STATE OF MINNESOTA

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Statement of Position
Deposits of Public Funds
(Depositories and Collateral)

State law limits where and how public funds may be deposited. Compliance with state and federal laws is a basic component of protecting the public funds that have been entrusted to government entities.

Designation of Depository

Minnesota law requires the governing body of each government entity to designate one or more financial institutions as a depository for its public funds.[1] The governing body is responsible for deciding where public funds will be deposited. Most government entities designate a depository on either an annual or biennial basis. The designation of a depository occurs at a public meeting.

Minnesota law also permits a governing body to authorize its treasurer or chief financial officer to designate depositories of funds. For public entities that delegate this authority, we recommend that the designation take place on an annual or biennial basis. Further, we recommend that designation of individual depositories be documented. The document can be in the form of a report to the governing board, a letter to the depository or simply a dated memorandum in the government entity's depository file.

Financial institutions eligible to receive public deposits include savings associations, commercial banks, trust companies, credit unions and industrial loan and thrift companies.[2] Not included in this list are securities broker-dealers or their affiliates.

As part of their stewardship of public funds, we recommend that government entities periodically (annually or biennially) re-examine and re-evaluate the banks and credit unions into which they place public funds. By leaving money in the same depository year after year and failing to designate a depository on a periodic basis, public entities may lose out on the competition many depositories are willing to undertake for the opportunity to receive public funds. They also neglect their duty to periodically evaluate the soundness of their selected financial institutions.

Collateral

Collateral represents protection for public funds in the event of a bank failure. All public funds on deposit in a bank or credit union must be protected by deposit insurance, a corporate surety bond or pledged collateral. Most institutions choose to pledge collateral for amounts not covered by the deposit

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[1] *See* Minn. Stat. § 118A.02, subd. 1.
[2] Minn. Stat. § 118A.01, subd. 3.

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insurance. The process involves the depository placing securities it owns within an account in the trust department of a commercial bank or a restricted account at the Federal Reserve, and pledging these securities to the government entity. If the depository fails, the government entity can take the securities pledged to make up for any loss to its deposited funds.[3]

Most compliance problems occur when the public entity fails to:

- Obtain a proper assignment,
- Obtain the proper kind of collateral,
- Obtain the proper amount of collateral, or to otherwise comply with the Federal Financial Institutions Reform, Recovery and Enforcement Act (FIRREA).[4]

Permissible Collateral

State law defines the types of collateral that a financial institution may pledge for public deposits.[5] These types of collateral include:

- United States Government Treasury issues;
- Issues of United States Government Agencies and Instrumentalities;
- Obligations of state and local governments;
- Time Deposits fully insured by the Federal Deposit Insurance Company (FDIC) or any federal agency; and
- Irrevocable standby letters of credit issued by federal home loan banks.

These very safe forms of collateral are necessary because, in the event of a failure of the depository, the government entity may need to obtain funds quickly to cover operating expenses.

All of these allowable forms of collateral must meet certain additional requirements. The public depositor should review Minn. Stat. § 118A.03, subd. 2, to determine whether the collateral being pledged meets the statutory requirements for "collateral."

Amount of Collateral

The FDIC provides $250,000 of deposit insurance which covers all accounts held by a single depositor at a depository institution.[6] For government depositors with funds on deposit in a bank located in the same state there is an additional $250,000 of deposit insurance available. These depositors have $250,000 of coverage available for all demand accounts and a second $250,000 available for all time/savings accounts. However, for government deposits in a bank located outside the state there is a single $250,000 of coverage for all demand and time/savings accounts combined.

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[3] *See* Minn. Stat. § 118A.03, subd. 4.
[4] *See* North Arkansas Medical Center v. Barrett, 962 F.2d 780 (1992).
[5] Minn. Stat. § 118A.03, subd. 2.
[6] 12 CFR § 330.15.

State law requires that the amount of collateral pledged equal 110% of the uninsured amount on deposit.[7] For example, if the government entity has on deposit $1,000 over and above the deposit insurance amount, the financial institution needs to pledge collateral with a market value of $1,100 to protect the deposit.

Since the amount a public entity has on deposit will vary from time to time, the financial institution needs sufficient amounts of pledged collateral to cover 110% of the uninsured amount on deposit during peak deposit times. Public entities should develop procedures to monitor the amount of collateral pledged throughout the year. The public entity’s chief financial officer or treasurer needs to monitor deposit amounts against the amount of collateral pledged.

If a government entity maintains a large bank account balance throughout the year, the excess funds could be used for direct investment in securities, but the securities must be authorized under Minn. Stat. §§ 118A.04 and 118A.05. Options include investment in the joint powers government investment pools through the 4M Fund (for cities), the Minnesota School District Liquid Asset Fund (MSDLAF), the MAGIC Fund (for counties), and MNTrust (for school districts). The allocation of public funds available for deposit and direct investment should be addressed by the governing body through resolution or in an adopted investment policy.

Compliance with FIRREA

State law requires that the pledge of collateral be done through a written assignment from the bank to the government entity. To perfect the security interest in the pledged collateral, the FIRREA requires that either the bank’s loan committee or the bank’s board of directors approve the assignment.[8] To document compliance, public entities should insist that the depository provide to the public entity a copy of the minutes or the resolution adopted either by the loan committee or the board of directors approving the pledge of collateral.

If the financial institution fails to obtain the approval of the assignment by the loan committee or board of directors, the written collateral assignment will be worthless. Should the financial institution be liquidated, the public entity will not be permitted to take the collateral and sell it; rather, the public entity will become one of the financial institution’s general creditors, and may receive only a portion of the actual money it had on deposit. So, it is imperative that public entities obtain enforceable assignments of collateral from their depositories.

Even though the risk of loss remains relatively low, the consequences of a bank failure on local government depositors can be devastating. This type of loss of public funds can be avoided by vigilant compliance with state and federal law.

[7] Minn. Stat. § 118A.03, subd. 3. When the collateral consists of standby letters of credit issued by the Federal Home Loan Bank, the amount of the letters of credit need only equal the insured amount on deposit.
[8] 12 U.S.C. § 1823 (e).