

BILL ANALYSIS

S.B. 638
By: Nichols
Pensions, Investments & Financial Services
Committee Report (Unamended)

BACKGROUND AND PURPOSE

Current law does not provide for a pooled collateral program. The current financing program requires a public entity depositing funds with financial institutions in excess of Federal Deposit Insurance Corporation limits to receive a pledge of securities having a market value greater than that of the deposits. This system requires each entity to have its deposits collateralized individually, even if a financial institution holds deposits from several different entities. A pooled collateral program would provide an alternative option to the current system by allowing the funds to be "pooled" by the comptroller of public accounts.

S.B. 638 establishes a permissive pooled collateral program, provides for the centralization of the collateral function in a pool to be tracked and verified to meet state requirements, and requires the comptroller to be responsible for the implementation of such a program.

RULEMAKING AUTHORITY

It is the committee's opinion that rulemaking authority is expressly granted to the comptroller of public accounts in SECTIONS 1, 2, and 4 of this bill.

ANALYSIS

S.B. 638 amends the Government Code to require the comptroller of public accounts by rule to establish a program for centralized pooled collateralization of deposits of public funds and for monitoring collateral maintained by participating institutions. The bill requires the rules to provide that deposits of county funds are not eligible for collateralization under the program. The bill requires the comptroller to provide a separate collateral pool for any single participating institution's deposits of public funds.

S.B. 638 prohibits the collateral of a participating institution pledged for a public deposit from being combined with, cross-collateralized with, aggregated with, or pledged to another participating institution's collateral pools for pledging purposes, but authorizes a participating institution to pledge its pooled securities to more than one participating depositor under contract with that participating institution. The bill requires the pooled collateral program to provide for voluntary participation in the program by a participating institution and each affected public entity, uniform processing procedures for all collateral transactions subject to an approved security agreement, and a single custodial account for the pledging of a participating institution's collateral securities instead of an account for each depositor of public funds.

S.B. 638 limits participation in the program to a financial institution that has entered into a binding collateral security agreement with a public agency for a deposit of public funds and the agreement permits the institution's participation, has comptroller approval for participation, and has used a collateral security agreement form approved or provided by the comptroller.

S.B. 638 requires each institution participating in the collateral program to secure its deposits of public funds with eligible securities the total value of which equals at least 102 percent of the

amount of the deposits of public funds covered by a binding collateral security agreement and deposited with the participating institution, reduced to the extent that the United States or an instrumentality of the United States insures the deposits. The bill exempts from minimum securitization requirements for the deposit of public funds of a school district a deposit of public funds held and collateralized under the program for purposes of determining whether collateral is sufficient to secure a deposit of public funds. The bill requires a participating institution to provide for the collateral securities to be held by a qualified custodian trustee on behalf of the participating institution, in trust for the benefit of the pooled collateral program.

S.B. 638 requires the comptroller by rule to regulate a custodian trustee under the pooled collateral program in the manner provided by regulations regarding custodians of securities to the extent practicable. The bill requires that the rules ensure that a custodian trustee depository does not own, is not owned by, and is independent of the financial institution or institutions for which it holds the securities in trust, except that the rules are required to allow a federal reserve bank, a banker's bank, as defined by other provisions of law, and a federal home loan bank to be a custodian trustee.

S.B. 638 requires each participating institution to file electronically with the comptroller, as prescribed by comptroller rules, a daily report of the aggregate ledger balance of deposits of public agencies participating in the pooled collateral program that are held by the institution, with each public entity's funds held itemized; a weekly summary report of the total market value of securities held by a custodian trustee on behalf of the participating institution; a monthly report listing the collateral securities held by a custodian trustee on behalf of the participating institution together with the value of the securities; and, as applicable, a participating institution's annual report that includes the participating institution's financial statements.

S.B. 638 requires the comptroller to provide the participating institution an acknowledgment of each report received, to provide a daily report of the market value of the securities held in each pool, and to post each report on the comptroller's Internet website. The bill authorizes the comptroller to impose an administrative penalty against a participating institution that does not timely file a required report.

S.B. 638 requires the comptroller, once each state fiscal year, to impose against each participating institution an assessment in an amount sufficient to pay the costs of administering the pooled collateral program. The bill requires the comptroller by rule to establish the formula for determining the amount of an assessment and to provide to each participating institution a notice of the amount of the assessment and establishes the factors on which the assessment is to be made. The bill requires a participating institution to remit to the comptroller the amount assessed against it not later than the 45th day after the date the institution receives the notice. The bill limits such money remitted to the comptroller to appropriation only for the purposes of administering the collateral program.

S.B. 638 authorizes the comptroller to issue a notice to a participating institution that the institution appears to be in violation of collateral requirements and rules of the comptroller, and to impose an administrative penalty against a participating institution that does not maintain collateral in an amount and in the manner required if the participating institution has not remedied the violation before the third business day after the date notice is issued. The bill authorizes the comptroller to impose an administrative penalty against a participating institution that does not pay the annual assessment against it in the time provided.

S.B. 638 requires the comptroller by rule to adopt a formula for determining the amount of a penalty for violations under the pooled collateral program, provided that for each violation and for each day of a continuing violation, a penalty is at least \$100 per day and not more than \$1,000 per day. The bill requires a penalty to be based on factors that include the aggregate average weekly deposit amounts during the state fiscal year of the institution's deposits of public funds, the number of violations by the institution during the state fiscal year, the number of days

of a continuing violation, and the average asset base of the institution as reported on the institution's year-end report of condition. The bill establishes that penalties under its provisions are in addition to those provided under other law. The bill provides that a proceeding to impose a penalty regarding violations under the collateral program is a contested case under the Administrative Procedure Act, and authorizes the attorney general to sue to collect a penalty.

S.B. 638 provides for the stay of enforcement of a penalty imposed under its provisions during the time the order is under judicial review if the participating institution pays the penalty to the clerk of the court or files a supersedeas bond with the court in the amount of the penalty. The bill authorizes a participating institution that cannot afford to pay the penalty or file the bond to stay the enforcement by filing an affidavit in the manner required by the Texas Rules of Civil Procedure for a party who cannot afford to file security for costs, subject to the right of the comptroller to contest the affidavit as provided by those rules. The bill specifies that money collected as penalties may be appropriated only for the purposes of administering the pooled collateral program.

S.B. 638 requires the comptroller to adopt rules as necessary to implement the pooled collateral program so that the program begins operating not later than the first business day of April 2010.

S.B. 638 adds as an alternative custodian with which a depository may deposit pledged securities a financial institution authorized to exercise fiduciary powers that has a capital stock and permanent surplus of not less than \$5 million; has its main office, branch office, or a trust office in Texas; and has been designated as a custodian by the comptroller. The bill authorizes the comptroller to designate those custodial applicants that are acceptable and to reject those whose management or condition, in the opinion of the comptroller, do not warrant the placing of securities pledged by state depositories. The bill authorizes the comptroller to adopt and enforce rules governing the designation and conduct of custodians with respect to the acceptance and holding of securities pledged by state depositories that the public interest requires and that are not inconsistent with the law governing custodians. The bill makes conforming changes related to such designation of a custodian to provisions governing the deposit of securities for public funds under state and local contracts.

S.B. 638 defines "participating institution" to mean a financial institution that holds one or more deposits of public funds and that participates in the pooled collateral program. The bill defines "financial institution."

EFFECTIVE DATE

September 1, 2009.