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## **OLR Bill Analysis**

### **sSB 827**

#### ***AN ACT CONCERNING PUBLIC DEPOSITS.***

#### **SUMMARY:**

This bill makes various changes to the public deposits laws.

Under current law, all public deposits must be protected against loss and to secure such deposits all qualified public depositories (QPD) must maintain a specified minimum amount of eligible collateral. "Eligible collateral" are investments for which prices or values are quoted or readily available. The bill restricts the types of investments that can be considered eligible collateral.

By law, a QPD is required to maintain a minimum amount of eligible collateral, separate from its other assets, based on the total amount of uninsured public deposits it holds and the level of risk-based capital (i.e., collateralization requirement). The bill changes the collateralization requirements by:

1. increasing the risk based capital ratio threshold;
2. making a distinction between a QPD that is a bank or out-of-state bank and a QPD that is a state or federal credit union, adding "tier one leverage ratio" as an additional measure for banks and "net worth ratio" as the measure for credit unions (see BACKGROUND);
3. establishing new minimum collateralization levels depending on whether the QPD (a) is not under a formal regulatory order, (b) has been conducting business in the state for less than two years, or (c) is an uninsured bank;
4. changing the conditions under which a QPD and a public depositor may agree to a collateralization level that is different

from the applicable statutory minimum; and

5. giving the commissioner authority to increase the required collateralization level as deemed necessary for the protection of public deposits.

By law, each QPD must transfer the eligible collateral it maintains to a trust account separate from its own assets. The bill sets new thresholds that determine the trust accounts to which the funds must be transferred depending on whether the QPD is a bank or a credit union.

The bill requires a QPD to determine and adjust the market value of eligible collateral on a monthly basis, rather than quarterly, as under current law, and gives the commissioner authority to require more frequent valuations.

The bill makes certain amendments to the QPD's reporting requirements and establishes new filing requirements for holders of eligible collateral.

The bill also makes conforming changes.

EFFECTIVE DATE: Upon passage

#### **ELIGIBLE COLLATERAL**

The bill changes the definition of eligible collateral, restricting the investments that are considered eligible collateral. In general:

1. United States treasury bills, notes, and bonds are still allowed as eligible collateral;
2. United States government agency securities and variable-rate securities have been limited to certain kinds;
3. government issued mortgage backed securities are allowed, but privately-issued mortgage backed securities are not allowed;
4. mortgages are no longer allowed; and

5. state and municipal bonds are still allowed but under more restricted parameters.

Specifically, the bill defines “eligible collateral” as the following investments for which prices or values are quoted or readily available:

1. general obligations that the United States or Connecticut guarantees fully as to principal and interest or for which the United States or Connecticut pledges its full faith and credit for the payment of principal and interest;
2. general obligations of any federal agency, including government sponsored enterprises, which are not guaranteed fully as to principal and interest by the United States or for which the full faith and credit of the United States is not pledged for the payment of principal and interest;
3. mortgage pass-through or participation certificates or similar securities that the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation or Government National Mortgage Association issued or guaranteed;
4. general obligations of municipalities and states other than this state that are rated in the three highest rating categories by a rating agency recognized by the banking commissioner; and
5. revenue obligations for essential services, including education, transportation, emergency, water, and sewer services of municipalities and states that are rated in the three highest rating categories by a rating agency recognized by the commissioner and that are determined to be a prudent investment by the QPD governing board, a management committee or board committee appointed by the governing board, or by an officer appointed by the governing board, management committee, or board committee.

#### **COLLATERAL REQUIREMENTS**

By law, each QPD must maintain at all times, separate from its other

assets, a minimum amount of eligible collateral to secure public deposits (collateralization level). The bill establishes new minimum collateralization levels for a QPD depending on whether it (1) is or is not under a formal regulatory order, (2) has been conducting business in the state for less than two years, or (3) is an uninsured bank.

Under the bill, “formal regulatory order” means a written agreement related to enforcement, including a letter of understanding or agreement or a written order that a supervisory agency is required to publish or publishes on its web site. It does not include any written agreement or order under which the QPD’s sole obligation is to pay a civil penalty, fine, or restitution.

***QPD Not Under a Formal Regulatory Order***

The bill requires a QPD that is not under a formal regulatory order to maintain eligible collateral of at least 25% of all uninsured public deposits held by the QPD, with the following exceptions:

1. if the QPD is a bank or out-of-state bank having a tier one leverage ratio of at least 6% and a risk-based capital ratio of at least 12%, or is a credit union or federal credit union having a net worth ratio of at least 8%, the amount of eligible collateral must be at least 10% of all uninsured deposits held by the QPD; or
2. if the QPD is a bank or out-of-state bank having a tier one leverage ratio below 5% or a risk-based capital ratio below 10%, or is a credit union or federal credit union having a net worth ratio below 7%, the amount of eligible collateral must be at least 110% of all uninsured public deposits held by the QPD.

***QPD under a Formal Regulatory Order***

The bill requires a QPD that is under a formal regulatory order to maintain eligible collateral of at least 110% of all uninsured public deposits held by the QPD. This does not apply when (1) the formal regulatory order is not related to capital, asset quality, earnings, or liquidity and (2) the QPD notifies each of its public depositors of the

issuance of the order. In that case, the required collateral may be reduced as follows:

1. if the QPD is a bank or out-of-state bank having a tier one leverage ratio of at least 5% and risk-based capital ratio of at least 10% or a credit union or federal credit union having a net worth ratio of at least 7%, the QPD may reduce the required amount of eligible collateral to at least 75% of all uninsured public deposits held by the QPD; or
2. if the QPD is a bank or out-of-state bank having a tier one leverage ratio of at least 7.5% and a risk-based capital ratio of at least 14% or a credit union or federal credit union having a net worth ratio of at least 9.5%, the amount of eligible collateral may be reduced to at least 50% of all uninsured public deposits held by the QPD.

***QPD Operating in the State for less than two years or Uninsured Bank***

The bill requires each QPD that (1) has been conducting business in Connecticut for less than two years, except for a successor institution to a depository that conducted business here for two years or more, or (2) is an uninsured bank, to maintain eligible collateral of at least 120% of all uninsured public deposits held by the QPD.

***Eligible Collateral Amounts Determined by Agreement***

By law, a QPD and a public depositor may agree on a collateralization level that is greater than the applicable statutory minimum amount required. Under current law, when determining the required statutory minimum, the amount of uninsured public deposit must be determined at the close of business on the day of receipt of any public deposit and any deficiency in the required amount of eligible collateral must be cured no later than the close of business on the following business day.

The bill maintains these requirements, but adds that in determining the minimum required amount of eligible collateral, the QPD's tier one leverage ratio and risk-based capital ratio or net worth ratio must be

calculated, in accordance with applicable federal and state regulations, based on the most recent quarterly call report (see BACKGROUND). If, in subsequent calendar quarters, the depository experiences a decline in its tier one leverage ratio, risk-based capital ratio, or net worth ratio such that the agreed upon collateral level is lower than the applicable statutory minimum, the bill requires the QPD to increase the amount of eligible collateral maintained to the applicable statutory minimum. By law, the QPD must notify the commissioner of such actions.

### ***Commissioner's Adjustment of Eligible Collateral Requirements***

The bill allows the commissioner to increase the required collateralization level, up to a maximum amount of 120%, if he reasonably determines that the increase is necessary for the protection of public deposits. If he determines that the increase is no longer necessary, he may allow the QPD to reduce the amount to not less than the applicable statutory minimum required amount.

### ***Segregation of Eligible Collateral from Other Assets***

By law, each QPD must transfer, in a manner consistent with the commissioner's requirements, the eligible collateral that it maintains to an account separate from its own assets based on the QPD's risk-based capital ratio. The bill increases, from 8% to 10%, the risk-based capital ratio threshold and adds "tier one leverage ratio" as a new measure to determine the accounts to which the funds are to be transferred.

Specifically, if the QPD is a bank or out-of-state bank having a tier one leverage ratio of at least 5% or a risk-based capital ratio of at least 10%, the QPD must transfer eligible collateral to (1) its own trust department within the state, unless approved by the commissioner, (2) another financial institution's trust department within the state, unless approved by the commissioner, or (3) a federal reserve bank or federal home loan bank. If the QPD is a bank or out-of-state bank having a tier one leverage ratio below 5% or a risk-based capital ratio below 10% or a credit union or federal credit union, the QPD must transfer eligible collateral to (1) the trust department of a financial institution, located in the state, unless approved by the commissioner, that is not owned or

controlled by the QPD or by a holding company owning or controlling the QPD, or (2) a federal reserve bank or federal home loan bank.

***Other Eligible Collateral Requirements***

The bill requires a QPD to determine and adjust the market value of eligible collateral on a monthly basis, instead of quarterly. The bill authorizes the commissioner to require the valuation of the collateral more frequently than monthly if necessary to protect public deposits.

By law, the commissioner has a perfected security interest in all eligible collateral held in the segregated trust accounts. Such interest has priority over all other perfected security interests and liens.

The bill requires each holder of eligible collateral to file a report with the commissioner, at the end of each calendar quarter, containing (1) the CUSIP number (see BACKGROUND) and (2) the description and par value of each investment it holds as eligible collateral.

Under current law, the QPD has the right to reduce the amount of eligible collateral maintained if it gives written notice to its public depositors. The bill allows reductions without written notice, but limits reductions to amounts that are in excess of the applicable statutory minimum required amount. By law, a QPD can make substitutions of eligible collateral at any time without notice and keep the income from the assets.

The bill repeals the provisions that pertain to required minimum collateral market values and the requirements that pertain to QPDs that are subject to cease and desist orders.

**QPD REPORTING REQUIREMENTS**

By law, each QPD must file a written report with the commissioner. The bill requires the report to include (1) the QPD's tier one leverage ratio and risk-based capital ratio or net worth ratio, (2) uninsured and total amount of public deposits, and (3) the description and market value of any eligible collateral.

All other reporting requirements remain unchanged, including the

requirements to (1) file the report on each call report date (2) certify the report under oath, (3) indicate the amount and name of the issuer of any letters of credit, and (4) provide a copy of the report to public depositors upon request. Failure to furnish any report or give any information as required will result in disqualification and loss of the right to receive public deposits.

## **BACKGROUND**

### ***Qualified Public Depository (QPD)***

By law, “qualified public depository” or “depository” means a bank, Connecticut credit union, federal credit union, or an out-of-state bank that maintains a branch in the state, which receives or holds public deposits (CGS § 36a-330(7)).

### ***Public deposit***

“Public deposit” means (1) money of the state or its subdivisions, or any commission, committee, board or officer thereof; any housing authority; or any Connecticut court and (2) money held by the Judicial Department in a fiduciary capacity (CGS § 36a-330(6)).

### ***Uninsured Public Deposit***

“Uninsured public deposit” means the portion of a public deposit that is not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or by the National Credit Union Administration (NCUA). Amounts of a public deposit that are insured by FDIC or NCUA include amounts that have been redeposited, with the authorization of the public depositor, into deposit accounts in one or more federally insured banks, out-of-state banks, Connecticut credit unions, or federal credit unions, including the qualified public depository, provided the full amounts are eligible for insurance coverage by FDIC or NCUA (CGS § 36a-330(8)).

### ***Tier One Leverage Ratio***

Tier one leverage ratio is an evaluative tool used to help determine capital adequacy and place constraints on the degree to which a banking firm can leverage its capital base. The ratio is calculated by dividing Tier one capital by the firm's average total consolidated

assets.

***Risk-based Capital Ratio***

In the case of a bank, “total risk-based capital ratio” means the ratio of qualifying total capital to risk-weighted assets, as calculated in accordance with the FDIC’s Statement of Policy on Risk-Based Capital (12 CFR § 325.2).

In the case of a Connecticut credit union and a federal credit union, “risk-based capital ratio” means net worth divided by total assets (Conn. Agencies Reg. § 36a-333-1).

***Net Worth***

Net worth means the retained earnings balance of the credit union at the end of a quarter as determined under generally accepted accounting principles (12 C.F.R. § 702.2).

***CUSIP Number***

CUSIP stands for Committee on Uniform Securities Identification Procedures. A CUSIP number identifies most securities, including: stocks of all registered U.S. and Canadian companies and U.S. government and municipal bonds. The CUSIP system facilitates the clearing and settlement process of securities. The number consists of nine characters (including letters and numbers) that uniquely identify a company or issuer and the type of security.

***Quarterly Call Report***

All regulated financial institutions in the United States are required to file periodic financial and other information with their respective regulators and other parties. One of the key reports required to be filed is the quarterly Consolidated Report of Condition and Income, generally referred to as the “call report”. Call reports are due no later than 30 days after the end of each calendar quarter.

**COMMITTEE ACTION**

Banks Committee

Joint Favorable Substitute

Yea 17 Nay 0 (03/14/2013)