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Article for *Minnesota Counties*

FDIC-Guaranteed Bank Bonds and Minnesota Counties

By Rebecca Otto, State Auditor

In 2008 Congress and the Federal Deposit Insurance Association (FDIC) instituted a number of programs aimed at increasing the liquidity of the nation's banks due to the economic downturn and the frozen credit market. One new program which can affect the investments made by public entities around the country is the Temporary Liquidity Guarantee Program (TLGP). In the TLGP, the FDIC guarantees bonds issued by banks, backing them with the full faith and credit of the United States Government.

The question is, do these guaranteed bank bonds qualify as public investments or as permissible collateral under Minnesota law? Despite the new guarantee that these bonds have, they do not fit the criteria established in state law to qualify as either a public investment or as permissible collateral for public deposits.

Public Entities and Bank Bonds

Public entities in Minnesota do not normally invest in bonds issued by banks. Unlike certificates of deposit, bank bonds are not on the list of permissible investments. The authority to invest in federal securities is very broad, including government bonds, notes, bills, mortgages and other securities. However, these securities must be "direct obligations" or "issues" of some federal entity. The bonds guaranteed under the TLGP remain direct obligations or issues of the involved bank, not the FDIC.

Similarly, for collateral for public deposits, bank bonds are not listed as a permissible form of collateral. In this instance, Federal securities are limited to Treasury bills, bonds and notes and "issues" of U.S. agencies and instrumentalities. Again, these FDIC-guaranteed bank bonds are issues of the involved banks, not the FDIC.

The dynamic forces in our financial marketplace always seem to be several steps ahead of Minnesota state law. This often prevents public investors from considering new types of securities for investment as they are unveiled. Some would argue that this is not necessarily a bad thing. However, FDIC-backed bonds represent part of a national

strategy to deal with liquidity in the banking system, and they have the full taxing authority of the Federal government backing them up. Despite the intent behind them and the guarantee by the Federal government, these bonds do not fit current criteria set out in Minnesota statute for investment or collateral purposes.

If you have further questions about this issue, please feel free to contact David Kenney at the Office of the State Auditor at 651-296-2551 or david.kenney@osa.state.mn.us.