

Collateralization of Public Deposits In South Carolina



Curtis M. Loftis, Jr., State Treasurer

**SC Office of the State Treasurer
Banking Division
October 30, 2018**

Statutory Requirements

The South Carolina Code of law requires all deposits consisting of public funds in a financial institution for which the State Treasurer is considered the custodian, to be adequately secured. Additionally, all deposits consisting of public funds belonging to a “local entity” are to be secured. Financial institutions are referred to as “qualified public depositories.”

- Section 11-13-60 - Public funds for which the State Treasurer is custodian
- Section 6-5-15 - Public funds belonging to a local governmental entity
- Section 11-1-50 - Public and trust funds for which the State Treasurer is not custodian

Federal Deposit Insurance

The first level of surety is insurance provided by the Federal Deposit Insurance Corporation (FDIC) under the provisions that apply to “Accounts Held by Government Depositors.” Section 330.15 of the FDIC's regulations (12 C.F.R. 330.15) governs the insurance coverage of public unit accounts.

For deposit insurance purposes, the term "public unit" includes a state, county, municipality, or any political subdivision of the public unit. Under Section 330.15, the "official custodian" is afforded the insurance coverage, not the public unit. (Note: The definition of a “public unit” only applies to FDIC insurance coverage, not to what types of entities are authorized by the SC Code to be collateralized.)

An “official custodian” is an officer, employee, or agent of a public unit having official custody of public funds and lawfully depositing the funds in an insured institution. In order to qualify as an official custodian, a person must have plenary authority - including control - over the funds. Control of public funds includes possession as well as the authority to establish accounts in insured depository institutions and to make deposits, withdrawals and disbursements.

Deposit insurance coverage cannot be increased by dividing funds among several putative official custodians who lack plenary authority over such funds. Likewise, coverage cannot be increased by dividing funds among several accounts controlled by the same official custodian for the same public unit.

For a public unit’s custodian (e.g., State Treasurer, local entity’s finance officer, or board of a qualified political subdivision), the FDIC insures demand deposits for to up to \$250,000, and time deposits up to a separate \$250,000. It is therefore possible for a public unit’s custodian to be afforded a combined total of \$500,000.

Methods of Surety

Any deposit amounts above the FDIC insurance coverage are to be secured, with either:

- Surety Bonds (Issued by an insurance company) (Not typically used)
- Letters of Credit (Issued by the Federal Home Loan Bank)
- Pledged Collateral Securities (Held by a custody agent)

This publication outlines the process for pledging collateral securities to the State Treasurer as pledgee.

Methods of Collateralization

Local Governments – Secured under Section 6-5-15

There are two methods of collateralization available to a depository bank for local entities:

- Dedicated Method – Securities are pledged by the depository bank (pledgor) to a specific custodian (pledgee) to secure the uninsured deposits of that one particular local entity.
- Pooling Method – Securities are pledged by the depository bank (pledgor) to the State Treasurer (pledgee) to secure the uninsured deposits of all enrolled local entities that may have funds on deposit with the institution.

For a particular local entity, the depository bank may use either the Dedicated Method or the Pooling Method. However, the bank may only use the Pooling Method if the local entity agrees to that method. It is possible for a depository bank to use the Pooling Method for the local entities that have so agreed, and the Dedicated Method for those that have not.

The depository bank using the Dedicated Method for a local entity's deposits should execute an appropriate Tri-party Agreement or Pledged Collateral Agreement directly with the local entity, with terms being agreed to by the entity's legal staff. The State Treasurer is not a party to such agreements.

State Treasurer as Custodian – Secured under Section 11-13-60

For deposits for which the State Treasurer is custodian, the depository bank may only use the Dedicated Method. The collateral securities are pledged to the State Treasurer as pledgee.

Other Public and Trust Funds of a State related Entity – Secured under Section 11-1-50

For any deposits consisting of public or trust funds of a state related entity for which the State Treasurer is not the official custodian, the depository bank may only use the Dedicated Method. Collateralization and identification of the funds' custodian is subject to the entity's enabling Code of Law.

For FDIC insurance purposes, any public or trust funds for which the State Treasurer is not the official custodian, a state entity would be considered a "public unit," as it is a "political subdivision" of the State of South Carolina, as defined by the FDIC regulations. The custodian of those funds and its chosen depository bank assume the responsibility for ensuring that authority exists for collateralization, and that proper arrangements and agreements are in place to provide a security interest in any securities that may be pledged.

Collateral Agreements

The Federal Deposit Insurance Corporation's (FDIC's) policies, including the "Statement of Policy on Qualified Financial Contracts," specify the requirements for creation of an enforceable security interest in any pledged collateral securities. These statements clarify the FDIC's policies on enforcing the requirements of Section 11(e) of the Federal Deposit Insurance Act, as amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Consequently, collateral Agreements are required to be executed in order to comply with the various FDIC policies.

Securities used as collateral must be held by a third-party safekeeping "custody agent." The collateral agreement to be executed depends upon:

- Method utilized - Dedicated or Pooling (and who is the pledgee, State Treasurer or Local Entity)
- Custody agent utilized - FRB, FHLB, or commercial bank

Collateral Agreement to Use – Dependent Upon Method and Custody Agent Applies to Pledgee Being the State Treasurer			
Method	Custody Agent		
	Commercial Bank	FHLB	FRB
Dedicated	Tri-Party Collateral Agreement - Dedicated	Tri-Party Collateral Agreement – Dedicated (FHLB version)	Pledged Security Agreement for FRB – Dedicated Method
Pooling	Tri-Party Collateral Agreement - Pooling	Tri-Party Collateral Agreement – Pooling (FHLB version)	Pledged Security Agreement for FRB – Pooling Method

Collateral Agreement to Use – Dependent Upon Method and Custody Agent Applies to Pledgee Being a Local Entity			
Method	Custody Agent		
	Commercial Bank	FHLB	FRB
Dedicated	Tri-Party Collateral Agreement – Provided by commercial bank with terms agreed to by entity’s Legal	Tri-Party Collateral Agreement – Provided by FHLB with terms agreed to by entity’s Legal	Pledged Security Agreement for FRB – Provided by commercial bank with terms agreed to by entity’s Legal
Pooling	N/A	N/A	N/A

If the Federal Reserve Bank (FRB) is the custody agent, by reference the current version of the FRB’s Operating Circular 7 and associated Appendix C are incorporated into the Pledged Security Agreement. Note that if the pledgee is not the State Treasurer (e.g., local entity utilizing the Dedicated Method, or public entity under Section 11-1-50), the State Treasurer is not a party to any agreement the entity may have with its depository bank, nor is responsible for any monitoring.

If a Letter of Credit (LOC) issued by the Federal Home Loan Bank (FHLB) is used as surety, a third-party custody agent is not involved. The typical “irrevocable standby letter of credit” issued by the FHLB lists the public entity as the “beneficiary.” Terms of the LOC include the stated amount and expiration date, and how the beneficiary may present the LOC for payment in the case of a default.

Pledging / Substituting / Releasing Collateral

For all pledges, the State Treasurer is to be provided a notice of the securities being pledged, to include a complete description and current market value of the securities.

For all substitutions, the State Treasurer is to be provided a notice of the substitution. Such notice shall contain a complete description of the securities, the total dollar amount as of the day of the notice, and the CUSIP number. After receipt of said notice, the State Treasurer may object to the substitution, and may, in his sole discretion, require that the substitution be rescinded. In such event, the Qualified Public Depository agrees to withdraw the securities so substituted and to substitute for the same other securities acceptable to the State Treasurer.

For all releases without substitution, the requested securities to be released must first be approved by the Banking Division, after demonstrating that the required amount of surety to protect uninsured deposits will remain after the release. All types of eligible surety will be considered when granting the approval (i.e., FDIC insurance and letters of credit).

Depository Reporting

The depository bank is required to provide the State Treasurer periodic reporting to demonstrate that all deposits are adequately secured. All reporting is to be made to the Banking Division. The reporting for deposits of the State Treasurer collateralized under the Dedicated Method is different than the reporting of local entities' deposits collateralized under the Pooling Method, in respect to the frequency of reporting.

State Treasurer Deposits - Under the Dedicated Method

On a quarterly basis, the depository bank must furnish the State Treasurer a report supporting the bank's calculations of the amount of collateral securities required to be pledged. The quarterly report must include: the amount of deposits subject to collateralization, by type (time and savings accounts combined, and demand deposits accounts); the applicable amount of FDIC insurance; the amount of any surety bonds or letters of credit, if any, used as surety; the amount of deposits required to be secured by Pledged Securities; the market value of the Pledged Securities; and the excess or deficit amount of Pledged Securities.

On a monthly basis, or as may be requested, the depository bank must furnish the State Treasurer statements designating the Pledged Securities, along with the bank's assigned market value of the securities.

Local Entities' Deposits – Under the Pooling Method

On a weekly basis, the depository bank must furnish the State Treasurer a report supporting the bank's calculations of the amount of collateral securities required to be pledged for each local entity. The weekly reports are due each Wednesday, based upon the closing balances of the previous banking day. In addition, a month-end report is to be prepared, and provided on the first business day of each month. reports must include: the amount of deposits subject to collateralization, by type (time and savings accounts combined, and demand deposits accounts); the applicable amount of FDIC insurance; the amount of any surety bonds or letters of credit, if any, used as surety; the amount of deposits required to be secured by Pledged Securities; the market value of the Pledged Securities; and the excess or deficit amount of Pledged Securities.

On a weekly basis, the depository bank must furnish the State Treasurer statements designating the Pledged Securities, along with the bank's assigned market value of the securities. The reports are due each Wednesday, indicating the securities pledged with the Custody Agent as of the close of the previous banking day. In addition, a month-end statement is to be prepared, and provided on the first business day of each month.

The following information is to be provided to the Banking Division of the Office of the State Treasurer each Wednesday and the first business day of the month.

Click on the excel workbook picture below to complete the required weekly collateral information to be provided to the treasurer’s office.

<p>This workbook should be sent each Wednesday and the 1st business day of the month to the SC State Treasurer's Office (stobankingdivision@sto.sc.gov and michelle.blanchfield@sto.sc.gov. If a holiday falls on a Wednesday, please send the next business day.</p>			
<p>Deposit Amount Tab Please enter bank name and the date of the deposit information in cell B2 and B3. Ensure the correct Tax Identification Number (column A) is entered for the correct Public Entity (column B). Enter information only in yellow cells</p>			
<p>Pledge amount and MV tab Please enter the CUSIP, Pledged Par, Pledged Mkt Value, MBS for mortgaged back securities or NMBS for all other types of securities, Pledge Description, and Coupon for each security pledged. Enter information only in yellow cells.</p>			
<p>Deposit amt summary tab This is a pivot table based on the information provided from the first 2 tabs. You need to refresh the table to see the information.</p>			
<p>Pledge market value calculation tab This tab will give a total of pledged securities between mortgage backed and all other types of securities.</p>			
<p>Collateralization Worksheet After the pivot table has been refreshed, this tab will give the required collateral percentage and the actual percentage collateralized.</p>			

Selected Financial Data Reporting

Each Qualified public depository having public funds for which the State Treasurer is custodian is required to submit a report quarterly that contains selected financial data from the depository’s call report provided to the Federal Financial Institutions Council (FFIC). The report is due 30 days following the end of each calendar quarter.

Monitoring

The Banking Division within the Office of State Treasurer monitors the collateralization process of each depository bank for securities pledged to the State Treasurer as pledgee under the:

- Dedicated Method - For deposits of the State Treasurer only
- Pooling Method - For deposits of the participating local entities

The finance officer (custodian) of each local entity is responsible for monitoring the collateralization process of any depository bank for securities pledged to the local entity under the Dedicated Method.

The Banking Division maintains an accounting of the collateral securities pledged to the State Treasurer as pledgee, based upon reports furnished by each depository bank, including the assigned market values to the pledged collateral.

For depository banks using the Dedicated Method to secured State Treasurer deposits, the Banking Division uses the bank’s online reporting systems to assist in ascertaining that the deposits are adequately secured.

For any local entity whose deposits are collateralized through the Pooling Method, upon request, the Banking Division will provide a report detailing the bank’s reported calculations of deposit amounts required to be collateralized and the amount actually collateralized.

The Banking Division responds to requests that may be received from auditors of local entities for verification of deposits secured under the Pooling Method.

Authorization to Collateralize Public or Trust Funds

A depository bank may receive deposits from a quasi-governmental entity for which the State Treasurer is not considered the “official custodian,” or from a quasi-governmental entity not considered a “local entity” as defined under Section 11-1-50 of the SC Code. The depository bank should ascertain that statutory authority exists for the funds to be collateralized. Collateralizing such deposits without authority may result in the pledging being deemed invalid in the case of the bank’s default.

Event of Default

In the event of the default of a depository bank where the State Treasurer is the pledgee, the State Treasurer will take the necessary actions as provided under the SC Code and the applicable Tri-party Collateral Agreement or Pledged Security Agreement to avoid loss of deposits so secured. In the case of the Pooling Method, it will be necessary for each participating local entity to follow a claim process established by the State Treasurer for deposits for which were in excess of the FDIC insurance coverage at the time of the default. The established claim process will assist in facilitating the liquidation of any collateral that may be necessary.

Applicable SC Codes of Law

SECTION 11-13-60. Security for state funds deposited in excess of FDIC coverage.

(A) A qualified public depository, as defined in subsection (E) of this section, upon the deposit of state funds by the State Treasurer, must secure these deposits by deposit insurance, surety bonds, investment securities, or letters of credit to protect the State against loss in the event of insolvency or liquidation of the institution or for any other cause. To the extent that these deposits exceed the amount of insurance coverage provided by the Federal Deposit Insurance Corporation, the qualified public depository, at the time of deposit, shall:

(1) furnish an indemnity bond in a responsible surety company authorized to do business in this State;

or

(2) pledge as collateral:

(a) obligations of the United States;

(b) obligations fully guaranteed both as to principal and interest by the United States;

(c) general obligations of this State or any political subdivision of this State; or

(d) obligations of the Federal National Mortgage Association, the Federal Home Loan Bank, Federal Farm Credit Bank, or the Federal Home Loan Mortgage Corporation; or

(3) provide an irrevocable letter of credit issued by the Federal National Mortgage Association, the Federal Home Loan Bank, Federal Farm Credit Bank, or the Federal Home Loan Mortgage Corporation, in which the State Treasurer is named as beneficiary and the letter of credit otherwise meets the criteria established and prescribed by the State Treasurer. The State Treasurer shall exercise prudence in accepting collateral securities or other forms of deposit security.

(B)(1) A qualified public depository has the following options:

(a) To secure all or a portion of uninsured state funds under the Dedicated Method where all or a portion of the uninsured state funds are secured separately. The qualified public depository shall maintain a record of all securities pledged, with the record being an official record of the qualified public depository

and made available to examiners or representatives of all regulatory agencies. The State Treasurer shall maintain a record of the securities pledged for monitoring purposes.

(b) To secure all or the remainder of uninsured state funds under the Pooling Method where a pool of collateral is established by the qualified public depository under the direction of the State Treasurer for the benefit of the State. The State Treasurer shall determine the requirements and operating procedures for this pool. The depository shall maintain a record of all securities pledged, with the record being an official record of the qualified public depository and made available to examiners or representatives of all regulatory agencies. The State Treasurer shall maintain a record of the securities pledged for monitoring purposes.

(2) Notwithstanding the provisions of item (1) of this subsection, the State Treasurer, when other federal or state law applies, may require a qualified public depository to secure all uninsured state funds separately under the Dedicated Method.

(C) A qualified public depository shall not accept or retain any state funds that are required to be secured unless it has deposited eligible collateral equal to its required collateral with some proper depository pursuant to this chapter.

(D) The State Treasurer may assess a fee against the investment earnings of various state funds managed or invested by the State Treasurer to cover the operation and management costs associated with this section and Section 6-5-15(E)(1)(b). These fees may be retained and expended to provide these services and may not exceed the actual costs associated with providing the services.

(E) "Qualified public depository" means any national banking association, state banking association, federal savings and loan association, or federal savings bank located in this State, and any bank, trust company, or savings institution organized under the law of this State that receives or holds state funds that are secured pursuant to this chapter.

SECTION 6-5-15. Securing deposits of funds by local entities.

(A) As used in this section, "local entity" means the governing body of a municipality, county, school district, other local government unit or political subdivision, or a county treasurer.

(B) A qualified public depository, as defined in subsection (G), upon the deposit of funds by a local entity, must secure these deposits by deposit insurance, surety bonds, investment securities, or letters of credit to protect the local entity against loss in the event of insolvency or liquidation of the institution or for any other cause.

(C) To the extent that these deposits exceed the amount of insurance coverage provided by the Federal Deposit Insurance Corporation, the qualified public depository at the time of deposit must:

(1) furnish an indemnity bond in a responsible surety company authorized to do business in this State; or

(2) pledge as collateral:

(a) obligations of the United States;

(b) obligations fully guaranteed both as to principal and interest by the United States;

(c) general obligations of this State or any political subdivision of this State; or

(d) obligations of the Federal National Mortgage Association, the Federal Home Loan Bank, Federal Farm Credit Bank, or the Federal Home Loan Mortgage Corporation; or

(3) provide an irrevocable letter of credit issued by the Federal National Mortgage Association, the Federal Home Loan Bank, Federal Farm Credit Bank, or the Federal Home Loan Mortgage Corporation, in which the local entity is named as beneficiary and the letter of credit otherwise meets the criteria established and prescribed by the local entity.

(D) The local entity must exercise prudence in accepting collateral securities or other forms of deposit security.

(E)(1) A qualified public depository has the following options:

(a) to secure all or a portion of uninsured funds under the Dedicated Method where all or a portion of the uninsured funds are secured separately. The qualified public depository shall maintain a record of all securities pledged, with the record being an official record of the qualified public depository and made available to examiners or representatives of all regulatory agencies. The local entity shall maintain a record of the securities pledged for monitoring purposes;

(b) to secure all or the remainder of uninsured funds under the Pooling Method where a pool of collateral is established by the qualified public depository under the direction of the State Treasurer for the benefit of local entities. The depository shall obtain written approval from each entity before pooling an entity's collateral. The depository shall maintain a record of all securities pledged, with the record being an official record of the qualified public depository and made available to examiners or representatives of all regulatory agencies. The State Treasurer shall determine the requirements and operating procedures for this pool. The State Treasurer is responsible for monitoring and ensuring a depository's compliance and providing monthly reports to each local entity in the pool.

(2) Notwithstanding the provisions of item (1), the local entity, when other federal or state law applies, may require a qualified public depository to secure all uninsured funds separately under the Dedicated Method.

(F) A qualified public depository shall not accept or retain any funds that are required to be secured unless it has deposited eligible collateral equal to its required collateral with some proper depository pursuant to this chapter.

(G) "Qualified public depository" means a national banking association, state banking association, federal savings and loan association, or federal savings bank located in this State and a bank, trust company, or savings institution organized under the law of this State that receives or holds funds that are secured pursuant to this chapter.

(H) In addition to the investments authorized for local entities in Section 6-5-10 and notwithstanding another provision of law, a local entity may deposit all or a portion of surplus public funds in its control or possession in accordance with the following conditions:

(1) the funds are initially deposited in a qualified public depository selected by the local entity;

(2) the selected qualified public depository arranges for depositing the funds in one or more federally insured banks or savings and loan associations, wherever located, for the account of the local entity;

(3) the full amount of the principal and accrued interest of each deposit is insured by the Federal Deposit Insurance Corporation; and

(4) the selected qualified public depository acts as custodian for the local entity with respect to each deposit.

SECTION 11-1-50. Protection of deposits of public funds and trust funds by Federal deposit insurance; other security.

Such portion of the public monies as may be on deposit in any bank and protected by Federal deposit insurance shall be exempt from the requirement that security be furnished for it by such bank and security shall be required only for such portion of such deposits as shall exceed the amount covered by such insurance. All public officers who have deposited public funds in banks for which security or collateral is required shall obtain it only for the amount by which the particular deposit exceeds the sum protected by Federal deposit insurance. Such portions of trust funds as may be on deposit in any bank and for which security is now required shall be secured only for the amount by which the same exceeds the amount protected by Federal deposit insurance.

Eligible Collateral and Associated Margins

Obligations of the United States or Guaranteed P&I by the United States			
Obligations of the United States	Margin	Governmental Nat'l Mortgage Assn.	Margin
US Bonds, Notes, Bills, Strips	102%	GNMA's	102%

General Obligations of S.C. or Political Subdivisions of S.C.			
Obligations of South Carolina	Margin	Obligations of Political Subdivisions	Margin
General Obligations	102%	General Obligations	105%

Obligations of Certain Federal Agencies	Margin
Federal National Mortgage Association	105%
Federal Home Loan Mortgage Corp.	105%
Federal Home Loan Bank	105%
Federal Farm Credit Bank	105%

In the event of the Qualified Public Depository having a capital adequacy condition of less than “adequately capitalized,” based on criteria established by the Federal Deposit Insurance Corporation, the State Treasurer may, in his discretion, require the above specified margins to be greater.

State Treasurer Office Contact Information

Office of the State Treasurer
Banking Division
1200 Senate Street, Suite 214
Wade Hampton Building
Columbia, SC 29201

Administrator:

Michelle Blanchfield
Cash Desk Manager
(803)734-0259
michelle.blanchfield@sto.sc.gov

Division Director:

Melissa D. Simmons, CPA
Senior Assistant State Treasurer
(803)734-2662
Melissa.simmons@sto.sc.gov