federal Reserve Bank
  - Federal Home Loan Bank
  - Any commercial bank having authority to conduct trust business

Calculating Requirements

- Dedicated Method
  - Based upon actual balances
  - Both time and demand deposits
- Pooling Method
  - Time deposits based upon actual balances
  - Demand deposits based upon approved averaging method
  - State Treasurer may require market value to be 110% for risk factors

Eligible Collateral

- U.S. Treasury securities
- U.S. Agency securities (SLMA, FHLB)
- Mortgage backed securities(FNMA, GMNA, FHLMC)
- Obligations of the State of NC
- Bonds or notes of any NC local government or public authority
- Surety Bonds (few if any are offered)

NOW YOU'VE HEARD THE FACTS…

JUST *WHO* IS MINDING THE STORE?

FDIC

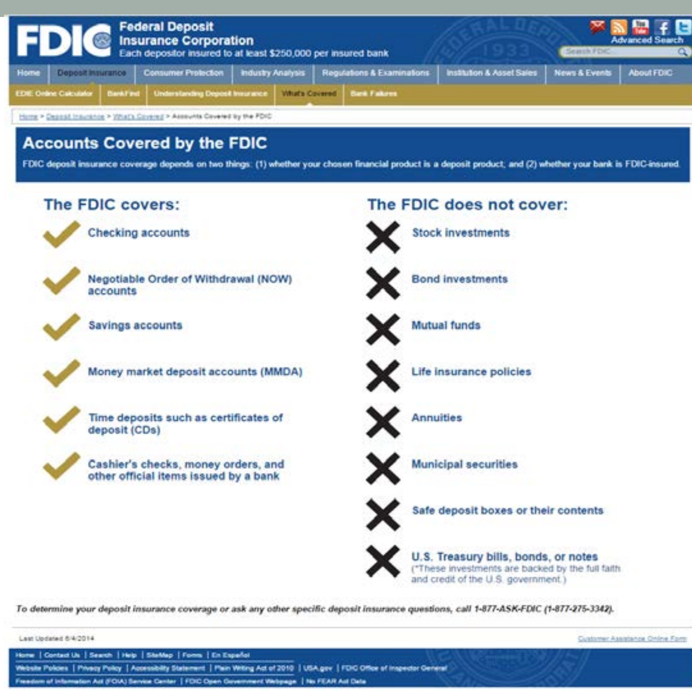
- Federal Deposit Insurance Corporation
- Independent federal agency
- Created in 1933
- Never had losses of **insured** deposits

FDIC

- $250,000 per custodian, per insured bank
- Government Accounts are allowed separate insurance coverage for demand deposit and time deposit accounts
- Full faith and credit of US Government

FDIC

- US Code establishing collateralization guidelines
- 12 C.F.R. 330.15
- FDIC ruling specifically delegates the monitoring of collateral requirements to the State level



Responsibilities of Banks

- INV 96 Quarterly Report on Public Deposits
- INV 99 Selected Financial Data Report (ffiec)
- INV 98 Annual/ Quarterly Report on Collateral for Public Deposits
- INV 97 Report on Public Deposits

  - All forms are found on the State Treasurer's website, under Collateralization of Public Deposits (www.nctreasurer.com)

Responsibilities of Banks

- Monitor values of collateral (pooling method)
- File collateralization reports with State Treasurer at least quarterly, if not monthly
- Establish and maintain the escrow account
- Pledge additional collateral based upon balances of public depositors

Responsibilities of Public Depositors

- Ensure your bank knows your deposits are **PUBLIC**
- Do not be seduced by the prospect of not being coded properly in order to receive higher rates
- If your account is not coded as public, those funds will not be covered by additional collateralization required

Responsibilities of Public Depositors

- Complete the **INV-91** and submit it timely to the depository based upon June 30 data.
  - Sooner than later
  - Banks must submit by August 15
- Submit **LGC-203** July 25 and January 25 (6/30 and 12/31)

Responsibilities of Collateral Desk

- Verify escrow accounts
- Receive and compile quarterly reports of collateral position
- Monitor collateral positions and request action on addition of security or additional reporting
- Respond to audit requests for collateral positions

Responsibilities of Collateral Desk

- Respond to requests to substitute or release collateral
- Maintain files of all required reports
- Maintain list of all pooling banks
- Communicate with escrow agents to confirm that securities are pledged

Collateralization and Capitalization

- North Carolina requires 100% collateralization of public deposits
- Not all states have this requirement
- Other states look to other factors to supplement collateralization
- Sliding scales

Capitalization

- International framework on how banks and depository institutions handle their capital (Basel Accords)
  - Now Basel III
  - Bank for International Standards (BIS)
- ***Capital Ratio*** is percentage of a bank's capital to its risk-weighted gains
- United States governed by Federal Reserve Bank (FRB)
- Evaluate capital adequacy based upon perceived credit risk with assets on balance sheet

Capital Requirements

- Tier 1 capital
- Tier 2 capital
- Reported quarterly on the Call Report or Thrift Financial Report (www.ffiec.gov)
  - Federal Financial Institution Examination Council

Capital Requirements

- Tier 1 Capital Ratio
  - =Tier 1 capital / Risk adjusted assets>= 6%
- Total Capital (Tier 1 and 2) Ratio
  - =Total Capital (1 +2) / Risk adjusted assets>=8%
    - Tier 2 Capital Ration must be 2% or higher
    - Total Capital Changed from 10% as of Basel III)
- Leverage Ratio
  - Tier 1 Capital / Average total consolidated assets
  - Strong Bank Holding Companies required >=3%
    - BOPEC
  - All others >=4%

Bank Actions

- Banks are under scrutiny
- Increased monitoring
  - NC Commissioner of Banks
  - Comptroller of the Currency
  - Office of Thrift Supervision (part of COC)
- FDIC
- FFIEC Call Reports

Bank Review

- NC DST Review
  - Collateralization
    - Strongest protection for public deposits
  - Review WHY collateralization is low
  - Contact bank for more information
  - Review orders issued by FDIC and NCCOB
  - Capitalization
    - Indicator of financial strength, but could be driven by other factors

Bank Failure

- Two possible scenarios
  - Bank taken over by another institution
  - Close without purchase

- North Carolina -- 8 failures since 2009

- All were re-opened under new ownership

Bank Failure

- In the event your bank fails
  - Regulators (esp. in NC) monitor and watch financials
  - Read the paper/watch the news
  - FDIC website (www.fdic.gov)

Bank Failure

- FDIC coverage
  - Pay depositors
  - Creditors
  - Uninsured balances

- Collateralization/ Pledged Securities
  - In the event of bank failure, the FDIC will honor the collateral agreement if it is valid and enforceable.
  - Banks work with escrow agents (pooling) for sales

What Should You Do?

- Keep in contact with State Treasurer's Office
  - Banking Operations
  - State and Local Government

- Talk to your bank

- Make sure your deposits are adequately secured

- Read the documents if there is an "action"

Monitoring Banks

- NCDST Collateralization Review
- External Bank Review sites
  - Take at face value
  - www.bankrate.com
  - www.bauerfinancial.com
- Federal Financial Institutions Examination Council
  - www.ffiec.gov
  - Cross-check bank's quarterly call report data

Resources

- NC Department of State Treasurer
  - Collateralization of Public Deposits Handbook
  - www.nctreasurer.com/fod/Pages/Collateralization.aspx
- Government Financial Officers Association– Best Practices
  - www.gfoa.org
- FDIC website
  - www.fdic.gov
  - www.myfdicinsurance.gov
- Federal Reserve website
  - www.federalreserve.gov

SAFEKEEPING OF SECURITIES

Safekeeping of Securities

- The storage of investment assets on behalf of a client
- Protect and control against fraud by arranging for a 3rd party to provide this service– a firm other than the one who sold the Unit the investment to provide for the transfer and safekeeping
- Financial firms should not serve as both broker-dealer and custodian

Safekeeping of Securities

- Safekeeping represents a financial institution's obligation to act on behalf of the owner under the owner's control
- Custody is more of a control position and does not normally take place in the public unit's depository bank
- Custodians typically larger and reputable banks or brokerage firms

Safekeeping of Securities

- Asset held in electronic or physical form
- Reduces the risk of loss or theft
- Transparency
- Legal review
- GFOA Guidance

LUNCH BREAK

ELECTRONIC PAYMENTS

Agenda

- Importance and History of Checks
- What are the payment options?
- What are the innovations and trends?
- How does an organization decide what and how to use?

When were checks first used?

- 321-185 BC In India during the Mauryan period, a commercial instrument called *adesha* ordered a banker to pay the money of the note to a third person.

When were checks first used?

- 1118 to 1307 AD Knights Templar introduced a cheque system for pilgrims travelling to the Holy Land or across Europe.

When were checks first used?

- 1717 Bank of England pioneered use of a pre-printed form printed on "cheque paper" to prevent fraud. Customers obtained a numbered form from a cashier. Once written, the cheque was brought back to the bank for settlement.

When were checks first used?

- 1811 Commercial Bank of Scotland was first bank to personalize customers' cheques.

Checks aren't going away…

But the volume of their usage is decreasing

57%	Payments made by check in the typical organization today
74%	Payments made by check in 2007
80%	Percentage of companies wanting to transition their B2B payments from paper to electronic

Source: AFP Electronic Payment Survey

Facts About Checks

- Despite their decline in usage, in 2012 (Fed Reserve triennial study) 4.5 billion B2B checks were issued
- Average amount of transaction increased to $1,420
- Sending a check can be up to 10 times more expensive than sending an ACH
- Median cost of sending a paper check is $3– can be as high at $7 (once you factor in personnel time to issue check, postal costs, time for reconciliation, paper cost)

2015 AFP Payments Cost Benchmarking Survey

What are the payment options?

Method	Funding Source	Speed	B2C/B2B
Wire	Company account	Immediate and final	Both
ACH	Company account	Next day	Both
Prepaid Card	Company account	Immediate or next day	B2C
Commercial Card	Company credit line	Same day	B2B
Check	Company account	Several days	Both

Wires

- Templated and free-form
- Real-time Processing– Single Transaction
- Same day settlement
- Domestic and International
- Higher cost
- Normally for larger transactions
- Bank is “fully aware” and notified of transaction

Automated Clearing House (ACH)

- Business: CTX, CCD
- Consumer: PPD
- Typically 2-3 day settlement
- Less expensive
- Used for frequent and recurring (payroll)
- Batch transactions – typically more than 1 at a time

Automated Clearing House (ACH)

- Check Conversion / eCheck involves converting checks to ACH for settlement
- Primarily Domestic
  - International is possible but involves additional steps
- Same Day ACH is now available
  - Higher costs for same day
  - Potentially higher risk
  - Tighter deadlines during the day

Automated Clearing House (ACH)

- ACH rules allow you three (3) times to collect if you are drafting an account and funds are not available
- Transaction between the two sending/ receiving parties
- Respond to NOC (notifications of change)
  - You will receive notification if the account number or ABA is wrong
  - You must fix it after you receive the NOC or you will be charged
  - #1 Rules violation

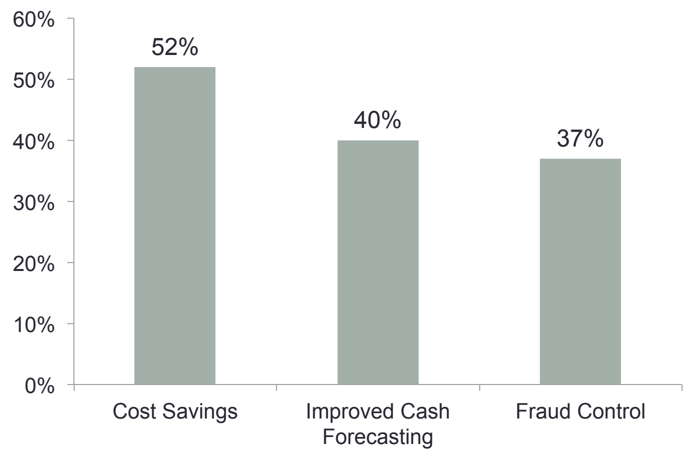
Pre-Paid Card

- Non reloadable vs. reloadable
- With or without cash access
- Pre-denominated
- Instant issue
- Temporary employees, first/ last check, incentives, one time payments, some entitlement programs (WIC, UI, Child Support)

Commercial Card/ P-card

- Purchasing/ T&E/ Procurement/ Expense
- Declining balance
- Virtual accounts
- Straight thru processing and single use accounts

How companies that use electronic payments benefit



What are the trends ?

by disbursement type

- **Payroll** – Employers are **moving to electronic pay**, and many have set the goal to be 100% with a combination of ACH and prepaid cards
- **AP** – Companies want to **manage working capital** and, in addition to ACH, many are exploring commercial cards
- **B2C disbursements** – **ACH where possible**, many still on checks and a growing segment moving to prepaid cards

What are the trends ?

by payment type

- **ACH credit** – payments volume grew **3.6% year-over-year** fueled by continued increases in both consumer and B2B use
- **Prepaid card** – loads in US will have compound annual growth rate (CAGR) of 21% through 2015, reaching **$388.7 billion**
- **Commercial card** – is expected to grow 10% each year through 2016. Estimated spend in North America should increase from $212 billion in 2012 to **$290 billion** by 2016

Sources: NACHA Members Memo - November 26, 2012 - Q3 2012 ACH Network Statistics; Mercator US Prepaid Cards Market Forecasts, October 2012 ; 2012 RPMG Purchasing Card Benchmark Survey Results

How Do You Decide?

It depends…

Primary difference is AP – Companies with a larger supplier base may see more benefits from the use of ACH and commercial cards with supplier on-boarding processes

The **type** of disbursement is more important

- **Who** is your company paying?
- Are the disbursements **recurring or one-time**?
- **How fast** do you need the funds to get to the payee?
- What are the **disbursement amounts**?
- What are the **disbursements for**?

How Do You Decide?

- Weigh benefits of cost savings vs reconciliation
- Consider staff experience
- Willingness of vendors to receive electronically
- Determine what amount of Payables can you send electronically
- Payment Optimization study
- Reduce paper but more importantly cost

REDUCING FRAUD

Businesses face fraud risk from external and internal sources

87% **Fraud instances where checks were the target**[1]

71% **Companies hit by online fraud**[2]

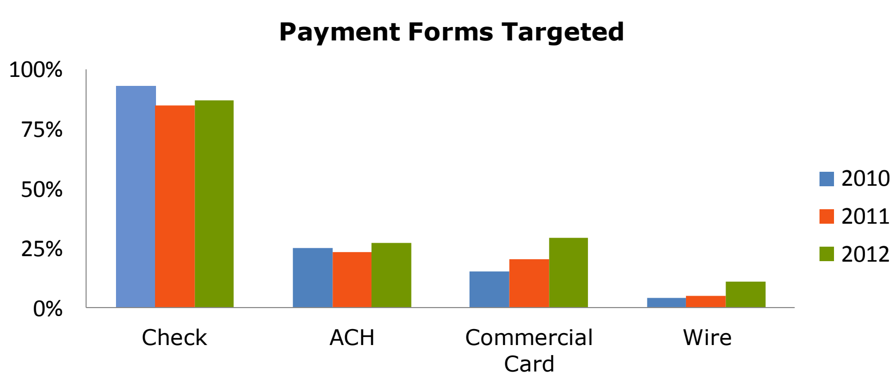
60% **Fraud incidents that involved employees**[3]

U.S. organizations lose about 7% of revenue to fraud[3]

[1] "2013 Payments Fraud & Control Survey," AFP, March 2013
[2] "State of Security Survey Global Results Symantec, 2011
[3] Association of Certified Fraud Examiners at: www.stopcheckfraud.com

Payment fraud trends

- More than 6 out of 10 of organizations experienced attempted or actual payments fraud in 2012
- Among organizations that suffered a financial loss resulting from payments fraud in 2012, the typical loss was $20,300



2013 AFP Payments Fraud and Control Study

Reducing Fraud

- In 2013, reported loss from account takeover topped $5 B
  - (Lexis Nexis True Cost of Fraud Study, August 2014)
- Imposter Fraud
- Check Fraud
- ACH Fraud
- Online Fraud
- Email Fraud

Reducing Fraud Best Practices

- **Checks:**
  - Secure your check stock– stay in check number order
  - Add Positive Pay
  - Include Payee Validation/ Teller / Image Verification (name per bank)
  - Stay up to date on Reconciliation
  - Void returned checks and secure check copies
  - Convert to image statements/ go paperless
  - Ensure proper security over signature plates/ stamps

Reducing Fraud Best Practices

- **ACH:**
  - Add ACH Blocks and Filters
  - Only allow certain vendors access to your accounts
  - UPIC numbers
    - Associated with the account number but are not the true bank account number.
    - Typically assigned to a particular client
  - For repetitive transactions, set up templates

Reducing Fraud Best Practices

- **Other:**
- Event Notifications
- Be attentive during Online Sessions
- DON'T send money to my uncle overseas
- You DID NOT lose money in Liberia that must be recovered
- Beware of Phishing– your bank will never ask for bank account information in an email
- Dual Controls
- Never share passwords
- Look for errors in the email names, address, etc.
- Set limits for users on Banking portals/ payments
- Use Chip and Pin/ EMV cards

Questions?

THANK YOU!