NATIONAL ASSOCIATION OF STATE TREASURERS

# Collateral Pools: Best Practices


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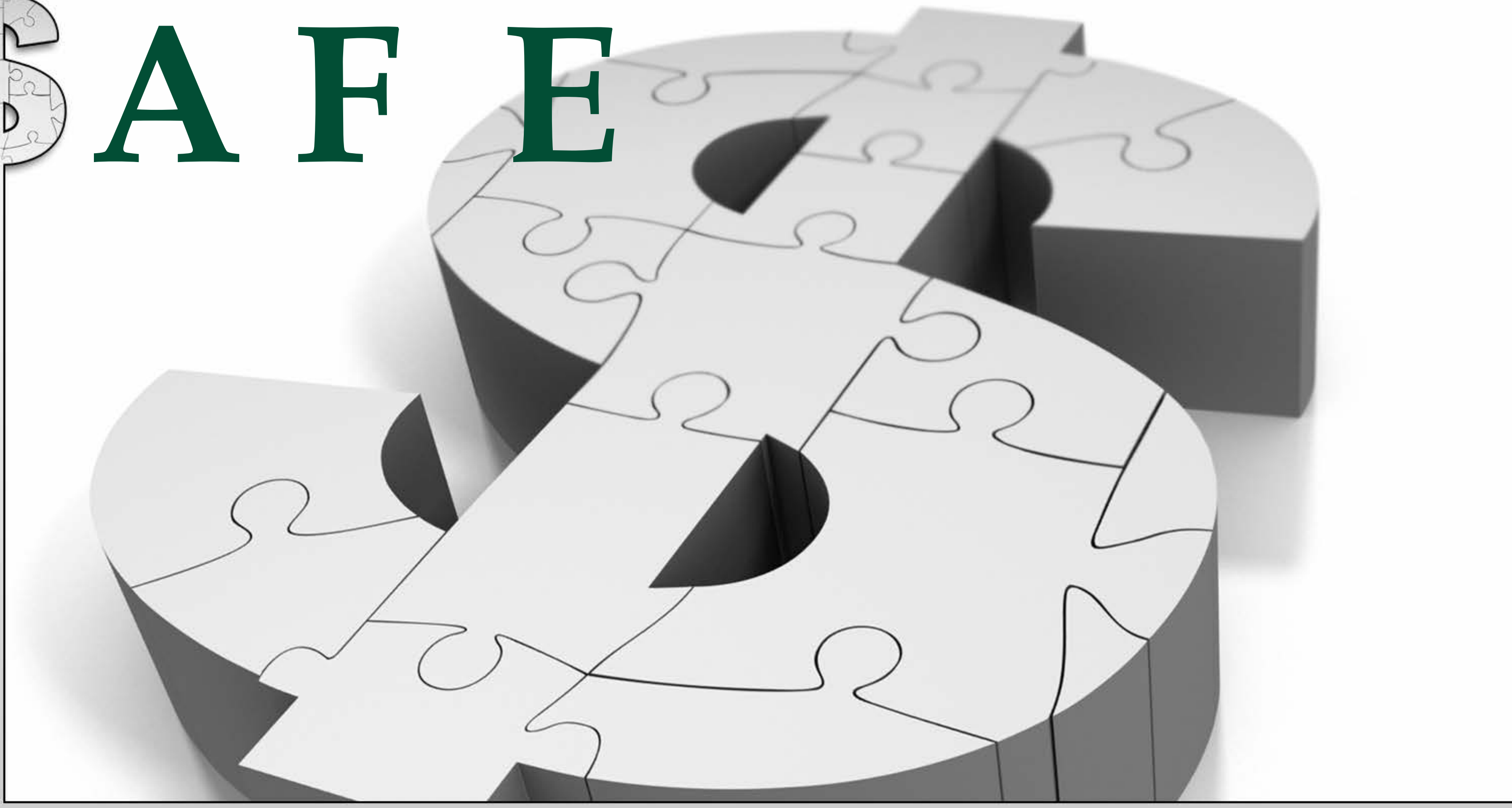
# $AFE



**Security for Alabama Funds Enhancement**

Young Boozer, State Treasurer

# History

- That Fateful Call
- The Headlines
- We have a problem
- Get a solution

# The Process

- Pledging Statute
  - Under Pledged
  - Over Pledged

- Bank Group Organized

- Other States

- Best Result

# The Solution

- SAFE
- Enacted 2001
- Going Strong

# SAFE: Description

Statute: Title 41, Chapter 14A, Code of Alabama (effective January 1, 2001)

Participants

- Board of Directors
- SAFE Staff
- Alabama Banks
- Alabama Public Depositors
- Custodian

SAFE Program Rules

Monthly Reporting by Banks

# Summary Report (as of 9.30.17)

| | |
|---|---|
| Avg. Public Deposit Pool (in millions) | $11,710 |
| Less FDIC (in millions) | $881 |
| Net Avg. Public Deposits (in millions) | $10,829 |
| Total Public Entities | 5,435 |
| Total # of QPDs | 150 |
| Coverage Ratio - Net Avg. Deposits | 92.94% |
| Coverage Ratio - Total Actual Deposits | 85.94% |

# Every State Approaches Collateralization of Deposits…Differently

**Across 50 states, there are effectively more than 50 different collateral programs. Each of the following collateral program variables can be unique for each program:**

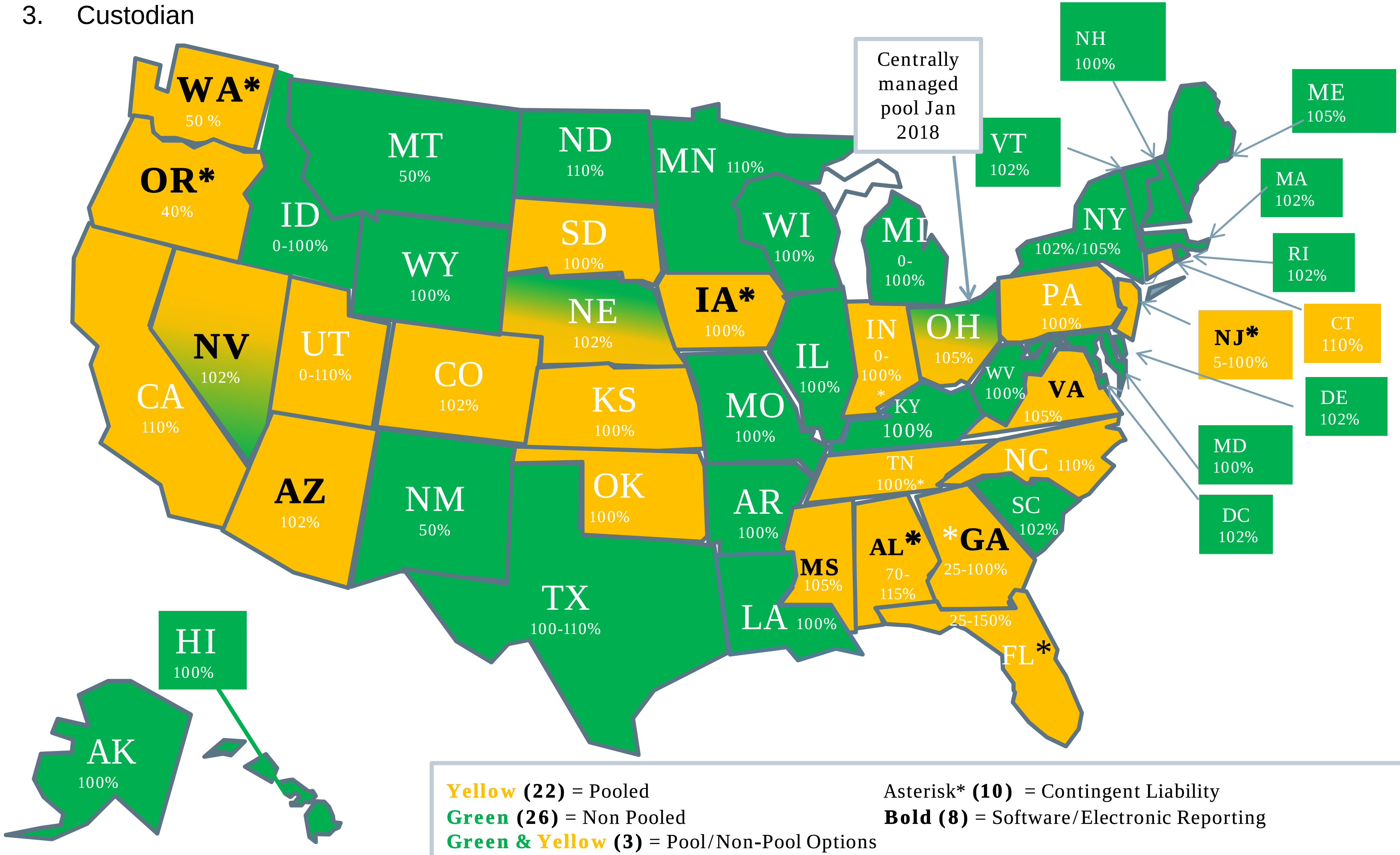
1. **How an institution qualifies as a Qualified Public Depositor**
2. **Pledging methodology:**
   - Direct to client OR
   - Pool
     - Mandatory or optional
     - Contingent or Non Contingent Liability
       - Contingent pledge % requirements
       - Contingent rating agencies
3. **Contracts/Agreements required**
   - Pool participants to sign contract
4. **Qualified custodian criteria**
   - State choice OR
   - QPD choice
5. **Margin of collateral pledged to support deposit balances**
   - Client Types within a State can be different
   - Tiers for non contingent liability
6. **Types of securities eligible to pledge**
   - Haircuts to specific types
   - Acceptability of In-state vs out-of-state bonds
   - Rating requirements (CUSIP vs. Parity)
   - Maturity dates requirements
7. **Who approves processing of collateral to:**
   - Pledge
   - Release
   - Substitute
8. **Reporting requirements**
   - Frequency
   - Data requirements
   - Method (email/online)
9. **Auditing requirements**

# Collateralization Programs by State

Provides perspective on pool/non-pool State mix

Does Not Take Additional Differences Into Consideration:

1. Eligible Collateral Types
2. Collateral Movement
3. Custodian




Yellow (22) = Pooled
Green (26) = Non Pooled
Green & Yellow (3) = Pool/Non-Pool Options

Asterisk* (10) = Contingent Liability
**Bold (8)** = Software/Electronic Reporting

WELLS FARGO

Updated Oct, 2017

# Side by Side State Comparison

| Different States: | A | B | C | D |
|---|---|---|---|---|
| Pool: | Yes | No* | Yes | Yes |
| Contingent Liability: | Yes | N/A | Yes | No |
| Depository Rating Agency: | SNL | N/A | FIS & IDC | In house |
| Collateral %: | 70 – 115% | 100 – 110% | 25 – 150% | 100% |
| Software/IT: | Yes | No | No | No |
| Eligible Collateral: | UST, MBS, In-State Muni Bonds, FHLB LC, CMO, FHLMCG or GNMA | UST, MBS, Muni Bonds(any state), Surety Bonds, CMO, FHLB LC, FHLMCG or GNMA | UST, FFCB, FLB, GO & Revenue Bonds, Muni Bonds(all states), All MBS, CMO, Real Estate Mortgage Conduits, Tax anticipation Certificate, FHLB LC, Corp Bonds, FHLMCG or GNMA | UST, Surety bonds, MBS, FHLB LC , FHLMCG or GNMA |

*Requires clients to notify their bank if a large deposit is being made to ensure immediate collateralization

# Contingent Liability Collateral Pool (Georgia Secure Deposit Program)

*Steve McCoy, State Treasurer*

*Georgia Office of the State Treasurer*

*November 30, 2017*

# *Why Contingent Liability Collateral Pool?*

- Large banks concern about high cost of collateral for public deposits given Basel III.
- Georgia previously offered only two options for public deposits collateralization – dedicated accounts and single bank pools. Both required 110% collateral.
- Public depositors need safety of deposits and to minimize banking fees.
- Simply reducing collateral requirements not acceptable due to higher risk.

# Georgia SDP Legislation

- State Treasurer, Banking Commissioner, and Georgia Bankers Association built a consensus among banks and local government associations for the need for legislation to establish the SDP, to reduce collateral in exchange for a contingent guarantee among all banks in the pool.
- Legislation was introduced on January 21, 2016, passed the House (162-1), the Senate (51-3), and sent to the Governor on March 29.
- OST worked with a task force to develop the SDP Policy which was approved by the State Depository Board and became effective on July 1, 2017.
- SDP Policy and program details located at http://sdp.azurewebsites.us/.

# Georgia SDP Participants

- Mandatory Participants are banks accepting public deposits in Georgia and have ≥ $50B in assets.
- Voluntary Participants are banks accepting public deposits in Georgia and have < $50B in assets that apply and are accepted.
  - Acceptance is conditioned upon financial criteria and State Depository Board approval.
  - Approved banks receive one year certificates subject to annual renewal.
  - The board may reject renewals at its discretion.
- Participating banks are required to secure all Georgia public deposits by the SDP (unless exempted).

# Georgia SDP Collateral Requirements

- The SDP has 4 Tiers determining collateral level: Tier I 25%; Tier II 50%; Tier III 75%; and, Tier IV 110%.
- The Tier for each bank is determined quarterly and based on financial condition.
- The State Treasurer, in consultation with Banking Commissioner, may increase required collateral up to 125% for any or all banks in order to proactively respond to deteriorating credit conditions.

# Georgia SDP Eligible Collateral

- Participating banks may pledge securities permitted by the SDP Policy. The State Depository Board is empowered to expand or contract eligible collateral. Currently, the following securities are permitted:
  - Treasuries, Agencies, SBA Pass-throughs, some Agency Mortgage Backs
  - GA municipal bonds (BBB); Out of State Municipals (A) with 25% limit
  - State-issued Private Placements with Treasurer's approval.
- Letters of Credit from the Federal Home Loan Bank are accepted as Eligible Collateral.

# Georgia SDP Contingent Liability

- Mandatory and Voluntary Participants are obligated to make public depositors whole from any loss of deposits secured by the SDP.
- Each depository's share of any shortfall liability will be assessed on a pro-rata basis.
- The contingent liability obligation continues for 12 months after a Voluntary Bank leaves the pool or a Mandatory Bank ceases to hold public deposits in Georgia.

# Georgia SDP Oversight & Reporting

- OST maintains overall oversight and responsibility for the SDP.
- OST contracts with Georgia Bankers Association to carry out certain administrative duties.
- Participating banks assessed fees to cover costs of administering SDP.
- Depositories report required information including public deposits, collateral, depositors, etc. in a secure, web-based platform.
- Public and internal reports are generated in the same platform.

# Sample 30-day SDP Report

## Georgia Secure Deposit Program Review

11/21/2017

As of: 9/30/2017

1,334 Total Depositors Reported.

| Bank Name | Total Public Deposits in Acounts Requiring Collateralization | FDIC Insurance Covering Public Deposits | Total Net Deposits in Pool (Total Public Deposits Req. collateralization less FDIC Insurance) | Pledge Level % | Total Required Collateral | Current Reported Collateral | Over /Under | Pro Rata - Net Deposits - Current Reporting Period |
|---|---|---|---|---|---|---|---|---|
| Ameris Bank | $400,819,799 | $38,972,898 | $361,846,901 | 50% | $180,923,450 | $181,936,249 | $1,012,798 | 4.55% |
| Bank of America, National Association | $1,018,273,860 | $15,214,266 | $1,003,059,594 | 25% | $250,764,898 | $325,000,000 | $74,235,102 | 12.62% |
| Branch Banking and Trust Company | $1,146,632,456 | $56,657,794 | $1,089,974,662 | 50% | $544,987,331 | $621,361,519 | $76,374,188 | 13.72% |
| Calumet Bank | $17,780,778 | $1,450,684 | $16,330,094 | 50% | $12,247,571 | $14,506,548 | $2,258,978 | 0.21% |
| Citibank, N.A. | $0 | $0 | $0 | 50% | $0 | $0 | $0 | 0.00% |
| Fifth Third Bank | $4,063,443 | $288,970 | $3,774,473 | 50% | $1,887,236 | $2,140,014 | $252,777 | 0.05% |
| First Landmark Bank | $28,716,199 | $2,457,316 | $26,258,883 | 50% | $13,129,441 | $13,920,153 | $528,885 | 0.33% |
| JPMorgan Chase Bank, National Association | $142,056,750 | $3,223,609 | $138,833,141 | 50% | $69,416,571 | $300,000,000 | $230,583,430 | 1.75% |
| PNC Bank, National Association | $74,750,442 | $9,186,957 | $65,563,485 | 50% | $32,781,743 | $53,795,631 | $21,013,889 | 0.83% |
| Regions Bank | $344,823,166 | $23,906,100 | $320,917,066 | 50% | $160,458,533 | $211,233,249 | $50,774,717 | 4.04% |
| SunTrust Bank | $2,315,154,364 | $68,304,509 | $2,246,849,856 | 50% | $1,429,533,107 | $1,762,093,348 | $483,779,278 | 28.27% |
| The Commercial Bank | $17,693,234 | $1,347,177 | $16,346,057 | 25% | $4,086,514 | $4,392,251 | $305,737 | 0.21% |
| U.S. Bank, National Association | $0 | $0 | $0 | 50% | $0 | $0 | $0 | 0.00% |
| Wells Fargo Bank, National Association | $2,741,462,128 | $84,705,564 | $2,656,756,564 | 50% | $1,839,439,815 | $2,177,479,823 | $338,040,007 | 33.43% |
| | $8,252,226,619 | $305,715,844 | $7,946,510,776 | | $4,539,656,211 | $5,667,858,785 | $1,279,159,785 | |

Note: Net deposits used for calculating 20% of pool for additional required collateral: $8,173,167,490.00

Note: Banks showing required collateral level totals above their required percentages indicate they have either deposits above 20% of net deposits in the pool based on above threshold, deposits above 200% of their Common Equity Tier 1 Capital or a combination of both, which requires additional collateral.

# PUBLIC SECTOR COLLATERAL MANAGEMENT MODEL: CONSIDERATIONS FOR DISCUSSION

November 2017



J.P.Morgan

J.P.Morgan

# Public Sector Collateral Management Model - Introduction

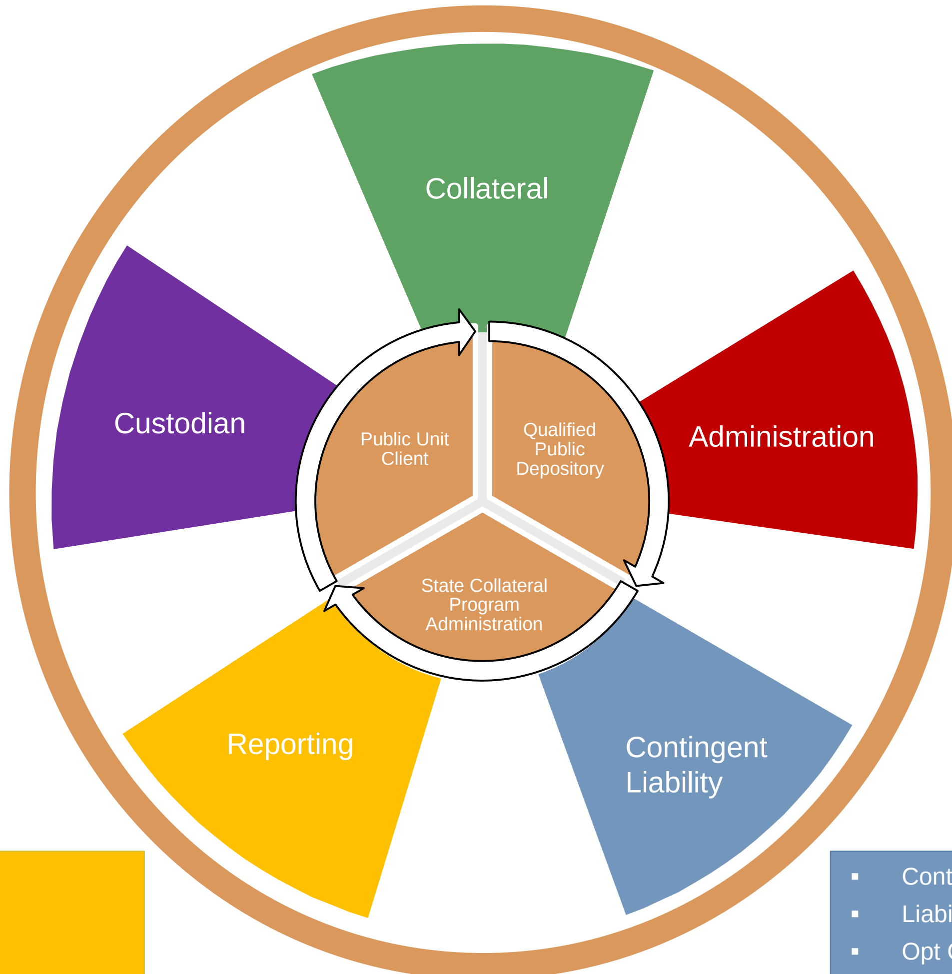
## Background and Introduction

- **What Is a Public Sector Collateral Management Model?**
  - A set of laws, regulations and rules that guide the management and administration of public fund deposits, which considers factors surrounding collateral, administration, reporting, custodians, and potentially contingent liability
  - Stakeholders in the model include the state Collateral Program Administrator, the public unit entities (municipalities, etc.), and the qualified bank depositories
  - Almost every state public sector collateral model is uniquely designed to fit the needs of public units in that state
- **What is the Current Environment Around Collateral Management Models?**
  - With changing and heightened regulatory requirements on depository banks, and the stressed rate environment, banks are finding it increasingly more challenging to participate in public sector depository business
  - As a result, some public units are having difficulty finding banking service providers since fewer banks are participating in this type of business
  - Many states are in the process of revising their public sector collateral management models to address these stress points
- **Who Benefits?**
  - By balancing considerations around collateral management, administrative oversight, cost considerations and safety of public unit deposits - the State Collateral Administrator, the Public Units, and the Qualified Public Depositories all benefit
- **What is J.P. Morgan Chase's Perspective?**
  - As a national provider of banking services in the public sector, we participate in multiple state public sector collateral management programs and we are uniquely positioned to understand the components and benefits of a well organized program

# Public Sector Collateral Management Model – Integrated View

- Eligible Collateral Types
- Collateralization Rate (percentage) and Tier Structure
- Collateral Valuation Method
- Collateral Substitutions
- Collateral Release

- Approved Custodians
- QPD as Custodian




- QPD Designation
- Structure (Pool vs. Direct pledge)
- Safe Harbor
- State Collateral Administration Fees
- Depository Bank Risk Ranking Criteria
- Deposit Concentration of QPD
- Independent Review by State Collateral Administrator

- Format
- Frequency
- Content
- Monitoring

- Contingent Liability Model
- Liability Calculation
- Opt Out Provision (by holding 100% collateral)
- Insurance Fund