

# Collateralization and Safekeeping Services

Presented By: Susan K. Anderson



# Objectives:

- Review Collateralization Rules and Regulations
- Outline Collateral Documentation
- Consider Collateral Management Issues
- Highlight Security Settlement Procedures



# How About Those Collateral Rules?

- Public Funds Investment Act – Ch. 2256 (PFIA)
- Public Funds Collateral Act – Ch. 2257 (PFCA)
- Financial Institution Reform Recovery and Enforcement Act (FIRREA)

# How About Those Collateral Rules?

- Depositories for County Public Funds – Ch. 116 of Local Government Code
- Depositories for Certain Trust Funds and Court Registry Funds– Ch. 117 of Local Government Code
  - Both give a much broader array of collateral options, but risk may not be appropriate. Require Court approval.

# Investments/Deposits Requiring Collateral:

- Demand Bank Accounts
- Money Market Accounts
- Certificates of Deposit
- Repurchase Agreements



## Collateral - PFCA 2257

- 2257.0025 High-Risk Mortgage Security
- **2257.021 Collateral Required**
- 2257.022 Amount of Collateral
  - (a) (1) ...not less than P&I less FDIC....
  - (d) Market Value

## PFCA 2257

- 2257.023 Collateral Policy
  - Institution “Security”
  - Substitution or Release
  - Collateral Market Value
- 2257.024 Contract for Securing
  - Possession
  - Substitution or Release
  - Ownership
  - Collateral Market Value

# PFCA 2257

- 2257.041 Custodian
  - (1) State or National Bank
    - (B) Main or Branch Office
  - (2) Texas Treasury Safekeeping Trust Company
  - (3) Federal Reserve Bank
  - (4) FHLB
  - (5) Comptroller Designated
- Record Keeping, **Perfected Security Interest**, Inspection
- Subchapter F - Pooled Collateral





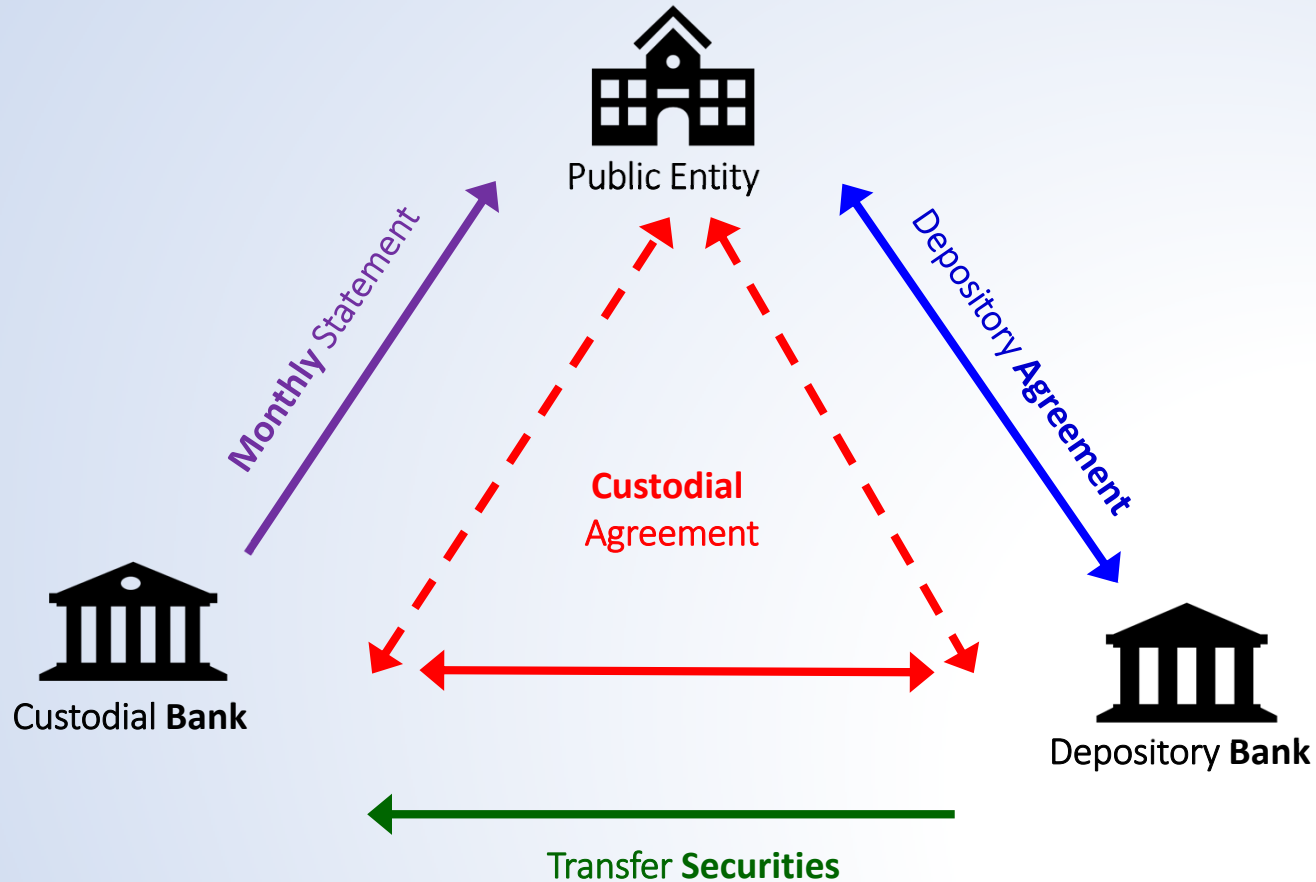
# Financial Institution Reform Recovery and Enforcement Act (FIRREA)

## **“Agreements Against Interests of Corporation”**

- a) Written Agreement
- b) Contemporaneous with Acquisition
- c) Approved by Bank Board or Committee**
- d) Continuous Part of Record

Codified to 12 U.S.C. 1823(e)  
[www.fdic.gov/regulations/laws/rules/1000-1500.html](http://www.fdic.gov/regulations/laws/rules/1000-1500.html)

# Third Party Custodian – A Must!



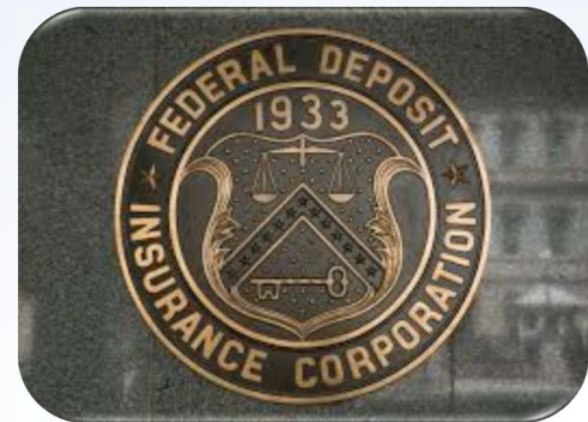
# Custodial Issues

- Two Party or Three Party Agreement
  - Federal Reserve/FHLB
  - Frost/TIB/BNYM
- Collateral Substitution
  - Written Permission
  - Parameter-based
- Collateral Release
  - Written Permission
  - **Depository Bank Discretion**

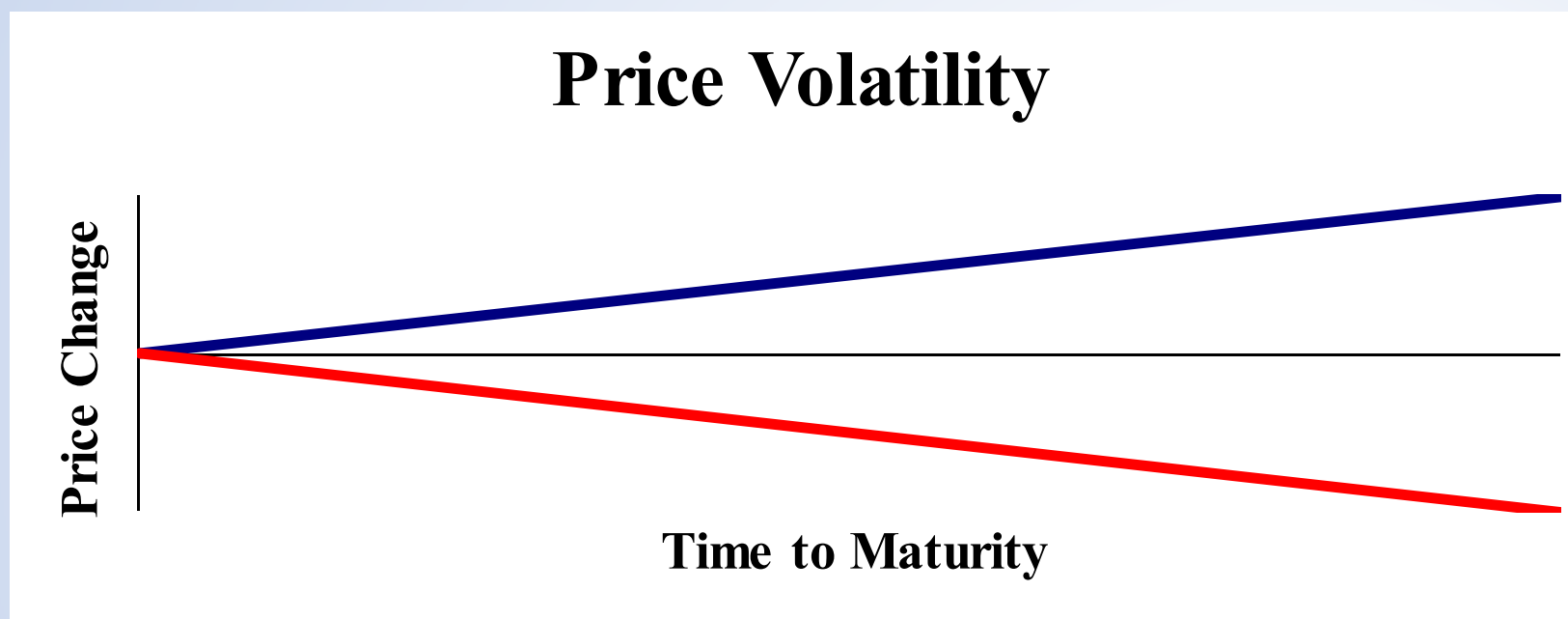


# Collateral Issues

- FDIC – Principal & Interest
  - Non-Interest Bearing
  - Interest-Bearing
  - Each Bondholder
- Market (Fair) Value
  - 100%
  - 102%
  - 110%
- **Who Determines Value?**
  - Depository Bank
  - Custodian
  - Independent Assessment



# Collateral Market Valuation



# 10 Year Treasury Note Value Reduction

Coupon Rate: 3.00%      Maturity Date: 5/2028

Par Amount: \$10,000,000

Yield Change: 4.00%

**Fair Value: +/- \$9,180,000 (8.2%)**

Yield Change: 5.00%

**Fair Value: \$8,440,000 (15.6%)**



# Letters of Credit as Collateral

- Issued by an Agency or Instrumentality (FHLB)
- Monitor Amount vs. Deposit
- Maintain Extra Business Days on Expiration
- **Read the LOC!!**



# Collateral – Required Documents

- Depository Agreement
- LOC or Custodial Agreement
- Collateral Receipt
- Bank Board or Committee Minutes
- **Check Investment Policy Collateral Language**





# Safekeeping Services: “Settling Trades and Parking Your Securities”



“Security”

CUSIP

CUSIP – Committee on Uniform  
Securities Identification Procedures

“Uniquely identify a company or  
issuer and the type of financial  
instrument”

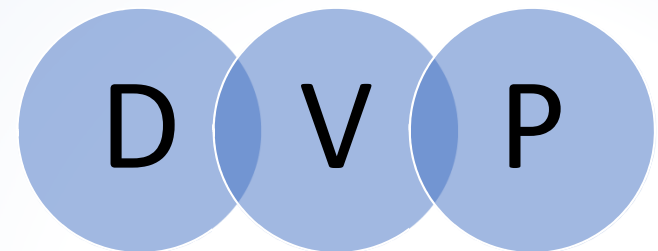
# Buying Securities – Need Broker/Dealer

- **Initially and Annually Approved**
- Primary or Secondary?
- Selected by:
  - Subjective Process?
  - Objective Process?
- How Many?

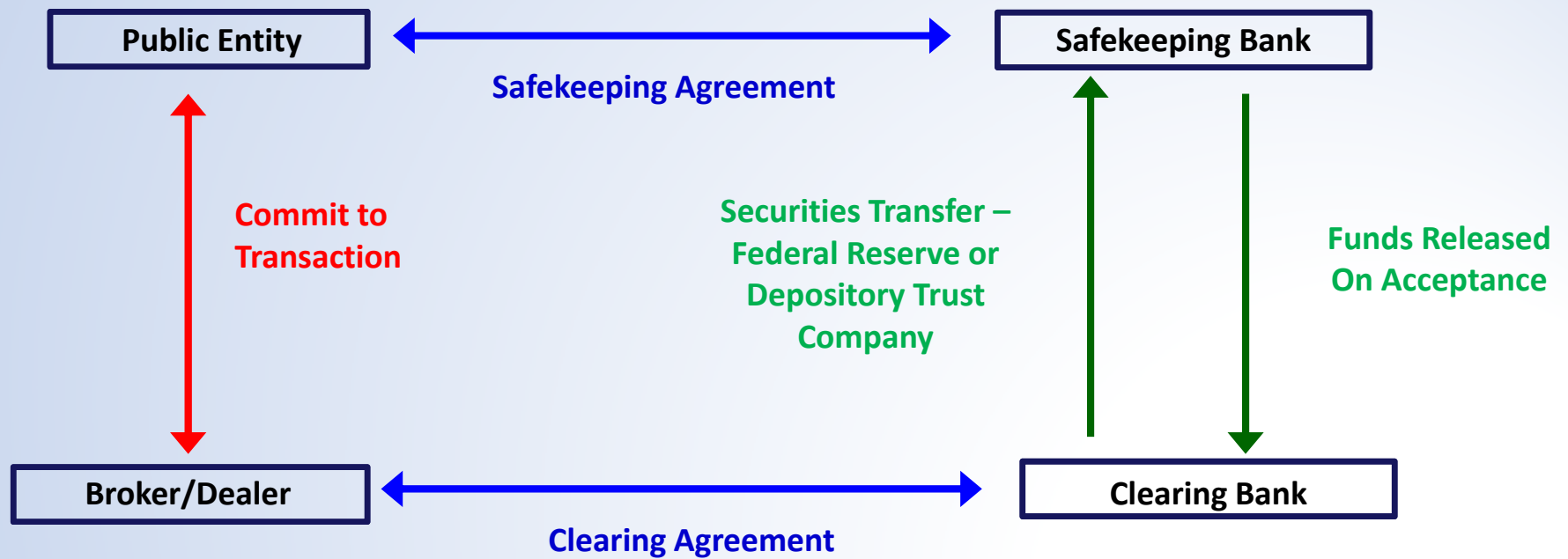


# Settling Security Transactions

- Delivery Versus Payment @ Third Party - DVP
  - Safest Way
  - **Required by PFIA**
  - Check Independence



# Delivery Versus Payment



# Security Clearance and Safekeeping Providers

- Primary Depository Bank
- “Third-Party” Providers
  - Several Texas Banks
  - Review Documentation
  - Funds Transfers – In & Out
  - Collateral? Sweeps?
- Fees





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# PFIA – Changes Made in 2019

Presented By: Tony Sekaly



## Texas Public Funds Investment Act Government Code, Chapter 2256, Summary of 2019 Amendments

The Texas Legislature approved amendments to Chapter 2256 of the Government Code, known as the Public Funds Investment Act (the Act), during the 2019 regular legislative session. H.B. 2706, which will take effect on September 1, 2019, provides that:

- eligible collateral for repurchase agreements (Section 2256.011) is expanded from a combination of cash and obligations of the United States, its agencies or instrumentalities to include commercial paper and corporate bonds, if applicable. Any restrictions associated with the investment of public funds in either commercial paper or corporate bonds as authorized in Section 2256.013 or Section 2256.0204, respectively, by the Act also apply to the use of these obligations as repurchase agreement collateral.

## Texas Public Funds Investment Act Government Code, Chapter 2256, Summary of 2019 Amendments

- extends the stated maximum maturity of commercial paper from **270 days or fewer to 365 days or fewer from the date of its issuance**. This maximum maturity extension also applies to commercial paper serving as repurchase agreement collateral.
- requires investment pools maintaining a \$1.00 net asset value to calculate and report yield to investors in the pool in accordance with federal regulations applicable to money market funds. An investment pool using amortized cost accounting, to the extent reasonably possible, must stabilize at a \$1.00 net asset value, when rounded and expressed to two decimal places. The governing body of an investment pool using amortized cost accounting must also take action to eliminate or reduce to the extent reasonably practicable any dilution or unfair result to existing pool participants, including a sale of portfolio holdings, to attempt to maintain the ratio of market value of the portfolio divided by the book value of the portfolio between 0.995 and 1.005.

## H.B. 293 – 2019

- H.B. 293, which was effective as of 06/07/2019, amended the investment training requirements for school district financial officers through the addition of Subsection (g).
- Subsection (g) provides that the treasurer, chief financial officer, or investment officer of a school district is not subject to the continuing investment training requirements of eight hours every two consecutive fiscal years under Section 2256.008(a-1) if the district does not invest district funds or only deposits district funds in interest-bearing deposit accounts or certificates of deposit as authorized by Section 2256.010 of the Act. The treasurer, chief financial officer, or investment officer must annually submit to the agency a sworn affidavit identifying the related investment categories in Subsection (g) that apply to the district.

## Texas Public Funds Investment Act Government Code, Chapter 2256, Summary of 2019 Amendments

- adds Section 2256.0208, Local Government Investment of Bond Proceeds and Pledged Revenue, to the Act. Local government investment officers are authorized to invest bond proceeds or revenue pledged to the payment of the debt obligation only to the extent permitted by the Act, in accordance with provisions governing the debt issuance, as applicable, and the local government's approved investment policy regarding the debt issuance, as applicable.
- repeals Section 2256.0204(g), which prohibited public funds investment pools from investing in corporate bonds.



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