Treasury Management

Certified Government Finance Officer (CGFO)
Combined Study Guide

PowerPoint Review Presentations

Treasury Management

Certified Government Finance Officer (CGFO) Review Session

Exam Topics

Investment Policy and Regulations - 40%

Investment Types – 15%

Ratings and Duration – 10%

Collections/Receipts/Cash Flow – 15%

Managing Banking Services – 20%

Investment Policy and Regulations

Learning Objectives

Recall the Florida statute requirements for local government investment policies

Identify the areas of focus for written investment policies

Recognize the objectives of local government investments

Identify the types of authorized investments

Learning Objectives

Recall the risks associated with investments

Recall the purpose of the Federal Reserve System

Identify requirements to serve as Board Member of Federal Reserve System

Recognize the roles and responsibilities of the Federal Reserve System

Local Government Investment Policies

Local Government Investment Policies

Florida Statutes 218.415

Local Government Investment Policies

- Written plan is not required
- Highest priority is the safety of the principal and liquidity of the funds
- Yield shall be secondary to the requirements for safety and liquidity

Local Government Investment Policies

Securities Purchased must be properly earmarked and;

- If registered with the issuer or its agents, must be immediately placed in safekeeping
- If in book entry, must be held for the credit of the governing body in an account separate and apart from the other assets of the financial institution
- If physically issued it must be held in a safe

Local Government Investment Policies

Authorized Deposits – Allows for the investment in CDARS

- Certificate of deposit account registry service or other similar services
- CDARS divides deposits into amounts that are equal to the FDIC insurance limit and spreads them amount many FDIC institutions allowing a larger deposit to be FDIC insured

Local Government Investment Policies

Florida Statutes 218.415 – Local Government Investment Policies

Sale Of Securities

- When the invested funds are needed or the purpose originally intended or for more optimal investments, they must be sold at the then-prevailing market price

Pre-existing Contract

- Any public funds subject to a contract or agreement existing on October 1, 2000, may not be invested contrary to such contract or agreement

Local Government Investment Policies

Florida Statutes 218.415 – Local Government Investment Policies

Audits

- Certified Public Accountants conducting audits of Local Governments shall report, as part of the audit, whether or not the Local Government has complied with this section

Local Government Investment Policies

Written investment policies must address the following 15 points adopted by the **Government Body** (e.g. Ordinance, and/or Resolution)

Scope	Risk and Diversification
Investment Objectives	Third Party Custodial Agreements
Performance Measurement	Master Repurchase Agreement
Prudent and Ethical Standards	Bid Requirements
Listing of Authorized Investments	Internal Controls
Maturity and Liquidity Requirements	Continuing Education
Portfolio Composition	Reporting
Authorized Investment Institutions & Dealers	

Local Government Investment Policies

Scope – Applies to funds in excess of those required to meet current expenses (does not apply to pension funds or funds related to debt where other policies or indentures apply)

- **Governing authority** – Legal
- **Applicability** – What Funds are Covered
- **Exclusions** – What Funds are not Covered
- **Pooling of funds** – Pooled Cash and Distribution in Investment Proceeds
- **Arbitrage** – Investment Earnings on Debt Subject to US Treasury Guidance

Local Government Investment Policies

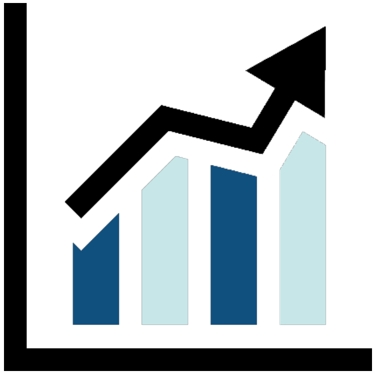
General Objectives in priority order:

- **Safety –** Credit and Interest Rate Risks
- Liquidity
- Yield
- Local Considerations

Local Government Investment Policies

Performance Measurement – Shall specify **performance measures** that are appropriate for the nature and size of the portfolio

- Methods
- Performance Standards
- Marketing to Market

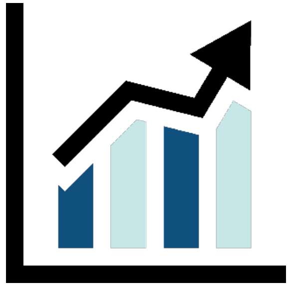


Local Government Investment Policies

Performance Measurement

Portfolio Returns

Effective Rate of Return	Risk Adjusted Return
Total Return	



Investment Returns

Coupon Yield	Current Yield
Discount Yield	Horizon Yield
Option Adjusted Yield	Yield to Maturity
Yield to Call	

Local Government Investment Policies

Prudent and Ethical Standards

Prudence "Prudent Person"

- Investments should be made with judgement and care, under circumstances then prevailing, which **persons of prudence, discretion, and intelligence** exercise in the management of their own affairs
- **Not for speculation**, but for investment, considering the probable safety of their capital as well as the probable income to be derived from the investment

Local Government Investment Policies

Prudent and Ethical Standards

Ethics and Conflicts of Interest

- Activities which could conflict with the proper execution and management of the investment program or could impair the ability to make impartial decisions

Delegation of Authority

▪ Governing Body	▪ Investment Officer
▪ Investment Committee	▪ Investment Advisors/Manager

Local Government Investment Policies

Listing of Authorized Investments

Collateralization

Investment Types

Repurchase Agreements

Purchase of Derivatives

Local Government Investment Policies

Listing of Authorized Investments

- **Collateralization**
  - Borrower pledges an asset as a recourse to the lender in the event the borrower defaults on the initial loan

- **Investment Types:**
  - Investment policy shall list authorized investments
  - Investments not listed are prohibited

Local Government Investment Policies

Written Investment Policy	No Written Investment Policy
SBA – Florida Prime	SBA – Florida Prime
SEC Registered Money Market Funds	SEC Registered Money Market Funds
CDs in Qualified Public Depositories	CDs in Qualified Public Depositories
Direct Obligations of the US Treasury	Direct Obligations of the US Treasury
Federal Agencies and Instrumentalities	
Instruments Backed by the Full Faith & Credit of Israel	
Registered Investment Company or Trust in US Govt, Agencies, or Instrumentalities – Take Possession	
Other Authorized Investments	

Local Government Investment Policies

Listing of Authorized Investments

❑ Derivatives

- Staff must have sufficient understanding and expertise if derivatives are authorized
- A **Derivative** is defined as a financial instrument the value of which depends on, or is derived from, the value of one or more of the underlying assets or index of values
- Mortgage backed securities (Example)

Local Government Investment Policies

Maturity and Liquidity Requirements

- The investment policy shall require that the investment portfolio is structured in such a manner as to provide sufficient liquidity to pay obligations as they come due
- To the extent possible, an attempt will be made to match investment maturities with known cash needs and anticipated cash-flow requirements

Local Government Investment Policies

Portfolio Composition

- The investment policy shall establish guidelines for investments and limits on security issues, issuers, and maturities
- Such guidelines shall be commensurate with the nature and size of the portfolio
- Passive management strategy or Active management strategy

Local Government Investment Policies

Portfolio Composition

Passive Management Strategy – Minimizes the training and labor to attain market-average portfolio performance

Managed Assets – Includes money market mutual funds and investment pools

Laddered Maturities – Investments are placed in every investment maturity within a given range

Barbell Maturities – Investing short-term (1-2 year) and long-term (30 years)

Horizon Investing – Investing money in instruments that mature when money is needed

Rolling T-Bills – Purchasing new T-Bills upon maturing of existing T-Bills

Local Government Investment Policies

Portfolio Composition

Active Management Strategy – increase portfolio performance by exceeding market-average rate of return

Market-timing – timing the market based on conditions

Money market arbitrage – reverse repurchase agreement

Downgrade investment quality – investing in low credit rated securities which results in a higher rate of return

SWAPS – derivative contract where two parties exchange financial instruments

Local Government Investment Policies

Portfolio Composition

Active Management Strategy

Yield curve analysis – analyzing interest rates which are affected by economic and political conditions

Buying long-term securities with the intent of selling the securities in the short-term on the secondary market is known as riding the yield curve

Riding the yield curve is more effective if short-term rates are rising

As the value of a bond increases, the yield decreases

Local Government Investment Policies

Authorized Investment Institutions And Dealers

- Policy should specify the authorized securities dealers, issuers, and banks from whom the unit of local government may purchase securities

▪ **Broker –** brings buyers and sellers together for a fee (e.g., Real estate agent)

▪ **Dealer –** bids to buy securities and offers securities for sale to a buyer (e.g., car dealership)

▪ **Direct issuer –** examples includes commercial paper and banker's acceptance securities

▪ Qualified public depositories (**QPDs**)

▪ Minority and community financial institutions

Risk and Diversification

- Types of Risk
- Managing Risks
- Diversification

Local Government Investment Policies

Risk and Diversification

Call Risk – A security will be called before it matures

Counterparty Credit Risk – Associated with derivatives and is the risk that a counterparty will not complete the repurchase transaction

Credit Or Default Risk – An issuer will default in payment of interest and/or principal

Custodial Credit Risk – Custodian will default

Geo Political Risk – War, disease, change in leadership will be affected by economic and political conditions

Local Government Investment Policies

Risk and Diversification

Interest Rate (Market) Risk – changes in interest rates which cause a fixed income security to change value

Liquidity Risk – Cash will not be available when needed

Reinvestment Risk – Cash generated by a security will be invested at a lower rate than the prevailing rate

Safekeeping Risk – Funds or securities in safekeeping will not be there when needed

Derivative Risk – A combination of counterparty credit risk, custodial risk, and market risk

Local Government Investment Policies

Risk and Diversification

Financial Reporting as Required by GASB 40 Addresses:

- Credit Risk (Custodial & Concentration)
- **Interest Rate Risk**
- Foreign Current Risk

Methods to identify and manage interest rate risk

• **Segmented Time Distribution**	• **Specific Identification**
• **Weighted Average Maturity**	• **Duration**
• **Simulation**	

Local Government Investment Policies

Risk and Diversification

Credit Risk Disclosure

- Dissimilar investments should not be aggregated
- Disclosure involves the credit quality ratings of investments in debt securities held in the portfolio at year-end
- Treasury securities are not considered to have credit risk

Local Government Investment Policies

Risk and Diversification

Custodial Credit Risk – Disclosure when securities are:

- Uninsured and not collateralized
- Collateralized with securities held by the counterparty
- Collateralized with securities held by the counterparty’s trust department but not in the government’s name

Local Government Investment Policies

Risk and Diversification

Concentration of Credit Risk

- Disclose by amount and issuer, investments in any one portfolio that represents more than 5% of the portfolio (investments in mutual funds, investments pools, and treasuries are excluded)

Local Government Investment Policies

Risk and Diversification

Diversification

Investments should be diversified to the extent practical to control the risk of loss resulting from overconcentration of assets in a specific maturity, issuer, instrument, dealer, or bank

Diversification strategies shall be reviewed and revised periodically

Don’t put all of your eggs in one basket

Local Government Investment Policies

Risk and Diversification

Covariance

- Measure of the degree to which returns on two securities move in tandem
- Positive covariance means returns move together
- Negative covariance means returns vary inversely

Asset Allocation

- Involves dividing the portfolio among different asset categories, such as bonds, stocks, and cash

Local Government Investment Policies

❑ **Third-Party Custodial Agreements**

- Securities should be held with a third party; and all securities purchased, and all collateral obtained, should be properly designated as an asset of the unit of local government
- No withdrawal of securities shall be made from safekeeping, except by an authorized staff member
- Securities transactions between a broker-dealer and the custodian **must** be made on a **delivery vs. payment** basis

Local Government Investment Policies

- **Master Repurchase Agreements**
  - Governing agreement with a dealer, broker, bank that will guide future potential investment opportunities

Repurchase Agreement - Agreement for a specific investment which establishes the amount to be invested, rate, and more importantly, the investment period

- XWY Government will invest $100,000 at 2% on February 1 until February 15
- Ensures liquidity when needed

Local Government Investment Policies

Bid Requirements

Staff determines the required maturity date based on cash-flow needs and market conditions

Analyze and select one or more optimal types of investments

Competitively bid the security in question when feasible and appropriate

Local Government Investment Policies

Internal Controls

- The investment policy shall provide for a system of internal controls and operational procedures
- Are the responsibility of the investment officer
- The officials responsible for making investment decisions shall establish a system of internal controls which shall be in writing and made a part of the operational procedures
- To be reviewed by independent auditors as part of any financial audit

Local Government Investment Policies

Internal Controls

- Designed to prevent loss of funds which might arise from fraud, employee error, misrepresentation by third parties, or imprudent actions
- Internal controls may include, but are not limited to:

▪ **Separation of Transaction Authority from Accounting**	▪ **Staff Training and Monitoring Procedures**
▪ **Custodial Safekeeping**	▪ **Avoidance of Physical Delivery**
▪ **Confirmations of Transactions/Wires**	▪ **Documentation**
▪ **Dual Authorization of Wire Transfers**	▪ **Clear Delegation of Authority**

Local Government Investment Policies

Continuing Education

- The investment policy shall provide for the continuing education of officials responsible for making investment decisions
- Officials must complete **8** hours of continuing education related to investment practices and products each year

Local Government Investment Policies

- **Reporting**
  - Shall provide for annual or more frequent reporting of investment

Interim Reporting

Frequency	In Conformance with Law
Staff Availability	In Conformance with Preference
Complexity	

Annual Reporting

Investment Manager's portfolio Outlook	Overall Performance Appraisal by Class
Economic Outlook	Interest Rate Trends
In Conformance with Law	

Local Government Investment Policies

- **Reporting**
  - The report shall include securities in the portfolio by class or type, book value, income earned, and market value as of the report date

Portfolio by Class or Type	**Maturity Structure**
Investment Quality	**Market Exposure**
Book Value	**Income Earned**
Market Value	**Bench Marks**

Local Government Investment Policies

❑ **Reporting**

GASB 31 Financial Reporting

- Establishes fair value standards for investments in interest-earning investment contracts, external investment pools, open-end mutual funds, debt securities, equity securities
- Report investments at fair value on the balance sheet
- Report all investment income, including changes in fair value, as revenue on the operating statement

Local Government Investment Policies

Authorized Investment Institutions and Dealers

Level of authority

Request for proposal and selection criteria

Advisory agreement

On-going review (see reporting)

Local Government Investment Policies

Authorized Investment Institutions and Dealers

Level of Authority

- **Non-Discretionary Agreement –** Advisor must obtain approval before executing any trade
- **Discretionary Agreement –** Advisor can execute trades for the government without prior approval on each transaction

Local Government Investment Policies

Authorized Investment Institutions and Dealers

Request for Proposal and Selection Criteria

- SEC Licenses
- Quantitative Information
- Organizational Structure of Firm and Business Affiliations
- Experience and Depth of Personnel
- Reporting Standards
- Investment Philosophy & Portfolio Management Strategies
- Trading Process
- Interview with Finalists
- Understanding Regulatory Censure or Litigation

Local Government Investment Policies

Authorized Investment Institutions and Dealers

Advisory Agreement

- Scope of services
- Appointment of the investment advisory and fiduciary responsibilities
- Establishment of account responsibilities
- Definition of accounts and custody
- Definition of discretionary or non-discretionary services with appropriate limitations
- Definition of standards (prudent expert)
- Establishment of objectives, restrictions, and benchmarks

Local Government Investment Policies

Authorized Investment Institutions and Dealers

Advisory Agreement

- Definition and processing of transaction procedures in accordance with policy including brokerage limitations
- Representations by entity and investment adviser
- Determinations of reasonable liability insurance for errors and omissions
- Establishment of invoicing and payment
- Procedure for termination by either party
- Specifications related to non-discrimination in contracting and ethic rules
- Certification of the government's policy by the investment adviser
- All provisions of the RFP as part of the contract

Federal Regulations

Federal Reserve System

- ❑Federal Reserve Act of 1913
- ❑Board of Governors
- ❑Federal Open Market Committee

Federal Reserve System

Federal Reserve Act of 1913

- "… to provide for the establishment of federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

Federal Reserve System

Board of Governors

- Seven members
- Nominated by the President
- Confirmed by Senate
- 14-Year terms

Federal Reserve System

Federal Open Market Committee

Twelve members

- Seven members of the Board of Governors
- President of the NY Federal Reserve Bank
- Four rotating member from remaining 11 federal reserve banks, each serving a one-year term

Federal Reserve System

Monetary Policy

Principal Responsibility:

- Foster the long-term objectives of price stability and sustainable growth through monetary policy
  - Bank Reserve Requirements
  - **Discount Rate –** Rate on loans by fed to member banks
  - Open market operations
    - Buy & sell U.S. treasuries
    - Designate and maintain list of primary dealers
  - Direct bank regulations

Federal Reserve System

Monetary Policy

Manages the money supply through open market operations

- Tight money supply increases the cost of credit
- Decrease money supply- sell securities
- “Relaxed” money supply decrease the cost of credit
- Expand money supply – buy securities

Investment Types

Learning Objectives

Recall the different types of investments

Identify the characteristics of each type of investment

Investment Types

- U.S. Treasury notes and bonds
- Federal agency securities
- Federal instrumentalities
- Investment pools
- Repurchase agreements
- Derivatives
- Securities lending agreements
- Other securities

Investment Types

U.S. Treasury Bills

- Backed by full faith and credit of the U.S. Government
- Credit & default risk fee
- Highly liquid
- Lowest rate of return (normally)
- Matures in one (1) year or less
- Sold and matures on Thursdays

Investment Types

U.S. Treasury Bills

- Issued at discount, interest paid at maturity
  - Discount = term X discount % / 360
  - Selling price = $100 – discount
  - Yield = earnings / price
  - Bond equivalent yield = discount / dollar price X 365 / term

Investment Types

U.S. Treasury Notes and Bonds

- Backed by full faith and credit of the U.S. Government
- Credit & default risk fee
- Highly liquid
- Slightly higher interest rate of return than bills (normally)
- Coupon bearing
- Interest paid semi-annually
- Matures from 2 – 30 years

Investment Types

Federal agencies

- ❑ Instruments backed by full faith and credit of U.S. Government
- ❑ Generally higher interest rates than comparable treasuries
- ❑ Generally long-term instruments
- ❑ Subject to liquidity and market risks

Examples:

- Small business administration
- Export-import bank
- Government national mortgage association

Investment Types

Federal instrumentalities

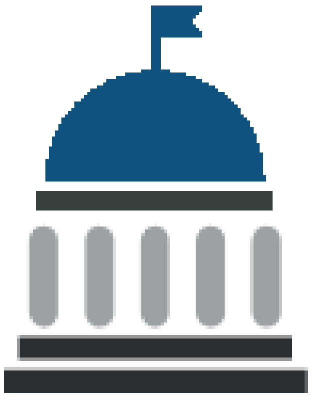
- Government-sponsored enterprise
- Established to implement federal lending programs
- Carries an implied backing of the federal government
- Backed by the full faith and credit of the issuing agency
- Generally higher interest rates compared to treasuries
- Short and long-term instrument

Investment Types

Federal Instrumentalities

Examples:

- Federal Farm Credit Banks
- Federal Home Loan Banks
- Federal Home Loan Mortgage Corporation
- Federal Nation Mortgage Corporation



Investment Types

Investment Pools

Allows local governments to pool funds to potentially achieve a higher rate of return

Pool sponsors (state-operated, political sub-divisions, third-parties)

❑ Before investing:

- Review policies – compare to your local government's investment policy
- Understand how they calculate and report interest
- Know the withdrawal requirements
- Know the costs

Investment Types

Repurchase agreements

- **Master repurchase agreements –** Governing agreement with a dealer, broker, bank that will guide future potential investment opportunities
- **Repurchase agreement –** Agreement with a counterparty for a specific investment which establishes the amount to be invested, rate, and more importantly, the investment period

- XWY government will invest $100,000 at 2% on February 1 until February 15
- Ensures liquidity when needed

Investment Types

Repurchase agreements

Reverse repurchase agreement

Purchase of securities with the agreement to sell them at a higher price at a specific date **(leveraging)**

For the party selling the security and agreeing to repurchase it in the future, it a repurchase agreement

For the party that is buying the security and agreeing to sell it in the future it is a reverse repurchase agreement

Classified as money market instrument and usually used to raise short-term capital

Investment Types

Other Securities

- **Asset-backed securities –** debt instruments backed by a pledge of assets such as cars, mobile homes, or loans
- **Banker's acceptance –** short-term debt securities (matures in less than 270 days) used to finance foreign trade transactions
- **Money market mutual funds –** short-term investments regulated by the securities and exchange commission rule 2a-7
- **Certificate of deposits –** time deposits which may be negotiable or non-negotiable; Florida prohibits negotiable CDs as an authorized investment

Investment Types

Other Securities

- **Commercial paper –** unsecured promissory notes of corporations maturing in 270 days or less
- **Mortgage backed securities –** debt instruments backed by a pledge of mortgage asset
- **Collateralized mortgage obligations (CMO) –** fixed income security that uses mortgage backed securities as collateral
- **Zero-coupon securities –** interest is paid upon final maturity
- **Odd lot –** order for a security that is less than the normal unit of trading

Investment Types

Derivatives

- Financial instrument whose value depends on, or is derived from, the value of one or more underlying assets or index or asset value

- **Put Option –** contract giving the owner the right, but not the obligation, to sell a specific amount of an underlying security at a specified price within a specified time period
- **Call Option –** agreement that gives an investor the right, but not the obligation, to buy a stock, bond, commodity, or other instrument at a specified price within a specified time period

Investment Types

Securities lending agreement

Generally conducted between brokers and/or dealers and not individual investors

Lender allows an investor to **borrow** (risk) an investment for a specified time for a price

Ownership of the asset transfers to the borrower

Borrower sells the asset with the hope to re-purchase the asset at a lower price

Securities lending agreement sets forth the terms

Ratings and Duration

Learning Objectives

Recall the different types of credit ratings

Identify the components of duration

Ratings and Duration

Credit Ratings

Investment Grade	
AAA	Extremely Strong Financials or Insured
AA	Very Strong Financials
A	Strong Financials
BBB	Good Financials

Ratings and Duration

Credit Ratings

Non-Investment Grade	
BB	Marginal Financials
B	Weak Financials
CCC/CC	Very/Extremely Weak Financials
R	Under Supervision

Ratings and Duration

Duration

Based on three variables:

- Term to maturity
- Coupon rate
- Yield to maturity

- Most commonly used to measure interest rate risk in bond investing

Ratings and Duration

Duration

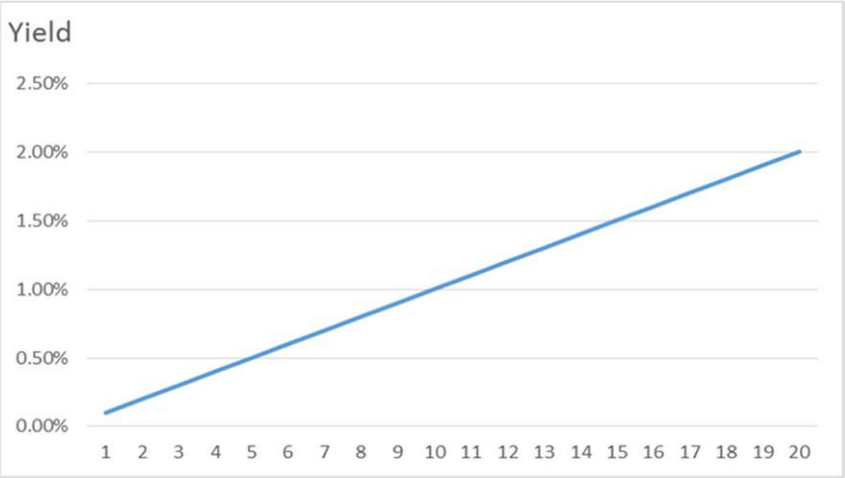
- **Fixed-income portfolio management**
  - Measures the average maturity of the portfolio
  - Immunizing portfolios from interest rate risk
  - Measures the sensitivity of price of a fixed rate investment to a change in interest rates

Ratings and Duration

Yield Curve

- Yields are low in the near term and rise for the long-term
- The longer the duration, the higher the interest rate risk and credit risk
- Value of a bond increases as the rate of return decreases

Normal Yield Curve



Collection/Receipts/Cash Flow

Learning Objectives

Identify the different methods of collections

Recall the internal controls for receipts

Define the types of collection floats

Recall the purpose of a cash flow forecast

Collections and Cash Flow

Collections

- Internal controls versus decreasing collections float

- **Central cashier and cash collections –** desirable if reasonable
- **Remote cashiering and cash collections –** should be used only where beneficial
- **Lockbox collections –** post office box for payments that are picked up by a bank and deposited
- **Federal wires –** fastest way to transfer/deposit funds through the federal reserve system
- **Accounts Receivable –** send invoices promptly

Collections and Cash Flow

Collections

- **Credit Cards**
  - **Merchant fees –** paid per transaction
  - **Interchange fees –** paid for the use of funds between merchant financial institution and the time of the settlement

Revenue control and management policy should consider:

▪ Internal Controls	▪ Returned Checks
▪ Billing Practices	▪ Escrowed Funds
▪ Depositing Funds Received for Service	▪ Budgetary Review Responsibilities

Collections and Cash Flow

Collections

❑ Cash Collection Internal Controls

▪ Segregation of Duties	▪ Daily Processing
▪ Timely Deposit of Funds	▪ Reconciliation to the General Ledger
▪ Physical Security	▪ Timely Pick-up From Remote Sites

Returned payments

- Process returned payments quickly
- GFOA recommends to deposit a returned check no more than twice

Collections and Cash Flow

Collections Float

Administrative Float	Time to process a receipt
Collection Float	Time to deposit a receipt
Mail Float	Time the receipt is in the mail
Availability Float	Time between the deposit and when funds become available

Collections and Cash Flow

❑ Treasury Cash Flow Forecast

- Used in the analyzing available surplus eligible to be invested and the term of the investment

❖ Liquidity needs

❖ Maximum maturities

❖ **Core fund –** surplus funds available for long-term investing

- Analysis of cash balances over time – not accounting or budgeting
- Understand the inflows and outflows of cash for your organization

Collections and Cash Flow

Treasury Cash Flow Model

		October	November	December	January	February	March	April	May	June	July	August	September
1	Beginning Cash Balance:	$ 2,000,000	$ 775,000	$ 350,000	$ 1,875,000	$ 400,000	$ 925,000	$ 950,000	$ 75,000	$ 100,000	$ 125,000	$ 650,000	$ 175,000
2													
3	**Revenues:**												
4	Property Taxes			$ 6,000,000	$ 3,000,000	$ 1,000,000	$ 500,000						
5	Other Revenues	$ 500,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000	$ 1,000,000
6	**Total Cash Balance & Revenues**	**$ 2,500,000**	**$ 1,775,000**	**$ 7,350,000**	**$ 5,875,000**	**$ 2,400,000**	**$ 2,425,000**	**$ 1,950,000**	**$ 1,075,000**	**$ 1,100,000**	**$ 1,125,000**	**$ 1,650,000**	**$ 1,175,000**
7													
8	**Expenditures:**												
9	Salaries & Benefits	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)	$ (100,000)
10	Operating Expenditures	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)	$ (125,000)
11	Capital Improvement Expenditures	$ (100,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)	$ (250,000)
12	Debt Service Payments							$ (2,500,000)					$ (5,000,000)
13	**Total Expenditures:**	**$ (325,000)**	**$ (475,000)**	**$ (475,000)**	**$ (475,000)**	**$ (475,000)**	**$ (475,000)**	**$ (2,975,000)**	**$ (475,000)**	**$ (475,000)**	**$ (475,000)**	**$ (475,000)**	**$ (5,475,000)**
14													
15	Investments Maturing		$ 50,000					$ 2,100,000	$ 500,000	$ 500,000	$ 1,000,000	$ -	$ 5,500,000
16	Minimum Cash Requirement	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)	$ (1,000,000)
17	Surplus Cash - Available to Invest	$ 1,175,000	$ 350,000	$ 5,875,000	$ 4,400,000	$ 925,000	$ 950,000	$ 75,000	$ 100,000	$ 125,000	$ 650,000	$ 175,000	$ 200,000
18													
19	Amount Invested	$ (400,000)		$ (4,000,000)	$ (4,000,000)								
20	Ending Cash Balance	$ 775,000	$ 350,000	$ 1,875,000	$ 400,000	$ 925,000	$ 950,000	$ 75,000	$ 100,000	$ 125,000	$ 650,000	$ 175,000	$ 200,000
21													
22													
23	**Investment Portfolio Balances**												
24	Beginning Portfolio Balance	$ 10,000,000	$ 10,400,000	$ 10,350,000	$ 14,350,000	$ 18,350,000	$ 18,350,000	$ 18,350,000	$ 16,250,000	$ 15,750,000	$ 15,250,000	$ 14,250,000	$ 14,250,000
25	Increased Investments	$ 400,000	$ -	$ 4,000,000	$ 4,000,000	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
26	Maturities	$ -	$ (50,000)	$ -	$ -	$ -	$ -	$ (2,100,000)	$ (500,000)	$ (500,000)	$ (1,000,000)	$ -	$ (5,500,000)
27		$ 10,400,000	$ 10,350,000	$ 14,350,000	$ 18,350,000	$ 18,350,000	$ 18,350,000	$ 16,250,000	$ 15,750,000	$ 15,250,000	$ 14,250,000	$ 14,250,000	$ 8,750,000

Managing Banking Services

Learning Objectives

Recall the requirements for public deposits

Identify the components of general banking services agreement

Define the elements of positive pay

Recognize common terminology used in banking services

Learning Objectives

Identify the reporting for banking services

Recall other banking services available

Managing Banking Services

❑ Public Deposits

Qualified public depository (QPD) – banks and savings associations that has:

- A branch authorized to receive deposits in Florida,
- FDIC deposit insurance,
- Meets the requirements of F.S. 280, and
- Been designated by Florida chief financial officer as a QPD

A bank must be designated as a QPD to accept Florida public funds for deposit

Managing Banking Services

❑ Public Deposits

- ❑ A QPD can fail
- ❑ A QPD can be bought by another bank
- ❑ QPDs must file:
  - **Form 1295 –** public deposit identification and acknowledgement form
  - **Form 1004 –** qualified public depository annual report to the chief financial officer

Managing Banking Services

General Banking Services Agreement

- Collecting and transferring amounts
- Describe fees, warranties, limitations of liability
- Term
- Governing law
- Notice and insurance
- Process to amend/modify the agreement

Managing Banking Services

Positive pay

- Automated fraud detection tool
- Matches the check number and dollar amount of each check presented for payment against a list of checks previously authorized

Default preferences:

- Pay all checks – bank reports mismatched checks and **will pay** unless otherwise directed by the government
- Return all checks – bank reports mismatched checks and **will not** pay unless otherwise directed by the government

Managing Banking Services

Reverse positive pay

- Banks sends the issuer a list of checks presented for payment for review
- Allows the issuer to further investigate checks that do not match those checks that were issued

Managing Banking Services

- **Funds transfer schedules –** How transfers are initiated and approved
- **ACH fraud control agreement –** Selects ACH blocks and controls by account
- **Deposit agreement –** Establishes the accounts and account characteristics and authorized personnel

Managing Banking Services

Account Balances

Available balance	• Balance that may be withdrawn or invested
Average daily balance	• Balance that is used in calculating bank fees and overnight earnings
Compensating balance	• Excess balance available to indirectly pay bank service charges
Sweep balance	• Method to transfer surplus balances from a deposit account to an investment account

Managing Banking Services

Accounts

Zero-balance accounts

- Account with sufficient funds to cover outstanding checks and a reconciled zero-dollar balance

Cash concentration accounts

- Account whose funds are periodically transferred to zero-balanced accounts to pay obligations

Controlled payment account

- Controls the amount of cash being presented for payment

Managing Banking Services

Banking Charges

Fee for service

- Tailor banking services to includes only those services needed
- Interest income is not lost with a compensating balance
- Avoid requirement to maintain a reserve

▪ **Compensating balance -** excess balance available to indirectly pay bank service charges

Managing Banking Services

Reporting

- ❑ **Account analysis -** similar to personal banking statements, however, in greater detail

Bank reconciliation

- Compare bank's records with government records
- Identify errors
- Central management function in banking services

- **Proof of cash statement –** roll forward of each line in a bank reconciliation from one period to the next; highlights discrepancies

Managing Banking Services

Other Banking Services

- **Electronic benefits transfer –** Electronic system that allows a recipient to authorize transfer of government benefits from a federal account to a retailer
- **Remote deposit capture -** Decreases deposit float

▪ Simplified processing of deposits	▪ Reduced costs
▪ Accelerated clearing of checks	▪ Improved availability of funds
▪ Added convenience	▪ Reduced return items risk
▪ Item archive	▪ Digitized format and reporting
▪ Expands window for deposit	▪ No physical check to deposit

Key Terms and Definitions

Definitions – Florida Statutes

- **Unit of local government –** any governmental entity within the state, including: county, municipality, property appraiser, tax collector, supervisor of elections, authority, board, public corporation, or any other political subdivision of the state
- **Governing board –** the body or board in which the legislative power of the local government is vested
- **Chief financial officer –** the mayor, manager, administrator, clerk, comptroller, treasurer, director of finance, or other local government official, regardless of title, charged with administering the fiscal affairs of the government

Definitions – Florida Statutes

- **Short-term –** A maximum of six months of operations
- **Current expenses –** expenses to meet known cash needs and anticipated cash-flow requirements for the short-term
- **Surplus funds –** any funds in any general or specific account or fund of a unit of local government, or funds held by an independent trustee on behalf of a unit of local government, which in reasonable contemplation will not be immediately needed for the purposes intended
- **Trust fund –** the pooled investment fund created by FS 218.405 and known as the local government surplus funds trust fund

Reference Materials

Reference Materials

Florida Statutes

http://www.leg.state.fl.us/STATUTES/

- **Chapter 218.405 –** Local Government Surplus Funds Trust Fund; Creation; Objectives; Certification; Interest; Rulemaking
- **Chapter 218.415 –** Local Government Investment Policies
- **Chapter 280 -** Security for Public Deposits

Reference Materials

Federal Reserve System

- Purpose, Requirements to Serve and Roles and Responsibilities

Governmental Accounting Standards Board (GASB)

- **Statement No 31**
  - Accounting and Financial Reporting for Certain Investments and External Investment Pools
- **Statement No 40**
  - Deposit and Investment Risk Disclosures

Reference Materials

Government Finance Officers Association

- **Investing Public Funds**, Second Edition, Girard Miller w/Corinne Larson and W. Paul Zorn

- **Best Practices – Treasury and Investment Management**

Questions?

Thank You!

Florida Statutes

FLORIDA GOVERNMENT FINANCE OFFICERS ASSOCIATION

CERTIFIED GOVERNMENT FINANCE OFFICERS EXAM

REFERENCE MATERIALS GUIDE

TREASURY MANAGEMENT

FLORIDA STATUTES REFERENCES

218.405 Local Government Surplus Funds Trust Fund; creation; objectives; certification; interest; rulemaking.

(1) There is hereby created a Local Government Surplus Funds Trust Fund to be administered by the board and to be composed of local government surplus funds deposited therein by units of local government under the procedures established in this part. The board may contract with a professional money management firm to manage the trust fund.

(2) The primary objectives, in priority order, of investment activities shall be safety, liquidity, and competitive returns with minimization of risks.

(3) The trustees shall annually certify to the Joint Legislative Auditing Committee that the trust fund is in compliance with the requirements of this part and that the trustees have conducted a review of the trust fund and determined that the management of the trust fund is in accord with best investment practices.

(4) The board may adopt rules to administer the provisions of this section.

History.—s. 1, ch. 77-394; s. 3, ch. 98-124; s. 3, ch. 2008-59.

218.415 Local government investment policies.

Investment activity by a unit of local government must be consistent with a written investment plan adopted by the governing body, or in the absence of the existence of a governing body, the respective principal officer of the unit of local government and maintained by the unit of local government or, in the alternative, such activity must be conducted in accordance with subsection (17). Any such unit of local government shall have an investment policy for any public funds in excess of the amounts needed to meet current expenses as provided in subsections (1)-(16), or shall meet the alternative investment guidelines contained in subsection (17). Such policies shall be structured to place the highest priority on the safety of principal and liquidity of funds. The optimization of investment returns shall be secondary to the requirements for safety and liquidity. Each unit of local government shall adopt policies that are commensurate with the nature and size of the public funds within its custody.

(1) SCOPE.—The investment policy shall apply to funds under the control of the unit of local government in excess of those required to meet current expenses. The investment policy shall not apply to pension funds, including those funds in chapters 175 and 185, or funds related to the issuance of debt where there are other existing policies or indentures in effect for such funds.

(2) INVESTMENT OBJECTIVES.—The investment policy shall describe the investment objectives of the unit of local government. Investment objectives shall include safety of capital, liquidity of funds, and investment income, in that order.

(3) PERFORMANCE MEASUREMENT.—The investment policy shall specify performance measures as are appropriate for the nature and size of the public funds within the custody of the unit of local government.

(4) PRUDENCE AND ETHICAL STANDARDS.—The investment policy shall describe the level of prudence and ethical standards to be followed by the unit of local government in carrying out its investment activities with respect to funds described in this section. The unit of local government shall adopt the Prudent Person Rule, which states that: "Investments should be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived from the investment."

(5) LISTING OF AUTHORIZED INVESTMENTS.—The investment policy shall list investments authorized by the governing body of the unit of local government, subject to the provisions of subsection (16). Investments not listed in the investment policy are prohibited. If the policy authorizes investments in derivative products, the policy must require that the unit of local government's officials responsible for making investment decisions or chief financial officer have developed sufficient understanding of the derivative products and have the expertise to manage them. For purposes of this subsection, a "derivative" is defined as a financial instrument the value of which depends on, or is derived from, the value of one or more underlying assets or index or asset values. If the policy authorizes investments in reverse repurchase agreements or other forms of leverage, the policy must limit the investments to transactions in which the proceeds are intended to provide liquidity and for which the unit of local government has sufficient resources and expertise.

(6) MATURITY AND LIQUIDITY REQUIREMENTS.—The investment policy shall require that the investment portfolio is structured in such manner as to provide sufficient liquidity to pay obligations as they come due. To that end, the investment policy should direct that, to the extent possible, an attempt will be made to match investment maturities with known cash needs and anticipated cash-flow requirements.

(7) PORTFOLIO COMPOSITION.—The investment policy shall establish guidelines for investments and limits on security issues, issuers, and maturities. Such guidelines shall be commensurate with the nature and size of the public funds within the custody of the unit of local government.

(8) RISK AND DIVERSIFICATION.—The investment policy shall provide for appropriate diversification of the investment portfolio. Investments held should be diversified to the extent practicable to control the risk of loss resulting from overconcentration of assets in a specific maturity, issuer, instrument, dealer, or bank through which financial instruments are bought and sold. Diversification strategies within the established guidelines shall be reviewed and revised periodically, as deemed necessary by the appropriate management staff.

(9) AUTHORIZED INVESTMENT INSTITUTIONS AND DEALERS.—The investment policy should specify the authorized securities dealers, issuers, and banks from whom the unit of local government may purchase securities.

(10) THIRD-PARTY CUSTODIAL AGREEMENTS.—The investment policy shall provide appropriate arrangements for the holding of assets of the unit of local government. Securities should be held with a third party; and all securities purchased by, and all collateral obtained by, the unit of local government should be properly designated as an asset of the unit of local government. No withdrawal of securities, in whole or in part, shall be made from safekeeping, except by an authorized staff member of the unit of local government. Securities transactions between a broker-dealer and the custodian involving purchase or sale of securities by transfer of money or securities must be made on a "delivery vs. payment" basis, if applicable, to ensure that the custodian will have the security or money, as appropriate, in hand at the conclusion of the transaction.

(11) MASTER REPURCHASE AGREEMENT.—The investment policy shall require all approved institutions and dealers transacting repurchase agreements to execute and perform as stated in the Master Repurchase Agreement. All repurchase agreement transactions shall adhere to the requirements of the Master Repurchase Agreement.

(12) BID REQUIREMENT.—The investment policy shall require that the unit of local government's staff determine the approximate maturity date based on cash-flow needs and market conditions, analyze and select one or more optimal types of investment, and competitively bid the security in question when feasible and appropriate. Except as otherwise required by law, the bid deemed to best meet the investment objectives specified in subsection (2) must be selected.

(13) INTERNAL CONTROLS.—The investment policy shall provide for a system of internal controls and operational procedures. The unit of local government's officials responsible for making investment decisions or chief financial officer shall establish a system of internal controls which shall be in writing and made a part of the governmental entity's operational procedures. The investment policy shall provide for review of such controls by independent auditors as part of any financial audit periodically required of the unit of local government. The internal controls should be designed to prevent losses of funds which might arise from fraud, employee error, misrepresentation by third parties, or imprudent actions by employees of the unit of local government.

(14) CONTINUING EDUCATION.—The investment policy shall provide for the continuing education of the unit of local government's officials responsible for making investment decisions or chief financial officer. Such officials must annually complete 8 hours of continuing education in subjects or courses of study related to investment practices and products.

(15) REPORTING.—The investment policy shall provide for appropriate annual or more frequent reporting of investment activities. To that end, the governmental entity's officials responsible for making investment decisions or chief financial officer shall prepare periodic reports for submission to the legislative and governing body of the unit of local government, which shall include securities in the portfolio by class or type, book value, income earned, and market value as of the report date. Such reports shall be available to the public.

(16) AUTHORIZED INVESTMENTS; WRITTEN INVESTMENT POLICIES.—Those units of local government electing to adopt a written investment policy as provided in subsections (1)-(15) may by resolution invest and reinvest any surplus public funds in their control or possession in:
(a) The Local Government Surplus Funds Trust Fund or any intergovernmental investment pool authorized pursuant to the Florida Interlocal Cooperation Act of 1969, as provided in s. 163.01.
(b) Securities and Exchange Commission registered money market funds with the highest credit quality rating from a nationally recognized rating agency.
(c) Interest-bearing time deposits or savings accounts in qualified public depositories as defined in s. 280.02.
(d) Direct obligations of the United States Treasury.
(e) Federal agencies and instrumentalities.
(f) Rated or unrated bonds, notes, or instruments backed by the full faith and credit of the government of Israel.
(g) Securities of, or other interests in, any open-end or closed-end management-type investment company or investment trust registered under the Investment Company Act of 1940, 15 U.S.C. ss. 80a-1 et seq., as amended from time to time, provided that the portfolio of such investment company or investment trust is limited to obligations of the United States Government or any agency or instrumentality thereof and to repurchase agreements fully collateralized by such United States Government obligations, and provided that such investment company or investment trust takes delivery of such collateral either directly or through an authorized custodian.
(h) Other investments authorized by law or by ordinance for a county or a municipality.
(i) Other investments authorized by law or by resolution for a school district or a special district.

(17) AUTHORIZED INVESTMENTS; NO WRITTEN INVESTMENT POLICY.—Those units of local government electing not to adopt a written investment policy in accordance with investment policies developed as provided in subsections (1)-(15) may invest or reinvest any surplus public funds in their control or possession in:
(a) The Local Government Surplus Funds Trust Fund, or any intergovernmental investment pool authorized pursuant to the Florida Interlocal Cooperation Act of 1969, as provided in s. 163.01.
(b) Securities and Exchange Commission registered money market funds with the highest credit quality rating from a nationally recognized rating agency.

(c) Interest-bearing time deposits or savings accounts in qualified public depositories, as defined in s. 280.02.
(d) Direct obligations of the U.S. Treasury.

The securities listed in paragraphs (c) and (d) shall be invested to provide sufficient liquidity to pay obligations as they come due.

(18) SECURITIES; DISPOSITION.—
(a) Every security purchased under this section on behalf of the governing body of a unit of local government must be properly earmarked and:
1. If registered with the issuer or its agents, must be immediately placed for safekeeping in a location that protects the governing body's interest in the security;
2. If in book entry form, must be held for the credit of the governing body by a depository chartered by the Federal Government, the state, or any other state or territory of the United States which has a branch or principal place of business in this state as defined in s. 658.12, or by a national association organized and existing under the laws of the United States which is authorized to accept and execute trusts and which is doing business in this state, and must be kept by the depository in an account separate and apart from the assets of the financial institution; or
3. If physically issued to the holder but not registered with the issuer or its agents, must be immediately placed for safekeeping in a secured vault.
(b) The unit of local government's governing body may also receive bank trust receipts in return for investment of surplus funds in securities. Any trust receipts received must enumerate the various securities held, together with the specific number of each security held. The actual securities on which the trust receipts are issued may be held by any bank depository chartered by the Federal Government, this state, or any other state or territory of the United States which has a branch or principal place of business in this state as defined in s. 658.12, or by a national association organized and existing under the laws of the United States which is authorized to accept and execute trusts and which is doing business in this state.

(19) SALE OF SECURITIES.—When the invested funds are needed in whole or in part for the purposes originally intended or for more optimal investments, the unit of local government's governing body may sell such investments at the then-prevailing market price and place the proceeds into the proper account or fund of the unit of local government.

(20) PREEXISTING CONTRACT.—Any public funds subject to a contract or agreement existing on October 1, 2000, may not be invested contrary to such contract or agreement.

(21) PREEMPTION.—Any provision of any special act, municipal charter, or other law which prohibits or restricts a local governmental entity from complying with this section or any rules adopted under this section is void to the extent of the conflict.
(22) AUDITS.—Certified public accountants conducting audits of units of local government pursuant to s. 218.39 shall report, as part of the audit, whether or not the unit of local government has complied with this section.

(23) AUTHORIZED DEPOSITS.—In addition to the investments authorized for local governments in subsections (16) and (17) and notwithstanding any other provisions of law, a unit of local government may deposit any portion of surplus public funds in its control or possession in accordance with the following conditions:
(a) The funds are initially deposited in a qualified public depository, as defined in s. 280.02, selected by the unit of local government.

(b) The selected depository arranges for depositing the funds in financial deposit instruments insured by the Federal Deposit Insurance Corporation in one or more federally insured banks or savings and loan associations, wherever located, for the account of the unit of local government.

(c) The full amount of the principal and accrued interest of each financial deposit instrument is insured by the Federal Deposit Insurance Corporation.

(d) The selected depository acts as custodian for the unit of local government with respect to each financial deposit instrument issued for its account.

History.—s. 1, ch. 95-194; s. 2, ch. 97-9; s. 3, ch. 2000-264; ss. 66, 141, ch. 2001-266; s. 2, ch. 2005-126; s. 1, ch. 2007-89; s. 42, ch. 2008-4; s. 2, ch. 2009-140.

CHAPTER 280
SECURITY FOR PUBLIC DEPOSITS

280.01 Short title.—This chapter may be cited as the “Florida Security for Public Deposits Act.”
History.—s. 3, ch. 81-285.

280.02 Definitions.—As used in this chapter, the term:
(1) “Affiliate” means an entity that is related through a parent corporation’s controlling interest. The term also includes a financial institution holding company or a subsidiary or service corporation of such holding company.
(2) “Alternative participation agreement” means an agreement of restrictions that a qualified public depository completes as an alternative to withdrawing from the public deposits program due to financial condition.
(3) “Average daily balance” means the average daily balance of public deposits held during the reported month. The average daily balance shall be determined by totaling, by account, the daily balances held by the depositor and dividing the total by the number of calendar days in the month. Deposit insurance is then deducted from each account balance and the resulting amounts are totaled to obtain the average daily balance.
(4) “Average monthly balance” means the average monthly balance of public deposits held by the depository during any 12 calendar months. The average monthly balance of the previous 12 calendar months shall be determined by adding the average daily balance for the reported month and the average daily balances for the 11 months preceding that month and dividing the total by 12.

(5) “Book-entry form” means that securities are not represented by a paper certificate but represented by an account entry on the records of a depository trust clearing system or, in the case of United States Government securities, a Federal Reserve Bank.
(6) “Capital account” or “tangible equity capital” means total equity capital, as defined on the balance-sheet portion of the Consolidated Reports of Condition and Income (call report), less intangible assets, as submitted to the regulatory banking authority.
(7) “Chief Financial Officer’s custody” is a collateral arrangement governed by a contract between a designated Chief Financial Officer’s custodian and the Chief Financial Officer. This arrangement requires that collateral be in the Chief Financial Officer’s name in order to perfect the security interest.
(8) “Collateral-pledging level” means the percentage of collateral required to be pledged by a qualified public depository as provided under s. 280.04.
(9) “Current month” means the month immediately following the month for which the monthly report is due from qualified public depositories.
(10) “Custodian” means the Chief Financial Officer or a bank, savings association, or trust company that:
(a) Is organized and existing under the laws of this state, any other state, or the United States;
(b) Has executed all forms required under this chapter or any rule adopted hereunder;
(c) Agrees to be subject to the jurisdiction of the courts of this state, or of the courts of the United States which are located within this state, for the purpose of any litigation arising out of this chapter; and
(d) Has been approved by the Chief Financial Officer to act as a custodian.
(11) “Default or insolvency” includes, without limitation, the failure or refusal of a qualified public depository to pay a check or warrant drawn upon sufficient and collected funds by a public depositor or to return a deposit on demand or at maturity together with interest as agreed; the issuance of an order by a supervisory authority restraining such depository from making payments of deposit liabilities; or the appointment of a receiver for such depository.
(12) “Effective date of notice of withdrawal or order of discontinuance” pursuant to s. 280.11(3) means that date which is set out as such in any notice of withdrawal or order of discontinuance from the Chief Financial Officer.
(13) “Eligible collateral” means securities, Federal Home Loan Bank letters of credit, and cash, as designated in s. 280.13.
(14) “Financial institution” means, including, but not limited to, an association, bank, brokerage firm, credit union, industrial savings bank, savings and loan association, trust company, or other type of financial institution organized under the laws of this state or any other state of the United States and doing business in this state or any other state, in the general nature of the business conducted by banks and savings associations.
(15) “Governmental unit” means the state or any county, school district, community college district, state university, special district, metropolitan government, or municipality, including any agency, board, bureau, commission, and institution of any of such entities, or any court.
(16) “Loss to public depositors” means loss of all principal and all interest or other earnings on the principal accrued or accruing as of the date the qualified public depository was declared in default or insolvent.
(17) “Market value” means the value of collateral calculated pursuant to s. 280.04.
(18) “Operating subsidiary” means the qualified public depository’s 100-percent owned corporation that has ownership of pledged collateral. The operating subsidiary may not have powers beyond those that its parent qualified public depository may itself exercise. The use of an operating subsidiary is at the discretion of the qualified public depository and must meet the Chief Financial Officer’s requirements.

(19) “Pledged collateral” means securities or cash held separately and distinctly by an eligible custodian for the benefit of the Chief Financial Officer to be used as security for Florida public deposits. This includes maturity and call proceeds.
(20) “Pledgor” means the qualified public depository and, if one is used, operating subsidiary.
(21) “Pool figure” means the total average monthly balances of public deposits held by all qualified public depositories during the immediately preceding 12-month period.
(22) “Previous month” means the month or months immediately preceding the month for which a monthly report is due from qualified public depositories.
(23) “Public deposit” means the moneys of the state or of any state university, county, school district, community college district, special district, metropolitan government, or municipality, including agencies, boards, bureaus, commissions, and institutions of any of the foregoing, or of any court, and includes the moneys of all county officers, including constitutional officers, which are placed on deposit in a bank, savings bank, or savings association. This includes, but is not limited to, time deposit accounts, demand deposit accounts, and nonnegotiable certificates of deposit. Moneys in deposit notes and in other nondeposit accounts such as repurchase or reverse repurchase operations are not public deposits. Securities, mutual funds, and similar types of investments are not public deposits and are not subject to this chapter.
(24) “Public depositor” means the official custodian of funds for a governmental unit who is responsible for handling public deposits.
(25) “Public deposits program” means the Florida Security for Public Deposits Act contained in this chapter and any rule adopted under this chapter.
(26) “Qualified public depository” means a bank, savings bank, or savings association that:
(a) Is organized and exists under the laws of the United States or the laws of this state or any other state or territory of the United States.
(b) Has its principal place of business in this state or has a branch office in this state which is authorized under the laws of this state or of the United States to receive deposits in this state.
(c) Has deposit insurance pursuant to the Federal Deposit Insurance Act, as amended, 12 U.S.C. ss. 1811 et seq.
(d) Has procedures and practices for accurate identification, classification, reporting, and collateralization of public deposits.
(e) Meets all the requirements of this chapter.
(f) Has been designated by the Chief Financial Officer as a qualified public depository.
(27) “Reported month” means the month for which a monthly report is due from qualified public depositories.
(28) “Required collateral” of a qualified public depository means eligible collateral having a market value equal to or in excess of the amount required under s. 280.04.
(29) “Triggering events” are events set out in s. 280.041 which give the Chief Financial Officer the right to:
(a) Instruct the custodian to transfer securities pledged, interest payments, and other proceeds of pledged collateral not previously credited to the pledgor.
(b) Demand payment under letters of credit.
History.—s. 3, ch. 81-285; s. 7, ch. 83-122; s. 1, ch. 84-216; s. 1, ch. 85-259; s. 1, ch. 86-84; s. 1, ch. 87-409; s. 1, ch. 88-185; s. 5, ch. 90-357; s. 10, ch. 91-244; s. 4, ch. 96-216; s. 1, ch. 97-30; s. 11, ch. 98-409; s. 1, ch. 2000-352; s. 1, ch. 2001-230; s. 286, ch. 2003-261; s. 33, ch. 2007-217; s. 1, ch. 2014-145.

280.03 Public deposits to be secured; prohibitions; exemptions.—
(1)(a) All public deposits shall be secured as provided in this chapter when public depositors comply with the requirements of this chapter.
(b) Public deposits shall be made in a qualified public depository unless exempted by law.
(2) Public funds shall not be deposited directly or indirectly in negotiable certificates of deposit.
(3) The following are exempt from the requirements of, and protection under, this chapter:
(a) Public deposits deposited in a bank or savings association by a trust department or trust company which are fully secured under trust business laws.
(b) Moneys of the System Trust Fund, as defined in s. 121.021(36).
(c) Public deposits held outside the country.
(d) Wire transfers and transfers of funds solely for the purpose of paying registrars and paying agents.
(e) Public deposits that are fully secured by a collateral requirement under federal regulations.
(f) Public deposits made in accordance with s. 17.57(7) or s. 218.415(23).
History.—s. 3, ch. 81-285; s. 8, ch. 83-122; s. 2, ch. 85-259; s. 55, ch. 86-152; s. 4, ch. 86-236; s. 2, ch. 87-409; s. 6, ch. 90-357; s. 2, ch. 93-75; s. 5, ch. 96-216; s. 17, ch. 97-30; s. 12, ch. 98-409; s. 3, ch. 2005-126; s. 2, ch. 2014-145.

280.04 Collateral for public deposits; general provisions.—
(1) The Chief Financial Officer shall determine the collateral requirements and collateral-pledging level for each qualified public depository following procedures established by rule. These procedures must include numerical parameters for 25-percent, 50-percent, 110-percent, and 150-percent pledge levels based on nationally recognized financial rating services information and established financial performance guidelines.
(2) A qualified public depository may not accept or retain any public deposit required to be secured unless it deposits with the Chief Financial Officer eligible collateral at least equal to the greater of:
(a) The average daily balance of public deposits that does not exceed the lesser of its tangible equity capital or 20 percent of the pool figure multiplied by the depository’s collateral-pledging level, plus the greater of:
1. One hundred ten percent of the average daily balance of public deposits in excess of its tangible equity capital; or
2. One hundred ten percent of the average daily balance of public deposits in excess of 20 percent of the pool figure.
(b) Twenty-five percent of the average monthly balance of public deposits.
(c) One hundred ten percent of the average daily balance of public deposits if the qualified public depository:
1. Has been established for less than 3 years;
2. Has experienced material decreases in its tangible equity capital; or
3. Has an overall financial condition that is materially deteriorating.
(d) One hundred fifty percent of an established maximum amount of public deposits which has been mutually agreed upon by and between the Chief Financial Officer and the qualified public depository.
(e) Minimum required collateral of $100,000.
(f) An amount as required in special instructions from the Chief Financial Officer to protect the integrity of the public deposits program.
(3) Each qualified public depository shall report its required collateral on the monthly report required in s. 280.16 and simultaneously pledge, deposit, or issue eligible collateral needed.

(4) Additional collateral is required within 2 business days if public deposits are accepted that would increase the qualified public depository's average daily balance for the current month by 25 percent over the average daily balance of the previously reported month.
(5) Additional collateral of 20 percent of required collateral is necessary if a valuation date other than the close of business as described below has been approved for the qualified public depository and the required collateral is found to be insufficient based on the Chief Financial Officer's valuation.
(6) Each qualified public depository shall value its collateral in the following manner; it must:
(a) Use a nationally recognized source.
(b) Use market price, quality ratings, and pay-down factors as of the close of business on the last banking day in the reported month, or as of a date approved by the Chief Financial Officer.
(c) Report any material decline in value that occurs before the date of mailing the monthly report, required in s. 280.16, to the Chief Financial Officer.
(d) Use 100 percent of the maximum amount available under Federal Home Loan Bank letters of credit as market value.
(7) A qualified public depository shall pledge, deposit, or issue additional eligible collateral between filing periods of the monthly report required in s. 280.16 when notified by the Chief Financial Officer that current market value of collateral does not meet required collateral. The pledge, deposit, or issuance of such additional collateral shall be made within 2 business days after the Chief Financial Officer's notification.
(8) A qualified public depository may be required to return public deposits to governmental units and be suspended or disqualified or subjected to administrative penalty as provided in s. 280.051 or s. 280.054 for failure to meet required collateral.
(9) The Chief Financial Officer shall adopt rules for the establishment of collateral requirements, collateral pledging levels, required collateral calculations, and market value and clarifying terms.
History.—s. 3, ch. 81-285; s. 9, ch. 83-122; s. 132, ch. 83-217; s. 3, ch. 85-259; s. 2, ch. 86-84; s. 3, ch. 87-409; s. 4, ch. 88-185; s. 7, ch. 90-357; s. 11, ch. 91-244; s. 188, ch. 95-148; s. 6, ch. 96-216; s. 13, ch. 98-409; s. 2, ch. 2000-352; s. 2, ch. 2001-230; s. 287, ch. 2003-261; s. 3, ch. 2014-145.

280.041 Collateral arrangements; agreements, provisions, and triggering events.—

(1) Eligible collateral listed in s. 280.13 may be pledged, deposited, or issued using the following collateral arrangements as approved by the Chief Financial Officer for a qualified public depository or operating subsidiary, if one is used, to meet required collateral:
(a) Regular custody arrangement for collateral pledged to the Chief Financial Officer pursuant to subsection (2).
(b) Federal Reserve Bank custody arrangement for collateral pledged to the Chief Financial Officer pursuant to subsection (3).
(c) Chief Financial Officer's custody arrangement for collateral deposited in the Chief Financial Officer's name pursuant to subsection (4).
(d) Federal Home Loan Bank letter of credit arrangement for collateral issued with the Chief Financial Officer as beneficiary pursuant to subsection (5).
(e) Cash arrangement for collateral held by the Chief Financial Officer or a custodian.
(2) With the approval of the Chief Financial Officer, a qualified public depository or operating subsidiary, as pledgor, may deposit eligible collateral with a custodian. A qualified public depository shall not act as its own custodian. Except in the case of using a Federal Reserve Bank as custodian, the following are necessary for the Chief Financial Officer's approval:

(a) A completed collateral agreement in a form prescribed by the Chief Financial Officer in which the pledgor agrees to the following provisions:

1. The pledgor shall own the pledged collateral and acknowledge that the Chief Financial Officer has a perfected security interest. The pledged collateral shall be eligible collateral and shall be at least equal to the amount of required collateral.

2. The pledgor shall grant to the Chief Financial Officer an interest in pledged collateral for the purposes of this section. The pledgor shall not enter into or execute any other agreement related to the pledged collateral that would create an interest in or lien on that collateral in any manner in favor of any third party without the written consent of the Chief Financial Officer.

3. The pledgor shall not grant the custodian any lien that attaches to the collateral in favor of the custodian that is superior or equal to the security interest of the Chief Financial Officer.

4. The pledgor shall agree that the Chief Financial Officer may, without notice to or consent by the pledgor, require the custodian to comply with and perform any and all requests and orders directly from the Chief Financial Officer. These include, but are not limited to, liquidating all collateral and submitting the proceeds directly to the Chief Financial Officer in the name of the Chief Financial Officer only or transferring all collateral into an account designated solely by the Chief Financial Officer.

5. The pledgor shall acknowledge that the Chief Financial Officer may, without notice to or consent by the pledgor, require the custodian to hold principal payments and income for the benefit of the Chief Financial Officer.

6. The pledgor shall initiate collateral transactions on forms prescribed by the Chief Financial Officer in the following manner:

a. A deposit transaction of eligible collateral may be made without prior approval from the Chief Financial Officer provided: security types that have restrictions have been approved in advance of the transaction by the Chief Financial Officer and simultaneous notification is given to the Chief Financial Officer; and the custodian has not received notice from the Chief Financial Officer prohibiting deposits without prior approval.

b. A substitution transaction of eligible collateral may be made without prior approval from the Chief Financial Officer provided: security types that have restrictions have been approved in advance of the transaction by the Chief Financial Officer; the market value of the securities to be substituted is at least equal to the amount withdrawn; simultaneous notification is given to the Chief Financial Officer; and the custodian has not received notice from the Chief Financial Officer prohibiting substitution.

c. A transfer of collateral between accounts at a custodian requires the Chief Financial Officer’s prior approval. The collateral shall be released subject to redeposit in the new account with a pledge to the Chief Financial Officer intact.

d. A transfer of collateral from a custodian to another custodian requires the Chief Financial Officer’s prior approval and a valid collateral agreement with the new custodian. The collateral shall be released subject to redeposit at the new custodian with a pledge to the Chief Financial Officer intact.

e. A withdrawal transaction requires the Chief Financial Officer’s prior approval. The market value of eligible collateral remaining after the withdrawal shall be at least equal to the amount of required collateral. A withdrawal transaction shall be executed for any release of collateral including maturity or call proceeds.

f. Written notice shall be sent to the Chief Financial Officer to remove from the inventory of pledged collateral a pay-down security that has paid out with zero principal remaining.

7. If pledged collateral includes definitive (physical) securities in registered form which are in the name of the pledgor or a nominee, the pledgor shall deliver the following documents when requested by the Chief Financial Officer:

a. A separate certified power of attorney in a form prescribed by the Chief Financial Officer for each issue of securities.

b. Separate bond assignment forms as required by the bond agent or trustee.
c. Certified copies of resolutions adopted by the pledgor's governing body authorizing execution of these documents.
8. The pledgor shall be responsible for all costs necessary to the functioning of the collateral agreement or associated with confirmation of pledged collateral to the Chief Financial Officer and acknowledges that these costs shall not be a charge against the Chief Financial Officer or his or her interests in the pledged collateral.
9. The pledgor, if notified by the Chief Financial Officer, shall not be allowed to use a custodian if that custodian fails to complete the collateral agreement, releases pledged collateral without the Chief Financial Officer's approval, fails to properly complete confirmations of pledged collateral, fails to honor a request for examination of definitive pledged collateral and records of book-entry securities, or fails to provide requested documents on definitive securities. The period for disallowing the use of a custodian shall be 1 year.
10. The pledgor shall be subject to the jurisdiction of the courts of the State of Florida, or of courts of the United States located within the State of Florida, for the purpose of any litigation arising out of the act.
11. The pledgor is responsible and liable to the Chief Financial Officer for any action of agents the pledgor uses to execute collateral transactions or submit reports to the Chief Financial Officer.
12. The pledgor shall agree that any information, forms, or reports electronically transmitted to the Chief Financial Officer shall have the same enforceability as a signed writing.
13. The pledgor shall submit proof that authorized individuals executed the collateral agreement on behalf of the pledgor.
14. The pledgor shall agree by resolution of the board of directors that collateral agreements entered into for purposes of this section have been formally accepted and constitute official records of the pledgor.
15. The pledgor shall be bound by any other provisions found necessary for a perfected security interest in collateral under the Uniform Commercial Code.
(b) A completed collateral agreement in a form prescribed by the Chief Financial Officer in which the custodian agrees to the following provisions:
1. The custodian shall have no responsibility to ascertain whether the pledged securities are at least equal to the amount of required collateral nor whether the pledged securities are eligible collateral.
2. The custodian shall hold pledged collateral in a custody account for the Chief Financial Officer for purposes of this section. The custodian shall not enter into or execute any other agreement related to the collateral that would create an interest in or lien on that collateral in any manner in favor of any third party without the written consent of the Chief Financial Officer.
3. The custodian shall agree that any lien that attaches to the collateral in favor of the custodian shall not be superior or equal to the security interest of the Chief Financial Officer.
4. The custodian shall, without notice to or consent by the pledgor, comply with and perform any and all requests and orders directly from the Chief Financial Officer. These include, but are not limited to, liquidating all collateral and submitting the proceeds directly to the Chief Financial Officer in the name of the Chief Financial Officer only or transferring all collateral into an account designated solely by the Chief Financial Officer.
5. The custodian shall consider principal payments on pay-down securities and income paid on pledged collateral as the property of the pledgor and shall pay thereto provided the custodian has not received written notice from the Chief Financial Officer to hold such principal payments and income for the benefit of the Chief Financial Officer.
6. The custodian shall process collateral transactions on forms prescribed by the Chief Financial Officer in the following manner:

a. A deposit transaction of eligible collateral may be made without prior approval from the Chief Financial Officer unless the custodian has received notice from the Chief Financial Officer requiring the Chief Financial Officer's prior approval.
b. A substitution transaction of eligible collateral may be made without prior approval from the Chief Financial Officer provided the pledgor certifies the market value of the securities to be substituted is at least equal to the market value amount of the securities to be withdrawn and the custodian has not received notice from the Chief Financial Officer prohibiting substitution.
c. A transfer of collateral between accounts at a custodian requires the Chief Financial Officer's prior approval. The collateral shall be released subject to redeposit in the new account with a pledge to the Chief Financial Officer intact. Confirmation from the custodian to the Chief Financial Officer must be received within 5 business days of the redeposit.
d. A transfer of collateral from a custodian to another custodian requires the Chief Financial Officer's prior approval. The collateral shall be released subject to redeposit at the new custodian with a pledge to the Chief Financial Officer intact. Confirmation from the new custodian to the Chief Financial Officer must be received within 5 business days of the redeposit.
e. A withdrawal transaction requires the Chief Financial Officer's prior approval. A withdrawal transaction shall be executed for the release of any pledged collateral including maturity or call proceeds.
7. If pledged collateral includes definitive (physical) securities in registered form, which are in the name of the custodian or a nominee, the custodian shall deliver the following documents when requested by the Chief Financial Officer:
a. A separate certified power of attorney in a form prescribed by the Chief Financial Officer for each issue of securities.
b. Separate bond assignment forms as required by the bond agent or trustee.
c. Certified copies of resolutions adopted by the custodian's governing body authorizing execution of these documents.
8. The custodian shall acknowledge that the pledgor is responsible for all costs necessary to the functioning of the collateral agreement or associated with confirmation of securities pledged to the Chief Financial Officer and that these costs shall not be a charge against the Chief Financial Officer or his or her interests in the pledged collateral.
9. The custodian shall agree to provide confirmation of pledged collateral upon request from the Chief Financial Officer. This confirmation shall be provided within 15 working days after the request, in a format prescribed by the Chief Financial Officer, and shall require no identification other than the pledgor name and location, unless the special identification is provided in the collateral agreement.
10. The custodian shall be subject to the jurisdiction of the courts of the State of Florida, or of courts of the United States located within the State of Florida, for the purpose of any litigation arising out of the act.
11. The custodian shall be responsible and liable to the Chief Financial Officer for any action of agents the custodian uses to hold and service collateral pledged to the Chief Financial Officer.
12. The custodian shall agree that any information, forms, or reports electronically transmitted to the Chief Financial Officer shall have the same enforceability as a signed writing.
13. The Chief Financial Officer shall have the right to examine definitive pledged collateral and records of book-entry securities during the regular business hours of the custodian without cost to the Chief Financial Officer.
14. The responsibilities of the custodian for the safekeeping of the pledged collateral shall be limited to the diligence and care usually exercised by a banking or trust institution toward its own property.

15. If there is any change in the Uniform Commercial Code, as adopted by law in this state, which affects the requirements for a perfected security interest in collateral, the Chief Financial Officer shall notify the custodian of such change. The custodian shall have a period of 180 calendar days after such notice to withdraw as custodian if the custodian cannot provide the required custodial services.

(3) With the approval of the Chief Financial Officer, a pledgor may deposit eligible collateral pursuant to an agreement with a Federal Reserve Bank. The Federal Reserve Bank agreement may require terms not consistent with subsection (2) but may not subject the Chief Financial Officer to any costs or indemnification requirements.

(4) The Chief Financial Officer may require deposit or transfer of collateral into a custodial account established in the Chief Financial Officer's name at a designated custodian. This requirement for Chief Financial Officer's custody shall have the following characteristics:

(a) One or more triggering events must have occurred.

(b) The custodian used must be a Chief Financial Officer's approved custodian that must:

1. Meet the definition of custodian.
2. Not be an affiliate of the qualified public depository.
3. Be bound under a distinct Chief Financial Officer's custodial contract.

(c) All deposit transactions require the approval of the Chief Financial Officer.

(d) All collateral must be in book-entry form.

(e) The qualified public depository shall be responsible for all costs necessary to the functioning of the contract or associated with the confirmation of securities in the name of the Chief Financial Officer and acknowledges that these costs shall not be a charge against the Chief Financial Officer and may be deducted from the collateral or income earned if unpaid.

(5) With the approval of the Chief Financial Officer, a qualified public depository may use Federal Home Loan Bank letters of credit to meet collateral requirements. A completed agreement that includes the following provisions is necessary for the Chief Financial Officer's approval:

(a) The letter of credit shall meet the definition of eligible collateral.

(b) The qualified public depository shall agree that the Chief Financial Officer, as beneficiary, may, without notice to or consent by the qualified public depository, demand payment under the letter of credit if any of the triggering events listed in this section occur.

(c) The qualified public depository shall agree that funds received by the Chief Financial Officer due to the occurrence of one or more triggering events may be deposited in the Treasury Cash Deposit Trust Fund for purposes of eligible collateral.

(d) The qualified public depository shall arrange for the issue of letters of credit which meet the requirements of s. 280.13 and delivery to the Chief Financial Officer. All transactions involving letters of credit require the Chief Financial Officer's approval.

(e) The qualified public depository shall be responsible for all costs necessary in the use or confirmation of letters of credit issued on behalf of the Chief Financial Officer and acknowledges that these costs shall not be a charge against the Chief Financial Officer.

(f) The qualified public depository shall be subject to the jurisdiction of the courts of this state, or of courts of the United States which are located within this state, for the purpose of any litigation arising out of the act.

(g) The qualified public depository shall agree that any information, form, or report electronically transmitted to the Chief Financial Officer shall have the same enforceability as a signed writing.

(h) The qualified public depository shall submit proof that authorized individuals executed the letters of credit agreement on its behalf.

(i) The qualified public depository shall agree by resolution of the board of directors that the letters of credit agreements entered into for purposes of this section have been formally accepted and constitute official records of the qualified public depository.

(6) The Chief Financial Officer may demand payment under a letter of credit or direct a custodian to deposit or transfer collateral and proceeds of securities not previously credited upon the occurrence of one or more triggering events provided that, to the extent not incompatible with the protection of public deposits, as determined in the Chief Financial Officer's sole and absolute discretion, the Chief Financial Officer shall provide a custodian and the qualified public depository with 48 hours' advance notice before directing such deposit or transfer. These events include:

(a) The Chief Financial Officer determines that an immediate danger to the public health, safety, or welfare exists.

(b) The qualified public depository fails to have adequate procedures and practices for the accurate identification, classification, reporting, and collateralization of public deposits.

(c) The custodian fails to provide or allow inspection and verification of documents, reports, records, or other information dealing with the pledged collateral or financial information.

(d) The qualified public depository or its operating subsidiary fails to provide or allow inspection and verification of documents, reports, records, or other information dealing with Florida public deposits, pledged collateral, or financial information.

(e) The custodian fails to hold income and principal payments made on securities held as collateral or fails to deposit or transfer such payments pursuant to the Chief Financial Officer's instructions.

(f) The qualified public depository defaults or becomes insolvent.

(g) The qualified public depository fails to pay an assessment.

(h) The qualified public depository fails to pay an administrative penalty.

(i) The qualified public depository fails to meet financial condition standards.

(j) The qualified public depository charges a withdrawal penalty to public depositors when the qualified public depository is suspended, disqualified, or withdrawn from the public deposits program.

(k) The qualified public depository does not provide, as required, the public depositor with annual confirmation information on all open Florida public deposit accounts.

(l) The qualified public depository pledges, deposits, or has issued insufficient or unacceptable collateral to meet required collateral within the required time.

(m) Collateral, other than a proper substitution, is released without the prior approval of the Chief Financial Officer.

(n) The qualified public depository, custodian, operating subsidiary, or agent violates any provision of the act and the Chief Financial Officer determines that such violation may be remedied by a move of collateral.

(o) The qualified public depository, custodian, operating subsidiary, or agent fails to timely cooperate in resolving problems by the date established in written communication from the Chief Financial Officer.

(p) The custodian fails to provide sufficient confirmation information.

(q) The Federal Home Loan Bank or the qualified public depository gives notification that a letter of credit will not be extended or renewed and other eligible collateral equal to required collateral has not been deposited within 30 days after the notice or 30 days before expiration of the letter of credit.

(r) The qualified public depository, if involved in a merger, acquisition, consolidation, or other organizational change, fails to notify the Chief Financial Officer or ensure that required collateral is properly maintained by the depository holding the Florida public deposits.

(s) Events that would bring about an administrative or legal action by the Chief Financial Officer.

(7) The Chief Financial Officer shall adopt rules to identify forms and establish procedures for collateral agreements and transactions, furnish confirmation requirements, establish procedures for using an operating subsidiary and agents, and clarify terms.

History.—s. 3, ch. 2000-352; s. 3, ch. 2001-230; s. 288, ch. 2003-261.

280.05 Powers and duties of the Chief Financial Officer.—In fulfilling the requirements of this act, the Chief Financial Officer has the power to take the following actions he or she deems necessary to protect the integrity of the public deposits program:

(1) Perform financial analysis of any qualified public depositories.

(2) Require collateral, or increase the collateral-pledging level, of any qualified public depository.

(3) Decline to accept, or reduce the reported value of, collateral in order to ensure the pledging or depositing of sufficient marketable collateral and acceptable letters of credit.

(4) Maintain perpetual inventory of collateral and perform monthly market valuations and quality ratings.

(5) Monitor and confirm collateral with custodians and letter of credit issuers.

(6) Move collateral into an account established in the Chief Financial Officer's name upon the occurrence of one or more triggering events.

(7) Issue notice to a qualified public depository that use of a custodian will be disallowed when the custodian has failed to follow collateral agreement terms.

(8) Furnish written notice to custodians of collateral to hold interest and principal payments made on securities held as collateral and to deposit or transfer such payments pursuant to the Chief Financial Officer's instructions.

(9) Release collateral held in the Chief Financial Officer's name, subject to sale and transfer of funds directly from the custodian to public depositors of a withdrawing depository.

(10) Demand payment under letters of credit for any of the triggering events listed in s. 280.041 and deposit the funds in:

(a) The Public Deposits Trust Fund for purposes of paying losses to public depositors.

(b) The Treasury Administrative and Investment Trust Fund for receiving payment of administrative penalties.

(c) The Treasury Cash Deposit Trust Fund for purposes of eligible collateral.

(11) Sell securities for the purpose of paying losses to public depositors not covered by deposit insurance.

(12) Transfer funds directly from the custodian to public depositors or the receiver in order to facilitate prompt payment of claims.

(13) Require the filing of the following reports, which the Chief Financial Officer shall process as provided:

(a) Qualified public depository monthly reports and schedules. The Chief Financial Officer shall review the reports of each qualified public depository for material changes in tangible equity capital or changes in name, address, or type of institution; record the average daily balances of public deposits held; and monitor the collateral-pledging levels and required collateral.

(b) Quarterly regulatory reports from qualified public depositories. The Chief Financial Officer shall analyze qualified public depositories ranked in the lowest category based on established financial condition criteria.

(c) Qualified public depository annual reports and public depositor annual reports. The Chief Financial Officer shall compare public deposit information reported by qualified public depositories and public depositors. Such comparison shall be conducted for qualified public depositories that are ranked in the lowest category based on established financial condition criteria of record on September 30. Additional comparison processes may be performed as public deposits program resources permit.

(d) Any related documents, reports, records, or other information deemed necessary by the Chief Financial Officer in order to ascertain compliance with this chapter.

(14) Verify the reports of any qualified public depository relating to public deposits it holds when necessary to protect the integrity of the public deposits program.

(15) Confirm public deposits, to the extent possible under current law, when needed.

(16) Require at his or her discretion the filing of any information or forms required under this chapter to be by electronic data transmission. Such filings of information or forms shall have the same enforceability as a signed writing.
(17) Suspend or disqualify or disqualify after suspension any qualified public depository that has violated any of the provisions of this chapter or of rules adopted hereunder.
(a) Any qualified public depository that is suspended or disqualified pursuant to this subsection is subject to the provisions of s. 280.11(2) governing withdrawal from the public deposits program and return of pledged collateral. Any suspension shall not exceed a period of 6 months. Any qualified public depository which has been disqualified may not reapply for qualification until after the expiration of 1 year from the date of the final order of disqualification or the final disposition of any appeal taken therefrom.
(b) In lieu of suspension or disqualification, impose an administrative penalty upon the qualified public depository as provided in s. 280.054.
(c) If the Chief Financial Officer has reason to believe that any qualified public depository or any other financial institution holding public deposits is or has been violating any of the provisions of this chapter or of rules adopted hereunder, he or she may issue to the qualified public depository or other financial institution an order to cease and desist from the violation or to correct the condition giving rise to or resulting from the violation. If any qualified public depository or other financial institution violates a cease-and-desist or corrective order, the Chief Financial Officer may impose an administrative penalty upon the qualified public depository or other financial institution as provided in s. 280.054 or s. 280.055. In addition to the administrative penalty, the Chief Financial Officer may suspend or disqualify any qualified public depository for violation of any order issued pursuant to this paragraph.
History.—s. 3, ch. 81-285; s. 10, ch. 83-122; s. 4, ch. 85-259; s. 5, ch. 87-409; ss. 5, 14, ch. 88-185; s. 8, ch. 90-357; s. 12, ch. 91-244; s. 5, ch. 91-429; s. 189, ch. 95-148; s. 7, ch. 96-216; s. 14, ch. 98-409; s. 4, ch. 2001-230; s. 289, ch. 2003-261; s. 4, ch. 2014-145.

280.051 Grounds for suspension or disqualification of a qualified public depository.—A qualified public depository may be suspended or disqualified or both if the Chief Financial Officer determines that the qualified public depository has:
(1) Violated any of the provisions of this chapter or any rule adopted by the Chief Financial Officer pursuant to this chapter.
(2) Submitted reports containing inaccurate or incomplete information regarding public deposits or collateral for such deposits, tangible equity capital, or the calculation of required collateral.
(3) Failed to maintain required collateral.
(4) Grossly misstated the market value of the securities pledged as collateral.
(5) Failed to pay any administrative penalty.
(6) Failed to furnish the Chief Financial Officer with prompt and accurate information, or failed to allow inspection and verification of any information, dealing with public deposits or dealing with the exact status of its tangible equity capital, or other financial information that the Chief Financial Officer determines necessary to verify compliance with this chapter or any rule adopted pursuant to this chapter.
(7) Failed to furnish the Chief Financial Officer, when the Chief Financial Officer requested, with a power of attorney or bond power or other bond assignment form required by the bond agent, bond trustee, or other transferor for each issue of registered certificated securities pledged.
(8) Failed to furnish any agreement, report, form, or other information required to be filed pursuant to s. 280.16, or when requested by the Chief Financial Officer.
(9) Submitted reports signed by an unauthorized individual.
(10) Submitted reports without a certified or verified signature, or both, if required by law.

(11) Released a security without notice or approval.
(12) Failed to execute or have the custodian execute a collateral control agreement before using a custodian.
(13) Failed to give notification as required by s. 280.10.
History.—s. 6, ch. 87-409; s. 6, ch. 88-185; s. 13, ch. 91-244; s. 8, ch. 96-216; s. 5, ch. 2001-230; s. 290, ch. 2003-261; s. 5, ch. 2014-145.

280.052 Order of suspension or disqualification; procedure.—
(1) The suspension or disqualification of a bank or savings association as a qualified public depository must be by order of the Chief Financial Officer and must be mailed to the qualified public depository by registered or certified mail.
(2) The Chief Financial Officer shall notify, by first-class mail, all public depositors that have complied with s. 280.17 of any such disqualification or suspension.
(3) The procedures for suspension or disqualification shall be as set forth in chapter 120 and in the rules of the Chief Financial Officer adopted pursuant to this section.
(4) Whenever the Chief Financial Officer determines that an immediate danger to the public health, safety, or welfare exists, the Chief Financial Officer may take any appropriate action available to her or him under the provisions of chapter 120.
History.—s. 7, ch. 87-409; s. 14, ch. 91-244; s. 190, ch. 95-148; s. 9, ch. 96-216; s. 291, ch. 2003-261.

280.053 Period of suspension or disqualification; obligations during period; reinstatement.—
(1)(a) The Chief Financial Officer may suspend a qualified public depository for any period that is fixed in the order of suspension, not exceeding 6 months. For the purposes of this section and ss. 280.051 and 280.052, the effective date of suspension or disqualification is that date which is set out as such in any order of suspension or disqualification.
(b) During the period of suspension, the contingent liability, required collateral, and reporting requirements of the suspended public depository remain in force under the same conditions as if the suspended depository had remained qualified.
(c) Upon expiration of the suspension period, the bank or savings association may, by order of the Chief Financial Officer, be reinstated as a qualified public depository, unless the cause of the suspension has not been corrected or the bank or savings association is otherwise not in compliance with this chapter or any rule adopted pursuant to this chapter.
(2)(a) A qualified public depository may be disqualified for a period of time not less than 1 year to be fixed in the order of disqualification.
(b) During the period of disqualification, the contingent liability, required collateral, and reporting requirements of the disqualified public depository remain in force under the same conditions as if the disqualified depository had remained qualified.
(c) Upon expiration of the disqualification period, the bank or savings association may reapply for qualification as a qualified public depository. If a disqualified bank or savings association is purchased or otherwise acquired by new owners, it may reapply to the Chief Financial Officer to be a qualified public depository prior to the expiration date of the disqualification period. Redesignation as a qualified public depository may occur only after the Chief Financial Officer has determined that all requirements for holding public deposits under the law have been met.
History.—s. 8, ch. 87-409; s. 15, ch. 91-244; s. 292, ch. 2003-261.

280.054 Administrative penalty in lieu of suspension or disqualification.—
(1) If the Chief Financial Officer finds that one or more grounds exist for the suspension or disqualification of a qualified public depository, the Chief Financial Officer may, in lieu of suspension or disqualification, impose an administrative penalty upon the qualified public depository.

(a) With respect to any nonwillful violation, such penalty may not exceed $250 for each violation, exclusive of any restitution found to be due. If a qualified public depository discovers a nonwillful violation, the qualified public depository shall correct the violation; and, if restitution is due, the qualified public depository shall make restitution upon the order of the Chief Financial Officer and shall pay interest on such amount at the legal rate from the date of the violation. Each day a violation continues constitutes a separate violation.
(b) With respect to any knowing and willful violation of a lawful order or rule, the Chief Financial Officer may impose a penalty upon the qualified public depository in an amount not exceeding $1,000 for each violation. If restitution is due, the qualified public depository shall make restitution upon the order of the Chief Financial Officer and shall pay interest on such amount at the legal rate. Each day a violation continues constitutes a separate violation.
(2) The failure of a qualified public depository to make restitution when due as required under this section constitutes a willful violation of this chapter. However, if a qualified public depository in good faith is uncertain whether any restitution is due or as to the amount of restitution due, it shall promptly notify the Chief Financial Officer of the circumstances. The failure to make restitution pending a determination of whether restitution is due or the amount of restitution due does not constitute a violation of this chapter.
(3) A qualified public depository is subject to an administrative penalty in an amount not exceeding the greater of $1,000 or 10 percent of the amount of withdrawal, not exceeding $10,000, if the depository fails to provide required collateral using eligible collateral and prescribed collateral agreements or withdraws collateral without the Chief Financial Officer’s approval.
History.—s. 9, ch. 87-409; s. 6, ch. 2001-230; s. 293, ch. 2003-261.

280.055 Cease and desist order; corrective order; administrative penalty.—
(1) The Chief Financial Officer may issue a cease and desist order and a corrective order upon determining that:
(a) A qualified public depository has requested and obtained a release of pledged collateral without approval of the Chief Financial Officer;
(b) A bank, savings association, or other financial institution is holding public deposits without a certificate of qualification issued by the Chief Financial Officer;
(c) A qualified public depository pledges, deposits, or arranges for the issuance of unacceptable collateral;
(d) A custodian has released pledged collateral without approval of the Chief Financial Officer;
(e) A qualified public depository or a custodian has not furnished to the Chief Financial Officer, when the Chief Financial Officer requested, a power of attorney or bond power or bond assignment form required by the bond agent or bond trustee for each issue of registered certificated securities pledged and registered in the name, or nominee name, of the qualified public depository or custodian; or
(f) A qualified public depository; a bank, savings association, or other financial institution; or a custodian has committed any other violation of this chapter or any rule adopted pursuant to this chapter that the Chief Financial Officer determines may be remedied by a cease and desist order or corrective order.
(2) Any qualified public depository or other bank, savings association, or financial institution or custodian that violates a cease and desist order or corrective order of the Chief Financial Officer is subject to an administrative penalty not exceeding $1,000 for each violation of the order. Each day the violation of the order continues constitutes a separate violation.
History.—s. 10, ch. 87-409; s. 7, ch. 88-185; s. 7, ch. 2001-230; s. 294, ch. 2003-261.

280.06 Penalty for violation of law, rule, or order to cease and desist or other lawful order.—
(1) The violation of any provision of this chapter, or any order or rule of the Chief Financial Officer, or any order to cease and desist or other lawful order is a misdemeanor of the second degree, punishable as provided in s. 775.082 or s. 775.083.
(2) It is a felony of the third degree, punishable as provided in s. 775.082 or s. 775.083, to knowingly and willfully give false information on any form made under oath and filed pursuant to this chapter with the intent to mislead the Chief Financial Officer in the administration or enforcement of this chapter.
(3) No action lies against the state, any state agency or instrumentality, or the Public Deposits Trust Fund for the submission of any false or fraudulent information, or for any misrepresentation made or given, by any qualified public depository or other financial institution or any officer, employee, or agent thereof, nor shall the same constitute any defense in law or in equity to payment of any assessment under this chapter.
History.—s. 11, ch. 87-409; s. 16, ch. 91-244; s. 295, ch. 2003-261.

280.07 Mutual responsibility and contingent liability.—Any bank or savings association that is designated as a qualified public depository and that is not insolvent shall guarantee public depositors against loss caused by the default or insolvency of other qualified public depositories. Each qualified public depository shall execute a form prescribed by the Chief Financial Officer for such guarantee which shall be approved by the board of directors and shall become an official record of the institution.
History.—s. 3, ch. 81-285; s. 12, ch. 87-409; s. 15, ch. 98-409; s. 8, ch. 2001-230; s. 296, ch. 2003-261.

280.08 Procedure for payment of losses.—When the Chief Financial Officer determines that a default or insolvency has occurred, he or she shall provide notice as required in s. 280.085 and implement the following procedures:
(1) The Division of Treasury, in cooperation with the Office of Financial Regulation of the Financial Services Commission or the receiver of the qualified public depository in default, shall ascertain the amount of funds of each public depositor on deposit at such depository and the amount of deposit insurance applicable to such deposits.
(2) The potential loss to public depositors shall be calculated by compiling claims received from such depositors. The Chief Financial Officer shall validate claims on public deposit accounts which meet the requirements of s. 280.17 and are confirmed as provided in subsection (1).
(3)(a) The loss to public depositors shall be satisfied, insofar as possible, first through any applicable deposit insurance and then through demanding payment under letters of credit or the sale of collateral pledged or deposited by the defaulting depository. The Chief Financial Officer may assess qualified public depositories as provided in paragraph (b) for the total loss if the demand for payment or sale of collateral cannot be accomplished within 7 business days.
(b) The Chief Financial Officer shall provide coverage of any remaining loss by assessment against the other qualified public depositories. The Chief Financial Officer shall determine such assessment for each qualified public depository by multiplying the total amount of any remaining loss to all public depositors by a percentage which represents the average monthly balance of public deposits held by each qualified public depository during the previous 12 months divided by the total average monthly balances of public deposits held by all qualified public depositories, excluding the defaulting depository, during the same period. The assessment calculation shall be computed to six decimal places.
(4) Each qualified public depository shall pay its assessment to the Chief Financial Officer within 7 business days after it receives notice of the assessment. If a depository fails to pay its assessment when due, the Chief Financial Officer shall satisfy the assessment by

demanding payment under letters of credit or selling collateral pledged or deposited by that depository.
(5) The Chief Financial Officer shall distribute the funds to the public depositors of the qualified public depository in default according to their validated claims. The Chief Financial Officer, at his or her discretion, may make partial payments to public depositors that have experienced a loss of public funds which payments are critical to the immediate operations of the public entity. The public depositor requesting partial payment of a claim shall provide the Chief Financial Officer with written documentation justifying the need for partial payment.
(6) Public depositors receiving payment under the provisions of this section shall assign to the Chief Financial Officer any interest they may have in funds that may subsequently be made available to the qualified public depository in default. If the qualified public depository in default or its receiver provides the funds to the Chief Financial Officer, the Chief Financial Officer shall distribute the funds, plus all accrued interest which has accumulated from the investment of the funds, if any, to the depositories which paid assessments on the same pro rata basis as the assessments were paid.
(7) Expenses incurred by the Chief Financial Officer in connection with a default or insolvency which are not normally incurred by the Chief Financial Officer in the administration of this act must be paid out of the amount paid under letters of credit or proceeds from the sale of collateral.
History.—s. 3, ch. 81-285; s. 5, ch. 85-259; s. 13, ch. 87-409; s. 8, ch. 88-185; s. 191, ch. 95-148; s. 10, ch. 96-216; s. 16, ch. 98-409; s. 18, ch. 99-155; s. 10, ch. 2001-230; s. 298, ch. 2003-261.

280.085 Notice to claimants.—

(1) Upon determining the default or insolvency of a qualified public depository, the Chief Financial Officer shall notify, by first-class mail, all public depositors that have complied with s. 280.17 of such default or insolvency. The notice must direct all public depositors having claims or demands against the Public Deposits Trust Fund occasioned by the default or insolvency to file their claims with the Chief Financial Officer within 30 days after the date of the notice.
(2) A claim against the Public Deposits Trust Fund is binding on the fund only if presented within 30 days after the date of the notice.
(3) This section does not affect any proceeding to:
(a) Enforce any real property mortgage, chattel mortgage, security interest, or other lien on property of a qualified public depository that is in default or insolvency; or
(b) Establish liability of a qualified public depository that is in default or insolvency to the limits of any federal or other casualty insurance protection.
(4) The notice required in subsection (1) is not required if the default or insolvency of a qualified public depository is resolved in a manner in which all Florida public deposits are acquired by another insured bank, savings bank, or savings association.
History.—s. 14, ch. 87-409; s. 17, ch. 91-244; s. 299, ch. 2003-261; s. 7, ch. 2014-145.

280.09 Public Deposits Trust Fund.—

(1) In order to facilitate the administration of this chapter, there is created the Public Deposits Trust Fund, hereafter in this section designated "the fund." The proceeds from the sale of securities or draw on letters of credit held as collateral or from any assessment pursuant to s. 280.08 shall be deposited into the fund. Any administrative penalty collected pursuant to this chapter shall be deposited into the Treasury Administrative and Investment Trust Fund.
(2) The Chief Financial Officer is authorized to pay any losses to public depositors from the fund, and there are hereby appropriated from the fund such sums as may be necessary from time to time to pay the losses. The term "losses," for purposes of this chapter, shall

also include losses of interest or other accumulations to the public depositor as a result of penalties for early withdrawal required by Depository Institution Deregulatory Commission Regulations or applicable successor federal laws or regulations because of suspension or disqualification of a qualified public depository by the Chief Financial Officer pursuant to s. 280.05 or because of withdrawal from the public deposits program pursuant to s. 280.11. In that event, the Chief Financial Officer is authorized to assess against the suspended, disqualified, or withdrawing public depository, in addition to any amount authorized by any other provision of this chapter, an administrative penalty equal to the amount of the early withdrawal penalty and to pay that amount over to the public depositor as reimbursement for such loss. Any money in the fund estimated not to be needed for immediate cash requirements shall be invested pursuant to s. 17.61.
History.—s. 11, ch. 83-122; s. 6, ch. 85-259; s. 4, ch. 86-84; s. 17, ch. 87-331; s. 15, ch. 87-409; s. 9, ch. 88-185; s. 18, ch. 91-244; s. 11, ch. 96-216; s. 39, ch. 99-13; s. 11, ch. 2001-230; s. 300, ch. 2003-261.

280.10 Effect of merger, acquisition, or consolidation; change of name or address.—

(1) When a qualified public depository is merged into, acquired by, or consolidated with a bank, savings bank, or savings association that is not a qualified public depository:
(a) The resulting institution shall automatically become a qualified public depository subject to the requirements of the public deposits program.
(b) The contingent liability of the former institution shall be a liability of the resulting institution.
(c) The public deposits and associated collateral of the former institution shall be public deposits and collateral of the resulting institution.
(d) The resulting institution shall, within 90 calendar days after the effective date of the merger, acquisition, or consolidation, deliver to the Chief Financial Officer:
1. Documentation in its name as required for participation in the public deposits program; or
2. Written notice of intent to withdraw from the program as provided in s. 280.11 and a proposed effective date of withdrawal which shall be within 180 days after the effective date of the acquisition, merger, or consolidation of the former institution.
(e) If the resulting institution does not meet qualifications to become a qualified public depository or does not submit required documentation within 90 calendar days after the effective date of the merger, acquisition, or consolidation, the Chief Financial Officer shall initiate mandatory withdrawal actions as provided in s. 280.11 and shall set an effective date of withdrawal that is within 180 days after the effective date of the acquisition, merger, or consolidation of the former institution.
(2) When a qualified public depository disposes of any of its Florida public deposits or collateral securing such deposits in a manner not covered by subsection (1), the qualified public depository originally holding the public deposits shall be responsible for:
(a) Ensuring the institution receiving such public deposits becomes a qualified public depository and meets collateral requirements with the Chief Financial Officer as part of the transaction.
(b) Notifying the Chief Financial Officer within 30 calendar days after the final approval by the appropriate regulator.

A qualified public depository that fails to meet such responsibilities shall continue to collateralize and report such public deposits until the receiving institution becomes a qualified public depository and collateralizes the deposits or the deposits are returned to the governmental unit.

(3) If the default or insolvency of a qualified public depository results in acquisition of all or part of its Florida public deposits by a bank, savings bank, or savings association that is not

a qualified public depository, the bank, savings bank, or savings association acquiring the Florida public deposits is subject to subsection (1).

(4) The qualified public depository shall notify the Chief Financial Officer of any acquisition or merger within 30 calendar days after the final approval of the acquisition or merger by its appropriate regulator.

(5) Collateral subject to a collateral agreement may not be released by the Chief Financial Officer or the custodian until the assumed liability is evidenced by the deposit of collateral pursuant to the collateral agreement of the successor entity. The reporting requirement and pledge of collateral will remain in force until the Chief Financial Officer determines that the liability no longer exists. The surviving or new qualified public depository shall be responsible and liable for all of the liabilities and obligations of each qualified public depository merged with or acquired by it.

(6) Each qualified public depository shall report any change of name and address to the Chief Financial Officer on a form provided by the Chief Financial Officer regardless of whether the name change is a result of an acquisition, merger, or consolidation. Notification of such change must be made within 30 calendar days after the effective date of the change.

(7) The Chief Financial Officer shall adopt rules establishing procedures for mergers, acquisitions, consolidations, and changes in name and address, providing forms, and clarifying terms.

History.—s. 12, ch. 83-122; s. 16, ch. 87-409; s. 9, ch. 90-357; s. 19, ch. 91-244; s. 12, ch. 96-216; s. 12, ch. 2001-230; s. 301, ch. 2003-261; s. 8, ch. 2014-145.

280.11 Withdrawal from public deposits program; return of pledged collateral.—

(1) A qualified public depository may withdraw from the public deposits program by giving written notice to the Chief Financial Officer. The contingent liability, required collateral, and reporting requirements of the depository withdrawing from the program shall continue for a period of 12 months after the effective date of the withdrawal, except that the filing of reports may no longer be required when the average monthly balance of public deposits is equal to zero. Notice of withdrawal shall be mailed or delivered in sufficient time to be received by the Chief Financial Officer at least 30 days before the effective date of withdrawal. The Chief Financial Officer shall timely publish the withdrawal notice in the Florida Administrative Register which shall constitute notice to all depositors. The withdrawing depository shall not receive or retain public deposits after the effective date of the withdrawal until such time as it again becomes a qualified public depository. The Chief Financial Officer shall, upon request, return to the depository that portion of the collateral pledged that is in excess of the required collateral as reported on the current public depository monthly report. Losses of interest or other accumulations, if any, because of withdrawal under this section shall be assessed and paid as provided in s. 280.09.

(2) A qualified public depository which has been disqualified pursuant to s. 280.051 shall not receive or retain public deposits after the effective date of the disqualification. Notice of and procedures for disqualification shall be made in accordance with ss. 280.052 and 280.053. The Chief Financial Officer shall, upon request, return to the depository that portion of the collateral pledged that is in excess of the required collateral as reported on the current public depository monthly report. Losses of interest or other accumulation, if any, because of disqualification shall be paid as provided in s. 280.09(2).

(3) A qualified public depository which is required to withdraw from the public deposits program pursuant to s. 280.05(17) shall not receive or retain public deposits after the effective date of withdrawal. The contingent liability, required collateral, and reporting requirements of the withdrawing depository shall continue until the effective date of withdrawal. Notice of withdrawal (order of discontinuance) from the Chief Financial Officer shall be mailed to the qualified public depository by registered or certified mail. Penalties

incurred because of withdrawal from the public deposits program shall be the responsibility of the withdrawing depository.

History.—s. 3, ch. 81-285; s. 13, ch. 83-122; s. 5, ch. 86-84; s. 17, ch. 87-409; s. 10, ch. 88-185; s. 10, ch. 90-357; s. 20, ch. 91-244; s. 13, ch. 96-216; s. 40, ch. 99-13; s. 13, ch. 2001-230; s. 302, ch. 2003-261; s. 22, ch. 2013-14; s. 9, ch. 2014-145.

280.13 Eligible collateral.—

(1) Securities eligible to be pledged as collateral by banks and savings associations shall be limited to:

(a) Direct obligations of the United States Government.

(b) Obligations of any federal agency that are fully guaranteed as to payment of principal and interest by the United States Government.

(c) Obligations of the following federal agencies:

1. Farm credit banks.
2. Federal land banks.
3. The Federal Home Loan Bank and its district banks.
4. Federal intermediate credit banks.
5. The Federal Home Loan Mortgage Corporation.
6. The Federal National Mortgage Association.
7. Obligations guaranteed by the Government National Mortgage Association.

(d) General obligations of a state of the United States, or of Puerto Rico, or of a political subdivision or municipality thereof.

(e) Obligations issued by the Florida State Board of Education under authority of the State Constitution or applicable statutes.

(f) Tax anticipation certificates or warrants of counties or municipalities having maturities not exceeding 1 year.

(g) Public housing authority obligations.

(h) Revenue bonds or certificates of a state of the United States or of a political subdivision or municipality thereof.

(i) Corporate bonds of any corporation that is not an affiliate or subsidiary of the qualified public depository.

(2) In addition to the securities listed in subsection (1), the Chief Financial Officer may, in his or her discretion, allow the pledge of the following types of securities. The Chief Financial Officer shall, by rule, define any restrictions, specific criteria, or circumstances for which these instruments will be acceptable.

(a) Securities of, or other interests in, any open-end management investment company registered under the Investment Company Act of 1940, 15 U.S.C. ss. 80a-1 et seq., as amended from time to time, provided the portfolio of such investment company is limited to direct obligations of the United States Government and to repurchase agreements fully collateralized by such direct obligations of the United States Government and provided such investment company takes delivery of such collateral either directly or through an authorized custodian.

(b) Collateralized Mortgage Obligations.

(c) Real Estate Mortgage Investment Conduits.

(3) Except as to obligations issued by or with respect to which payment of interest and principal is guaranteed by the United States Government or obligations of federal agencies listed in subsection (1), the debt obligations mentioned in this section shall be rated in one of the four highest classifications by an established, nationally recognized investment rating service.

(4) To be eligible as collateral under this section, all debt obligations shall be interest bearing or accruing.

(5) Letters of credit issued by a Federal Home Loan Bank are eligible as collateral under this section provided that:

(a) The letter of credit has been delivered to the Chief Financial Officer in the standard format approved by the Chief Financial Officer.
(b) The letter of credit meets required conditions of:
1. Being irrevocable.
2. Being clean and unconditional and containing a statement that it is not subject to any agreement, condition, or qualification outside of the letter of credit and providing that a beneficiary need only present the original letter of credit with any amendments and the demand form to promptly obtain funds, and that no other document need be presented.
3. Being issued, presentable, and payable at a Federal Home Loan Bank in United States dollars. Presentation may be made by the beneficiary submitting the original letter of credit, including any amendments, and the demand in writing, by overnight delivery.
4. Containing a statement that identifies and defines the Chief Financial Officer as beneficiary.
5. Containing an issue date and a date of expiration.
6. Containing a term of at least 1 year and an evergreen clause that provides at least 60 days' written notice to the beneficiary prior to expiration date for nonrenewal.
7. Containing a statement that it is subject to and governed by the laws of the State of Florida and that, in the event of any conflict with other laws, the laws of the State of Florida will control.
8. Containing a statement that the letter of credit is an obligation of the Federal Home Loan Bank and is in no way contingent upon reimbursement.
9. Any other provision found necessary under the Uniform Commercial Code—Letters of Credit.
(c) Obligations issued by the Federal Home Loan Bank remain triple-A rated by a nationally recognized source or, if no longer triple-A rated, rated by a nationally recognized source at not lower than its rating of the long-term sovereign credit of the United States.
(d) The Federal Home Loan Bank issuing the letter of credit agrees to provide confirmation upon request from the Chief Financial Officer. Such confirmation shall be provided within 15 working days after the request, in a format prescribed by the Chief Financial Officer, and shall require no identification other than the qualified public depository's name and location.
(e) The qualified public depository completes an agreement covering the use of the letters of credit as eligible collateral, as described in s. 280.041(5).
(f) The qualified public depository, if notified by the Chief Financial Officer, shall not be allowed to use letters of credit if the Federal Home Loan Bank fails to pay a draw request as provided for in the letters of credit or fails to properly complete a confirmation of such letters of credit.
(6) Cash held by the Chief Financial Officer in the Treasury Cash Deposit Trust Fund or by a custodian is eligible as collateral under this section. Interest earned on cash deposits that is in excess of required collateral shall be paid to the qualified public depository upon request.
(7) The Chief Financial Officer may disapprove any security or letter of credit that does not meet the requirements of this section or any rule adopted pursuant to this section or any security for which no current market price can be obtained from a nationally recognized source deemed acceptable to the Chief Financial Officer or cannot be converted to cash.
(8) The Chief Financial Officer shall adopt rules defining restrictions and special requirements for eligible collateral and clarifying terms.
History.—s. 3, ch. 81-285; s. 14, ch. 83-122; s. 133, ch. 83-217; s. 18, ch. 87-409; s. 7, ch. 88-171; s. 11, ch. 90-357; s. 21, ch. 91-244; s. 192, ch. 95-148; s. 14, ch. 96-216; s. 4, ch. 2000-352; s. 14, ch. 2001-230; s. 303, ch. 2003-261; s. 1, ch. 2013-129.

280.16 Requirements of qualified public depositories; confidentiality.—

(1) In addition to any other requirements specified in this chapter, qualified public depositories shall:

(a) Take the following actions for each public deposit account:

1. Identify the account as a “Florida public deposit” on the deposit account record with the name of the public depositor or provide a unique code for the account for such designation.

2. When the form prescribed by the Chief Financial Officer for acknowledgment of receipt of each public deposit account is presented to the qualified public depository by the public depositor opening an account, the qualified public depository shall execute and return the completed form to the public depositor.

3. When the acknowledgment of receipt form is presented to the qualified public depository by the public depositor due to a change of account name, account number, or qualified public depository name on an existing public deposit account, the qualified public depository shall execute and return the completed form to the public depositor within 45 calendar days after such presentation.

4. When the acknowledgment of receipt form is presented to the qualified public depository by the public depositor on an account existing before July 1, 1998, the qualified public depository shall execute and return the completed form to the public depositor within 45 calendar days after such presentation.

(b) Within 15 days after the end of each calendar month, or when requested by the Chief Financial Officer, submit to the Chief Financial Officer a written report, under oath, indicating the average daily balance of all public deposits held by it during the reported month, required collateral, a detailed schedule of all securities pledged as collateral, selected financial information, and any other information the Chief Financial Officer deems necessary to administer this chapter.

(c) Provide to each public depositor annually by October 30 the following information on all open accounts identified as a “Florida public deposit” for that public depositor as of September 30, to be used for confirmation purposes: the federal employer identification number of the qualified public depository, the name on the deposit account record, the federal employer identification number on the deposit account record, and the account number, account type, and actual account balance on deposit. Any discrepancy found in the confirmation process must be reconciled before November 30.

(d) Submit to the Chief Financial Officer annually by November 30 a report of all public deposits held for the credit of all public depositors at the close of business on September 30. Such annual report must consist of public deposit information in a report format prescribed by the Chief Financial Officer. The manner of required filing may be as a signed writing or electronic data transmission, at the discretion of the Chief Financial Officer.

(e) Participate in the Financial Literacy Program for Individuals with Developmental Disabilities as required under s. 17.68.

(2) The following forms must be made under oath:

(a) The agreement of contingent liability.

(b) Collateral control agreements and letter of credit agreements.

(3) Any information contained in a report of a qualified public depository required under this chapter or any rule adopted under this chapter, together with any information required of a financial institution that is not a qualified public depository, is, if made confidential by any law of the United States or of this state, confidential and exempt from s. 119.07(1) and not subject to dissemination to anyone other than the Chief Financial Officer under this chapter. However, each qualified public depository and each financial institution from which information is required shall inform the Chief Financial Officer of information that is confidential and the law providing for the confidentiality of that information, and the Chief Financial Officer does not have a duty to inquire into whether information is confidential.

History.—s. 3, ch. 81-285; s. 16, ch. 83-122; s. 7, ch. 85-259; s. 6, ch. 86-84; s. 20, ch. 87-409; s. 11, ch. 88-185; s. 1, ch. 89-265; s. 23, ch. 91-244; s. 15, ch. 96-216; s. 129, ch. 96-406; s. 17, ch. 98-409; s. 15, ch. 2001-230; s. 304, ch. 2003-261; s. 22, ch. 2005-2; s. 10, ch. 2014-145; s. 5, ch. 2016-3.

280.17 Requirements for public depositors; notice to public depositors and governmental units; loss of protection.—In addition to any other requirement specified in this chapter, public depositors shall comply with the following:

(1)(a) Each official custodian of moneys that meet the definition of a public deposit under s. 280.02 shall ensure such moneys are placed in a qualified public depository unless the moneys are exempt under the laws of this state.

(b) Each depositor, asserting that moneys meet the definition of a public deposit and are not exempt under the laws of this state, is responsible for any research or defense required to support such assertion.

(2) Each public depositor shall take the following actions for each public deposit account:

(a) Ensure that the name of the public depositor is on the account or certificate or other form provided to the public depositor by the qualified public depository in a manner sufficient to identify that the account is a Florida public deposit.

(b) Execute a form prescribed by the Chief Financial Officer for identification of each public deposit account and obtain acknowledgment of receipt on the form from the qualified public depository at the time of opening the account. Such public deposit identification and acknowledgment form shall be replaced with a current form as required in subsection (3). A public deposit account existing before July 1, 1998, must have a form completed before September 30, 1998.

(c) Maintain the current public deposit identification and acknowledgment form as a valuable record. Such form is mandatory for filing a claim with the Chief Financial Officer upon default or insolvency of a qualified public depository.

(3) Each public depositor shall review the Chief Financial Officer's published list of qualified public depositories and ascertain the status of depositories used. For status changes of depositories, a public depositor shall:

(a) Execute a replacement public deposit identification and acknowledgment form, as described in subsection (2), for each public deposit account when there is a merger, acquisition, name change, or other event which changes the account name, account number, or name of the qualified public depository.

(b) Move and close public deposit accounts when an institution is not included in the authorized list of qualified public depositories or is shown as withdrawing.

(4) If public deposits are in a qualified public depository that has been declared to be in default or insolvent, each public depositor shall:

(a) Notify the Chief Financial Officer immediately by telecommunication after receiving notice of the default or insolvency from the receiver of the depository with subsequent written confirmation and a copy of the notice.

(b) Submit to the Chief Financial Officer for each public deposit, within 30 days after the date of official notification from the Chief Financial Officer, the following:

1. A claim form and agreement, as prescribed by the Chief Financial Officer, executed under oath, accompanied by proof of authority to execute the form on behalf of the public depositor.

2. A completed public deposit identification and acknowledgment form, as described in subsection (2).

3. Evidence of the insurance afforded the deposit pursuant to the Federal Deposit Insurance Act.

(5) Each public depositor shall confirm annually that public deposit information as of the close of business on September 30 has been provided by each qualified public depository and is in agreement with public depositor records. Such confirmation must include the federal employer identification number of the qualified public depository, the name on the deposit account record, the federal employer identification number on the deposit account

record, and the account number, account type, and actual account balance on deposit. Any discrepancy found in the confirmation process must be resolved before November 30.

(6) Each public depositor shall submit by November 30 an annual report to the Chief Financial Officer which includes:

(a) The official name, mailing address, and federal employer identification number of the public depositor.

(b) Verification that confirmation of public deposit information as of September 30, as described in subsection (5), has been completed.

(c) Public deposit information in a report format prescribed by the Chief Financial Officer. The manner of required filing may be as a signed writing or electronic data transmission, at the discretion of the Chief Financial Officer.

(d) Confirmation that a current public deposit identification and acknowledgment form, as described in subsection (2), has been completed for each public deposit account and is in the possession of the public depositor.

(7) Notices relating to the public deposits program shall be mailed to public depositors and governmental units from a list developed annually from:

(a) Public depositors that filed an annual report under subsection (6).

(b) A governmental unit existing on September 30 which had no public deposits but filed an annual report stating “no public deposits.”

(c) A governmental unit established during the year that filed an annual report as a new governmental unit or otherwise furnished in writing to the Chief Financial Officer its official name, address, and federal employer identification number.

(8) If a public depositor does not comply with this section on each public deposit account, the protection from loss provided in s. 280.18 is not effective as to that public deposit account. However, the protection from loss provided in s. 280.18 remains effective if a public depositor fails to present the form prescribed by the Chief Financial Officer for identification of public deposit accounts and the Chief Financial Officer determines that the defaulting or insolvent depository had classified, reported, and collateralized the account as a public deposit account.

History.—s. 21, ch. 87-409; s. 12, ch. 88-185; s. 24, ch. 91-244; s. 16, ch. 96-216; s. 18, ch. 98-409; s. 305, ch. 2003-261; s. 11, ch. 2014-145.

280.18 Protection of public depositors; liability of the state.—

(1) When public deposits are made in accordance with this chapter, there shall be protection from loss to public depositors, as defined in s. 280.02, in the absence of negligence, malfeasance, misfeasance, or nonfeasance on the part of the public depositor or on the part of his or her agents or employees.

(2) The liability of the state, the Chief Financial Officer, or any state agency, or any employee or agent of the state, the Chief Financial Officer, or a state agency, for any action taken in the performance of their powers and duties under this chapter shall be limited to that as a public depositor.

History.—s. 3, ch. 81-285; s. 22, ch. 87-409; s. 194, ch. 95-148; s. 19, ch. 98-409; s. 306, ch. 2003-261.

280.19 Rules.—The Chief Financial Officer shall adopt rules pursuant to ss. 120.536(1) and 120.54 to administer the provisions of this chapter.

History.—s. 3, ch. 81-285; s. 55, ch. 98-200; s. 307, ch. 2003-261.

GFOA Best Practices
Treasury and Investment Management

Government Finance Officers Association

BEST PRACTICE

Government Relationships with Securities Dealers

BACKGROUND:

Finance officers, treasurers and investment officers (hereafter referred to as government investors) who manage and invest public funds place billions of dollars in the fixed-income and money markets on a daily basis. They have a fiduciary responsibility to protect public funds, to always act in the best interest of their entity, to maintain safety and an appropriate level of liquidity and to attain a competitive return on their portfolio.

Generally, access to the securities markets is made through securities dealers who are registered broker/dealers and through financial institutions (banks) with broker/dealer subsidiaries. The fiduciary responsibilities of a government investor include ensuring that:

- reasonable comparisons are made to judge the appropriateness of all investments;
- securities meet the criteria established in the investment policy, including liquidity, diversity and risk of investments;
- security transactions are made on a best execution basis through a competitive process;
- the counterparty to the transaction will fulfill all of its obligations; and,
- the securities are properly safe-kept at a qualified custodial agent in a segregated account.

It is important to note that brokers/firms may have unique strengths that may provide exceptional value within a specific category of investments, provided that you understand the security that you are purchasing, it dovetails with your investment policy, and you are aware of the risks associated with the transaction. A unique strength may compliment the skills and abilities of other approved brokers/firms.

Communication with broker/dealers for the purposes of discussing market conditions, reviewing investment strategies and transacting a trade often occurs by phone, e-mail, or fax. Regardless of the method of communicating with a broker, a government investor needs to perform due diligence on all securities dealers prior to adding them to their list of approved brokers/dealers for transacting trades.

RECOMMENDATION:

GFOA makes the following specific recommendations to government investors in selecting securities dealers for their approved vendor list, managing the relationships with the broker/dealers, and conducting investment transactions with them:

1. All securities are held in a third party bank separate from the broker/dealer that is transacting business.

2. Use a defined internal process to select, qualify, renew, or terminate brokers and dealers.
    1. Use a questionnaire, conduct an interview, and/or conduct peer references to help determine that the broker understands the public entity's needs/objectives.
    2. Determine that the broker is actively involved in the market sectors utilized by the government entity.
    3. Select a number of brokers suitable to the entity, allowing for appropriate competition/service on all transactions, while limiting it to a manageable number.
    4. Require security brokers and dealers to comply with the Federal Reserve Bank of New York's capital adequacy guidelines or SEC Net Capital Rule as a condition of doing business. Obtain annual financial reports of the securities firm.
    5. Require that brokers provide written acknowledgement or certification of their review and understanding of the government entity's investment policy to assure compliance with its objectives, portfolio risk constraints, and investment trading requirements.
    6. Record and retain pertinent information on the firm and the individual broker including an annual review of the Central Registration Depository (CRD®) information for both maintained by the Financial Industry Regulation Authority (FINRA). Violations or sanctions imposed by a regulatory agency or government should be carefully reviewed for termination of relationship.
    7. Establish parameters that guide periodic review and potential termination of a broker dealer relationship.
    8. Do not select or approve more broker/dealers than will be reasonably used. It is better to develop good relationships with a small number of approved dealers than to have a long list of firms who transact little or no business with the investing entity.
3. Due diligence on broker/dealers should include obtaining information on:
    1. a security dealer's experience and knowledge of public funds investing;
    2. all contact information for the primary contact, backup and operations staff;
    3. a broker's manager and supervisor;
    4. the financial strength of the firm;
    5. areas of expertise and trading activity;
    6. registration with FINRA and any citations;
    7. the names and contact information for references similar to the entity; and
    8. potential conflicts of interest.
4. Establish a competitive procedure for attaining reasonable market rates on investment transactions:
    1. Require that all security sales be made through a competitive bid process. If possible, use a competitive offer process on purchases as well.
    2. Securities sold through a selling group at a set price (usually par) or available for specific bidding should be compared to comparable maturity securities as part of the competitive process to determine the best relative value.
5. Require that all security transactions be settled on a delivery versus payment basis at the entity's custodian bank to perfect ownership under a written custodial agreement.
6. Retain complete transaction documentation for audit trail purposes including trade tickets, confirmations and safekeeping receipts.
7. Electronic trading platforms, such as Bloomberg and Tradeweb, are becoming another alternative to competitive pricing. These platforms can provide improved transparency over competitive bids and should be considered if cost effective for the government. It is still important to have a broker assigned to the account on the electronic platforms so that contact can be made if necessary. The same due diligence should be completed with all broker dealers on the electronic platforms.
8. Follow all state and entity ethics policies when dealing with all broker/dealers and investment vendors.

References:

- *Introduction to Broker-Dealers for State and Local Governments*, Second Edition, Sofia Anastopoulos, GFOA, 2008.
- *Investing Public Funds*, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- Federal Reserve Bank of New York, www.frb.ny.gov, http://www.newyorkfed.org/markets/pridealers_listing.html.
- WWW.FINRA.GOV; http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=370.
- Securities and Exchange Commission, www.sec.gov, VI. Financial Responsibility of Broker Dealers, A. Net Capital Rule 15c3-1 (17 CFR 240.15c3-1) http://www.sec.gov/divisions/marketreg/bdguide.htm#VI.

Government Finance Officers Association

BEST PRACTICE

Accepting Payment Cards and Selection of Payment Card Service Providers

BACKGROUND:

Acceptance of credit and debit cards (herein referred to as 'payment cards') as a payment method has become virtually universal within the private sector, and more common within the public sector. Many governments now accept cards for taxes, fines, user charges and fees. For a fee, a payment card processing service provider will work with a government to accept and process payment card payments.

While governments may have to absorb extra costs or citizens may have to pay an additional convenience fee for the transaction, establishing a payment card system may be an attractive addition to a government's collection office, as long as it is executed properly.

There are many benefits to accepting payment cards, including:

- Enhanced customer service and convenience
- Increased certainty of collection
- Accelerated payments and the availability of funds
- Improved audit trail
- Reduced cashiering costs
- Improved overall cash flow and forecasting
- Lessened delinquencies
- Reduced return check processing costs
- Reduced collection costs

RECOMMENDATION:

GFOA recommends that governments evaluate whether accepting payment cards as a payment option is reasonable and appropriate for the type of charges or fees being paid, and the level of customer service desired.

In establishing a payment card acceptance program, governments should consider and evaluate the following:

- **Federal, state, provincial and local laws**. Governments should first review applicable laws to determine whether card acceptance is an option.

- **Scope**. Typically, in implementing a system to accept payment cards, governments should determine the required scope for the system and the services required from a payment card service provider. Governments should:
    - Review existing (or estimate potential) usage of each card brand (e.g., Visa, MasterCard, American Express, and Discover) and types (credit or debit cards), in order to determine which brands and types to accept. Be sure to review seasonal use, such as park fees in the summer.
    - Consider payment type. Governments should consider whether they want to accept cards for mandatory charges (such as taxes and utility bills) or discretionary charges (such as recreation fees and performing arts admissions), or both.
    - Inventory any hardware the government uses to accept payment cards. In some cases, the equipment may be easily and inexpensively reprogrammed for a new vendor, while in other cases, new hardware may be necessary.
    - Consider the government's potential need to accept payment cards at special events (at different locations and for limited periods of time, and the staffing implications).
    - Review and document existing processing procedures, focusing on the process used to receive cards.
    - Consider mode of presentation: office, Internet, lockbox processing facility, temporary or mobile location, telephone.
    - Evaluate internal system security capabilities to determine whether to contract directly with a payment processor or through a third party portal. It is the government's responsibility to be payment card industry (PCI) compliant.
    - Consider government's liability in the event of a security breach, loss of data, or default by the payment card service provider or third-party portal.
    - Consider intergovernmental cooperation arrangements and whether piggy-backing is an option.
    - Determine if changes are needed to the government's internal control system to the acceptance of payment cards.

- **Fees**. Governments should be aware that different card processing service providers may have significantly different rates and fees depending on the methods they use to process payment card transactions. Fees may include:
    - *Discount rate* - The fee that payment card service providers charge merchants for processing transactions. These are fees based upon the mode of presentation (card present, telephone, Internet).
    - *Interchange fees* - This is the largest component of the discount rate. It is paid by the merchant's bank to the customer's bank, but is passed along to the merchant in the discount rate. These are the standard fees applied based upon merchant code by the merchant card companies (e.g. VISA, Mastercard).
    - *Bank fees* - These are variable fees based upon the value of the transaction or fixed fee per transaction. Due to the complexity of the fee structure, governments should be prepared to monitor the billings on a regular basis in order to ensure that the government is not overcharged.
    - *Administrative fees* - Various fees that may be charged by the payment card provider or processor.

Governments should negotiate the lowest possible fee to minimize the financial impact to the government
or to the consumer, whichever party will ultimately pay the fee.

- Internal costs and benefits. Governments should bear in mind their own costs in processing cards, such as:

    - *Administrative costs*. Governments have their own costs for equipment and associated personnel necessary to process card transactions, including costs associated in ensuring PCI compliance, which is the governments' responsibility.
    - *Cost savings*. Governments should measure their administrative cost savings and compare this against receiving and processing checks and cash transactions.
    - *Convenience fees*. Governments should consider charging a convenience fee for transactions. The advantage of convenience fees is that they can recoup the cost of merchant fees. A disadvantage of convenience fees is that they may deter some users from paying with a card. In addition, card companies have strict regulations that limit the use of convenience fees (for example, payments made by telephone or via a third-party processor. In most instances, major card companies do not allow governments or businesses to pass on merchant fees directly to customers.

- **Request for Proposal**. GFOA recommends competitive procurement of card processing service providers. Governments should use the RFP process when selecting a vendor. This process allows a government to gather data necessary to make an appropriate selection.

Governments may consider issuing a joint RFP with other jurisdictions because larger card volumes generally result in lower fees. As well, governments may include a section on merchant services in their banking services procurement RFP. Third-party processors, such as commercial automated services capable of processing card transactions seven days per week, 24 hours per day, should be considered as part of the evaluation because they may prove to be essential in recovering discount fees. GFOA further recommends that a card acceptance agreement be made as a bank services agreement administered by the public official in charge of the treasury function.

In the RFP process, governments should evaluate:

- How funds are made available to the government. The funds' availability may range from same day, next day credit to next week credit. Depending on volume, this could be important in determining the profit/cost/benefit position of the program.
- The equipment that may be required. Differences in equipment requirements may affect the initial cost of the program as well as its the long term operating efficiency. For example, the cost of new equipment may be offset by a lower discount rate or per -item fee. A break-even analysis should be performed to evaluate the options. Consider leasing versus buying for equipment as leasing provides the flexibility to stay current with changing technology and security requirements.
- Whether the payment vendor fees and the actual payment to the government are considered two different and separate transactions, so that the tax/fee is automatically sent to the government and the processing fees are automatically sent to the payment vendor service for processing.
- The vendors' reporting capabilities. Each vendor's reporting capabilities should be evaluated. While most vendors provide the basic information, governments should evaluate the vendor's ability to provide customized reports and interfacing capability.
- The vendors' procedures and experience in maintaining security. This review should include the vendor's response to security breaches or loss of information. Service providers should provide a comprehensive review of their internal and external security procedures. Pay particular attention to the Internet sign-on and multi factor identification procedures. Standard protocols include passwords, tokens, fingerprint or bio-metrics.
- The government's liability in the event of a security breach, loss of data, or default by the payment card service provider or third-party portal.
- Experience with governments as the needs of governments differ from private sector entities. Governments should consider this and any special pricing arrangements the vendor has for governments.
- The training provided by vendor.

- The vendor's problem resolution, including the timely processing of chargebacks.

References:

- *An Introduction to Treasury Management Practices*, GFOA, 1998.
- *An Introduction to Electronic Commerce: Government Cash Management Programs*, GFOA, 1998
- *Banking Services: A Guide for Governments*; GFOA, 2004.
- *Treasury Management Newsletter* articles
    - Five Myths About the Payment Card Industry Data Security Standard May 2008
    - The Payment Card Industry Data Security Standard: Where to Begin January 2008
- PCI Security Standards Council, https://www.pcisecuritystandards.org/
- Payment Card Industry Standards: https://www.pcisecuritystandards.org/

Government Finance Officers Association

BEST PRACTICE

Bank Account Fraud Prevention

BACKGROUND:

Protecting public funds is a high priority for all governments. The Uniform Commercial Code (UCC) regulates and defines the responsibilities of counterparties in business and banking transactions. The UCC states that, in certain situations, liability and monetary loss in a fraudulent transaction is split between the counterparties in a transaction based on each party's due diligence and negligence. Consequently, to reduce liability in the event of a fraudulent transaction, it is important to have proper controls in place.

Advances in technology have reduced the effectiveness of traditional fraud prevention techniques and have even enabled new forms of fraud. For example, in the past, many governments relied upon physical security features embedded in check stock to prevent check fraud. These included watermarks, unique colors, and graphical designs. Advanced duplication technology and remote deposit capture have reduced the effectiveness of these physical measures to prevent fraud.

The banking industry has developed the following fraud prevention tools:

- **Positive pay** is a type of account reconciliation service provided by banks. In positive pay, a bank compares checks that it receives for payment against the record of the checks issued by the government. If the bank receives a check that does not match the information (date, check number, and amount) in the government's record, it identifies it as an exception item (i.e., a non-conforming positive pay item). Payee positive pay is an enhanced positive pay service that requires the validation of the payee name in addition to validating the date, check number, and amount.
- **ACH blocks and filters** stop any attempt by an outside entity to process an ACH transfer and remove funds from a checking account without prior permission. ACH blocks prevent all disbursements from an account. ACH filters prevent disbursements that do not match a list of pre-authorized transactions or identification numbers. ACH filters involve: (a) giving prior permission to certain approved business partners to draw upon the account, (b) establishing an approval process for pending ACH transmissions, and/or (c) setting maximum dollar limits on ACH debit transactions.
- **Reconciliation tools** allow governments to extract information from their bank or have information sent from their bank that assists the government in performing period end reconciliation of bank accounts. The bank may also provide a tool that completes a full reconciliation of the account and produces detailed reports of reconciled items.
- **Intra-day access** allows a government to see bank account transactions that occur at various times throughout the business day. The information may be accessed via online systems provided by the bank, as well as through other methods including fax, email, and direct transmission of data from the bank to the government's computer systems.

- **Universal Payment Identification Codes (UPIC)** may be used instead of the government's bank account numbers so that the government's account numbers are not disclosed.

RECOMMENDATION:

GFOA recommends that governments consider the following steps to protect themselves against bank account fraud:

Internal Controls

- Conduct periodic surprise audits and annual reviews of procedures.
- Provide for the physical security of all checks.
  - Maintain check images in preference to paper copies.
  - Keep check stock in a locked and secure location with a formal inventory listing maintained. Secure check stock daily. Remove continuous check stock from printers. Lock and secure check specific printers. Consider the use of blank or unprinted check stock with inventory control numbers. The actual check number may be generated through the financial accounting system.
  - Physically void returned checks and check copies, and retain in a locked and secure location or destroy on a schedule.
  - Provide for the temporary physical security of electronically deposited checks, including storage in a secure facility, timely destruction such as secure shredding. (The depositing government is liable for any fraudulent usage of these checks.)
- Ensure appropriate security over signature plates, cards, and software.
- Require additional review process for all checks over a specified amount.
- Consider using a Controlled Disbursement account, to the extent permitted by law, for all payroll and Accounts Payable disbursements to provide additional control. It is preferable to make payments via batch ACH (direct deposit) for both Payroll and Accounts Payable as opposed to checks to reduce fraud potential and payment expenses.
- Require two party authorizations (initiation and release) on all wires and ACH files.
- Require daily staff reconciliation of wires and ACH releases.
- Ensure proper segregation of duties among staff initiating, authorizing, preparing, signing, and mailing payments and reconciling bank statements.
- Review signature cards and authority levels whenever any changes occur and annually at a minimum. Remove individuals from bank transaction authority immediately upon resignation or termination.
- Review all bank accounts at least annually. Consolidate or eliminate bank accounts that are not frequently utilized.
- Depending on the complexity, size and volume, consider segregating cash inflow and outflow in separate accounts to allow for placement of appropriate fraud prevention practices and products. When appropriate (i.e. if no restrictions exist) these types of separate accounts should be maintained as Zero Balance Accounts (ZBAs) that are swept into the governmental entity's concentration account.
- Ensure that controls exist for the storage and destruction of all documents that contain account and other related information.
- Determine that appropriate controls are present if employees access the government's financial and banking systems from remote sites (i.e., restrict the sharing of files).
- On at least an annual basis, request the government's legal counsel to research changes in laws that shift liability for fraudulent transactions to the government.

Fraud Prevention Measures in Cooperation with Government's Financial Institution(s)

- Implement positive pay, or preferably payee positive pay, on all disbursement bank accounts and reconcile exceptions daily. Positive pay is the single best fraud prevention tool available.

If a government's bank offers a positive pay service and the government chooses not to utilize it, then the government (not the bank) will be liable for fraudulent transactions.

    - Instruct the bank to return all non-conforming positive pay items as the default instruction.
    - Ensure that a clear policy exists to separate responsibilities between staff approving positive pay exceptions and staff initially requesting and/or preparing the check.
    - Avoid reverse positive pay because with this service the liability remains with the government.

- Direct the bank to reject or block any and all withdrawals not initiated by the government from accounts that only accept deposits.
- Place ACH filters and/or blocks on all accounts.
    - Place total or selective ACH blocks on all disbursement accounts. Selective ACH blocks, also known as ACH filters, allow electronic debits to occur only for pre-designated transactions.
    - Develop a formal plan to review ACH blocks/filters. This should be done on an annual basis, at a minimum.
- Consider the use of Universal Payments Identification Codes (UPIC) for all receivables accounts.
- Ensure that your financial institutions provides for multi-factor identification for on-line banking services involving transactions and administrative functions. Ensure separation of duties (initiation and release/approved) for financial transactions and administration of the on-line system. Multi-factor identification may include numerous passwords and/or utilization of user specific tokens.
- Ensure that your financial institution provides a quarterly listing, by account, of all approved signers and access-only individuals.
- Utilize bank reconciliation services to reduce time on reconciliation and focus on exception items.
- Discuss enhanced or new account security features with your financial institution on at least an annual basis.

References:

- *Evaluating Internal Controls: A Local Government Manager's Guide*, Stephen J. Gauthier, GFOA, 1996.

- *Banking Services: A Guide for Governments*, Nick Greifer, GFOA, 2004.
- Uniform Commercial Code as cited on the following website: http://www.law.cornell.edu/ucc/ucc.table.html

Government Finance Officers Association

BEST PRACTICE

Cash Flow Analysis

BACKGROUND:

Governments conduct cash flow analysis to estimate available cash deposits, expected inflows, and required disbursements during a given period so they can ensure sufficient liquidity. Common inflows include tax receipts, bond proceeds, utility payments, grants, other revenue from fees and penalties, and maturities of all securities held in investments that will mature during the forecast time frame. Outflows represent anticipated payments such as debt service, employee payroll or benefits, and payments to vendors for goods and services anticipated during the forecast time frame. Governments shoulds also consider and accommodate non-repetitive payments such as capital expenditures or expected legal settlements, using reasonable assumptions.

The analysis is intended to measure and assess the government's ability to meet its needs, to negate the need for any short-term borrowing or liquidation of long-term investments before maturity, and to identify any idle funds, and the duration of that idle period, to determine whether those funds could be invested over that time frame. Cash flow analysis can also help governments recognize issues that might have a negative impact on their cash positions. When looking at the entire organization, governments can use cash flow analysis to coordinate spending patterns to mitigate potential shortfalls by using information to improve revenue collection practices. Cash flow analysis is therefore an essential tool for informed management decision making.

RECOMMENDATION:

GFOA recommends that governments perform ongoing cash flow analysis to ensure that they have sufficient cash liquidity to meet disbursement requirements and limit idle cash. When conducting a cash flow analysis governments should:

- Create a pooled portfolio of unrestricted operating funds across all government funds, creating one pot of money that will be available for all routine operating obligations. This allows cash flow to be analyzed more efficiently. A government might need to exclude unspent bond proceeds or other similarly restricted funds from its cash flow planning analysis, depending on the timing and purpose of their use.
- Consider historical information and projected financial activity, which are critical to developing and maintening the cash flow analysis process. Historical information, which can be derived from banking or financial system reports, is particularly useful if a given government's cash flows are predictable over time. Prospective information (e.g., a subsequent year's budget or the amortization schedules associated with new debt issuance) can help the analyst anticipate deviations from the historical norm.
- Compare actual cash flow results with projections and determine the reasons for those differences in the analysis. The precision of cash flow analysis depends on a government's size and complexity, and the size of its cash liquidity position, but adding this step will help make future analysis more accurate.

- Make conservative assumptions about both the cash receipts and disbursement portions of the analysis, and update these assumptions regularly, as well after any major changes in operations (e.g., a new debt issuance or at the beginning of a fiscal year).
- Monitor cash position daily to ensure sufficient liquidity. The accuracy of the cash flow forecast should be evaluated at least quarterly, and if any adjustments are needed, they should be made at this point. No forecast will be 100% accurate, and governments should weigh the amount of effort these evaluations require against any expected improvements in the model. A simple model often works best; consider making the model as straightforward as possible (while maintaining the reliability and precision of information needed for makingappropriate management decisions).
- Select an appropriate tool for conducting the cash flow analysis. Many governments can complete an analysis using simple spreadsheet software, while organizations that require more complex modeling can use commercially available analytic or business intelligence systems, or modules found within common enterprise resource planning (ERP) or financial management systems.

An effective cash flow analysis should also encourage the government to communicate decisions that could affect cash inflows and outflows (e.g., decisions regarding legal settlements, changes in revenue collections, or significant milestones for capital projects) to the responsible parties so they can ensure sufficient cash liquidity.

Government Finance Officers Association

BEST PRACTICE

Collateralizing Public Deposits

BACKGROUND:

The safety of public funds should be the foremost objective in public fund management. Collateralization of public deposits through the pledging of appropriate securities or other instruments (i.e. surety bonds or letters of credit) by depositories is an important safeguard for such deposits. The amount of pledged collateral is determined by a governmental entity's deposit level and the policy or legal required collateral margin. Some states have established programs for the pooling of collateral for deposit of public funds.

Federal law imposes certain limitations on collateral agreements between financial institutions and public entities in order to secure governmental entity deposits. Under certain circumstances, as are discussed in recommendations below, the Federal Deposit Insurance Corporation (FDIC) may void an otherwise perfected security interest and leave the governmental depositor. with only the right to share with other creditors in the pro rata distribution of the assets of a failed institution for the amount of deposits that exceed the FDIC coverage. Separate governmental 'corporations' such as economic development corporations or water supply corporations, etc., do not fulfill the FDIC's definition of 'public unit'[1] and therefore even accurately completed collateral definition may not be honored by the FDIC on a bankruptcy.

RECOMMENDATION:

GFOA recommends the use of a written agreement with pledging requirements as protection for state or local government's deposits. GFOA encourages governmental entities to establish adequate and efficient administrative systems to monitor such pledged collateral, including state or locally administered collateral pledging or collateral pools. To accomplish these goals, GFOA recommends the following:

1. Governmental entities should implement programs of prudent risk control. Such programs could include a formal depository risk policy, credit analysis, and use of fully secured investments. In the absence of a state program for pooling collateral, public entities should establish and implement collateralization procedures, including procedures to monitor their collateral positions. Monitoring informs a public entity of undercollateralization, which may threaten the safety of an entity's deposits, and overcollateralization, which may increase the cost of banking services. Governmental entities however can not and should not accept the liability for maintaining collateral levels which liability must fall to the financial institution.

2. Governmental entities/depositors should take all possible actions to comply with state and federal requirements in order to ensure that their security interests in collateral pledged to secure deposits are enforceable against the receiver of a failed financial institution. Federal law provides that a depositor's security agreement, which tends to diminish or defeat the interest of the FDIC in an asset

acquired by it as receiver of an insured depository, shall not be valid against the FDIC unless the agreement:

- is in writing;
- was approved by the board of directors of the depository or its loan committee and[2]
- has been, continuously, from the time of its execution, an official record of the depository institution.[3]

3. Governmental entities should have all pledged collateral held at an independent third-party institution outside the holding company of their bank, and evidenced by a written agreement in an effort to satisfy the Uniform Commercial Code (UCC) requirement for control. The UCC states that the depositor does not have a perfected interest in a security unless the depositor controls it. Control means that swaps, sales, and transfers cannot occur without the depositor's written approval.

- The value of the pledged collateral should be marked to market monthly, or more frequently depending on the volatility of the collateral pledged. Some state statutes do dictate a minimum margin level for collateral based on deposit levels (e.g., Georgia and Minnesota statutes require 110 percent). If not, the margin levels should be at least 102 percent, depending on the liquidity and volatility of the collateral pledged. State statutes also govern whether minimum margin levels apply to principal only or to accrued interest as well. On a sale, accrued interest would be received. Governmental entities should review applicable state statutes and confirm compliance.
- Substitutions of collateral should meet the requirements of the collateral agreement, be approved, by the entity in writing prior to release, and the collateral should not be released until the replacement collateral has been received.
- The public entity should require reporting directly from the custodian. The custodian should warrant and be signatory to the agreement
- Reporting by the third party institution should at a minimum be monthly.

4. The pledge of collateral should comply with the investment policy or state statute, whichever is more restrictive. Governmental entities should know and understand securities pledged as collateral.

5. Governmental entities that use surety bonds in lieu of collateral should limit the insurers to those of the highest credit quality as determined by a nationally recognized insurance rating agency. A thorough review of the terms of the bond is required.

6. The governmental entity should thoroughly review the terms and conditions of any letters of credit, including those issued by a federal agency or government sponsored enterprise.

7. The governmental entity should establish and follow procedures for on-going review of collateral.

Note: As a result of the court case North Arkansas Medical Center v. Barrett, 963 F.2d 780 (8th Cir. 1992), the FDIC issued a policy statement in March 1993 indicating that it would not seek to void a security interest of a federal, state, or local public unit solely because the security agreement did not comply with the contemporaneous execution requirement set forth in Section 13(e) of the Federal Deposit Insurance Act 12 U.S.C.1823(e). The policy statement was officially enacted by Section 317 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Public Law 103-325).

Notes:

[1] For deposit insurance purposes, the term "public unit" includes a state, county, municipality, or "political subdivision" thereof. Governments should review Section 330.15 of the FDIC's regulations (12 C.F.R. 330.15) to identify if they fall within the FDIC's definition of "public unit" and to determine

whether they are public entity qualifying for collateral protection under the definition. This information can be found at http://www.fdic.gov/deposit/deposits/FactSheet.html

[2] The FDIC does not require every transaction to be reviewed by the board of directors. The board may fulfill this function by setting parameters and authorizing a particular officer to carry out its wishes. The officer would be performing ministerial acts on behalf of the board. (FDIC Interpretive Letters)

[3] Corporate resolutions that list specific officers who are authorized by the board of directors to execute agreements securing public deposits will meet this requirement.

References:

- GFOA Sample Security Agreement (long and short versions), www.gfoa.org, 2009.
- GFOA Sample Custodial Trust Agreement, www.gfoa.org, 2006.
- An Introduction to Collateralizing Public Deposits for State and Local Governments, Second Edition, M. Corinne Larson, GFOA, 2006.
- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- FDIC Act (12 U.S.C. 1811 et seq. and 12 C.F.R. Part 330.330.15 Public Unit Accounts (www.FDIC.gov)

Government Finance Officers Association

BEST PRACTICE

Diversifying the Investment Portfolio

BACKGROUND:

Government investors have a fiduciary responsibility to protect public funds and to prudently manage their investments in order to achieve the investment objectives of safety, liquidity, and return. Generally, greater risk in a portfolio increases the opportunity for higher returns. However, greater risk also increases the volatility of the returns, which is another definition of risk. The effective management of risk in a portfolio is critical for achieving an entity's investment objectives.

A useful strategy for managing risk in a portfolio is through diversification. To this end, a government should establish a target risk profile. In establishing a risk profile, an entity considers its investment objectives and constraints, risk tolerances, liquidity requirements and the current risk/reward characteristics of the market. The profile should be adjusted as needed to changes in any of those considerations. Such a profile provides a framework and discipline for making individual investment decisions that manage the risk and create the structure of a portfolio.

The government entity's risk profile, in turn, helps it determine appropriate levels of diversification. Diversification of investments in a portfolio is based on the different types of risk - primarily interest rate or market risk, liquidity risk and credit risk. Diversification is achieved by investing in a variety of securities with dissimilar risk characteristics that respond differently to changes in the market. Areas where diversification can be achieved include the maturity distribution in a portfolio (market and liquidity risk), sector allocation (credit risk), issuer allocation (credit risk), and the structures (noncallable vs. callable) of securities (market and liquidity risk).

RECOMMENDATION:

GFOA recommends that state and local governments properly manage the risk in their portfolios to achieve their investment objectives and comply with their investment constraints. GFOA further recommends the use of diversification in a portfolio as an important strategy for managing risk. Diversification strategies can be implemented through the following steps:

- carefully and clearly defining what the objectives safety, liquidity and return mean to the government entity
- preparing a cash flow projection to determine liquidity needs and the level and distribution of risk that is appropriate for the portfolio
- considering political climate, stakeholders' view toward risk, and risk tolerances
- ensuring liquidity to meet ongoing obligations by investing a portion of the portfolio in readily available funds, such as Local Government Investment Pools (LGIPs), money market funds, or overnight repurchase agreements
- establishing limits on positions in specific securities to protect against default risk
- establishing limits on specific business sectors

- developing strategies and guidelines for investments in single class of securities (such as commercial paper or bankers acceptances)
- limiting investments in securities that have higher credit and/or market risks (such as derivatives)
- limiting particular structures (i.e. optionality, amortizing components, coupons, issue sizes)
- defining parameters for maturity/duration ranges
- establishing a targeted risk profile for the portfolio based on investment objectives and constraints, risk tolerances, liquidity requirements and the current risk/reward characteristics of the market.

References:

- *Elected Official's Guide Investing, Second Edition*, Sofia Anastopoulos, GFOA, 2007.
- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.

Government Finance Officers Association

BEST PRACTICE

Due Diligence on Bank and Treasury Management Providers

BACKGROUND:

Governments have fiduciary duties to protect and safeguard the public funds entrusted to them, one of which is the proper selection of and ongoing oversight of bank and non-bank depositories and treasury management service providers. Government cash and near-cash assets are processed and held by banks, their third-party partners and, in some cases, non-banks; therefore, it is important to carefully choose bank and non-bank vendors and to perform on-going supervision and evaluation of each bank and non-bank that processes and/or holds government assets. The banking industry is highly regulated by both Federal and State oversight agencies and certain balances on deposit with those banks are protected by insurance made available by the Federal Deposit Insurance Corporation ('FDIC').

As part of a due diligence program, government officials should review the quarterly and annual financial reports of key counterparty banks as well as summary reports retrieved from each bank's regulator. These quarterly summary reports are known as Call Reports and can be viewed at https://cdr.ffiec.gov/public/ . Regulators establish certain key publicly reported financial standards for banks, such as the Total Risk Based Capital Ratio, the Tier 1 Risk Based Capital Ratio or the leverage Ratio. Banks must maintain sufficient book equity capital to meet the regulatory minimums otherwise the regulator will require that the bank raise new capital.

Credit Rating Agencies publish a rating in alpha and/or numeric form, and may rank bank debt instruments as indicators of a bank's ability to satisfy its obligations. It is a best practice for government officials to track and trend Private Rating Agency scores for key banks and establish a minimum threshold which primary counterparty banks must maintain in order to retain the government's depository relationship.

Other methods of determining the credit and soundness of a counterparty are the CAMELS (Capital, Asset Quality, Management Quality, Assets, Liquidity, Sensitivity to Marker Risk) ratings and the Probability of Default. The regulatory CAMELS ratings are not public information, however IDC publishes a unique rating (www.idcfp.com) based on CAMELS. The Probability of Default is an indication of the likelihood of a default over a particular time horizon, typically one and five years and is measured Through The Cycle (TTC) or as a Point in Time (PIT).

RECOMMENDATION:

The Government Finance Officers Association (GFOA) recommends that government treasury practitioners review the regulated banks, regulated and non-regulated bank partners, and non-bank companies that process, validate, transfer, disburse and 'hold on deposit' cash and near cash assets and apply prudent due diligence throughout the life of the relationship.

As part of the ongoing due diligence and prudent management of relationships, the GFOA further recommends that governments evaluate their key bank(s) and issue an internal Bank Review Summary on a quarterly basis.

In addition to monitoring and reporting, the government's operating relationship with a bank or non-bank processor of cash and near cash assets needs to be managed pro-actively.

A. Relationship Management

When monitoring regulated and non-regulated bank partners, and non-bank companies that process, validate, transfer, disburse and 'hold on deposit' cash and near cash assets and apply prudent, the following should be considered:

1. Maintain a current knowledge of the products, services and exposures that the government maintains with the bank or non-bank;
2. Create policies and procedures for all of the activities and interactions involving the bank or non-bank, including techniques to control misuse of government assets and plans to respond to any variance from policy.
3. Be aware of the competitors and their ability to replace the bank or non-bank in the event of a temporary or permanent interruption of service or change of bank or non-bank;
4. Particularly for sensitive products like payroll, make certain that an emergency back-up plan is available in the event that the bank is unable to process for the government;
5. Develop an action plan in the event of a confidential information breach internally or at the bank or non-bank.
6. Prepare a comprehensive business resumption plan for all of the services used from the bank or non-bank to respond to any emergency disruption of service, whether internal to the government or caused by the bank or non-bank, and to assure the on-going availability of disaster recovery and that those plans are tested frequently, both internally and against the bank or non-bank's business continuity plans.

B. Bank Review Summary

The Government's Bank Review Summary should:

1. Identify the government's product usage at the bank;
2. Describe the government's exposure at the bank (balance levels, exposure to product issues, etc.);
3. Evaluate changes in the bank's financial condition;
4. Report whether the bank's Credit Rating Agency scores meet or exceed established minimum thresholds;
5. Review any recent news including management changes, legal and regulatory actions, key product changes, changes in market capitalization, mergers or acquisitions, and any other meaningful financial events that may change the bank's condition, status or abilities;
6. Consider the actions required of the government in the event that the bank no longer qualifies as an approved depository/counterparty for the government.

C. Monitoring Financial Conditions

Monitoring the financial conditions of a bank or non-bank relationships should consist of the following:

1. A Review of the monthly account analysis statement or invoice to determine if volume counts are appropriate and consistent and to be sure that contract pricing is properly applied to the account analysis or invoice. Use the account analysis/invoice as well as internal knowledge to determine if product usage is appropriate from month to month. For example:
    1. Should new products available in the marketplace replace existing product choices?

    2. Are there less expensive ways available to process the transactions without giving up important value?
    3. Can transactions be processed more safely?
2. A review of the financial condition of the banks or non-banks as well as a continual scan of news reports that may indicate changes in bank or non-bank financial performance or strategies.
   Conduct quarterly relationship review meetings with representatives of the bank or non-bank to maintain open communications, exchange ideas for improvement and stay informed of developments at the bank or non-bank.
    1. Large banks and non-bank relationships should be reviewed quarterly.
    2. Small banks and non-bank relationships should be reviewed annually.

References:

Adler, J. (2011, August 12). Bank Exam Ratings May Not Be as Secret as You Think. *American Banker.*

Evangelisti, C.J. and Lockhart, K.C. (2009, October). Banking Due Diligence in the New Financial World. *Government Finance Review.*

GFOA Best Practice Using Safekeeping and Third-Party Custodian Services (2010).

Government Finance Officers Association

BEST PRACTICE

Establishing a Policy for Repurchase Agreements

BACKGROUND:

Where permitted by statute and investment policy, governmental entities often enter into Repurchase Agreements (repos) to invest funds on a short-term basis primarily to fund liquidity needs. Repos are contractual financial transactions in which an investor (e.g. governmental entity) purchases securities from a bank or dealer with a simultaneous contractual agreement by both parties to reverse the transaction at the same price (plus interest) at some mutually agreed-upon future date. The parties to the agreement (governmental entity and bank/dealer) are commonly referred to as counterparties. Repos are an integral part of an investment program of state and local governments and provide an alternative or supplement to local government investment pools, money market mutual funds and other money market instruments. However, like all investments, there are associated risks with repos, one in particular is the counterparty's credit risk. Such risk can be mitigated by the utilizing proper securitization practices.

Common Types of Repos:

- **Overnight Repo**: refers to a repo that goes from one business day to the next business day. These repos have a negotiated fixed interest rate.
- **Term Repo**: refers to a repo agreement with a specified maturity of several days to several weeks. Term repos can be established for up to several years when the investment policy permits. The interest rate for the period is usually fixed.
- **Open Repo**: typically, has no maturity date, and renews daily until terminated by either one of the counterparties. The interest rate adjusts daily to the overnight rate and is averaged for the period of the repo.
- **Flex Repo (flexible repurchase agreements)**: are often used for the reinvestment of bond proceeds used for capital projects. These repos are often for multi-year periods associated with a specific capital program. The flexible portion of the agreement permits multiple cash draw-downs to fund the expenditure requirement. Governments should ensure that these investments meet the liquidity requirements of the project and adhere to any bond covenants.
- **Tri-Party Repo**: occurs when a custodian (a.k.a. the tri-party agent) participates as an intermediary between the two parties (investor and lender) of the repo. The custodian administers and ensures the transaction occurs simultaneously and that necessary safeguards are in place to protect the underlying securities during term of the repo.

Benefits of Repos:

- Repos are safe when properly established and monitored;
- At times, provide higher yields than other money market alternatives;
- Provide diversification to other money market investments; and

- Provides flexibility.

Risks Associated with Repos:

- The repurchase agreement with an entity's counterparty is not properly established;
- The financial strength of the counterparties and value of the collateral are not properly monitored;
- The bank or dealer cannot buy securities back when repo is closed by governmental entity.
- The collateral for the repo is not liquid or easily marketable; and
- The value of the repo is not sufficient to cover the funds invested and interest earned.

Mitigating the Risk:

- Execute a SIFMA *Master Repurchase Agreement* including additional provisions specific to the governmental agency that is signed by a duly authorized officer with each counterparty;
- Establish financial strength criteria for counterparties and review financial statements at inception of relationship and at least annually. Some entities will limit counterparties to primary dealers;
- Allow only highly marketable, easily priced collateral priced at a minimum of 102% and monitoring their value at least weekly; and
- Have collateral settled delivery-versus-payment (DVP) at the entity's custodian or trustee for third-party safekeeping.

Master Repurchase Agreement. A Master Repurchase Agreement is the contractual agreement a governmental entity enters into with a bank or counterparty. A form of the agreement, also known as a blanket agreement may be obtained from the website of the Securities Industry and Financial Markets Association (SIFMA) formerly known as The Bond Market Association (TBMA). However, governmental entities may wish to amend SIFMA's form of the Master Repurchase Agreement to suit the specificities of their respective transactions.

A master repurchase agreement governs the repurchase transaction. An agreement should reflect the following characteristics:

- Defines and provides detail as to the nature of the transaction;
- Identifies the relationship of the parties to the agreement;
- Establishes the parameters concerning the ownership and custody of the collateral securities for the term of the agreement;
- May include right to substitute collateral during the term of the agreement; and
- Provides for remedies in the event of default by either party.

SIFMA has also published an optional substitution/termination provision to its *Master Repurchase Agreement* that allows the repo seller (bank or dealer) to retain effective control over the purchased securities, or the repo seller could elect to terminate the transaction prior to maturity on short notice to the repo buyer (government entity).

Securitization Provisions.

Safekeeping: In order to protect public funds, governmental entities should ensure proper securitization practices when utilizing repurchase agreements for investments. Safekeeping should be performed by an independent or third-party custodian. Duties of the custodian (direct or tri-party) should be outlined in a written safekeeping agreement.

Collateral: The underlying security of a repurchase agreement is collateral. Collateral arrangements for repurchase agreements are short-term and liquid in nature. Typical collateral instruments are U.S. Treasuries (e.g. U.S. Treasury bills) and governmental agency securities (e.g. Farm Credit Banks, Home Loan Banks bonds). Governmental entities should be aware of the risk factors of the underlying collateral instrument for the repo and refer to their respective investment policies to verify if such collateral instruments are permissible to utilize for the repurchase transaction. The purchased securities (collateral) to collateralize the repurchase agreement should maintain a market value in excess of the value of the repurchase agreement (called margin, "haircut," or over securitization).

Although governmental entities are not bound by the Financial Accounting Standards Board (FASB), FASB Statement No.140 affects the counterparties to repurchase transactions with governments. FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," generally provides that if the repo buyer (i.e., government entity) has the right to sell or substitute the securities, then the repo seller (i.e., bank or dealer) does not have the right to substitute the securities or terminate the contract on short notice. The repo buyer will be obligated to record both the securities, together with any obligation to return the securities. The repo seller will be required to reclassify the securities from a securities inventory or investment account to a securities collateral account on its balance sheet. Accordingly, the nature of the underlying repurchase agreement may change from a buy-sell transaction to a collateralized loan. **This change of treating repurchase agreements as collateralized loans would make them illegal for local governments in many states.**

RECOMMENDATION:

GFOA recommends that state and local government finance officers develop policies and procedures to ensure the safety of repos.

The following actions are recommended:

1. Government entities and investment officers should exercise special caution in selecting and evaluating the creditworthiness of counterparties with whom they will conduct repurchase transactions and be able to identify the parties acting as principals to the transaction.
2. Master repurchase agreements should be employed, subject to appropriate legal and technical review. Governments using the prototype agreement developed by SIFMA should include appropriate supplemental provisions regarding the types of securities, delivery, substitution, margin maintenance, margin amounts, seller representations, and governing law as contained in the GFOA-developed *Considerations for Governments in Developing a Master Repurchase Agreement*.
3. Government entities' legal department should review SIFMA's optional substitution/termination provision in its master agreement to assure no loss has incurred (e.g. in event of a default). In jurisdictions where substitution of securities is permitted, a loss provision is provided that is intended to place the repo buyer in the same position it would have been had the repo seller not exercised the substitution/termination right. However, in jurisdictions where substitution is restricted, the effect of FASB Statement No.140 may be troublesome depending on the relationship established with the bank or dealer; the jurisdiction's position with respect to the change in accounting treatment of the transaction; and whether the government has the ability to avoid the restriction on substitution of purchased securities.
4. Proper securitization practices are necessary to protect the public funds invested in repurchase agreements. Safekeeping duties should be performed by a third-party custodian in accordance with an executed agreement. The purchased securities (collateral) to collateralize the repurchase agreement should maintain a market value in excess of the value of the repurchase agreement (called margin, "haircut," or over securitization). Routine market valuing of the purchased securities during the term of the repurchase agreement should be a mandatory practice in order to ensure the purchased securities maintain sufficient market value to cover any default. A typical margin requirement for a short-term repo using US Treasuries or US agency securities as collateral is at least 102% and higher (typically 105%) for other securities.

5. Consideration should be given to restricting the allowable securities that are used for collateral. Entities may prefer to only allow for security maturity and security types that are allowable for direct investment under their policy. If there is a default of the counterparty, the securities held as collateral of the repo will be owned by the entity, supporting the need to restrict the maturity and type of security to what is allowable under policy.

References:

- "Do You Know Your Repurchase Agreements as Well as You Think?" GFOA's *Treasury Management Newsletter*, October 3, 2009, Volume 27, Number 10.
- *An Introduction to Broker-Dealers for State and Local Governments, Second Edition*, Sofia Anastopoulos, GFOA, 2008.
- "GFOA Best Practice, Securities Lending Programs" (1995, 2002, 2008).
- *An Introduction to Collateralizing Public Deposits for State and Local Governments, Second Edition*, M. Corinne Larson, GFOA, 2006.
- GFOA Best Practice, Frequency of Purchased Securities Valuation in Repurchase Agreements (1999, 2003, 2006, 2008).
- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- "GFOA Best Practice, Securities Lending Programs" (1995, 2002, 2008).
- Sample Custodial Trust Agreement, GFOA.
- FASB Statement 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," http://www.fasb.org/pdf/fas140.pdf.
- The Securities Industry and Financial Markets Association (SIFMA) http://www.sifma.org

Government Finance Officers Association

BEST PRACTICE

Government Relationships with Securities Dealers

BACKGROUND:

Finance officers, treasurers and investment officers (hereafter referred to as government investors) who manage and invest public funds place billions of dollars in the fixed-income and money markets on a daily basis. They have a fiduciary responsibility to protect public funds, to always act in the best interest of their entity, to maintain safety and an appropriate level of liquidity and to attain a competitive return on their portfolio.

Generally, access to the securities markets is made through securities dealers who are registered broker/dealers and through financial institutions (banks) with broker/dealer subsidiaries. The fiduciary responsibilities of a government investor include ensuring that:

- reasonable comparisons are made to judge the appropriateness of all investments;
- securities meet the criteria established in the investment policy, including liquidity, diversity and risk of investments;
- security transactions are made on a best execution basis through a competitive process;
- the counterparty to the transaction will fulfill all of its obligations; and,
- the securities are properly safe-kept at a qualified custodial agent in a segregated account.

It is important to note that brokers/firms may have unique strengths that may provide exceptional value within a specific category of investments, provided that you understand the security that you are purchasing, it dovetails with your investment policy, and you are aware of the risks associated with the transaction. A unique strength may compliment the skills and abilities of other approved brokers/firms.

Communication with broker/dealers for the purposes of discussing market conditions, reviewing investment strategies and transacting a trade often occurs by phone, e-mail, or fax. Regardless of the method of communicating with a broker, a government investor needs to perform due diligence on all securities dealers prior to adding them to their list of approved brokers/dealers for transacting trades.

RECOMMENDATION:

GFOA makes the following specific recommendations to government investors in selecting securities dealers for their approved vendor list, managing the relationships with the broker/dealers, and conducting investment transactions with them:

1. All securities are held in a third party bank separate from the broker/dealer that is transacting business.

2. Use a defined internal process to select, qualify, renew, or terminate brokers and dealers.
    1. Use a questionnaire, conduct an interview, and/or conduct peer references to help determine that the broker understands the public entity's needs/objectives.
    2. Determine that the broker is actively involved in the market sectors utilized by the government entity.
    3. Select a number of brokers suitable to the entity, allowing for appropriate competition/service on all transactions, while limiting it to a manageable number.
    4. Require security brokers and dealers to comply with the Federal Reserve Bank of New York's capital adequacy guidelines or SEC Net Capital Rule as a condition of doing business. Obtain annual financial reports of the securities firm.
    5. Require that brokers provide written acknowledgement or certification of their review and understanding of the government entity's investment policy to assure compliance with its objectives, portfolio risk constraints, and investment trading requirements.
    6. Record and retain pertinent information on the firm and the individual broker including an annual review of the Central Registration Depository (CRD®) information for both maintained by the Financial Industry Regulation Authority (FINRA). Violations or sanctions imposed by a regulatory agency or government should be carefully reviewed for termination of relationship.
    7. Establish parameters that guide periodic review and potential termination of a broker dealer relationship.
    8. Do not select or approve more broker/dealers than will be reasonably used. It is better to develop good relationships with a small number of approved dealers than to have a long list of firms who transact little or no business with the investing entity.
3. Due diligence on broker/dealers should include obtaining information on:
    1. a security dealer's experience and knowledge of public funds investing;
    2. all contact information for the primary contact, backup and operations staff;
    3. a broker's manager and supervisor;
    4. the financial strength of the firm;
    5. areas of expertise and trading activity;
    6. registration with FINRA and any citations;
    7. the names and contact information for references similar to the entity; and
    8. potential conflicts of interest.
4. Establish a competitive procedure for attaining reasonable market rates on investment transactions:
    1. Require that all security sales be made through a competitive bid process. If possible, use a competitive offer process on purchases as well.
    2. Securities sold through a selling group at a set price (usually par) or available for specific bidding should be compared to comparable maturity securities as part of the competitive process to determine the best relative value.
5. Require that all security transactions be settled on a delivery versus payment basis at the entity's custodian bank to perfect ownership under a written custodial agreement.
6. Retain complete transaction documentation for audit trail purposes including trade tickets, confirmations and safekeeping receipts.
7. Electronic trading platforms, such as Bloomberg and Tradeweb, are becoming another alternative to competitive pricing. These platforms can provide improved transparency over competitive bids and should be considered if cost effective for the government. It is still important to have a broker assigned to the account on the electronic platforms so that contact can be made if necessary. The same due diligence should be completed with all broker dealers on the electronic platforms.
8. Follow all state and entity ethics policies when dealing with all broker/dealers and investment vendors.

References:

- *Introduction to Broker-Dealers for State and Local Governments*, Second Edition, Sofia Anastopoulos, GFOA, 2008.
- *Investing Public Funds*, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- Federal Reserve Bank of New York, www.frb.ny.gov, http://www.newyorkfed.org/markets/pridealers_listing.html.
- WWW.FINRA.GOV; http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&nodeId=370.
- Securities and Exchange Commission, www.sec.gov, VI. Financial Responsibility of Broker Dealers, A. Net Capital Rule 15c3-1 (17 CFR 240.15c3-1) http://www.sec.gov/divisions/marketreg/bdguide.htm#VI.

Government Finance Officers Association

BEST PRACTICE

Investment and Management of Bond Proceeds

BACKGROUND:

When governments issue bonds, additional considerations are likely to apply to bond proceeds. Investment policies, legal requirements such as the arbitrage yield permitted under federal tax rules, requirements from bond covenants and/or credit enhancement providers, and the anticipated timing of drawdown of bond proceeds should be taken into account when determining what investments to purchase. Multiple accounts with varied investment horizons are often involved.

Cash flow analyses are critical components of the process and are useful in reducing the possibility of “negative arbitrage” that may occur when the rate of interest paid on the bonds that are issued exceeds the interest received from reinvestment opportunities. The manner in which bond proceeds are invested may have a material impact on the size and cost of a bond issue, and on the cash flow available to make debt service payments, and needs to be understood and analyzed by governmental issuers in that context.

RECOMMENDATION:

The Government Finance Officers Association (GFOA) recommends the following:

- Issuers should have an Investment Policy that addresses a bond indenture’s permitted investments and other investment requirements related to bond proceeds with that policy.
- Issuers should be aware of unique considerations related to investing bond proceeds such as multiple accounts that may be required for a bond issue, the Municipal Advisor Rule as it relates to investment advice on bond proceeds, and tax compliance issues related to tax-exempt bond proceeds.
- Issuers should coordinate the management of bond proceeds with the necessary staff in their government to ensure funds are spent properly and cash flows are matched with investment maturities.

Coordination of Bond Requirements with Investment Policy

GFOA recommends that governments have an Investment Policy which takes into consideration all inherent risks and which also includes specific policies for the investment of bond proceeds to ensure that legal and regulatory requirements are met, fair market value bids are received, and issuer objectives for various uses of proceeds are attained. Governments should be aware that different types of bond proceeds may have different investment goals.

Often the bond indenture will contain a list of permitted investments as well as any other investment requirements related to credit enhancement providers. Different types of debt issuances may have unique investment requirements related to various Federal, State and other programs. These requirements need to be coordinated with the Investment Policy. In addition, governments should discuss with bond counsel any required disclosures related to investments.

Establishment of Multiple Funds and Accounts

Governments typically must establish various funds and accounts as required in the bond indentures and must be knowledgeable of different types of investment that each fund may require. Some common funds and accounts and associated investment horizons include the following:

- Construction Fund (investment horizon is short-term, typically ranges from 12-36 months)
- Capitalized Interest Fund (investment horizon is short-term, typically ranges from 6-18 months)
- Interest Account (investment horizon is usually 6 months)
- Sinking Fund/ Principal Account (investment horizon is usually 12 months)
- Escrow Fund/ Redemption Account (investment horizon depends on a redemption date)
- Debt Service Reserve Fund (investment horizon is long-term, maximum duration investment allowed under governments' Investment Policy may be used)

While these are typical investment horizons for each of the funds/accounts described above, expectations and requirements can vary across governments and each issuer should consult with their advisory team and Investment Policy to determine optional timeframes and security options.

The MA Rule and Broker-Dealers Advice

Due to the Securities and Exchange Commission's (SEC) Municipal Advisor (MA) Rule, brokers may be considered municipal advisors if they provide advice on investments of bond proceeds to governments, which limits the ability to directly solicit information from broker-dealers on reinvestment choices.

Governments should understand their interactions with broker-dealers under the existing regulatory environment at the time of a bond sale and how they will engage specific professionals to formulate an ultimate decision on the efficiency of reinvestment options that will be selected.

Governments may obtain advice from a broker-dealer through a Request for Proposals (RFP) process or when they have retained an independent registered municipal advisor (IRMA) whose duties include advice on investments. The GFOA Alert on the MA Rule can serve as a resource for issuers on understating the MA roles, their fiduciary duties, and the RFP or IRMA exemption. Issuers may also choose to retain a registered investment adviser if they want more than de minimis investment advice.

Tax Compliance

Municipal issuers should be knowledgeable and consult with tax and legal counsel on various Federal tax rules and post-issuance tax compliance requirements for tax-exempt bond proceeds in order to maintain their tax-exempt status. In the broadest terms, the tax requirements can be grouped into two categories: (1) arbitrage and rebate; and (2) use of bond proceeds and of bond-financed facilities. Each of these categories involve rules that make it advisable for an issuer to adopt practices that track how bond proceeds are invested and how and when bond proceeds are spent. Further, issuers should maintain proper records for the required time period, which is typically the life of the bonds plus three years.

Management of Bond Proceeds Spending

When an issuer sells new money bonds and expects to take a considerable period of time to spend bond proceeds on capital projects, this may result in an interest cost that exceeds interest earnings during that time period ("negative arbitrage"). It is critical to develop consistent and reliable spend-down estimates for the associated capital projects and periodically update those estimates to compare against investment income projections based upon prevailing and expected market conditions.

Issuers will need to identify and ensure coordination between the persons responsible for monitoring and managing spending, cash flow projections, and investment performance and compliance. This is especially true if these areas involve different offices and staff and can typically include debt management staff, treasury staff, public works or engineering staff, etc. This coordination is critical and GFOA recommends that governments do the following:

- Monitor how and when bond proceeds will be invested and spent with respect to federal tax law requirements, especially when there are changes in timing or spending plans from what was planned at the time of bond issuance.
- Make certain that the drawdown of proceeds is planned and recorded and that the investment duration is shorter than the expected drawdown schedule. Since the draw schedule may change over time, it should be periodically revisited.
- Borrow only as much as needed to fund capital projects or expected expenses, after consideration of cash funding, grants, or other funding sources.
- Explore options to stage bond issues over the capital construction period to minimize potential arbitrage liability and/or negative arbitrage.

Consider not issuing bonds significantly earlier than proceeds are expected to begin being spent on capital expenditures.

References:

- *GFOA Investment Policy BP and Sample Investment Policy;*
- *GFOA Investment Program for Public Fund BP;*
- *GFOA Primary Market Disclosure BP;*
- *GFOA Alert: The MA Rule and Issuers;*
- *GFOA Selection and Review of Investment Advisors BP;*
- *GFOA Government Relationships with Securities Dealers BP;*
- *GFOA Post-Issuance Compliance BP;*
- *GFOA Developing and Implementing Procedures for Post-Issuance Tax Compliance for Issuers of Governmental Bonds Alert;*
- *NABL Considerations for Developing Post-Issuance Tax Compliance Procedures.*

Government Finance Officers Association

BEST PRACTICE

Investment Policy

BACKGROUND:

An investment policy describes the parameters for investing government funds and identifies the investment objectives, preferences or tolerance for risk, constraints on the investment portfolio, and how the investment program will be managed and monitored. The document itself serves as a communication tool for the staff, elected officials, the public, rating agencies, bondholders, and any other stakeholders on investment guidelines and priorities. An investment policy enhances the quality of decision making and demonstrates a commitment to the fiduciary care of public funds, making it the most important element in a public funds investment program.

RECOMMENDATION:

GFOA recommends that all governments establish a comprehensive written investment policy, which should be adopted by the governing body. The investment policy should be reviewed and updated annually and should include statements on the following:

- **Scope and investment objectives**: Tailor the scope and investment objectives to the type of investment to which the policy applies (e.g., excess operating funds, bond proceeds, pension fund assets).
- **Roles, responsibilities, and standards of care**: Identify the roles of all persons involved in the investment program by title and responsibility. Standards of care should include language on prudence (i.e., the prudent person rule), due diligence, ethics and conflicts of interest, delegation and authority, and knowledge and qualifications.
- **Suitable and authorized investments**: Include guidelines on selecting investment types, investment advisors, interest rate risk, maturities, and credit quality, along with any collateralization requirements.
- **Investment diversification**: State the government's approach to investment diversification, identifying the method that will be used to create a mix of assets that will achieve and maintain the government's investment objectives.
- **Safekeeping, custody, and internal controls**: Develop guidelines to enhance the separation of duties and reduce the risk of fraud.
- **Authorized financial institutions, depositories, and broker/dealers**: Establish a process for creating a list of financial institutions, depositories, and broker/dealers that will provide the primary services necessary for executing the investment program.
- **Risk and performance standards**: Establish one or more appropriate benchmarks against which the portfolio should be measured and compared.
- **Reporting and disclosure standards**: Define the frequency of reporting to the governing body and the government's management team.

References:

- GFOA Sample Investment Policy

Government Finance Officers Association

BEST PRACTICE

Investment Program for Public Funds

BACKGROUND:

Governments have a fiduciary responsibility in managing their funds, including the ongoing management and monitoring of investment activity. A government's investment program should derive from the entity's Investment Policy.

Developing a public funds investment program is essential to effective financial management, and it sets the foundation for creating protocols and internal controls, constructing and managing the portfolio, navigating changing economic conditions, and communicating information to stakeholders. While different types and sizes of governments require differing levels of complexity in their investment programs, all governments need to recognize their fiduciary responsibility. Having an established public funds investment program provides the structure to effectively set policy, make decisions, and safeguard a government's financial assets.

RECOMMENDATION:

GFOA recommends that all governments establish a public funds investment program by completing the following steps:

1. Review all applicable laws and regulations – Research all applicable federal, state/provincial, and local laws and regulations to become familiar with required parameters that may have been established by an overlapping entity.
2. Establish an investment leadership team – The investment leadership team should provide oversight, set policy and strategy, and identify appropriate individuals to administer the program. Typically, this investment leadership team may include senior-level representatives from finance, administration, risk, legal, and representatives of the governing body. This team will participate in establishing the public funds investment program.
3. Create an investment policy – Create a written investment policy, which will be adopted by the governing body. The investment policy documents key guidelines and expected outcomes during the process of establishing the public funds investment program, as well as other criteria, such as NACHA.
4. Determine the portfolio management team – Decide if the investment portfolio will be managed using internal staff and/or if the government will engage an external investment consultant. Governments should carefully consider if internal staff has the knowledge and ongoing training opportunities to perform portfolio management tasks in house. When using investment consultants (including registered investment advisors), governments should ensure that these professionals have significant experience and expertise in public funds investing, and have gone through an appropriate vetting and selection process.

5. Establish risk and return objectives – Establish a risk profile that is consistent with the government's risk tolerance and a process for evaluating portfolio risk and a return objective in accord with the entity's risk tolerance, and subject to investment constraints.
6. Identify the funds being invested and develop a cash flow forecast for each – Determine which funds will be invested and whether they are excess operating funds, bond proceeds, pension fund assets, or some other type of funds. To establish the proper investment parameters for each classification of funds, estimate how frequently they will be used; this will require an understanding of cash flow requirements and preparation of an appropriate forecast.

Government Finance Officers Association

BEST PRACTICE

Local Government Investment Pools

BACKGROUND:

In many states, the state treasurer or the authorized governing board of another governmental entity (such as a county) oversees a pooled investment fund that operates like a money market mutual fund for the exclusive benefit of governments within the entity's jurisdiction.

Unlike mutual funds, however, local government investment pools (LGIPs) are not registered with the Securities and Exchange Commission (SEC) and are exempt from SEC regulatory requirements because they fall under a governmental exclusion clause. While this exemption allows pools greater flexibility, it also reduces investor protection. Investments in these pools are not insured or guaranteed and substantial losses have occurred in the past.

These pools typically combine the cash of participating jurisdictions and invest the cash in securities allowed under the state's laws regarding government investments. By pooling funds, participating governments benefit from economies of scale, full-time portfolio management, diversification, and liquidity (especially in the case of pools that seek a constant net asset value of $1.00). Interest is normally allocated to the participants on a daily basis, proportionate to the size of the investment. Most pools offer a check writing or wire transfer feature that adds value as a cash management tool.

Government Sponsored versus Joint Powers Agreement Pools

Local government investment pools (LGIPs) may be authorized under state statutes and sponsored by the state or local governments, or may be set up through intergovernmental agreements known as "joint powers" agreements. In several states, local governments have joined together through joint powers agreements to sponsor the creation of LGIPs that operate independent of the state government. The investment authorization to pool funds is generally derived from state statutes that allow governments to perform collectively any service or administrative function that they may undertake individually. A board of trustees, normally made up of public officials, oversees these pools and typically selects a financial services firm to provide services such as the following: investment management, custodial services, participant record keeping, independent audits, and legal services. These pools may invest only in securities otherwise allowed to individual governments.

Whether the LGIP is state-sponsored or created through a joint powers agreement, it is important to be aware that the authorizing entity typically does not guarantee investments in the LGIP.

Not All Pools Are the Same

Although there are many similarities between the various LGIPs, there are also differences. One significant difference among pools that must be understood before placing money in them is their investment objectives. When LGIPs were first created, most emulated money market mutual funds with the objective of maintaining a "constant" Net Asset Value (NAV) of $1.00 and providing excellent liquidity for the investor. Such LGIPs invest in short-term securities with average maturities sufficiently short to avoid market price risk. The "constant" NAV pools are appropriate investments for funds that must be liquid and have virtually no price volatility.

There are also government investment pools that have an investment objective of maximizing return. These pools are variable Net Asset Value (NAV) pools and introduce market risk to the investor through a fluctuating NAV. They invest in longer-term securities, thus subjecting their portfolios and their participants to greater market price volatility. The principal invested in the pool may not be the same principal returned to the investor, depending on the movement of interest rates. While they may be appropriate for longer-term strategies, these pools ***would not*** be appropriate for funds that must be liquid and stable.

Other differences among pools include legal structure, authorized investments, procedures for depositing and withdrawing money, and services provided to participants. Each pool has a process that a participant must complete, including documents to be signed and banking information to be provided, in order to establish an account. Sources of information for evaluating pools may include a pool offering statement, investment policy or audited financial statements.

Rated LGIPs[1]

Rating agencies rate constant dollar LGIPs using the same criteria that they use for rating money market mutual funds. These ratings are based on safety of principal and ability to maintain a NAV of $1. Fluctuating NAV pool ratings include a volatility factor. Pool ratings can provide an additional method of due diligence.

RECOMMENDATION:

GFOA makes the following recommendations to governments that invest in or are considering investing in Local Government Investment Pools (LGIPs).

Government investors should:

1. Confirm LGIPs are eligible investments under governing law and the government's investment policy.
2. Fully understand the investment objectives, legal structure and operating procedures of the investment pool before they place any money in the pool. When evaluating an LGIP, investors should read the pool's offering statement, investment policy, and audited financial statements carefully.
3. Pay particular attention to the investment objectives of a pool to determine whether the pool seeks to maintain a constant NAV of $1.00 or could have a fluctuating NAV. This information is essential in order to determine which pools are appropriate for liquidity strategies (constant NAV) and which ones are only appropriate for longer-term strategies (fluctuating NAV).
4. Review the pool's list of eligible securities to determine compliance with the participating government's investment policy. Portfolio maturity restrictions and diversification policies should be evaluated to determine potential market and credit risks.
5. Evaluate portfolio pricing practices.
6. Review custodial policies (e.g., delivery versus payment).
7. Evaluate the qualifications and experience of the portfolio manager, management team and/or investment adviser.
8. Review the earnings performance history relative to other investment alternatives. On constant NAV LGIP funds, the current yield of the portfolio can be compared with competitive institutional money market funds, or overnight repurchase agreement rates. Standard & Poor's releases an index of LGIPs on a weekly basis that reports the average 7- and 30-day

yields and average maturities of LGIPs holding its highest ratings (AAAm and AAm). Any pool with above-average yields or longer maturities should be further evaluated for risk.

9. Evaluate variable NAV LGIPs in relation to appropriate benchmarks.
10. Although ratings are not mandatory, seek LGIPs with the highest ratings, where possible.
11. Fully understand procedures for establishing an account, making deposits and withdrawals, and allocating interest earnings. There may be limits to the number of deposits and withdrawals in a month. There may also be dollar limits for deposits, withdrawals and balances. Deposits or withdrawals may require advanced notification, especially if they are large. If so, investors should be aware of the deadlines.
12. When selecting an LGIP, consider any additional services offered by an LGIP, such as: check writing, wire transfers, issuing paying agent services, setting up multiple accounts for an entity, and arbitrage accounting for bond funds.
13. Confirm that an LGIP provides regular, detailed reporting to pool participants and follows accepted reporting standards. GFOA recommends that pool administrators, on a daily basis, determine the market value of all securities in the pool and report this information to all pool participants on at least a monthly basis. These values should be obtained from a reputable and independent source. This information should be included in the report to the governing body prepared on at least a quarterly basis.
14. Be aware that an LGIP may be a part of a diversified portfolio but that a portfolio comprised solely of an LGIP may not provide the government entity with appropriate diversification.

Notes:

[1] Not all LGIPs are rated.

References:

- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- *Elected Officials Guide Investing, Second Edition,* Sofia Anastopoulos, GFOA, 2007.
- GFOA Best Practice, "Diversification of Investments in a Portfolio," 2007.
- *Standard & Poor's Guide to LGIPs*

Government Finance Officers Association

BEST PRACTICE

Managing Market Risk in Investment Portfolios

BACKGROUND:

Fixed-income securities are investment instruments that provide a stream of cash flows in the form of coupon and principal payments. Typically, they are issued with maturities ranging from one year to 30 years. A security's stated maturity is the date on which its final interest and principal payments are due. There are several general structures for fixed-income securities:

- **Bullet securities** - the principal amount will be paid in one payment at maturity. They are issued without any option that could cause redemption prior to the stated maturity;
- **Securities with options** - issued with either a call or put option that could change the stream of cash flows. Call options give the issuer the right to redeem bonds prior to maturity in accordance with the call schedule. Securities with call options have greater volatility than bullet securities. Issuers of callable securities typically call these when interest rates have fallen, causing investors to lose the higher interest rate in periods when such rates are hard to replace. Put options give the investor the right to submit a bond for redemption prior to maturity in accordance with the rules of the put. Buyers pay a premium for the put option. Typically, investors of putable securities "put" these when interest rates have risen, gaining the opportunity to reinvest their principal at the then prevailing higher market rates; and
- **Amortizing securities** - pay a portion of the principal with each interest payment throughout the life of the bond (e.g.: mortgage securities, asset-backed securities). They have a stated final maturity and an average maturity, and can also have early redemption options.

Market risk refers to the effect that changing interest rates have on the present value of a fixed-income security, and can also be referred to as interest rate risk. There is an inverse relationship between interest rates and price. As interest rates rise, the value of a security falls. The reverse is true as interest rates fall. The extent of price change is a function of the length of term to maturity, the structure of the security (type of embedded options), the level of interest rates, and the size of the coupon.

Of these factors, the most important are the length of term to maturity and the structure. Generally, the longer the maturity of a security, the greater its market risk as measured by price volatility. Longer maturities have greater volatility because as the time to maturity increases, each change in interest rates has a greater impact on the present value of a security.

The size of a security's coupon also affects price volatility. When analyzing securities with the same maturity, securities with low coupons will have greater price volatility than securities with high coupons. The security with the greatest price volatility for any given maturity is a zero coupon security.

Many government investors employ a buy-and-hold approach, so that changes in a security's market value are never realized and the full face value of the security is received upon maturity. Despite this, market value must be managed for three reasons:

1. The total return of the portfolio is computed and compared to the total return of the portfolio's benchmark to evaluate portfolio performance.
2. The market value of an entity's investments must be disclosed in its annual financial report. Often an entity will include it in more frequent reports to the governing body and public. Accordingly, an entity must be able to understand and explain changes in the market value of its portfolio.
3. Circumstances may arise in which an entity is forced to sell a security before its maturity. In such instances, a government entity may have to accept a loss on a security that it had never planned to sell. Market risk is a critical risk for a government investor. Therefore, it is necessary to understand fully the maturity structure of securities before investing. To ensure appropriate liquidity and to reduce interest rate risk in operating portfolios, most state and local governments:
    1. Limit the maximum maturity for securities they purchase;

2. Ensure that funds are available for scheduled disbursement by developing cash flow projections and properly structuring the maturities in a portfolio according to the expected cash flows;
3. Ensure that a reasonable liquidity buffer is maintained to meet unexpected disbursements; and
4. Ensure that a security can be sold with ease and minimal cost (price disruption) to the investor by investing in high grade, actively traded fixed-income securities.

Maximum maturity and weighted average maturity limits relate directly to an entity's statute and policy constraints, investment objectives and cash flow projections. Although setting maximum maturity constraints may help limit the market risk in a portfolio, it is not generally considered to be the most effective way for managing market risk and understanding the potential price volatility of either an individual security or an entire portfolio. Maximum maturities allow the portfolio to take advantage of longer securities and the weighted average maturity protects against over-extension of the portfolio in those longer maturities.

A widely used measure of market risk in the investment industry is *modified duration*. Durations can be obtained from professional market resources such as Bloomberg. For governments without access to these resources, broker-dealers may send documentation of the durations. Duration is more comprehensive and accurate in measuring market risk than the maturity of a security for two important reasons. First, duration takes into consideration all cash flows (interest and principal payments) of a fixed-income security using their present values. Maturity as a market risk measure only considers the principal payment of a security using its future value.

Second, modified duration is a multiplier that measures the approximate percentage change in the value of a security or portfolio given a 1% (100 basis points) move in interest rates. For example, if a security has a modified duration of 1.74 and interest rates rose by 50 basis points, the security would experience approximately a -0.87% change in value.

Formula and calculation:

$$\%\text{ change in market value} = (-1)^{*} \times (\text{modified duration}) \times \left(\frac{\text{basis points change in yield}}{100}\right)$$

$$-0.87\% = (-1) \times (1.74) x \left(\frac{+50}{100}\right)$$

* multiplied by -1 because of inverse relationship between price and interest rates

With this type of price volatility analysis, a government investor can determine more accurately the amount of market risk in a security or portfolio.

Weighted average maturity and weighted average duration in a portfolio are calculated using the maturity and duration values of all the securities in a portfolio. Weighted average maturity allows a government to verify compliance with investment constraints since most investment policies and state statutes have maximum weighted average maturity limitations. Weighted average duration is considered industry wide as an acceptable measure of market risk in a portfolio. As such, it can provide the government investor with valuable information for managing the market risk in a portfolio.

The Governmental Accounting Standards Board (GASB) in GASB Statement No. 40 requires a disclosure of all risks associated with a government entity's portfolio, including market risk, including market rate or interest rate risk. Weighted average maturity and weighted average duration are two of five accepted methods for disclosing a portfolio's market risk. (A description of the other three is beyond the scope of this Best Practice.) In accordance with the GASB fair market value reporting requirements in GASB Statement No. 31, a government entity's portfolio could show unrealized losses or gains for any reporting period.

RECOMMENDATION:

State and local governments should comply with state statutes pertaining to investing public funds along with all investment policy parameters. Fixed income investing involves a certain level of market risk. Investors should be aware of their risk tolerance and confirm that the market risk they assume is within this tolerance level.

GFOA makes the following recommendations to government investors with respect to managing market risk:

1. Develop and update cash flow projections to determine: a) the dollar amount of the portfolio that needs to remain liquid (liquidity buffer) to meet disbursement obligations within a six-month period (shortterm), b) what dollar amount is required within the next 6 - 12 month period, and c) whether there is a 'core' of funds available for longer-term investing.
2. Structure the portfolio to provide sufficient liquidity for anticipated cash flow requirements by continuously investing a portion of the portfolio in money market type investments such as local government investment pools, money market mutual funds, overnight repurchase agreements and money market securities.
3. Understand fully the maturity structure of a security. Prior to purchase, the government should confirm compliance with its investment constraints and overall investment strategy. If a security has options associated with it such as call options, the structure of the option should be analyzed to determine its potential impact on market risk through an analysis such as option adjusted spread (OAS) analysis. The stated maturity date should always be used to determine compliance with maximum maturity constraints, not any potential call dates unless an official announcement of a call has been released.
4. Adopt weighted average maturity limitations and/or weighted average duration targets, consistent with the government's investment objectives, constraints, cash flow needs and risk tolerances. The weighted average maturity limitations is used to limit the liquidity and market risk in a portfolio consistent with the constraints in the governing state statutes and the investment policy. The weighted average duration targets can be used to manage market risk in a portfolio.
5. Do not directly invest in securities with maturities greater than the limits imposed by investment policy. In general, the maturities in a portfolio should coincide as nearly as practicable with the expected use of funds. Securities with maturities greater than five years should be matched to a specific cash requirement. The government should include in its investment policy a process for authorizing longer-term investments and for providing disclosures.

References:

- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA,
  1998.
- GFOA Sample Investment Policy, 2003.
- GASB Statement No. 31 and Statement No. 40, www.GASB.org

Government Finance Officers Association

BEST PRACTICE

Mark-to-Market Reporting for Public Investment Portfolios

BACKGROUND:

Market risk is significant in public investment portfolios. Due to price volatility, valuing investments at their current price is necessary to provide a realistic measure of a portfolio's true liquidation value. Over time, reporting standards for state and local government investment portfolios have been enhanced so that investors, governing bodies, and the public remain informed of the current market value of the portfolio. Regular disclosure of the value of a governmental entity's investments is an important step to furthering taxpayer and market confidence in state and local government investment practices. The Governmental Accounting Standards Board (GASB) has also recognized the need to report investments at fair value at fiscal year end. Government officials should be aware of state, local, accounting, and rating agency requirements regarding markto-market practices.

RECOMMENDATION:

GFOA recommends that state and local government officials responsible for investment portfolio reporting determine the market value of all securities in the portfolio on at least a quarterly basis. These values should be obtained from a reputable and independent source and disclosed to the governing body or other oversight body at least quarterly in a written report. The independent source of pricing should not be one of the parties to the transaction being valued and could include:

1. a broker or other financial institution who was not a counterparty to the transaction,
2. the custodial bank if the bank was not a counterparty to the transaction,
3. publicly available publications such as the *Wall Street Journal*, or
4. other pricing services for which a separate fee would be paid.

It is recommended that the written report include the market value, book value, and unrealized gain or loss of the securities in the portfolio.

If there is a significant event in the local or national economy that might affect the value of the portfolio, then a mid-term valuation of the portfolio should be conducted. Governments that employ a more active portfolio management style should consider more frequent marking to market and reporting.

References:

- *GASB Statement 31 and Implementation Guide, Accounting and Financial Reporting for Certain Investment and for External Investment Pools*, March, 1997.
- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- *Investment Procedures and Internal Controls Guideline*, GFOA, May 2003.

- *Elected Official's Guide Investing, Second Edition*, Sofia Anastopoulos, GFOA, 2007.

Government Finance Officers Association

BEST PRACTICE

Monitoring the Value of Securities in Repurchase Agreements

BACKGROUND:

A repurchase agreement (repo) is a transaction between a buyer/investor (e.g. government entity) and a seller/counterparty (e.g. bank or securities dealer) in which the counterparty sells securities to the investor with a simultaneous agreement to buy the securities back from the investor on a future date. The securities are repurchased, or bought back, at the same price plus the interest earned at the repo rate for the period of the repo. U.S. Treasury Securities (Bills, Notes, Bonds) and Government Sponsored Enterprise (GSE) (e.g. Fannie Mae, Freddie Mac) securities are the most common securities sold for repos involving government entities. Terms for repos can be overnight (from one business day to the next business day), for a specified number of days (term repo) or as a continuing open contract (open repo) to be closed at the request of either party.

Public funds have used repos since the 1970s. In September 1996, the Securities Industry and Financial Markets Association (SIFMA) formerly, The Bond Market Association, published a revised version of its *Master Repurchase Agreement*, which previously had been amended in 1987. The revised agreement includes modifications designed to reflect the expansion of the repo market, changes in the law and "'market participants' experience in exercising liquidation and similar closeout rights in the context of counterparty insolvency." (SIFMA *Guidance Notes and Supplemental Guidance Notes*).

In March of 2003, the Governmental Accounting Standards Board (GASB) published Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment to GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements)*, and *Reverse Repurchase Agreements* which states that government entities should briefly describe policies regarding securitization and safekeeping for deposits and investments, including repos, that are related to the risks that must be disclosed under this Statement No.40.

An important factor in managing the risk of default in repurchase transactions is the valuation of the purchased securities. For the term of the repo agreement, it is common practice for the counterparty to deliver purchased securities to the investor in a total value amount (market value plus accrued interest) that is equal to the investor's investment plus a margin percentage. The margin percentage, typically 102% for Treasury and GSE securities, protects the investor from a decline in the price of the purchased securities during the time the repo transaction is in effect. The value of the securities must be monitored frequently to insure the market value remains at least equal to the invested amount plus margin percentage in case of default of the counterparty. If the value of the purchased securities falls below the invested amount plus margin percentage, then the counterparty is required to deliver additional securities to the investor upon their request.

The frequency of the valuation depends on several factors:

- The maturity of the purchased securities, since longer maturities have greater price volatility;
- The security types, since certain securities have greater price volatility;
- Market volatility; and,
- The margin percentage that is required by the investor; the lower the margin percentage, the more frequent the valuation of the purchased securities.

RECOMMENDATION:

Because the investor may need to liquidate the purchased securities in the secondary market in the event the counterparty defaults on the repurchase agreement transaction, GFOA recommends that government entities establish a policy and procedure for monitoring the value of the purchased securities in a repo transactio to insure that it does not drop below the value of the repo investment plus any required margin percentage. For maximum protection, government entities should value the purchased securities in their repo transactions to their current market price on a daily basis. At a minimum, the purchased securities should be valued:

- Weekly;
- Whenever there is a major increase in rates or market volatility is high; or,
- Whenever a coupon and/or principal payment on the purchased securities is wired back to the counterparty.

In order to facilitate the determination of market value, government entities should specify the acceptable securities for a repo transaction. Acceptable securities are those that have readily available pricing information from a reputable, independent pricing source. The independent source of pricing should not be a counterparty to the repo transaction and could include:

- a broker or other financial institution that was not a counterparty to the transaction,
- the custodial bank if the bank was not a counterparty to the transaction,
- publicly available publications such as the Wall Street Journal, or
- other pricing services for which a separate fee would be paid.

When valuing securities, the purchased securities are valued using their current market price plus accrued interest to compute their total value. The total value is then compared to the repo value multiplied by any margin percentage. If the total value of the purchased securities is less than the repo value plus the margin percentage, then the investor/buyer should request sufficient additional securities on a same-day or next-day basis from the counterparty to bring the total value up to the proper level.

Further discussion of repos and recommended safeguards is provided in the references listed below. Public investors should consult their investment policy as well as state law and local ordinances for any further restrictions or guidance on repurchase agreements and valuation of purchased securities.

References:

- GFOA Best Practice, "Establishing a Policy for Repurchase Agreements," (2003, 2006, 2008 and 2010), GFOA Committee on Treasury and Investment Management
- GFOA Advisory, "Ensuring the Safety of Reverse Repurchase Agreements," (2003, 2006, 2008 and 2010), GFOA Committee on Treasury and Investment Management
- "Do You Know Your Repurchase Agreements as Well as You Think?" GFOA's *Treasury Management Newsletter*, October 3, 2009, Volume 27, Number 10.
- *Introduction to Broker-Dealers for State and Local Governments, Second Edition*, Sofia Anastopoulos, GFOA, 2008.
- *An Introduction to Collateralizing Public Deposits for State and Local Governments, Second Edition*, M. Corinne Larson, GFOA, 2006.

- *Considerations for Governments in Developing a Master Repurchase Agreement, Second Edition*, GFOA Committee on Cash Management, 2001.
- *Investing Public Funds, Second Edition,* Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- Master Repurchase Agreement, September 1996 The Securities Industry and Financial Markets Association (SIFMA), http://www.sifma.org
- Governmental Accounting Standards Board (GASB), http://www.gasb.org

Government Finance Officers Association

BEST PRACTICE

Payment Consolidation Services

BACKGROUND:

Payment consolidation services provide an efficient, cost-effective method of collecting payments made through on-line payment services. This service is provided, primarily, by financial institutions and may go by a variety of names such as: 'payment consolidation service,' 'electronic lockbox,' and 'lockbox plus.' Currently, most financial institutions and companies such as CheckFree offer free payment services. Businesses and individuals have the option to make payments directly from their financial institution without the need to write a check or use a mail service to return the payment. They can even designate the specific day the payment should be made.

This new method of making payments has created significant problems for many governments. Governments no longer receive payment stubs with a check, but instead, they receive a check with an attachment listing multiple payments to the government from multiple payees. For entities using lockboxes, this creates exceptions that must be manually processed, often resulting in higher costs and potential delays before funds are deposited. Governments that receive payments directly spend significant additional time on processing since these payments cannot be electronically processed.

In a payment consolidation service, a financial institution acts as an agent on behalf of a government. The selected financial institution provider contacts those other financial institutions that provide online payments and arranges that all the payments to a specific government be sent to them. The financial institution processes these payments, deposits them daily, and sends the data to the government entity in a format that can be processed electronically. This process is similar to how a lockbox works with the exception that the payment consolidation service provider receives the payments and payment information electronically from the online financial institutions. A payment consolidation service allows for faster identification of these online payments so they can be posted more efficiently and accurately to a government's accounts receivable and ERP systems.

There are numerous benefits to a payment consolidation service, including:

- expedited processing of payments,
- quicker updates to accounts receivable systems,
- reduced payment processing costs for lockbox services,
- reduced costs associated with check-and-list reporting,
- elimination of exception handling of electronic bill payments, and
- lower overall transaction processing costs per payment.

RECOMMENDATION:

GFOA recommends that governments consider the use of a payment consolidation service to improve the efficiency of their collection process. A competitive process can be used to select a payment consolidation service provider. Consideration should be given to vendors that provide daily deposits, exception listings, and electronic file remittance to the government entity.

Governments should consider the following when evaluating a consolidation service:

1. **Availability of Consolidation Services**. Governments seeking a consolidation service should evaluate which firms can provide consolidation services.

2. **Workflow and Cash Flow**. Any evaluation of consolidation services must include:

- an analysis of the existing workflow from receiving mail to depositing payments and posting receivables,
- volume of transactions,
- staffing requirements,
- time required to complete,
- expected float savings from use of service,
- security of the process,
- employee accuracy,
- customer service,
- software or capital requirements, if any, and
- service charges.

Costs associated with these processes can then be evaluated against the costs and benefits of engaging a consolidation service provider. Particular attention should be paid to any delays in depositing funds or posting of receivables.

3. **Technical Requirements**. Consolidation service processing has certain technical requirements. Depending on the needs and capabilities of the government entity, the transmission of data from the consolidation service back to the entity can range in sophistication from the exchange of hard copy records to retrieving the information via Internet access. Changes to existing software may be necessary to upload the information electronically.

4. **Other Considerations**. Government billings and cash flows are often cyclical, causing problems in cash management operation staffing levels. Shifting payment processing responsibility to a consolidation service alleviates the dilemma of adequately staffing to meet a limited number of peak periods versus overburdening a small staff during critical periods.

GFOA also recommends that any contract entered into by a government entity and consolidation service provider at a minimum include the following:

- treatment of exception (non-standard) items,
- turnaround time,
- disposition of documents (including imaging capabilities),
- funds availability schedule, and
- error tolerance.

In the event that these services are procured through the use of a request for proposal, the request for proposal and the vendor response should be included as part of the contract.

References:

- GFOA Best Practice, "Use of Lockbox Services," 2009.

Government Finance Officers Association

BEST PRACTICE

Payments Made by Governments

BACKGROUND:

Governments make payments in a variety of ways including cash, checks, and various electronic payment methods. Governments rarely make payments using cash but a government may have one or more petty cash funds for employee reimbursement. In addition, fewer and fewer payments by governments are being made by check as more electronic options have been made available but check payments still exist and have unique control and fraud prevention requirements.

RECOMMENDATION:

The GFOA recommends that governments have policies and procedures and internal controls in place for each payment method and use electronic means to make payments as often as possible.

Electronic Payment Methods

- **Automated clearing house** (ACH) – movement of funds in a batch process, which is best for high volume, low dollar transactions such as payroll, expense reimbursement, and routine vendor payments, as the cost per transaction is low relative to other forms of electronic payment.
- **Wire transfer** – immediate movement of funds between bank accounts with guaranteed settlement, which is most suitable for high dollar transactions because the cost per transaction is high relative to other forms of electronic payment.
- **Purchasing (procurement) cards** – a credit card transaction designed to reduce the volume of small dollar purchase orders issued, field purchase orders or to eliminate petty cash. Purchasing cards are used at the point of sale, which is convenient for the employee and the customer, and payments are made in aggregate. Vendors that accept the payment will pay a processing fee. There is usually no cost to the government, and the issuing bank may provide a rebate based on transaction volume. In addition, restrictions can be put on the purchasing cards such as a per purchase dollar amount limit, dollar limits per transaction cycle and by MCC (merchant category code).
- **Electronic accounts payable** – – a credit card transaction, often without physical cards, that allows governments to pay invoices electronically. These payments are made during the normal accounts payable process, but the vendor or government has designated a preference to receive funds via the card instead of checks. As with purchasing cards, the vendor pays a processing fee, and the government may receive a rebate.
- **Stored value cards** –generally used for payroll to unbanked employees or for rebate/incentive programs. The card is tied to a bank account and is loaded via an ACH transaction. There are costs associated with activation and use of the card.
- **ACH debits** – withdrawal of funds directly out of the government's bank account. This type of payment is usually requested by vendors who do repetitive business with the government such as benefit providers who have long term contracts with the government. Generally, a

government should have debit blocks in place against ACH debits unless specifically identified by the government as trusted vendors.
- **Cryptocurrency** – governments should not make payments through cryptocurrency vehicles, due to risk and volatility of that market. Cryptocurrency is “any form of currency that only exists digitally, that usually has no central issuing or regulating authority but instead uses a decentralized system to record transactions and manage the issuance of new units, and that relies on cryptography to prevent counterfeiting and fraudulent transactions.” (Merriam Webster)

Benefits to using electronic payments including:

- Eliminating the storage, handling, and processing of paper checks.
- Reducing the time spent on reconciliation.
- Eliminating the occurrence of lost or stolen checks and the cost of check reissuance.
- Reducing security risks, including the visibility of information used in check payment fraud.
- Improve the tracking of payments through enterprise resource planning (ERP) systems and integration with banking technologies.

Cash Payment Methods

- Petty cash and change funds should be covered in the government’s cash handling policies and procedures:
    - Establish reconciliation process and timeliness
    - Establish verification procedures to prevent duplicate payments (petty cash)

Check Payment Methods

- Check usage (if not able to be eliminated) should be minimized.
- Physical security over check stock and check copy retainage should be in place and documented.
- Bank fraud prevention tools should be in place (e.g., positive pay).
- Timely reconciliation and escheatment should be practiced.
- Governments should have protocols in place for electronic and facsimile signatures, and may want to consider use of multiple signatures on checks.
- Governments may also want to consider outsourcing the check writing function to a bank or other third-party provider.

Government Finance Officers Association

BEST PRACTICE

Procurement of Banking Services

BACKGROUND:

State and local governments use a wide variety of banking services for the deposits, disbursement, and safekeeping of public funds. Prudent procurement practices require the reevaluation of banking services on a periodic basis. In addition, continual changes in technology, treasury management practices, and banking industry structure offer public funds managers opportunities to reevaluate banking services and costs.

RECOMMENDATION:

GFOA recommends that state and local governments establish a procurement process and assure periodic reviews of banking services. Adhering to a defined due diligence in selecting banking services and establishing proper controls will help a government achieve its objectives of appropriate and cost-effective banking services while protecting its funds and reducing risk to its reputation. Governments should consider including the following practices in their procurement of banking services:

1. Periodically initiate a process of competitive procurement in accordance with the state and local laws and regulations, for major banking services. The process should use a request for proposals (RFP) that should include services, fees, earnings credit rates, and availability schedules for deposited funds. In addition, it is important to utilize independent bank evaluation services to verify creditworthiness of the financial institution prior to award of a contract and throughout the contract period.

2. Have contracts for banking services that specify services, fees, and other components of compensation. If applicable, this should include tri-party depository contracts that require that the custodian complies with collateral requirements.

3. Identify a primary relationship manager who will serve as a central point of contact, understand the needs of the entity and be able to offer recommendations for service improvements.

4. Evaluate the relative benefits and costs of paying for services through direct fees, compensating balances, or a combination of the two (blended). Factors to consider in this evaluation are the earnings credit rate, reserve requirements and insurance fees on deposits.

5. Evaluate the government's needs in comparison to the costs and benefits of specific banking services, including:

- Electronic
  - balance and transaction-reporting services (image access and usage)
  - stop payments
  - payment capabilities

- deposit capabilities
- transmitted analysis and statements
- digitized storage of paid checks and statements
- stale date check management
- access to safekeeping/custodial information
- access to investment performance reporting

- Accounts
  - controlled disbursement
  - collection account
  - zero-balance
  - interest-bearing
  - investment sweep account

- Security features
  - positive pay services including payee positive pay service (which is payee matching)
  - reconciliation services
  - Automated Clearing House (ACH) blocking/filtering services
  - check to ACH conversion
  - Non-sufficient funds (NSF)/ACH conversion for representment of NSF check (Represented Check Entries, RCK)
  - collateral requirements (reporting by the custodian required)

- Treasury management services
  - lock-box services
  - credit card receipt merchant services
  - safekeeping or custody arrangements (delivery versus payment, DVP)
  - procurement cards
  - stored value (payroll) cards
  - Web links for Internet payment for services

6. A treasury management review and comprehensive evaluation should be performed prior to the issuance of an RFP to ensure that the treasury manager asked for all required and optional banking services. Consider using a Request for Information (RFI) or meeting with several banks in advance of the RFP process to determine if there are any products/services available that your jurisdiction would be interested in adding. This preliminary work is necessary periodically to take advantage of changes in banking services and technology as new services become available. In the event that these services are procured through the use of a request for proposal, the request for proposal and the vendor response should be included as part of the contract.

Notes:

- GFOA Banking Services RFP Checklist

References:

- *An Introduction to Treasury Agreements*, Linda Sheimo, GFOA, 1993.
- *An Introduction to Treasury Management Practices*, GFOA, 1998.
- *Banking Relations: A Guide for Governments*, Nicholas Greifer, GFOA, 2004.
- GFOA Best Practice, Collateralization of Public Deposits, 2007.

Government Finance Officers Association

BEST PRACTICE

Procurement of Financial Services

BACKGROUND:

Governments rely on a variety of vendors to provide essential financial services, including:

- Banking services
- Trustee/custodial
- Securities broker/dealer
- Underwriting and other debt related services
- Financial advisory
- Merchant services
- Investment advisory services

These industries are subject to constantly changing regulations, technologies, and market conditions. As a result, governments must provide regular due diligence of all financial service providers. Part of ongoing due diligence includes regular competition for the procurement of services.

RECOMMENDATION:

GFOA recommends that governments review their financial services contracts every five years and use a competitive process for the procurement of financial services. A competitive procurement process provides an opportunity for the government to obtain market competitive rates and negotiate preferable terms and conditions and/or service enhancements in financial service contracts. It also gives the government an opportunity to take advantage of technology enhancements, service changes, or evolution in the market. Identifying a regular schedule for soliciting competitive bids for financial service providers also helps reduce the risk of a government becoming too reliant on one vendor.

With every competitive procurement process, governments should define the scope of the procurement opportunity, identify specific evaluation criteria, and prepare a strategy to evaluate responses. Evaluation criteria should specifically address the following:

- **Product and service breadth, depth and quality –** the service provider's ability to provide solutions that meet the government's specific needs.
- **Quality of servicing staff –** the individual experience, skills, and qualifications of the staff members who will provide services on the account, if selected, and their ability to meet the government's needs.
- **Financial strength –** the service provider's profitability, operating history, and net capital (which should be of sufficient size to satisfy service requirements).
- **Service capacity –** the provider's ability to process sufficient transaction volumes and dollars of throughput.
- **Regulatory standing –** the provider's status with the applicable regulatory agency.

- **Reputation and social responsibility –** the experience peer governments have had with the provider and the provider's demonstration of being a good citizen that is fair and honest in its dealings.
- **Cost –** the overall cost or rate included in the proposal, which can include consideration of potential future price escalations.

References:

- Sample RFPs (coming soon)
- Sample evaluation criteria/checklist (coming soon)

Government Finance Officers Association

BEST PRACTICE

Purchasing Card Programs

BACKGROUND:

The purpose of a purchasing card (also known as a procurement card or P-Card) program is to provide an efficient, cost-effective method of purchasing and paying for small-dollar as well as high-volume purchases. This type of program is used as an alternative to the traditional purchasing process and can result in a significant reduction in the volume of purchase orders, invoices, and checks processed. Purchasing cards can be used whenever a purchase order, check request, or petty cash would have been processed and with any vendor that accepts credit cards.

There are numerous benefits to a purchasing card program. Benefits to the cardholder can include:

1. convenience of purchasing without a purchase order,
2. expedited delivery of goods,
3. better pricing on goods,
4. expanded list of merchants from whom purchases can be made, and
5. reduced paperwork.

Benefits to the government can include:

1. simplified purchasing and payment process,
2. lower overall transaction processing costs per purchase,
3. increased management information on purchasing histories,
4. reduced paperwork,
5. decentralized procurement function,
6. the ability to set and control purchasing dollar limits,
7. the ability to control purchases to specific merchant categories and vendors, and
8. receipt of rebates from the bank based upon dollar volume of total purchases.

Benefits to the vendor include:

1. expedited payments,
2. reduced paperwork, and
3. lowered risk of nonpayment.

Purchasing cards may be issued in a designated individual's name and/or the government's name clearly indicated on the card as the buyer of goods and services. The purchasing card and any transactions made with the card may become a liability of the governmental entity. For this reason, it is important that governments be aware of the risks related to the use of purchasing cards and establish controls to address those risks.

Disadvantages of purchasing cards include:

1. the potential for duplicate payments to vendors, unless payments are recorded by individual vendor within the accounting system,
2. the perception in the public about issuing 'credit cards' to employees may be negative, and
3. the potential for abuse despite the controls available with purchasing cards.

RECOMMENDATION:

GFOA recommends that governments explore the use of purchasing cards to improve the efficiency of their purchasing procedures. A competitive process should be used to select a purchasing card provider.

Consideration should be given to vendors who can provide:

- automated approval and reconciliation software. This software should provide for the ability to integrate to the entity's accounting records in a timely fashion;
- a program that is simple and easy to use;
- comprehensive control restrictions for single transactions, the number and amounts authorized per day and per cycle; and restrictions on the types of vendors and merchant category codes with which the card may be used;
- provisions for handling questioned items and chargebacks;
- a broad selection of reports or ad hoc reporting ability;
- training materials;
- customer support; and
- program rebates.

Governments need to maintain appropriate controls, in accordance with their purchasing policy, to ensure the ongoing success of a purchasing card program. These controls should include: written agreements with banks, which include fee schedules, processing procedures, and security requirements;

1. written policies and procedures for internal staff, including:
    1. instructions on employee responsibility and written acknowledgments signed by the employee
    2. ongoing training of cardholders and supervisors
    3. spending and transaction limits for each cardholder both per transaction and on a monthly basis
    4. written requests for higher spending limits
    5. recordkeeping requirements, including review and approval processes
    6. clear guidelines on the appropriate uses of purchasing cards, including approved and unapproved Merchant Category Codes (MCC)
    7. guidelines for making purchases by telephone and fax or over the Internet
    8. periodic audits for card activity and retention of sales receipts and documentation of purchases
    9. timely reconciliation by cardholders and supervisors
    10. procedures for handling disputes and unauthorized purchases
    11. procedures for card issuance and cancellation, lost or stolen cards, and employee termination
    12. segregation of duties for payment approvals, accounting, and reconciliations
    13. regular review of spending per vendor and merchant category codes
2. systems to ensure compliance with IRS 1099 reporting regulations.

References:

- *Banking Services: A Guide for Governments*, Nicholas Greifer, GFOA, 2004.
- *An Elected Official's Guide to Procurement*, GFOA, 1995.

Government Finance Officers Association

BEST PRACTICE

Receivables and Handling Receipts in the Treasury Office

BACKGROUND:

Governments have many types of receivables: utilities, taxes, service fees as well as other miscellaneous invoices. The timing of the receipt of the receivables is critical to the cash flow and treasury function of a government. Therefore, care must be taken to establish enforceable invoicing and collection policies and the consequences of non-payment of amounts due. Governments should ensure their revenue control and management policy and procedures are in full compliance with any applicable laws or requirements. Due to the special nature of funds received from grants, developers, or those which originated from a referendum, governments should consider whether separate procedures should be established for recording and depositing these funds.

RECOMMENDATION:

The GFOA recommends that governments should have written policies and procedures for invoicing and collection of revenues, which should include the following elements:

- Governments should ensure that all policies and procedures related to customer receipts and accounts receivable are in conformance with all applicable laws and regulations. Due to the special nature of certain receipts including grants, governments may need to adopt separate procedures for recording and deposit of these funds.
- Governments should establish invoicing and accounts receivable controls, processes, and procedures for services provided in advance of payment, considering the following: billing timeframe, dollar thresholds, use of outside collection services, write-off of bad debt, receivables aging analysis, and decision-making authority.
- Governments should accept a variety of receipt types and establish specific policies and procedures outlining proper handling, reconciliation, accounting, fraud prevention, and safekeeping of each. Acceptable types of receipts may include cash, check, credit/debit card, and automated clearing house (ACH), and wire transfer. Electronic receipt methods should be encouraged when feasible and cost-effective to reduce overall risk and improve cash flow certainty. Governments should not collect revenues through cryptocurrencies, and be cautious with other emerging technologies.
- Governments should establish appropriate controls related to receiving money from customers including the use of integrated receipts and accounting systems, where practical, to allow for the timely deposit, reconciliation, and recognition of collected revenue. Also, a way to ensure proper controls are in place and working, variances to budgeted revenue should be monitored and significant deviations should be investigated thoroughly and immediately.

- Governments should establish and deliver training programs for employees to cover proper procedures for cash handling, customer receipts and accounts receivable including the ability to detect fraud related to various payment types. In addition, new employees who will handle money should be properly vetted via a criminal background check or a similar process.
- Governments should have robust segregation of duties and supervision policies incorporated into to their receivables policies and procedures. These policies should try and avoid having a single individual be responsible for both the receiving and recording of revenues. If the government does not have the personnel available for this separation it should develop mitigating controls to prevent recording errors and/or fraud.
- Governments should also have policies and procedures in place for record retention of receivables information.

References:

1. GFOA Best Practice - Bank Account Fraud Prevention
2. GFOA Best Practice - Payment Consolidation Services
3. GFOA Best Practice - Lockbox Services
4. GFOA Best Practice - Remote Deposit Capture
5. GFOA Best Practice - Accepting Payment Cards
6. GFOA Best Practice - Revenue Control Policy

Government Finance Officers Association

BEST PRACTICE

Revenue Control Policy

BACKGROUND:

A revenue control and management policy establishes proper control over all receipts and receivables and helps ensure sound financial management practices. Governments should adopt a revenue control and management policy over revenues as an integral component of their overall financial policies. A formal manual that documents the entity's revenue control and management procedures can facilitate policy implementation, as well as serve as an effective internal control in and of itself.

RECOMMENDATION:

GFOA recommends governments establish a revenue control and management policy and review it on an annual basis. This policy should be customized for the size and resources of the government.

The following factors should be considered in developing a general revenue control and management policy:

- Internal controls - Management should establish controls, and ensure they are documented and followed. All aspects of cash receipting and accounts receivables should be subject to proper internal controls including:
  - Segregation of duties such as initiation and authorization of transactions, execution of transactions (receipting and disbursement), recording transactions, reconcilement, and maintaining custody.
  - Daily processing and timely deposit of receipts. Ideally, all funds should be deposited within 24 hours of receipt.
  - Timely reconciliation to applicable ledgers.
  - Physical security procedures. This is especially important for funds not deposited day of receipt.
  - Fraud reporting procedures.
  - Use of integrated receipt and accounting systems wherever practical and cost-effective.
- Accounting practices - All receipts and receivables should be recorded in accordance with generally accepted accounting principles (GAAP).
- Billing and collection practices - Accounts receivable should be established for services provided in advance of payment and terms for collection should be established. In accordance with established procedures, bills should be initiated, recorded in an accounts receivable system, and generated within an established timely manner after initial service delivery. Effort should be made to ensure that receivables are collected in a timely fashion. A

policy should be established to provide for 'write-offs' of accounts receivable, including timeframe, dollar thresholds and decision-making authority.

- Methods of payment - A policy outlining the acceptable methods of payment for the governments should be established. This policy should include the method of access (as well as method of payment) while promoting electronic methods of access and payment when feasible and cost-effective to reduce overall risk and increase cash flow.
- Depositing of received funds - Treasury management should serve as the primary recipient for all revenue collection sites. There should be timely recognition and depositing of revenue collected. Smaller governments that do not have a formal treasury function are encouraged to establish a formal single point of receipt or cashier function to control access to received funds.
- Due to the special nature of funds received from grants, developers, partners and other entities, governments should consider whether separate procedures should be established for recording and depositing these funds.
- Returned checks - Procedures for processing and collection of returned checks should be established, including the assessment of fees to offset the costs associated with the returned items.
- Accounts receivable management - All accounts receivable should be recorded in a manner that allows for aging analysis. After reviewing available collection options, governments should establish procedures that maximize collections. Collection agencies that are familiar with federal, state, and local notice requirements and regulations should be considered when their use proves cost-effective.
    - Bad Debts - An allowance for doubtful accounts and a write-off policy should be established. Bad debt expense should be estimated based upon a documented method of calculation. An allowance for doubtful accounts should be recorded. Write-offs should be performed periodically to ensure that accounts receivable and allowance balances are not overstated. Efforts should be made to pursue the timely collection of delinquent accounts.
- Budgetary review responsibilities - Revenue collections and accounts receivable should be monitored in a timely manner. Both actual and budgeted or forecast revenues should be monitored. Any significant variance of actual from the forecast or budgeted revenues should be investigated thoroughly.
- Compliance - Governments should ensure their revenue control and management policy and procedures are in full compliance with any federal, state, local or other applicable laws or requirements.

References:

- *Financial Policies*, Shayne Kavanagh, GFOA, 2012.
- GFOA Best Practice, *Adopting Financial Policies*, 2001.
- *An Elected Official's Guide to Internal Controls and Fraud Prevention*, Stephen Gauthier,GFOA,1994.
- *Revenue Collection Administration: A Guide for Smaller Governments*, Ian J. Allan, GFOA, 1993.

Government Finance Officers Association

BEST PRACTICE

Selection and Review of Investment Advisors

BACKGROUND:

Many governments engage investment advisers for assistance in managing their non-pension fund investment portfolios. State and local government treasury and investment managers augment their investment programs by retaining investment advisers to perform various portfolio services, ranging from advice-only consultation to full discretionary management. In engaging an investment adviser, a government may benefit from professional portfolio management, risk management, potential audit savings, and continuity in the investment function, among other benefits. Most of these engagements have been positive. However, there have been some instances of inappropriate investment activities. The problems and reported losses have often resulted from governments hiring an adviser before they have clearly defined their needs, performed sufficient due diligence, and established proper controls and ongoing oversight.

It is important for governments to take a careful and informed approach in the selection and use of investment advisers. When hiring an investment adviser, the government must determine the level of authority to grant the adviser. Advisory services will differ in the level of authority the government grants the adviser and the corresponding level of involvement the government retains in the investment process.

Under a **non-discretionary** agreement, the adviser must obtain approval before executing any trade. All activity must comply with the guidelines of a government's investment policy, investment objectives, governing laws, and written or oral instructions. With a non-discretionary agreement the government is directly involved in investment transactions, whether to establish a comfort level with external management or the adviser, to learn from the adviser, or for some other reason.

Under a **discretionary** agreement, the adviser can execute trades for the government without prior approval on each transaction. The adviser follows the same guidelines and restrictions as a non-discretionary adviser. With a discretionary agreement the government is less involved in the investment transactions, thus enabling staff resources to be directed to other duties, giving the adviser the ability to execute investment strategies more quickly, and allowing the government to hold the adviser totally responsible for the performance in the portfolio.

Under either agreement type, the government maintains control of its investment program by establishing the guidelines and policies to which the adviser must adhere.

RECOMMENDATION:

GFOA recommends that state and local governments exercise caution and prudence in their selection of investment advisers. Because fiduciary responsibility for the safety and liquidity of government funds cannot be delegated to an investment adviser, the implementation of a safe and effective investment program must be carefully coordinated with the adviser.

The GFOA urges state and local governments that are considering retaining an investment adviser to define and control the procurement process and assure periodic reviews of investment advisory services. Adhering to defined due diligence in selecting a qualified investment adviser and establishing proper controls will help a government achieve its objectives for hiring an adviser while protecting its funds and reducing risk to its reputation.

Within the scope of Securities and Exchange Commission (SEC) regulations, state and local laws, and any other requirements, relationships with investment advisers should address the following:

- **Identification of adviser responsibilities**. Responsibilities of the investment adviser should be identified before the selection process. During the process these should be clearly defined and communicated.

- **Impartial procurement**. The responsible government official or the governing board should appoint a consultant and/or internal review committee to conduct the search process. Such staff, consultant, and/or review committee members should be independent of any interest in or relationship with any investment advisory firm. The procurement process should be competitive and merit-based.

- **On-going review**. Investment advisory services should be reviewed on an on-going basis. The on-going review, monitoring and evaluation of the investment adviser are as important as the due diligence undertaken during the initial selection process. The responsible government official or the governing board and/or review committee should determine the scope and frequency of such review process.

Criteria - The responsible government official or the governing board and/or review committee should determine the criteria to be used in the selection process. Identifying relevant criteria upfront promotes transparency in the selection process. Assigning weightings to these criteria can create a workable method to rank or quantify the importance of each. Criteria should include:

- the investment adviser's understanding of the government's investment program, objectives and constraints
- the investment adviser's background, including the experience, resources, and qualifications of the firm in general, that of the individuals assigned to handle the government's account, and the firm's experience in managing state and local government operating funds
- the investment adviser's recommended approach to management of the portfolio: Is this approach
- appropriate for the government?
- fees and fee basis

Risk Control - As part of the procurement process and prior to a final decision on the investment adviser, the government entity should have made decisions regarding its risk tolerance and developed corresponding risk control requirements, including:

- the level of discretion afforded the investment adviser
- prohibitions against self-dealing for trade execution
- competitive trade execution
- trade confirmations
- delivery versus payment trade settlement
- independent third-party custody of securities (no investment adviser custody)
- timely reconciliations of trade confirmations and custodial statements
- monthly reporting that complies with industry standards and local requirements
- ongoing compliance reviews

- allowance for independent audits

Selection Process - Once the government defines the services it seeks to obtain and the criteria it will use to make its selection, a Request for Proposal (RFP) is useful to gather information for the decision-making process.

Information that might be part of the RFP include:

- SEC licenses
- quantitative information (e.g., financial stability and performance review)
- organizational structure of firm including any business affiliations
- experience and depth of personnel in firm, including turnover and single versus team management
- reporting standards (Global Investment Performance Standards or GIPS)
- firm-specific investment philosophy and portfolio management strategies
- trading process
- interviews with finalists
- understanding of current or historic regulatory censure or litigation

The sources for potential candidates may include:

- references from other governments
- consultants' database(s) on investment advisory firms
- association databases
- industry reports and articles
- marketing materials

Final decisions will require an objective compilation and analysis of the results of the RFP. Most importantly, the investment adviser and the services offered must match the needs of the particular government entity.

Advisory Agreement - A well-constructed agreement containing specific instructions concerning objectives and risk parameters, allowable investment instruments and strategies, and required reporting procedures is critical to a successful outcome. After a recommendation regarding the selection of an investment adviser has been made, the contractual agreement should include:

- scope of services
- appointment of the investment adviser and fiduciary responsibilities
- establishment of account responsibilities
- definition of accounts and custody
- definition of discretionary or non-discretionary services with appropriate limitations
- definition of standards (Prudent Expert)
- establishment of objectives, restrictions and benchmarks
- definition and processing of transaction procedures in accordance with policy including brokerage limitations
- representations by entity and investment adviser
- determination of reasonable liability insurance for errors and omissions
- establishment of invoicing and payment
- procedure for termination by either party
- specifications related to nondiscrimination in contracting and ethics rules
- certification of the government's policy by the investment adviser
- all provisions of the RFP as part of the contract

References:

- *Investing Public Funds*, Second Edition, Girard Miller with M. Corrine Larson and W. Paul Zorn, GFOA, 1998.
- *An Introduction to Investment Advisers for State and Local Governments*, Sofia Anastopoulos, GFOA 2007. This publication includes a sample Request for Proposal (RFP) for investment advisory services and a sample investment advisory agreement.
- *An Elected Official's Guide: Investing, second edition*, Sofia Anastopoulos, GFOA, 2007.
- GFOA Sample Request for Proposal for Investment Advisory Services, GFOA, 2007.

Government Finance Officers Association

BEST PRACTICE

Use of Lockbox Services

BACKGROUND:

Lockbox services are designed to expedite the collection of paper-based payments and provide timely payment information to update accounts receivable records. Lockbox services are usually provided by a third-party processor (usually a bank) that receives, opens, and processes payments for a government or business. For most governments, lockbox services should increase payment and posting accuracy, improve cash flow by reducing processing time between delivery of mail and depositing of payments, and increase staff productivity by freeing personnel from the labor-intensive process of manually handling mail, making daily deposits, and posting manual payments.

There are two basic types of lockbox services: wholesale (used for high dollar, low volume payments) and retail (used for high volume, low dollar payments, such as taxes, utilities, licenses and fees, and accompanied by standardized remittance documents). Governments usually have more need for retail lockbox services.

RECOMMENDATION:

GFOA recommends that governments evaluate the benefits and costs of using lockbox services to determine if advantages can be gained in the areas of accuracy, cash flow, internal controls, and efficiency.

The evaluation should consider:

1. **Availability of Lockbox Services**. Lockbox services have become a mature banking service and most areas typically have multiple banks and companies competing for lockbox processing accounts. Governments seeking a lockbox processor should investigate the efficiency models of local utilities and cable television firms process their payments. In areas that are not serviced, governments should evaluate the use of regional lockbox processors. Other than overcoming the public confusion about sending local payments to an out-of-area address, there is normally no technical requirement for lockbox processing to be performed locally.

2. **Workflow and Cash Flow**. Any evaluation of lockbox services must include:

- an analysis of the existing workflow from receiving mail to depositing payments and posting receivables,
- volume of transactions,
- staffing requirements,
- time necessary to complete,
- lockbox service charges,
- enhanced cash flow and increased interest earnings from using a lockbox,
- ability of the provider to accept payments other than checks (i.e., credit cards),
- security of the process,

- employee accuracy,
- customer service,
- any capital requirements, and
- service charges associated with any required bank accounts.

The costs of performing these processes internally should be weighed against the costs and benefits of outsourcing to a lockbox processor. Particular attention should be paid to any delays in depositing funds or posting of receivables. Most lockbox processors guarantee that payments received are deposited into the organization's bank account the same day they are received.

Some lockbox processors offer the conversion of checks into Automated Clearing House (ACH) payments at the lockbox site to decrease processing time. ACH processing may result in a cost savings as compared to check processing and should be evaluated as an option for future and existing lockbox services.

3. **Technical Requirements**. Technical requirements include the processor's specifications, such as the character recognition scan line (for identification and payment information), form size, character placement, inclusion of a check digit, ink type, and paper quality. In addition, the type of printer used to generate the remittance document can affect processing error rates and overall costs. Laser printing with non-magnetic ink is recommended.

The transmission of data between the processor and the government can range from the exchange of hard copy records to electronic transmission via the Internet and depends on the needs and capabilities of the government. Other options include direct electronic transmission of data and data on CD-ROM. Changes to existing software may be necessary to upload the information electronically. Lockbox processors can also offer data storage services by converting remittances to electronic data. Some lockbox processors offer on-line access to digital images of remittance checks and documents.

4. **Other Considerations**. Government billings and cash flows are often cyclical, creating peaks and valleys in cash management staffing demand. Shifting payment processing responsibility to a lockbox processor alleviates the challenges of staffing to meet a limited number of peak periods or overburdening a small staff during critical periods. Governments should analyze the efficiency and cost/benefit of using payment consolidation services to expedite the processing of on-line payments processed through the customer's financial institution. Governments should also consider the benefits of remote deposit capture compared to the benefits of lockboxes.

Contract. GFOA recommends that any contract entered into by a government and lockbox provider, at a minimum, include the following:

- treatment of exception (non-standard) items,
- ability of the lockbox provider to handle payments containing multiple remittance advices,
- turnaround time,
- disposition of documents (including imaging capabilities),
- funds availability schedule,
- technical specifications for transmission of data to the government,
- error tolerance, and
- bonding requirements of lockbox personnel, including subcontractors (e.g., courier service).

In the event that these services are procured through the use of a request for proposal, the request for proposal and the vendor response should be included as part of the contract.

References:

- *An Introduction to Treasury Agreements for State and Local Governments*, Linda Sheimo, GFOA, 1993.

- *An Introduction to Treasury Management Practices*, GFOA, 1998
- *Banking Services: A Guide for Governments*, Nick Greifer, GFOA, 2004.

Government Finance Officers Association

BEST PRACTICE

Using Mutual Funds for Cash Management Purposes

BACKGROUND:

State and local government cash managers may benefit from investing public monies through mutual funds. Mutual funds are SEC-regulated investment instruments that pool and jointly invest monies of multiple investors. Mutual funds are available for both fixed income and equity investments.

Short-term liquid fixed income mutual funds that maintain a weighted average maturity of 60 days or less and have a stated aim to maintain investor shares with a constant one dollar ($1) Net Asset Value (NAV) are called money market mutual funds. While these funds seek to maintain a constant or stable NAV, this is not guaranteed and investors of public monies should be aware of this risk. Other non-money market fixed income mutual funds generally have a longer-term weighted average maturity and also have a fluctuating price or NAV.

The Government Finance Officers Association (GFOA) has endorsed the use of money market mutual funds by public cash managers in the past. Portfolio safety, liquidity, diversification, and professional management are desirable features of these investment vehicles; however, liquidity may be impaired by the floating NAV.

RECOMMENDATION:

The GFOA recommends that state and local governments restrict their use of mutual funds for cash management purposes exclusively to: (1) money market mutual funds that are invested in Treasury, federal government agency, or first tier categories and possess the highest ratings available from at least one nationally-recognized ratings agency and (2) short-term bond funds that receive the highest credit quality ratings and the lowest risk ratings available.

Risk Assessment. When analyzing risk, the following should be taken into consideration:

1. **Local Investment Policy.** State and local government cash managers should exercise prudence and caution when investing in short-term bond funds. Public cash managers should also check applicable statutes to determine if the use of money market mutual funds and/or short- term bond funds is permitted within their jurisdictions.
2. **Fund Prospectus.** Before investing, governments should review and understand a fund's prospectus and statement of additional information to determine:
    1. Portfolio composition;
    2. Risk characteristics;
    3. The duration and weighted average maturity of the mutual fund;
    4. The reputation and experience of the investment company;
    5. The performance history relative to appropriate benchmarks;

    6. Total expense ratio;
    7. Philosophy, strategies, and portfolio policies;
    8. If the fund is rated by a nationally recognized rating agency; and
    9. Whether the fund can meet the compliance requirements of the government's approved investment policy.

    Cash managers should continue to monitor these characteristics as they may change over time.

3. **Restriction on Redemptions (Gates).** Prior to investing in a money market mutual fund, cash managers should familiarize themselves with any restriction gates assessed against the fund which could impair the ability of an entity to withdraw monies from the fund on a timely basis in order to meet current liquidity requirements.
4. **Fees.** During extremely low interest rate environments, mutual fund expenses may exceed yield. While fees are included in all mutual funds, these fees should be considered when investing in mutual funds. Investors should assess the risk that the net yield (gross yield minus expenses) will be less than zero – in some cases it may be more beneficial to own the underlying securities directly.
5. **Duration.** Bond funds investing in shorterm instruments, with a varying NAV, may be legal and appropriate investments in some jurisdictions when monies are not needed for near-term disbursement. However, mutual funds of an intermediate or long-term duration should be avoided by investors if short-term liquidity is a concern.
6. **Holdings.** Investors should review the specific holdings of their mutual fund at least monthly to know what underlying securities the fund owns. Prime money market funds that are AAA rated and hold A1+ paper may have foreign debt exposure that is not obvious. In addition, Investors should review the NAV at least monthly. If the NAV varies below $0.995 (known as "breaking the buck"), investors should reevaluate their investments in these funds. Governments should consider investing in money market funds that invest in US government securities, which have a higher level of safety and will not be subject to the floating NAV.

References:

- GFOA Best Practice – *Managing Market Risk in Investment Portfolios*
- An Introduction to Investment Advisers for State and Local Governments, Second Edition, Sofia Anastopoulos, GFOA, 2007.
- A Public Investor's Guide to Money Market Instruments, Second Edition, edited by M. Corinne Larson, GFOA, 1994.
- Investing Public Funds, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.

Government Finance Officers Association

BEST PRACTICE

Using Remote Deposit Capture

BACKGROUND:

Remote Deposit Capture (RDC) is a service that expands the window for deposit by allowing checks to be scanned into digital images and cleared electronically. A user can scan checks that it receives and transmit the scanned images to a financial institution for posting and clearing. Some financial institutions offer optional ACH conversion and clearing in combination with the RDC service. Typically, this option includes automatic decisioning of the items whereby the provider financial institution determines for the government what items can be converted to an Automated Clearing House (ACH). Thus, RDC removes the requirement of processing an actual physical check at a financial institution.

The basic requirements for RDC include a computer, an internet connection, a check scanner and a service provider such as a financial institution. RDC functionality spans from basic electronic check clearing to data download capabilities ranging from uploading to government receivables software, and, full interfacing with the government's receivables software.

The basic process is as follows:

1. Checks are received in the mail or in person.
2. Normal remittance processing is performed. This may include preparing the deposit and updating the accounts receivable system.
3. Checks are scanned, capturing the front and back of the check as well as microline data and dollar amount, to create a digital deposit.
4. The digital deposit is transmitted over an encrypted or secure internet connection to an RDC financial institution or service provider.
5. The bank receives the deposit images and data, and based upon the government entity's clearing options, the financial institution will provide ACH decisioning of the file. The financial institution will then clear the items based upon ACH and/or image deposit clearing, assign float to the items, and post the deposit to the government's account. Good funds are reflected based upon an agreed upon availability schedule.

Checks converted to ACH transactions are processed electronically. To use the ACH conversion option, a government entity must establish processes that conform with National Automated Clearing House Association (NACHA) rules. The most visible guideline put forth by NACHA is to provide proper notification to individuals submitting a check as payment.

There are two types of check-to-ACH conversion options:

- **Accounts Receivable Conversion** - Allows for the conversion of checks to ACH transactions at the point of sale.
- **Back Office Conversion** - Allows for the conversion of eligible checks to ACH transactions after the point of sale during back office processing.

Each conversion option has its own required process and notification. Checks that are not eligible for conversion may be cleared either as images or re-printed and cleared as paper documents. The re-printed checks are called Image Replacement Documents (IRDs).

The benefits of RDC include:

- **Simplified processing of deposits** - By eliminating a visit to the financial institution, electronic deposits of checks streamline the deposit process and saves time in travel, deposit balancing and data entry.
- **Reduced costs** - Because deposits are made electronically, transportation costs are reduced. In addition, the process streamlines, reduces or redirects staff costs.
- **Accelerated clearing of checks** - Receivables collection is accelerated when deposits are made electronically throughout the day. Reduction in travel time provides a longer time for processing checks. Also, many financial institutions that offer RDC offer extended cutoff time for deposits.
- **Improved availability of funds** - As deposits can take place earlier and in less time, the deposit window is expanded and the availability of funds improves as financial institutions have more time to process checks.
- **Added convenience** - Employees can transmit multiple deposits throughout the day, not restricted to branch hours.
- **Reduced return item risks** - Collection rates may be improved as return items are identified faster.
- **Consolidation of financial institution relationships** - A financial institution's physical location no longer limits relationships. This portability and competition among financial institutions may allow for a consolidation of financial institution relationships.
- **Broader choice of financial institution relationships** - This same portability and competition among financial institutions may also allow for broader choice of financial relationships.
- **Item archive** - Typical RDC applications include some type of an archive that allows for quick and easy retrieval of images and or transactions.
- **Digitized format and reporting** - All data that is captured can be used in reporting and is easily downloaded and formatted for reports, or system/application integration.

RECOMMENDATION:

GFOA recommends that governments consider remote deposit capture to improve efficiency and effectiveness of accounts receivable processing.

In evaluating use of RDC, governments should consider:

- **Security** - Pursuant to standard industry approaches, the government is responsible for the safekeeping or destruction of the original checks. A government should coordinate with their provider for security in the retention, handling, voiding and destruction of the documents and images. While some RDC providers assist with the storage or destruction of the original items, most providers only offer recommended guidelines. Most service providers recommend retention time for keeping the original checks although there is no standard timeline. The timing of the financial institution reconciliation process should be considered when establishing a retention period. Governments should coordinate with their service providers to identify which items must be destroyed in this timeframe.
- **Financial institution policies and regulations** - The financial institution should provide guidance in a timely manner of applicable policies and regulations for RDC and any changes to these as they occur.
- **Image quality -** The government should ensure that the image captured is adequate to allow for processing and possible re-presentment for returned items.

- **Duplicate item presentment -** Governments should establish controls to ensure that items are only presented once for payment. While some service providers offer this service, the government is responsible for ensuring that an RDC-scanned item is processed only once.
- **Cost and risk-** The government should identify all equipment and service costs and determine if there is a cost benefit, and consider any associated risk.
- **Cash deposits** - RDC does not offer any solutions for cash payments, so governments will still need to address the deposit of cash.
- **Integration into existing applications** - RDC is characteristically a desk top application designed for check deposit. Some RDC applications offer additional functionality that includes data-keying, capture of additional data, and download of data with potential further use for reporting or importing into an enterprise system. Because it is an electronic deposit process, RDC may not be able to replicate current manual processes. Most government entities will need to evaluate their current deposit process and potentially re-engineer processes to fully take advantage of the savings and improvements of an RDC application. Not all RDC applications can be effectively integrated into enterprise applications, so data import and automated positing of receivables/enterprise systems should be carefully reviewed.
- **Point of Purchase** - Allows for the conversion of checks to ACH transactions at the point of sale with the physical check returned to the payee during the transaction. This is another electronic conversion option that should be considered based upon the type of transaction.

References:

- *Banking Services*, GFOA, Nick Greifer, 2004.
- National Automated Clearing House Association (NACHA), www.nacha.org.
- The U.S. Federal Reserve, www.federalreserve.gov.
- www.remotedepositcapture.com.

Government Finance Officers Association

BEST PRACTICE

Using Benchmarks to Assess Portfolio Risk and Return

BACKGROUND:

Measuring portfolio risk and return results against appropriate market benchmarks[1] is a technique to verify that all the investment objectives are being met and that portfolio investment returns are appropriate for the risk incurred. Comparing total return to a proper benchmark or index is the preferred means for assessing performance relative to risk and investment objectives.

Investment yield alone is not sufficient for assessing risk and performance. Investment yield measures the percentage increase or decrease that a portfolio generates during a given period and is useful for budgeting purposes but overall, is unreliable for decision making and assessing the risk and return characteristics of the portfolio.

1. There are many definitions of yield such as: yield to maturity, yield to call, book yield, and market yield.
2. Yield results can be distorted by the timing of investing relative to the current level of interest rates and by the presence of call options. For example, it is possible to sell a bond at a loss and buy another bond with a higher yield leaving an increase in the investment portfolio yield but a decrease in the portfolio size.
3. Yield can be manipulated to generate more income or show higher yield in one particular period as opposed to others.

RECOMMENDATION:

The Government Finance Officers Association recommends that government investors assess their investment portfolio for performance and risk by comparing the total return of the portfolio to carefully selected benchmarks. Total return provides a complete snapshot of the outcomes resulting from investment decisions since it measures the percent change in the value of a portfolio over a defined historical period.

1. Total return comparisons should be completed as least quarterly and more often for portfolios managed by external provides and those containing large investments.

Any total return measurement that is much greater or much less than that of the benchmark should be analyzed since significant deviations between the total return measurement and the benchmark often correlates to the portfolio risk profile. Based on total return analysis, investment managers can make adjustments to the portfolio's risk profile when it is determined to be outside the acceptable variance with the benchmark.

To provide a valid reference for comparison of an entity’s investment portfolio, it is important to select a benchmark that closely resembles policy constraints and management practice in terms of duration, maturity range, average duration, security types, sector allocations and credit quality. Selected benchmark should:

1. Be unambiguous and transparent – The names and weights of securities that constitute a benchmark should be clearly defined;
2. Be investable – The benchmark should contain securities that an investor can purchase in the market or easily replicate;
3. Be priced on a regular basis – The benchmark's return should be calculated regularly;
4. Be supported by historical data – Past returns of the benchmark should be available in order to gauge historical returns;
5. Be specified in advance – The benchmark should be adopted prior to the start of evaluation;
6. Be consistent – Consistently keep the same bench mark for comparison purposes;
7. Have published risk characteristics – The benchmark provider should regularly publish detailed risk metrics of the benchmark so an investor can compare his/her portfolio risks against the benchmark risks; and
8. Have a composition that is similar to the portfolio holdings.

Notes:

[1] A benchmark (or index) is an unmanaged basket of securities that provides a reference for understanding performance and risk characteristics of an investment strategy given investment policy parameters.

Government Finance Officers Association

BEST PRACTICE

Using Safekeeping and Third-Party Custodian Services

BACKGROUND:

The safety of public funds should be the primary objective of all governments. One of the most important protections and a control against fraud is the separation of the safekeeping and custody function from the investment function Investment policies should include a section regarding independent third-party safekeeping or custody of securities. By arranging to have securities held by a third party, governments can effectively minimize safekeeping or custodial risk in an investment transaction.

In a third-party safekeeping agreement, the government arranges for a firm other than the party that sold the investment to provide for the transfer and safekeeping of the securities. Financial firms should not serve as both government broker-dealer and custodian. Safekeeping represents a financial institution's obligation to act on behalf of the owner under the owner's control. Custody is a more clearly defined control position by the agent responding to the owner's requirements. Custody normally does not take place in the governmental entity's depository bank.

Investments should be settled in a delivery-versus-payment (DVP) basis. In this procedure, the buyer's payment for securities is due at the time of delivery. Security delivery and payment occur simultaneously. This practice ensures that no funds are at risk in an investment transaction as funds are not released until securities are delivered, ensuring the governmental entity has either money or securities at all times during the transaction.

RECOMMENDATION:

GFOA recommends that state and local governments utilize independent third-party custodians to safeguard their investments and protect against safekeeping/custodial risks.

To accomplish this goal, GFOA recommends that governmental entities:

1. competitively select third-party custodians and safekeeping agents
2. have safekeeping/custodial agreements reviewed by government legal counsel prior to execution
3. evidence their safekeeping or custodial relationship with a signed, written security agreement that is reviewed by counsel and establishes the firm as its agent
4. execute all investment transactions on a delivery-versus-payment basis
5. designate a specific DDA (demand deposit account) clearing account in conjunction with the safekeeping or custodial account
6. require that the independent third-party safekeeping agent or custodian mark the portfolio to market at least monthly. Ideally, marking should take place daily with independent pricing.

7. require reports and monthly statements to be received directly by the governmental entity from the agent.
8. ideally, have electronic access to the safekeeping or custody account for monitoring and reporting purposes, if cost effective.
9. require safekeeping or custodial agents to be insured for error and omissions.
10. require review of internal safekeeping and custodial procedures annually with the independent auditor.

References:

- *Investing Public Funds, Second Edition*, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- GFOA Sample Custodial Trust Agreement, 2006.
- *An Introduction to Collateralizing Public Deposits for State and Local Governments, Second Edition*, M. Corinne Larson, GFOA, 2006.
- GFOA Best Practice Collateralizing Public Deposits (1984, 1987, 1993, 2000, and 2007)
- GFOA Sample Security Agreement (long and short version) 2010.