

INFRASTRUCTURE AND PUBLIC DEPOSITORY TASK FORCE

Meeting Minutes

October 20, 2017

**John A. Cherberg Building, Capitol Campus
Senate Hearing Room A/B/C**

MEMBERS PRESENT:

Brad Hendrickson, Chair, Office of the State Treasurer
Scott Merriman, Vice-chair, Office of Financial Management
Scott Nelson, Office of the State Auditor
Darwin Roberts, Deputy Attorney General
Sen. Patty Kuderer
Rep. Steve Kirby
Rep. Mike Volz (via phone)
Jennifer Lawson, US Bank (via phone)
Denise Portmann, Bank of the Pacific (via phone)
Commissioner Kate Dean, Jefferson County
John Comerford (via phone)
Bill Longbrake (via phone)
Yona Makowski
Becky Thompson, Washington Student Achievement Council

MEMBERS NOT IN ATTENDANCE:

Sen. Jan Angel
Alan Crain, Kitsap Bank

GUESTS PRESENT:

Paula Sardinias, Northwest Credit Union Association
Dominique Meyers, House Democratic Caucus
Robbi Kesler, Office of Program Research
Peter Clodfelter, Officer of Program Research
Anthony Hemstad, Office of the State Treasurer
Kim Herman, Washington State Housing Finance Commission
Catherine Mele-Hetter, Department of Financial Institutions
Roberta Hollingshead, Department of Financial Institutions
Doug Extine, Office of the State Treasurer
Johnna Craig, Office of the State Treasurer
Shad Pruitt, Office of the State Treasurer
Wendy Kancianich, Office of the State Treasurer
Krystelle Purkey, Northwest Credit Union Association
Brenda Snyder, Office of the State Treasurer

WELCOME

Chairman Brad Hendrickson called the meeting to order and introduced himself and Vice-chair Scott Merriman to the audience. Members introduced themselves for viewing audience.

Hendrickson explained that Treasurer Duane Davidson hoped to attend this meeting due to OST's presentation but is travelling.

APPROVAL OF MINUTES

Commissioner Kate Dean moved to approve the minutes from October 12, 2017. Sen. Patty Kuderer seconded. There was no discussion. Minutes unanimously approved.

PRESENTATION: REGULATORY CONSIDERATIONS-Department of Financial Institutions

(Full presentation materials available separately)

Roberta Hollingshead and Catherine Mele-Hetter from Department of Financial Institutions presented DFI's roles in regulations of state-chartered banks.

1. Introduction to DFI
 - a. DFI oversees banks and trust companies, credit unions, , consumer services, securities and administration
 - b. Deposits insured by federal government
 - c. DFI only regulates state-chartered banks
 - d. RCW 30.A and RCW 32
 - e. WAC 208-512
2. Bank Charter Selection
 - a. Either member of federal reserve or regulated additionally by FDIC
3. Federal Regulators
 - a. FDIC, Federal Reserve, CFPB, Comptroller of Currency
4. Prudential Regulation
 - a. Sets rules and regulation on risk taking through safety and soundness examination
5. CAMELS Rating System, Areas of Review
 - a. Capital, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk
6. Regulatory Enforcement Action
 - a. Informal, formal, closure
7. Forming a Bank (under current rules)
 - a. Requires plan for board of directors, bank management selection, business plan and financial projections, and capital needed before application
 - b. Second step: application and investigation
8. Cannabis Banking in Washington
 - a. Some banks accept deposits with written guidance provided through:
 - i. Cole Memorandum
 - ii. FinCEN Guidance

Questions:

Hendrickson asked about a rating system for health of the bank. Hollingshead explained banks are rated on a composite scale of 1-5 with 1 being good and 5 being close to failure. Most Washington banks are 1 and 2. The ratings are highly confidential.

John Comerford asked about minimum capitalization for a new bank. Hollingshead stated banks are required to hold a 10% leverage ratio. Capitalization requirement is dependent on the business plan for first 3 years and how quickly institution expects to grow.

Hendrickson asked about loan capabilities and ratio of 1:10 in deposits and loans. Hollingshead said that is a broad generalization of how banking system works. Reserve requirements look at all factors under liquidity and volatility of deposits. The reserve ratio calculation is mandated by federal reserve and is the percentage of deposits that are required to be held at the end of every day—typically far below liquidity number DFI expects banks to hold.

Sen. Kuderer asked for clarification on capital amounts. Hollingshead explained that Washington is in the western district and a California example is \$25-35M in Capital with business model running about \$250M in assets.

Hendrickson asked if it is likely that a state bank would require statutory changes on top of the traditional application process. Hollingshead confirmed. Sen. Kuderer suggested idea of adding a separate RCW to address the state bank and Mele-Hetter advised that more research is needed. Discussion followed regarding lack of FDIC insurance for Bank of North Dakota and how bank is backed by full faith and credit of state.

Hollingshead explained an additional issue for a state bank is access to the payment system. Example is Bank of Samoa's attempts to get access to Federal Reserve now that Bank of Hawaii is pulling out. The application for master account with Federal Reserve does include government entity as candidate. Federal Reserve would likely not give an answer on approval of access until formal application is completed.

Current litigation is ongoing between the Federal Reserve and a credit union in Colorado focused on cannabis banking.

Scott Nelson asked about timeline for starting a bank. Hollingshead reiterated requirements for application. Once DFI steps it, the average period is 6 months.

Denise Portmann requested clarification on 1:10 ratio and explained that it is not a deposit to lending ratio but rather how many times the capital can be leveraged. \$1 in capital can be leveraged 10 times. If there are more loans than deposits, the bank has strained liquidity positions and looks for ways to amend that.

Sen. Kuderer asked about capitalization and King County's ability to lend \$1B out of \$5B in reserves to help fund a state bank. Hollingshead stated that banks can lend out municipal deposits but they must be collateralized.

PRESENTATION: OVERVIEW OF TREASURY OPERATIONS-Office of the State Treasurer

Cash Management: Shad Pruitt, Deputy Treasurer of Operations

(Full presentation materials available separately)

Washington Treasurer's Office

1. Washington Treasurer's Office
 - a. Responsible for receiving, maintaining, disbursing and transferring public monies
 - b. Manages cash flow
 - c. Invests operating cash
2. Managing Cash Flow
 - a. Provides vision and implementation of statewide systems
 - b. Performs a variety of financial transactions to concentrate funds together,
 - c. Acts as liaison between state agencies and financial institutions
3. History:
 - a. 1993 passing of Cash Management Act (CMA)
 - b. 2010 CMA improve by legislature to fully combine state funds
4. Strategy for Implementing CMA
5. Fundamental Areas of Cash Management
 - a. Collection, disbursement, concentration, cash flow forecasting, investment, and safety/security of public funds
6. Primary goals of cash management
 - a. Speed up inflows, control outflows, minimize net cost (concentration), optimize cash resources and provide liquidity
7. Cash Management Contracts
 - a. Lockbox
 - b. Master depository services
 - c. Merchant bankcard services
 - d. State concentration account
8. Public Deposit Protection Commission
 - a. Governor, Lt. Governor and State Treasurer
 - b. Ensures the safety and security of public funds on deposit in qualified public depositories
 - c. As of August 31, 2017, \$5.8B in banks and \$2.9M in credit unions

Questions:

Commissioner Dean asked who OST currently contracts with for concentration account. Deputy Treasurer Shad Pruitt stated US bank since 2014, previously Bank of America. Contract is up for bid again in 2018.

Hendrickson asked Pruitt to explain TMS. Pruitt: Treasury Management Systems, an in-house software with modules to allow various sections of staff to coordinate efforts. It is a live system that has updated balances of all accounts at any given time.

Merriman asked what happens if a bank becomes insolvent and what that would look like for a state bank. Depends on how the state bank would be structured. In PDPDC, Pruitt explained the three levels of protection—FDIC, collateral pledged by failed bank and PDPC member banks providing backstop.

Discussion ensued regarding determination of collateral. It is dependent on the health of the bank. Only banks that are well capitalized can provide less than 100% collateral. Assets for collateralization are outlined in statute.

Pruitt spoke to earlier question about King County's reserve fund. There is a difference between a deposit and investment. Pruitt said it is likely that King County's \$5B is not a deposit but that it is invested somehow.

More discussion ensued regarding statutory changes needed for uninsured deposits from local government entities. The current bill exempts the state bank from PDPC oversight.

Investments: Doug Extine, Deputy Treasurer of Investments

(Full presentation materials available separately)

1. Two separate pools
 - a. Local Government Investment Pool (LGIP)
 - b. State Treasury
2. LGIP
 - a. Created by legislation in 1986 and open to all governmental entities in the state
 - b. 100% liquidity by 10am each day
 - c. Safe, short-term investment vehicle
3. Treasury Trust Portfolio
 - a. Pooled portfolio of several hundred agency accounts that experiences significant seasonal and monthly cyclicity
4. Treasury Pool
 - a. Investment of temporary surplus balances
 - b. Safety, liquidity and yield are main objectives
 - c. Subdivided into two portfolios
 - i. Liquidity
 - ii. Core
5. Limitations on Treasury and Treasurer's Trust
 - a. IRS restrictions on use of bond proceeds
 - b. State Constitutional restrictions on WSDOT funds
 - c. Impact of diversion of certain funds on OMWBE and veteran owned businesses
 - d. Difference in intra-month and month-end balances

Questions:

Discussion ensued regarding various graphs presented in materials and the chosen portfolio holdings. Deputy Treasurer Doug Extine explained the reason for the differences between LGIP and short-term investment holdings and that of the Treasury Trust with longer-term holdings. Volatility is what lead to the subdivision in the Treasury pool to give better accountability and oversight.

Questions arose regarding the volatility that lead to subdividing the pool into two portfolios. Extine explained that it had to do with property tax spikes as well as the ACA. The delay in the capital budget also cause a delay in bond sales this year as they normally occur in July and had to wait until October.

Discussion ensued regarding the difference between the treasury and treasury trust. Treasury refers to the funds in the state treasury. Trust refers to funds in accounts notated as 'in custody of state treasurer'. Generally, treasury funds are appropriated whereas treasury trust funds may not be.

Debt: Johnna Craig, Deputy Treasurer of Debt and Wendy Kancianich, COP Program Administrator

(Full presentation materials available separately)

1. State debt obligations
 - a. Type of debt:
 - i. Subject to constitutional debt limit: various purpose state general obligation (GO) bonds
 - ii. Not subject to constitutional debt limit: MVFT/GO bonds, COP, 63-20 Financing, Garvee bonds and TIFIA loans
2. Outstanding bonds and COPs
 - a. See graph
3. Constitutional debt limit
 - a. Two specific programs for local government
 - i. LOCAL program-takes place of local government needing to create own debt program
 - ii. School bond guarantee program
 - iii. If state agencies need to buy essential equipment, they can do so through OST

Questions:

Discussion ensued regarding funding of infrastructure through current programs. Sen. Kuderer asked if the current programs are essentially what the state bank would do with lending for infrastructure. Kancianich explained that it depends on what is considered infrastructure. Under current programs, the equipment must be tangible such as firetrucks. Collateral needs to be a tangible asset, not utility type projects such as roads. The collateral is the purchase of a trackable asset like cars for DES. Entities have to go through a credit review to be part of the programs and are examined based on available debt capacity of agency.

Distributed materials included a report of all LOCAL program participants.

PROPOSED MEETING SCHEDULE/AGENDAS

Hendrickson went over proposed meeting schedule that includes four more meetings prior to the deadline.

Discussion ensued regarding schedule and topics with consensus being to move core issues such as capitalization, constitutionality and governance/structure earlier on the agenda. Hendrickson and Merriman will move topics around to accommodate request.

Next meeting set for October 31 from 10:00-2:00. Location to be determined.

ADMINISTRATIVE ITEMS

Travel reimbursement form will be available on website. Suggestions welcome for additional items to include.

PUBLIC COMMENT

There was no public comment.

GOOD OF THE ORDER

Sen. Kuderer shared an update on the trip to California's IBank. She is working to set up meetings with other agencies that are involved in oversight. Hendrickson and Merriman also attending.

Hendrickson arranged meetings with California State Treasurer to discuss cannabis-banking issue on October 26 prior to IBank meeting on October 27.

ADJOURNMENT

Scott Merriman motioned to adjourn the meeting. Yona Makowski seconded the motion. The meeting adjourned at 1:13 pm.

Respectfully submitted by:



Brenda Snyder, Recorder, Infrastructure and Public Depository Task Force
Office of the State Treasurer

Approved by:



Brad Hendrickson, Chair, Infrastructure and Public Depository Task Force
Office of the State Treasurer