

Collateral, Safekeeping and Public Fund Options



**North Central Texas
Council of Governments**

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Objectives:

- Review Collateralization Rules and Regulations
 - PFIA – Public Funds Investment Act
 - PFCA – Public Funds Collateral Act
 - FDIC – Federal Deposit Insurance Corporation
 - FIRREA – Financial Institutions Recovery, and Enforcement Act of 1989
 - FHLB – Federal Home Loan Bank
- Outline Collateral Options and Documentation
- Consider Collateral Management Issues

Collateral Rules, Laws and Considerations

- Public Funds Investment Act –
 - Ch. 2256 (PFIA) - <https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2256.htm>
- Public Funds Collateral Act –
 - Ch. 2257 (PFCA) - <https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2257.htm>
- Federal Deposit and Credit Union Insurance Coverage –
 - (FDIC / NCUSIF) - <https://www.fdic.gov/deposit/deposits/factsheet.html>
- Financial Institution Reform Recovery and Enforcement Act –
 - (FIRREA)
- Federal Home Loan Bank – Letter of Credit
 - (FHLB – LOC)

Recommended Collateral Practices

1. Understand Texas Collateralization Law
2. Identify the Depository Risk Exposure
3. Establish a Written Depository Collateralization Agreement
 1. Funds to be Collateralized
 2. Eligible Collateral Instruments
 3. Market Value
 4. Margin / Collateralization Ratios
 5. Safekeeping Procedures
 6. Substitution – notification or authorization
 7. Monthly Statements
4. Establish Effective Safekeeping Procedures
5. Financial Reporting and Disclosures

Recommended Collateral Practices

1. Understanding Texas Collateralization Law

- Public Funds Collateral Act –
 - Ch. 2257 (PFCA) -
<https://statutes.capitol.texas.gov/Docs/GV/htm/GV.2257.htm>
- Review the statute and discuss with your legal counsel
- Ensure local government requirements are carefully followed

Recommended Collateral Practices

2. Identify your Depository Risk Exposure

- Monitor for rating changes information/new from the rating agencies
- Determine and closely monitor demand deposit balances for fluctuations and sufficient collateral levels
- Sweep mechanism help move excess balances at the end of day into money market funds or repos
- Ensure collateral valuation is based on market value versus face value
- Monitor for inferior quality or illiquid instruments being pledged

Recommended Collateral Practices

3. Establish Written Security / Custodial / Depository Agreements

- Agreements –
 - A valid Security agreement executed by the owner of the collateral and the secured party creates a security interest.
 - At a minimum, agreements should consist of:
 - A description of the collateral
 - Funds to be collateralized
 - Eligible collateral instruments
 - Safekeeping procedures
 - Valuation methods
 - Substitution procedures
 - Margin levels or ratios for coverage
 - Statement of the intention of providing security interest
 - Signatures from all parties involved.

Recommended Collateral Practices

3. Establish Written Security / Custodial / Depository Agreements

- Agreements –
 - Safekeeping Procedures:
 - Federal Reserve Bank
 - Doesn't require an agreement, but 2 signatures for release
 - FRB has their own agreement
 - Third-Party collateral safekeeping (correspondent relationships)
 - A written agreement should document the relationship
 - Trust Department of the local bank
 - A trust agreement should document the separation and boundaries
 - The Security Agreement should relate to and follow the Depository Agreement. The written agreement ensures enforcement of collateral practices and protections.

Recommended Collateral Practices

4. Establish Effective Safekeeping Procedures

- Develop processes and procedures to support an effective program.
 - Monitoring collateral
 - Notification to depository for significant changes in deposit size or account activity that might impact collateral levels.
 - Deciding on notification or authorization for substitutions, new collateral etc.
 - Effective reconciliation and review of monthly reports.
 - Monitoring the depository for rating changes or 'head-line risk'.

Recommended Collateral Practices

5. Prepare for Financial Reporting Disclosures

- Develop reports and disclosures that ensures an effective program.
 - Accounting considerations
 - Audit considerations
 - Verifiable valuation methods

Eligible Securities Listing (Schedule “A”)

- Review eligible securities for collateral pledging.
- Evaluate eligible securities to allowable investment in the Investment Policy.
- Consider limiting maximum maturities to less than 10 years.
 - Specifically, Mortgage securities

Depository Credit Analysis

- Use Fed. Financial Institutions Examination Council (FFIEC) to review financial ratios and compare to other institutions.
 - Capital Adequacy and capitalization ratios. Comparing equity to total assets.
 - Asset Quality, looking for a declining loan-loss reserve.
 - Management, seeking a low overhead expense to total assets.
 - Analyzing net earnings to total assets.
 - Liquidity via short-term marketable investments.

Additional Considerations

- Minimizing deposit levels
 - Utilization of sweep accounts and lower compensating balances
 - Utilization of Investment Pools and late day transaction capabilities
- Investing in fully secured instruments

Public Funds Investment Act Collateral References

- 2256.009 Investments
- (a)(3)... collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States...
- (a)(4)... obligations fully guaranteed or insured by the FDIC...
- (a) (7) ...fully guaranteed or insured by the FDIC and NCUSIF....
- (a) (8) ...fully guaranteed or insured by the FDIC and NCUSIF through...
 - (A) (i) Broker – main or branch office
 - (A) (ii) Depository – main or branch office
 - (B) Spreads to insured depositories
 - (C) Fully insured
 - (D) Appoints Custodian

Public Funds Investment Act Collateral References

- 2256.010 Investments
- (a) Certificates of Deposit
 - (1) Insured
 - (2) Collateralized
 - (3) Follows PFCA
- (b) (1) Additional Certificates of Deposit
 - (A) Broker – main or branch office
 - (B) Depository – main or branch office
- (b) (2) Spreads to insured depositories
- (b) (3) Fully insured
- (b) (4) Appoints Custodian

Public Funds Collateral Act - 2257

- 2257.0025. HIGH-RISK MORTGAGE SECURITY
- A fixed-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
 - (1) has an average life sensitivity with a weighted average life that:
 - (A) extends by more than four years, assuming an immediate and sustained parallel shift in the yield curve of plus 300 basis points; or
 - (B) shortens by more than six years, assuming an immediate and sustained parallel shift in the yield curve of minus 300 basis points; and
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.
- A floating-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
 - (1) bears an interest rate that is equal to the contractual cap on the instrument; or
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

Public Funds Collateral Act - 2257

- 2257.003. CHAPTER NOT APPLICABLE TO DEFERRED COMPENSATION PLANS. This chapter does not apply to funds that a public entity maintains or administers under a deferred compensation plan, the federal income tax treatment of which is governed by Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Sections 401(k) and 457).
- 2257.004. CONFLICT WITH OTHER LAW. This chapter prevails over any other law relating to security for a deposit of public funds to the extent of any conflict.
- 2257.005. CONTRACT GOVERNS LEGAL ACTION. A legal action brought by or against a public entity that arises out of or in connection with the duties of a depository, custodian, or permitted institution under this chapter must be brought and maintained as provided by the contract with the public entity.

Public Funds Collateral Act - 2257

- 2257.021. COLLATERAL REQUIRED

- A deposit of public funds shall be secured by eligible security to the extent and in the manner required by this chapter.

- 2257.022. AMOUNT OF COLLATERAL

- (a) Except as provided by Subsection (b), the total value of eligible security to secure a deposit of public funds must be in an amount not less than the amount of the deposit of public funds:
 - (1) increased by the amount of any accrued interest; and
 - (2) reduced to the extent that the United States or an instrumentality of the United States insures the deposit.
- (b) The total value of eligible security described by Section 45.201(4)(D), Education Code, to secure a deposit of public funds of a school district must be in an amount not less than 110 percent of the amount of the deposit as determined under Subsection (a). The total market value of the eligible security must be reported at least once each month to the school district.
- (c) The value of a surety bond is its face value.
- (d) The value of an investment security is its market value.

Public Funds Collateral Act - 2257

- 2257.023. COLLATERAL POLICY
- (a) In accordance with a written policy approved by the governing body of the public entity, a public entity shall determine if an investment security is eligible to secure deposits of public funds.
- (b) The written policy may include:
 - (1) the security of the institution that obtains or holds an investment security;
 - (2) the substitution or release of an investment security; and
 - (3) the method by which an investment security used to secure a deposit of public funds is valued.

Public Funds Collateral Act - 2257

- 2257.024. CONTRACT FOR SECURING
- (a) A public entity may contract with a bank that has its main office or a branch office in this state to secure a deposit of public funds.
- (b) The contract may contain a term or condition relating to an investment security used as security for a deposit of public funds, including a term or condition relating to the:
 - (1) possession of the collateral;
 - (2) substitution or release of an investment security;
 - (3) ownership of the investment securities of the bank used to secure a deposit of public funds; and
 - (4) method by which an investment security used to secure a deposit of public funds is valued.

Public Funds Collateral Act - 2257

- 2256.025. RECORDS OF DEPOSITORY
- (a) A public entity's depository shall maintain a separate, accurate, and complete record relating to a pledged investment security, a deposit of public funds, and a transaction related to a pledged investment security.
- (b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a depository maintains under this section.

Public Funds Collateral Act - 2257

- 2257.026. CHANGE IN AMOUNT OR ACTIVITY OF DEPOSITS OF PUBLIC FUNDS
 - A public entity shall inform the depository for the public entity's deposit of public funds of a significant change in the amount or activity of those deposits within a reasonable time before the change occurs.

Public Funds Collateral Act - 2257

- 2257.041. DEPOSIT OF SECURITIES WITH CUSTODIAN
- (a) In addition to other authority granted by law, a depository for a public entity other than a state agency may deposit with a custodian a security pledged to secure a deposit of public funds.
- (b) At the request of the public entity, a depository for a public entity other than a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds.
- (c) A depository for a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds. The custodian and the state agency shall agree in writing on the terms and conditions for securing a deposit of public funds.

Public Funds Collateral Act - 2257

- 2257.041. DEPOSIT OF SECURITIES WITH CUSTODIAN
- (d) A custodian must be approved by the public entity and be:
 - (1) a state or national bank that:
 - (A) is designated by the comptroller as a state depository;
 - (B) has its main office or a branch office in this state; and
 - (C) has a capital stock and permanent surplus of \$5 million or more;
 - (2) the Texas Treasury Safekeeping Trust Company;
 - (3) a Federal Reserve Bank or a branch of a Federal Reserve Bank;
 - (4) a federal home loan bank; or
 - (5) a financial institution authorized to exercise fiduciary powers that is designated by the comptroller as a custodian pursuant to Section 404.031(e).
 - Comptroller Designated
- (e) A custodian holds in trust the securities to secure the deposit of public funds of the public entity in the depository pledging the securities.

Public Funds Collateral Act - 2257

- 2257.042. DEPOSIT OF SECURITIES WITH PERMITTED INSTITUTION
- (a) A custodian may deposit with a permitted institution an investment security the custodian holds under Section 2257.041.
- (b) If a deposit is made under Subsection (a):
 - (1) the permitted institution shall hold the investment security to secure funds the public entity deposits in the depository that pledges the investment security;
 - (2) the trust receipt the custodian issues under Section 2257.045 shall show that the custodian has deposited the security in a permitted institution; and
 - (3) the permitted institution, on receipt of the investment security, shall immediately issue to the custodian an advice of transaction or other document that is evidence that the custodian deposited the security in the permitted institution.

Public Funds Collateral Act - 2257

- 2257.043 DEPOSITORY AS CUSTODIAN OR PERMITTED INSTITUTION
- (a) A public entity other than a state agency may prohibit a depository or an entity of which the depository is a branch from being the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds.
- (b) A depository or an entity of which the depository is a branch may not be the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds by a state agency.

Public Funds Collateral Act - 2257

- 2257.044. CUSTODIAN AS BAILEE
- (a) A custodian under this chapter or a custodian of a security pledged to an institution of higher education, as defined by Section 61.003, Education Code, whether acting alone or through a permitted institution, is for all purposes the bailee or agent of the public entity or institution depositing the public funds with the depository.
- (b) To the extent of any conflict, Subsection (a) prevails over Chapter 8 or 9, Business & Commerce Code.

Public Funds Collateral Act - 2257

- 2257.045. RECEIPT OF SECURITY BY CUSTODIAN
- (a) On receipt of an investment security, a custodian shall immediately identify on its books and records, by book entry or another method, the pledge of the security to the public entity.
- (b) For a deposit of public funds under Subchapter F, the custodian shall issue and deliver to the comptroller a trust receipt for the pledged security.
- (c) For any other deposit of public funds under this chapter, at the written direction of the appropriate public entity officer, the custodian shall:
 - (1) issue and deliver to the appropriate public entity officer a trust receipt for the pledged security; or
 - (2) issue and deliver a trust receipt for the pledged security to the public entity's depository and instruct the depository to deliver the trust receipt to the public entity officer immediately.
- (d) The custodian shall issue and deliver the trust receipt as soon as practicable on the same business day on which the investment security is received.

Public Funds Collateral Act - 2257

- 2257.046. BOOKS AND RECORDS OF CUSTODIAN; INSPECTION
- (a) A public entity's custodian shall maintain a separate, accurate, and complete record relating to each pledged investment security and each transaction relating to a pledged investment security.
- (b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a custodian maintains under this section. The public entity or its agent may inspect at any time an investment security evidenced by a trust receipt.
- (c) The public entity's custodian shall file a collateral report with the comptroller in the manner and on the dates prescribed by the comptroller.
- (d) At the request of the appropriate public entity officer, the public entity's custodian shall provide a current list of all pledged investment securities. The list must include, for each pledged investment security:
 - (1) the name of the public entity;
 - (2) the date the security was pledged to secure the public entity's deposit;
 - (3) the Committee on Uniform Security Identification Procedures (CUSIP) number of the security;
 - (4) the face value and maturity date of the security; and
 - (5) the confirmation number on the trust receipt issued by the custodian.

Public Funds Collateral Act - 2257

- 2256.047. BOOKS AND RECORDS OF PERMITTED INSTITUTION
- (a) A permitted institution may apply book entry procedures when an investment security held by a custodian is deposited under Section 2257.042.
- (b) A permitted institution's records must at all times state the name of the custodian that deposits an investment security in the permitted institution.

Public Funds Collateral Act - 2257

- 2257.048. ATTACHMENT AND PERFECTION OF SECURITY INTEREST
- (a) A security interest that arises out of a depository's pledge of a security to secure a deposit of public funds by a public entity or an institution of higher education, as defined by Section 61.003, Education Code, is created, attaches, and is perfected for all purposes under state law from the time that the custodian identifies the pledge of the security on the custodian's books and records and issues the trust receipt.
- (b) A security interest in a pledged security remains perfected in the hands of a subsequent custodian or permitted institution.
 - [Perfected - Any secure interest in an asset that cannot be claimed by any other party. The interest is “perfected” by registering it with the appropriate statutory authority, so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.]

Public Funds Collateral Act - 2257

- 2257.061. AUDIT AND EXAMINATION
- As part of an audit or regulatory examination of a public entity's depository or custodian, the auditor or examiner shall:
 - (1) examine and verify pledged investment securities and records maintained under Section 2257.025 or 2257.046; and
 - (2) report any significant or material noncompliance with this chapter to the comptroller.

Public Funds Collateral Act - 2257

- 2257.062. PENALTIES
- a) The comptroller may revoke a depository's designation as a state depository for one year if, after notice and a hearing, the comptroller makes a written finding that the depository, while acting as either a depository or a custodian:
 - (1) did not maintain reasonable compliance with this chapter; and
 - (2) failed to remedy a violation of this chapter within a reasonable time after receiving written notice of the violation.
- (b) The comptroller may permanently revoke a depository's designation as a state depository if the comptroller makes a written finding that the depository:
 - (1) has not maintained reasonable compliance with this chapter; and
 - (2) has acted in bad faith by not remedying a violation of this chapter.

Public Funds Collateral Act - 2257

- 2257.063. MITIGATING CIRCUMSTANCES
- (a) The comptroller shall consider the total circumstances relating to the performance of a depository or custodian when the comptroller makes a finding required by Section 2257.062, including the extent to which the noncompliance is minor, isolated, temporary, or nonrecurrent.
- (b) The comptroller may not find that a depository or custodian did not maintain reasonable compliance with this chapter if the noncompliance results from the public entity's failure to comply with Section 2257.026.
- (c) This section does not relieve a depository or custodian of the obligation to secure a deposit of public funds with eligible security in the amount and manner required by this chapter within a reasonable time after the public entity deposits the deposit of public funds with the depository.

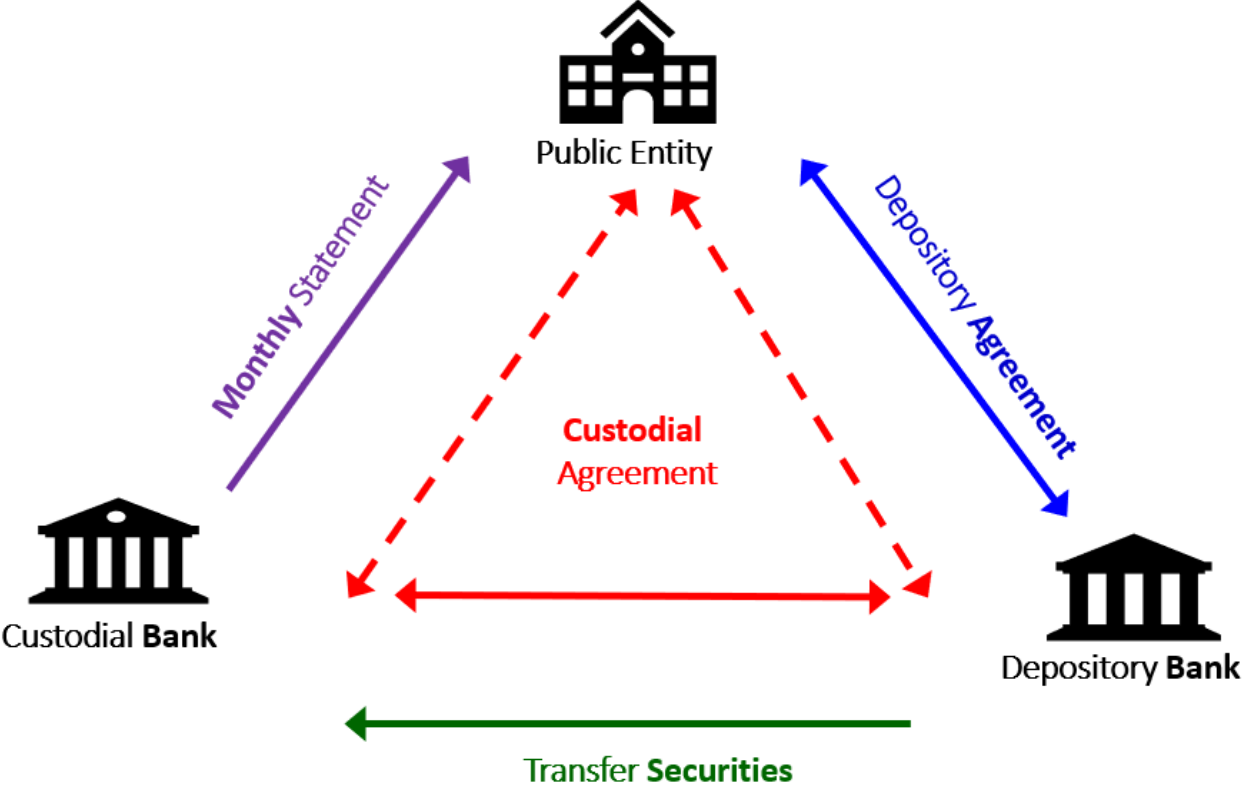
Public Funds Collateral Act - 2257

- 2257.064. REINSTATEMENT
- The comptroller may reinstate a depository's designation as a state depository if:
 - (1) the comptroller determines that the depository has remedied all violations of this chapter; and
 - (2) the depository assures the comptroller to the comptroller's satisfaction that the depository will maintain reasonable compliance with this chapter.

Public Funds Collateral Act - 2257

- Sec. 2257.081. DEFINITION. In this subchapter, "exempt institution" means:
 - (1) a public retirement system, as defined by Section 802.001; or
 - (2) the permanent school fund, as described by Section 43.001, Education Code.
- Sec. 2257.082. FUNDS OF EXEMPT INSTITUTION. An exempt institution is not required to have its funds fully insured or collateralized at all times if:
 - (1) the funds are held by:
 - (A) a custodian of the institution's assets under a trust agreement; or
 - (B) a person in connection with a transaction related to an investment; and
 - (2) the governing body of the institution, in exercising its fiduciary responsibility, determines that the institution is adequately protected by using a trust agreement, special deposit, surety bond, substantial deposit insurance, or other method an exempt institution commonly uses to protect itself from liability.
- Sec. 2257.083. INVESTMENT; SELECTION OF DEPOSITORY. This chapter does not:
 - (1) prohibit an exempt institution from prudently investing in a certificate of deposit; or
 - (2) restrict the selection of a depository by the governing body of an exempt institution in accordance with its fiduciary duty.
- Sec. 2257.101 – 2257.114. POOLED COLLATERAL

Third Party Custodian



FDIC

- FDIC coverage - \$250,000
 - Will CD investments (Principle and Interest) be under the FDIC \$250,000 limit?
 - \$250,000 coverage based on the FDIC definition of “political subdivision”.
 - <http://www.fdic.gov/deposit/deposits/FactSheet.html>
 - Consider other local units of your municipality when calculating total deposits at your local depository unless:
 - Any non-profit corporation, created by the local government is a 501C-3 entity that stands alone
 - Economic Development Corporation, Housing Finance Corporation, Etc...
 - TaxID is the FDIC identifier

FDIC

- All time and savings deposits (interest bearing) owned by a public unit and held by the same official custodian in an insured depository institution within the State in which the public unit is located are added together and insured up to \$250,000.
 - For the purpose of these rules, the term "savings deposits" includes NOW accounts, money market deposit accounts and other interest-bearing checking accounts.
- Separately, all demand deposits (non-interest bearing) owned by a public unit and held by the same official custodian in an insured depository institution within the State in which the public unit is located are added together and insured up to \$250,000.

FDIC

- If the depository is headquartered in Texas, the FDIC will provide \$250,000 for all interest bearing accounts and an additional \$250,000 for non-interest bearing accounts.
- If the depository is headquarters in another state, the FDIC will provide only \$250,000 for all accounts regardless of type.

FIRREA - Codified to 12 U.S.C. 1823(e)

- (e) Agreements against interests of Corporation
 - (1) In general, no agreement which tends to diminish or defeat the interest of the Corporation in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the Corporation unless such agreement—
 - (A) is in writing,
 - (B) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,
 - (C) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and
 - (D) has been, continuously, from the time of its execution, an official record of the depository institution.
- www.fdic.gov/regulations/laws/rules/1000-1500.html

FIRREA - Codified to 12 U.S.C. 1823(e)

Ensures that the municipality will possess a preferred claim to pledged securities in the event of default by the depository bank.

FIRREA

Safekeeping and Custody Requirements of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989

FIRREA requires that the depository institution's board of directors or a designated committee approves depository agreements. The governmental entity should request a copy of the depository's resolution approving the agreement. The following are examples of FIRREA documentation:

Certificate of Secretary of the Board of Directors of _____. The undersigned, being the duly elected Secretary of the Board of Directors ("the Board") of _____ (the "Bank") hereby certifies that attached hereto is a true and correct copy of a resolution of the Board adopted at a meeting held on _____, 2010, and such resolution has not been amended, modified, or repealed in any respect, and is in full force and effect on the date hereof.

Resolution Granting Certain Corporate Authority to Loan and Discount Committee

RESOLVED, the Senior Loan and Discount Committee is hereby granted the corporate authority to approve on behalf of _____ (the "Bank") such security agreements and other agreements related to the deposit of funds in this Bank by any governmental entity as such Senior Loan and Discount Committee shall deem in the best interests of this Bank from time to time.

Certificate of Secretary of the Senior Loan and Discount Committee of _____. The undersigned, being the duly appointed Secretary of the Senior Loan and Discount Committee (the "Committee") of _____ (the "Bank"), hereby certifies that:

1. In accordance with the authority granted to it by the Board of Directors of the Bank, on _____, 2010, the Committee approved the pledge of collateral, as required by the depository contract with the City of Buckstop (the "City"), to secure the Bank's obligations with respect to deposits maintained at the Bank by the City.
2. The Committee approval has not been amended, modified, or repealed in any respect, and is in full force and effect on the date hereof;
3. The minutes of the Committee meeting held on _____, 2009, will be maintained as part of the permanent records of the Bank.

FHLB Letter of Credit

- Eligibility
 - 2257.002(4)(F) - a letter of credit issued by a federal home loan bank.
- 2017 Legislative Changes
 - HB 2928 – Passed in House and Senate, signed by Governor June 15, 2017, takes effect September 1, 2017. HB 2928 makes two minor revisions. The first, to Section 2256.009(a) specifically includes obligations of the Federal Home Loan Banks as authorized investments. This solves a potential problem created by the Attorney General’s opinion # KP-0128 which questioned whether the FHLB would be considered a U.S. agency or instrumentality for purposes of the PFIA. HB 2928 also modifies Section 2256.010(a) by adding a reference to Chapter 2257 (the Public Funds Collateral Act) in the section that describes the means for securing a certificate of deposit. This will clarify that certificates of deposit can be secured by an FHLB letter of credit.

FHLB Letter of Credit

- Used in lieu of collateral pledged to the entity.
- Each letter of credit has a fixed and defined face value, not subject to market fluctuations or third-party monitoring or valuations.
- Easily and quickly liquidated.
- Direct obligation of FHLB.
- Limited monitoring by the depositing entity. Eliminates issues related to securities such as prepayments, fluctuating values, maturities, and calculations determining the excess of the required coverage.
- LOCs are not assets of the depository institution, and therefore, would receive different consideration in a receivership scenario.
- Courts recognize payments under LOC's as being from property of the issuer (FHLB) and not of the debtor (Your Bank).
- Collecting on an LOC requires no Court Action.
- Read the LOC and maintain extra business days on expiration.

Custodial Considerations

- 2257.026. CHANGE IN AMOUNT OR ACTIVITY OF DEPOSITS OF PUBLIC FUNDS
 - A public entity shall inform the depository for the public entity's deposit of public funds of a significant change in the amount or activity of those deposits within a reasonable time before the change occurs.
- This notification requirement means that the depository is not liable for under-collateralizing the account if the entity does not inform the bank in advance that a large deposit (bond proceeds delivery, property tax due date etc.) will be made or is expected to be made on a specific date. During times of high deposit activity, the entity should check collateral values more often than monthly.
- Also, remember that auditors check collateral values as of fiscal year-end date, and it would become an audit issue if the balance were found to be under-collateralized.

Custodial Considerations

- The collateral pledged to the public entity is not an asset of the entity, but an asset of the depository.
- In the event of a FDIC takeover of the depository. The FDIC would confirm the market valuation of the collateral and liquidate the securities to reimburse the public entity for the collateral pledged.

Custodial Issues

- Two Party or Three-Party Agreement
 - Federal Reserve/FHLB
 - Frost/TIB/BNYM
- Collateral Substitution
 - Written Permission
 - Parameter-based
 - Notification / Authorization
- Collateral Release
 - Written Permission
 - Depository Bank Discretion

Custodial Issues

- FDIC – Principal & Interest
 - Non-Interest Bearing
 - Interest-Bearing
 - Each Bondholder
- Market (Fair) Value
 - 100%
 - 102%
 - 110%
- Who Determines Value?
 - Depository Bank
 - Custodian
 - Independent Assessment

Collateral Documents

- Depository Agreement
- LOC or Custodial Agreement
- Collateral Receipts and Statements
- Bank Board or Committee Minutes
- Review your Investment Policy Language