

Protecting Illinois Public Funds – Today's Expanded Deposit Options

Presented by:
Sue Kling
Regional Director

ICCCFO Annual Conference
October 19, 2007
Alton, Illinois



Seminar Agenda

This session will cover:

- Challenges facing government finance officers
- Typical cash management choices
- FDIC-insured cash management options—the law in Illinois for investment of public funds
- Examples of how government entities can use FDIC-insured deposit options
- What you need to know



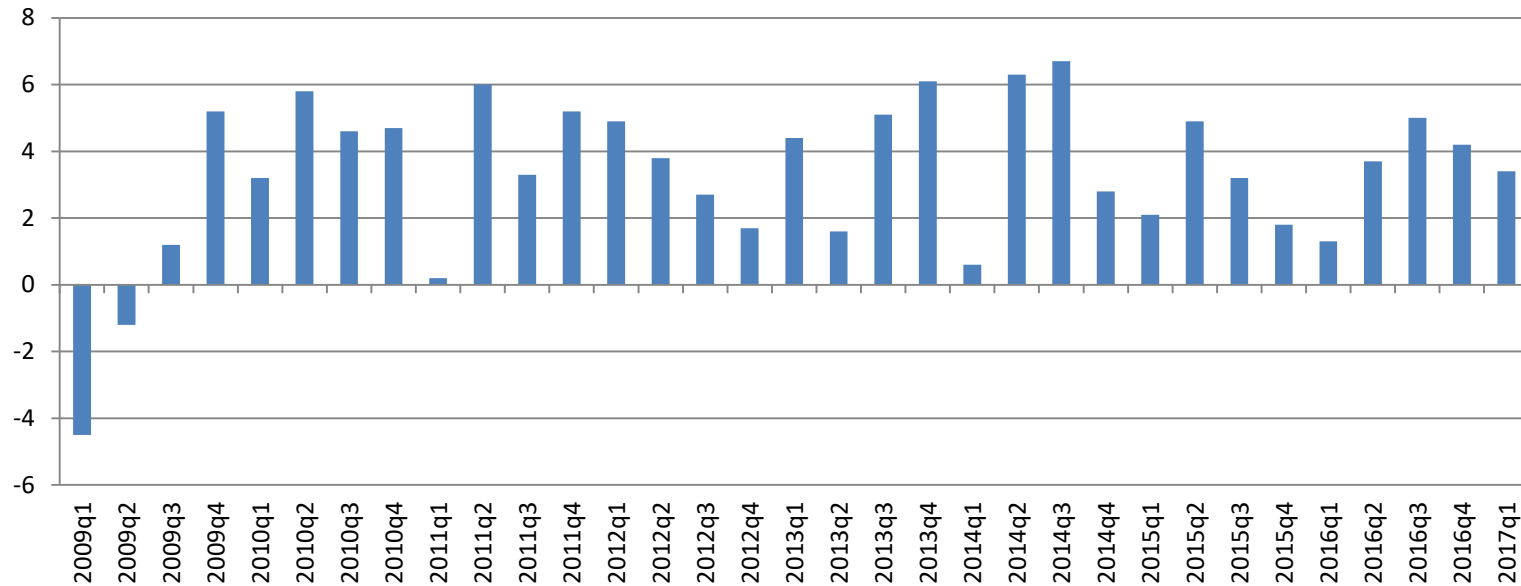


The Economic Landscape Today

The Economic Landscape Today

United States GDP levels remain unpredictable.

GDP Percent Change from Preceding Period*



Data Source: U.S. Bureau of Economic Analysis, Gross Domestic Product, (May 26, 2017), <http://www.bea.gov/national/index.htm#gdp>.

* Real GDP growth is measured at seasonally adjusted annual rates.

Financial Stability is Top of Mind

Investors continue to read about market uncertainty.



Millions of Young People Shut Out of the Housing Market

– wsj.com, June 27, 2017

Economists Slash Second Quarter Growth Outlook, Dimming Hope for a Strong Snapback

– cnbc.com, May 25, 2017

Global bond rout spills into stocks amid fears over easy money

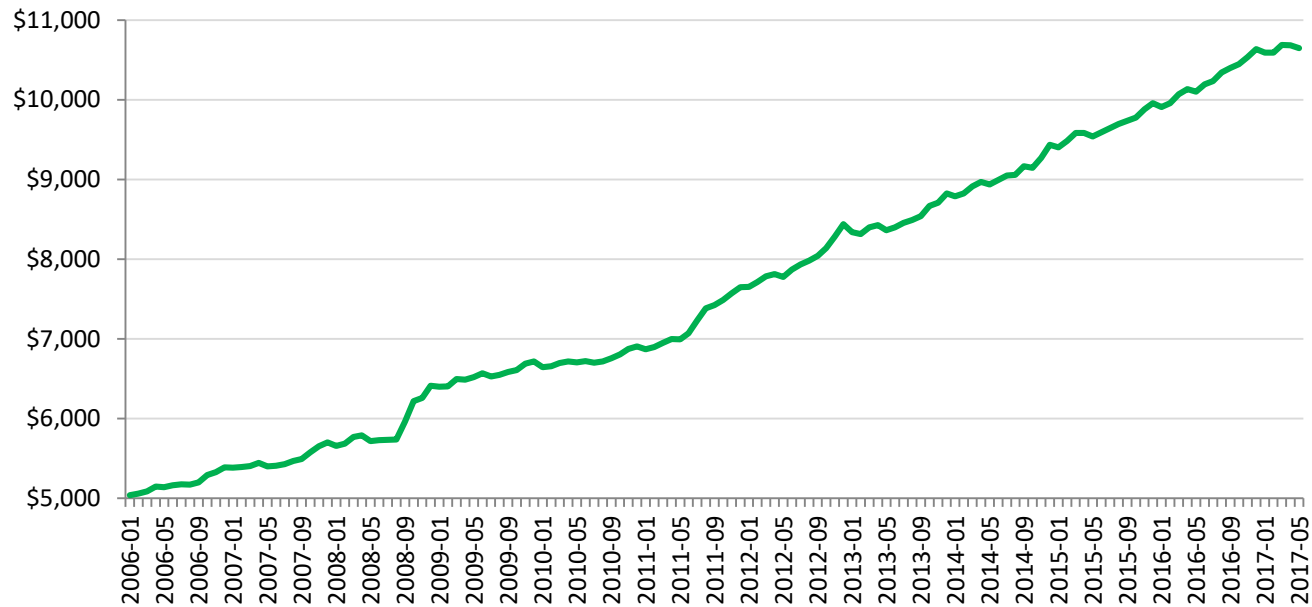
– ft.com, June 29, 2017

Investors Scramble to Keep Pace With New Market Outlook

– bloomberg.com, June 28, 2017

Investors Placing More Funds in Banks

Bank Deposits



Data Source: Board of Governors of the Federal Reserve System, H.8 Assets and Liabilities of Commercial Banks in the United States, (June 23, 2017), <http://www.federalreserve.gov/releases/h8/current>.

Government Organizations Require Security

As you know...

- Governments typically entrust depositories with millions of dollars in checking accounts, savings accounts, and certificates of deposit.
- The safety of public funds is paramount—so much so that government entities generally are required to protect their deposits through insurance, collateralization, or other means.



Finance Officers Face Additional Challenges

- Today, budgets are tighter and government entities are expected to do more with less.
- Government finance officers have to manage intermittent cash flows.
- Changes to money market mutual fund (MMMF) industry regulations require some MMMFs to report daily changes in asset values, which can complicate accounting or make certain MMMFs ineligible for consideration by government entities.
- New financial institution regulations related to bank capital requirements have resulted in government entity deposits becoming more expensive for certain banks and more desirable for others. This can affect the rates government entities are offered for deposits.



Finance Officers Face Additional Challenges

Investment guidelines and requirements:

- Maximize investment returns while minimizing risk
- Preserve adequate liquidity
- Fully protect funds—most states require deposits to be collateralized or fully insured
- Keep funds local—government entities may be subject to statutes or may prefer to keep the full amount of their deposits in their own communities

In Illinois, the list of legally permitted temporary investments for local governments tends to be fairly conservative.

Typical Cash Management Choices

Typical Cash Management Choices

Interest-Bearing Time Deposit Accounts; Traditional CDs

PROS

- Earn interest

CONS

- Funds are insured only up to \$250,000 per insured capacity, per bank
- Withdrawal limitations can restrict the availability of funds

Local governments in Illinois can temporarily deposit funds in time deposit accounts or certificates of deposit issued by a bank or trust company located and authorized to do business in Illinois.

Typical Cash Management Choices

Bonds, Notes, Treasury Bills Illinois local governments

PROS

- Safe
- Keeps funds local for Illinois and local government obligations

CONS

- Low yield

Typical Cash Management Choices

Approved Cooperative Investment Pools

PROS

- Pools are liquid (primarily short-term paper and cash)

CONS

- Low yields
- Funds may not remain local

Market risk is taken by the investment pool, not the municipality.

Typical Cash Management Choices

Repurchase Agreements and Collateralized Deposits

PROS

- Provide security
- May earn interest (although the yield can be very low)
- Repurchase agreements offer unlimited withdrawals

CONS

- Resources needed to track and mark to market changing collateral values on an ongoing basis
- Risk potential due to changing value of pledged collateral
- Reliance on issuer's credit
- May have to include a footnote on financial statements about collateral
- Banks without collateral will not bid for public funds, making it more difficult to keep funds local
- Collateralized deposits typically have a daily withdrawal limit



FDIC-Insured Cash Management Options

Public Deposits in Illinois

Signed into law by the Governor, Illinois allows public agencies to invest their funds through banks or thrifts using insured reciprocal deposits. Investments must initially be made at or through a bank located in or authorized to do business in the state of Illinois



A Big Win for Public Entities and Illinois Banks

What does the law in Illinois mean for public entities and banks who do business in Illinois?

- Public funds can be placed through insured reciprocal deposit sweep services and deposited in term deposit accounts.
- Government entities have access to FDIC insurance on large deposits through a single bank relationship.
- Insured reciprocal deposit sweep and term deposits minimize the need for ongoing collateralization—a benefit for both banks and their government entity customers.
- Besides providing access to multi-million-dollar FDIC insurance, reciprocal deposit sweep and term deposit services allow banks to repurpose collateral, thereby reducing collateral-tracking burdens and associated costs (which may result in their willingness to bid higher rates).

FDIC-Insured Choices

Insured Deposit Sweep Services

- May provide access to multi-million-dollar FDIC insurance (limits vary widely by program)
- Earn interest
- Users can forego the hassles of requiring and monitoring collateralization on an ongoing basis
- Not subject to floating net asset values, liquidity fees, or MMMF redemption gates

CONS

- May have some withdrawal limits (withdrawal limits vary by provider)

How One Insured Deposit Sweep Service Works

Promontory Interfinancial Network's ICS[®], or Insured Cash Sweep[®], service is an example of a reciprocal deposit sweep service that provides access to FDIC insurance.

An example:



*The ICS demand option, where funds are placed into demand deposit accounts, allows for unlimited program withdrawals. The ICS savings option, where funds are placed into money market deposit accounts, allows up to 6 program withdrawals per month.

FDIC-Insured Deposit Choices

CDARS[®], Certificate of Deposit Account Registry Service[®]

PROS

- Provides access to multi-million-dollar FDIC insurance
- Earns interest
- Enables users to forego the hassles of requiring and monitoring collateralization on an ongoing basis

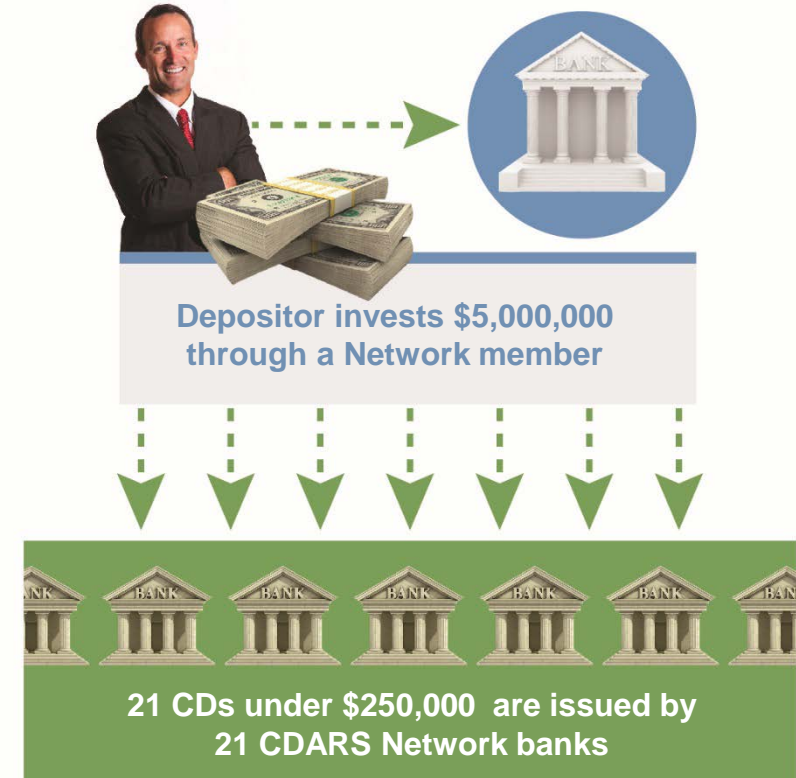
CONS

- Less liquid, although CDs can be laddered to create some flexibility

How CDARS Works

The depositor can receive coverage through many banks while working directly with just one institution. And, the depositor receives one easy-to-read statement summarizing all of the depositor's CDARS holdings.

An example:



The standard FDIC insurance maximum is \$250,000 per insured capacity, per bank.

How CDARS Works

An example:



FDIC-Insured Choices – Example 1

A county government has \$15 million to invest. It needs to keep its investment secure and also to plan for intermittent cash flows.

The government financial officer uses a competitive bidding process to obtain rates from several local banks. The bid is won by a local bank that offers ICS and CDARS.



FDIC-Insured Choices – Example 1 (cont'd)

The bank places \$12 million of the county's funds using ICS to meet its safety and liquidity needs.

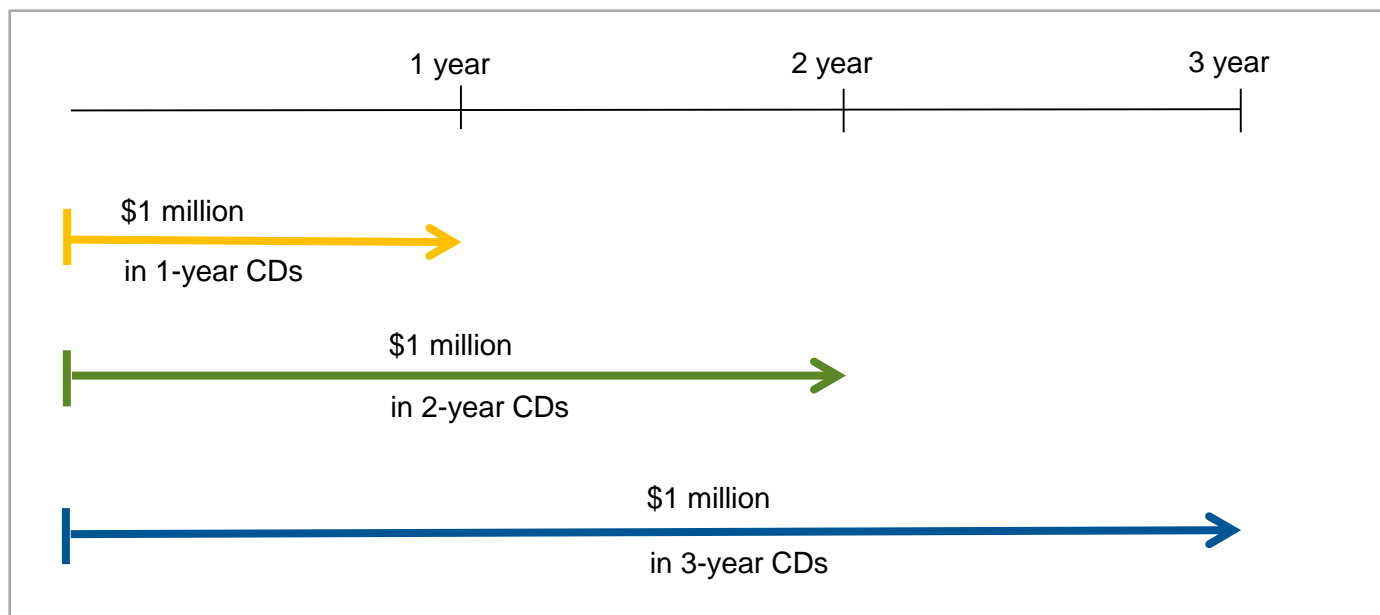
And, it uses CDARS to ladder CD maturities for the remaining \$3 million to match the county's desire to earn CD-level interest (which often compares favorably to Treasuries) and its investment mandate requiring FDIC insurance.

In summary, the county accesses \$15 million of FDIC insurance while working directly with one local bank. And the use of both ICS and CDARS helps it to meet its cash-flow needs while earning returns and supporting lending in the local community.



FDIC-Insured Choices – Example 1 (cont'd)

In this example, the county invests \$1 million in each of three CD maturities so that it has access to \$1 million at the end of every year.



FDIC-Insured Choices – Example 2

A school district had historically collateralized all of its deposits at a local bank with Treasuries and bonds. As a result, the school district was responsible for continuing to monitor whether the pledged assets maintained sufficient value to cover the full value of its deposits.

- Once the school board approved the use of ICS and CDARS, funds were deposited at a local bank using CDARS for longer-term investments and using ICS for shorter-term funds.
- With ICS and CDARS, the school district was able to make constant collateral tracking a thing of the past, saving time and freeing its bank's funds for local lending.



Selection Criteria

When working with your bank to choose a reciprocal deposit option, it is vital to choose wisely. Below are some criteria to consider.

Due Diligence (research and inquire)

- Organizational stability—company reputation, financial stability, quality, and thought leadership of senior management and board of directors

Confidentiality, Integrity, Availability

- How is my information protected?

3rd Party Independent Validation

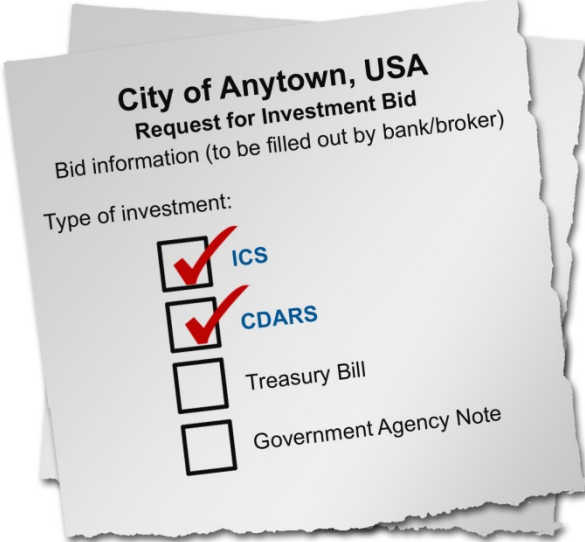
- Industry endorsements
- Security assessments & audits (e.g., penetration testing, secure software development & verification, and SSAE 16 SOC 1)

Update Your Bid or RFP Requests

To simplify your financing efforts, modify your RFP process to include language indicating that you will accept bids utilizing the new authority.

- Add the new options to your RFP forms.
- Over time, these options may increase the number and quality of bids received.

For example:



City of Anytown, USA
Request for Investment Bid
Bid information (to be filled out by bank/broker)

Type of investment:

<input checked="" type="checkbox"/>	ICS
<input checked="" type="checkbox"/>	CDARS
<input type="checkbox"/>	Treasury Bill
<input type="checkbox"/>	Government Agency Note

To Learn More

Sue Kling

Regional Director

Phone: (866) 776-6426, ext. 3423

Email: skling@promnetwork.com

Disclosures

Placement of funds through the ICS or CDARS service is subject to the terms, conditions, and disclosures in the service agreements, including the Deposit Placement Agreement (“DPA”). Limits apply and customer eligibility criteria may apply. In the ICS savings option, program withdrawals are limited to six per month. Although funds are placed at destination banks in amounts that do not exceed the FDIC standard maximum deposit insurance amount (“SMDIA”), a depositor’s balances at the relationship institution that places the funds may exceed the SMDIA (e.g., before ICS or CDARS settlement for a deposit or after ICS or CDARS settlement for a withdrawal) or be ineligible for FDIC insurance (if the relationship institution is not a bank). As stated in the DPA, the depositor is responsible for making any necessary arrangements to protect such balances consistent with applicable law. If the depositor is subject to restrictions on placement of its funds, the depositor is responsible for determining whether its use of ICS or CDARS satisfies those restrictions. ICS, Insured Cash Sweep, and CDARS are registered service marks of Promontory Interfinancial Network, LLC.

When funds are exchanged on a dollar-for-dollar basis with other banks in the CDARS or ICS Network, a Network member can use the full amount of a deposit placed through CDARS or ICS for local lending, satisfying some depositors’ local investment goals or mandates. Alternatively, with a depositor’s consent to certain types of CDARS transactions, the member institution may choose to receive fee income instead of deposits from other members. Under these circumstances, deposited funds would not be available for local lending.