House Bill 2779 (2017) Public Funds Work Group

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The Work Group

House Bill 2779 (2017) directed the State Treasurer to convene a work group to review provisions of state law relating to depositories of public funds (ORS chapter 295) and to consider changes to state law to improve processes for transfer and deposit of public funds or to better protect public funds against loss. Treasury requested that direction in order to consider changes to state law to improve processes for the transfer and deposit of public funds while protecting public funds against loss.

The work group met four times throughout 2018 and included representatives from Treasury, state agencies, local governments, and depositories:

Chair
Cora R. Parker, Oregon State Treasury

Members
Joe Bonawitz, Oregon Department of Transportation
Kevin Christiansen, Oregon Bankers Association
Sharon Capizzo Guisande, Columbia Bank
Michelle Hawkins, Association of Oregon Counties
Wendy Johnson, League of Oregon Cities
Tracy Louden, Oregon Parks and Recreation Department
Kathy Ortega, Oregon State Lottery
John Trull, Northwest Credit Union Association
David Ulbricht, Special Districts Association of Oregon

Staff
Cynthia Byrnes, Oregon Department of Justice
Kristin Ennis, Oregon Department of Justice
Bryan Cruz González, Oregon State Treasury
Sharon Prentice, Oregon State Treasury

Treasury wishes to thank the work group members, staff, and all others who contributed to this important effort.

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Oregon’s Public Funds Law

ORS chapter 295 outlines requirements surrounding the deposit and collateralization of public funds. Public funds are defined as funds that a public official has custody of or controls by virtue of office. The law provides that a public official may deposit public funds up to the amount insured (currently $250,000) by the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration (NCUA) in any insured financial institution with a head office or branch in Oregon. Public funds deposits that exceed those insurance limits must be held in a qualified public funds depository, which is a bank or credit union that participates in the Public Funds Collateralization Program administered by Treasury.

The chapter applies to the state or an agency, political subdivision or public or municipal corporation of the state, or a housing authority. Compliance with public funds law requirements relieves a public official of *personal liability* for the loss of public funds in the official’s custody or control.

Oregon’s public funds law was first enacted in the 1930s following the failure of financial institutions during the Great Depression. The law’s requirements are specifically structured to protect public funds against loss due to financial institution failure or insolvency.

Under the Public Funds Collateralization Program, qualified public funds depositories are required to pledge collateral against any public funds deposits in excess of deposit insurance limits. This provides additional protection for public funds in the event of a participating depository’s failure or loss. ORS chapter 295 sets the specific value of the collateral, as well as the types of collateral that are acceptable. The chapter also creates a shared liability structure, which spreads risk across each of the two collateral pools—one for bank depositories and one for credit union depositories.

Today's Challenges

Much in the world has changed since Oregon's public funds law was first enacted in the 1930s. Public bodies across Oregon, driven by constrained resources and the efficiencies of modern technology, are increasingly pursuing partnerships with third party vendors to provide governmental services. When those partnerships include payment-related components, Oregon's public funds law can create challenges.

As the sole banking and cash management officer for the state (ORS 293.875), Treasury provides state agencies with banking and cash management services that comply with public funds requirements. Treasury also accommodates state agencies' use of third party vendors by reviewing such partnerships to ensure compliance with public funds requirements; industry and regulatory requirements; Treasury operating requirements; and other security, interface, or depository requirements. In 2018, Treasury formally reviewed more than 30 proposed partnerships and participated in several other preliminary discussions. Local government bodies and special government bodies are responsible for ensuring their own (and their third party vendors') compliance with public funds requirements.

To comply with existing law when partnering with a third party vendor, a public body must ensure that the third party vendor *at all times* (1) segregates the public body's funds from all other funds; (2) holds the public body's funds in a segregated account on behalf of the public body; and (3) deposits the public body's funds with a qualified public funds depository.

While a public body may identify a third party vendor that complies with public funds requirements, or be able to successfully negotiate with a third party vendor to alter the vendor's established business processes so as to comply with public funds requirements, increasingly that is not the case. Third party vendors often serve clients nationally or internationally—across both public and private sectors—and may be unable or unwilling to establish unique processes, alter existing systems and technology, or alter their own established relationships with financial institutions in order to meet Oregon's public funds requirements.

If a public body is unable to negotiate compliance with public funds requirements with a third party vendor, the public body may be unable to

use the third party vendor's services. That can lead to increased costs, reduced services, and a poorer customer experience. In cases of already established third party vendor partnerships, a public body may end up maintaining a partnership that does not comply with public funds requirements in order to avoid the costs and disruption of ending the partnership.

Problem Statements

As part of its discussions, the work group identified the following problem statements. The problem statements highlight the two main challenges that public bodies may encounter when evaluating partnerships with third party vendors.

- Proposed or current third party vendors that *do not* bank with a qualified public funds depository.
- Proposed or current third party vendors that *do* bank with a qualified public funds depository, but funds are not segregated or are not held in a segregated account on behalf of the public body (meaning funds are, effectively, not collateralized).

A Way Forward

Based on its discussion of existing challenges and the problem statements listed above, the work group identified a set of four complementary solutions that Treasury recommends implementing. These recommended solutions are designed to protect public funds while also supporting modern and efficient business practices.

The work group expressed that the recommended solutions should operate as *exceptions* to existing public funds requirements and not supplant those requirements. Treasury agrees and will request statutory changes to grant Treasury the authority and flexibility to effect the recommended solutions for state agencies by rule, policy, or procedure *as exceptions* to existing public funds requirements. For state agencies, Treasury intends to continue its oversight role (pursuant to ORS 293.875) in reviewing third party vendor partnerships to ensure compliance with public funds requirements and the recommended solutions (as exceptions).

Treasury also will recommend statutory changes to extend the recommended solutions to local government bodies and special government bodies. The proposed statutory changes will grant local government bodies and special government bodies the authority and flexibility to adopt written policies to implement the recommended solutions (as exceptions). Recognizing that these public bodies may have limited resources to implement the recommended solutions, Treasury will consider developing materials that local government bodies and special government bodies may choose to reference when developing their own written policies.

E-commerce Exception

Broaden the e-commerce exception contained in ORS 295.097:

> “(1) Notwithstanding any provision of ORS 295.001 to 295.108, and subject to subsection (2) of this section, with the written approval of the State Treasurer, a state agency may enter into agreements with third parties to facilitate through the use of electronic commerce the sale of public property, the collection of amounts owed to a state agency or the transaction of other state agency business.

> “(2) The State Treasurer may approve an agreement under subsection (1) of this section only if the State Treasurer determines that a depository cannot provide, in a cost-effective manner, the service that is the subject of the proposed agreement.
>
> “(3) The State Treasurer may establish procedures, standards and related requirements under ORS 293.875 that the State Treasurer considers necessary to implement this section.
>
> “(4) As used in this section, “state agency” means any officer, board, commission, department, division or institution of state government, as that term is defined in ORS 174.111.”

The e-commerce exception contained in ORS 295.097 was enacted via Senate Bill 14 (2011) at the request of Treasury. The exception was driven in part by State Surplus’s then use of eBay. State Surplus had partnered with eBay to sell surplus goods online after eBay created a special interface to comply with public funds requirements. eBay subsequently stopped supporting the special interface, which presented both financial and logistical problems for State Surplus. Treasury pursued the exception specifically to address State Surplus’s needs and similar needs shared by programs in other state agencies.

After the exception was enacted, State Surplus ended its partnership with eBay and subsequently did not need the exception. Because the exception was narrowly constructed and not pursued by other state agencies, Treasury did not establish related procedures for implementing the exception.

Broadening ORS 295.097 is the foundation of the recommended solution set. It would provide Treasury the statutory authority to effect the other recommended solutions *for state agencies* by rule, policy, or procedure. Given the rapid pace of change across the financial and technology sectors, Treasury is recommending this approach to provide ongoing flexibility in how to achieve the policy goal of protecting public funds. Additional statutory language would extend the recommended solutions to local government bodies and special government bodies.

Vendor Collateralization

Allow third party vendors to post collateral (cash) to protect public funds not held in a qualified public funds depository.

This concept is based on statutory authority granted to the Oregon Liquor Control Commission via Senate Bill 1044 (2017) and codified in ORS 471.805:

> "(3) Moneys from the retail sale of distilled liquor that are being held by an agent appointed under ORS 471.750 or by a distillery retail outlet agent appointed under ORS 471.230 are not subject to ORS 295.001 to 295.108 if the agent has on deposit with the commission an amount equaling or exceeding an amount the commission, in its discretion, deems to be reasonable and sufficient and to be not less than the average daily gross receipts from retail sales of distilled liquor by the agent. The commission shall remit moneys deposited with the commission under this subsection to the State Treasurer for deposit to a separate reserve account of the commission. Moneys in the reserve account are not revenue of the commission for purposes of ORS 221.770. The commission shall return the deposit, and any interest earned on the deposit, if the appointment of the agent terminates and the agent has forwarded to the commission all moneys owed the commission from retail sales of distilled liquor by the agent."

Under existing law, public funds are protected either by FDIC/NCUA deposit insurance or by the collateral that qualified public funds depositories pledge under the Public Funds Collateralization Program. In either case, the protection of public funds is provided via the *financial institution* where such funds are deposited.

In this concept, public funds would be protected by collateral (cash) posted by *third party vendors*. The collateral (cash) would be deposited in a qualified public funds depository for the benefit of the public body. A public body would need to contractually establish its right to seize the collateral if public funds are lost by either the third party vendor or the third party vendor's financial institution.

This concept would require that a third party vendor be willing and able to commit sufficient funds to the posting of collateral and could result in related additional costs being passed on to the public body.

Surety Bonding

Allow third party vendors to provide surety bonds to protect public funds not held in a qualified public funds depository.

Under existing law, public funds are protected either by FDIC/NCUA deposit insurance or by the collateral that qualified public funds depositories pledge under the Public Funds Collateralization Program. In either case, the protection of public funds is provided via the *financial institution* where such funds are deposited.

In this concept, public funds would be protected by surety bonds obtained and provided by *third party vendors*. A public body would need to ensure that the amount of the surety bond is sufficient to protect the amount of public funds the third party vendor would hold outside of a qualified public funds depository at any time. And the public body would need to ensure that the surety bond protects against loss of public funds both by the third party vendor and by the third party vendor's financial institution.

This concept would require that a third party vendor be willing and able to obtain a surety bond that meets the above requirements and could result in related additional costs being passed on to the public body.

Letters of Credit

Allow third party vendors to provide letters of credit to protect public funds not held in a qualified public funds depository.

Under existing law, public funds are protected either by FDIC/NCUA deposit insurance or by the collateral that qualified public funds depositories pledge under the Public Funds Collateralization Program. In either case, the protection of public funds is provided via the *financial institution* where such funds are deposited.

In this concept, public funds would be protected by letters of credit obtained and provided by *third party vendors*. A public body would need to ensure that the amount of the letter of credit is sufficient to protect the amount of

public funds the third party vendor would hold outside of a qualified public funds depository at any time. And the public body would need to ensure that the letter of credit protects against loss of public funds both by the third party vendor and by the third party vendor's financial institution.

This concept would require that a third party vendor be willing and able to obtain a letter of credit that meets the above requirements and could result in related additional costs being passed on to the public body.

Conclusion

In order to protect public funds while also supporting modern and efficient business practices, Treasury recommends implementing the above set of four complementary solutions as exceptions to existing public funds requirements.

By implementing the recommended solutions for state agencies via rule, policy, or procedure, Treasury will maintain the flexibility to adapt to ongoing changes across the financial and technology sectors while achieving the policy goal of protecting public funds. And by extending the recommended solutions to local government bodies and special government bodies, public bodies across Oregon will have a way forward.

Treasury requested the presession filling of House Bill 2390 (2019) as a placeholder for the recommended solutions. Treasury is working with the Oregon Department of Justice to draft the recommended statutory changes—and broader statutory clarifications throughout ORS chapter 295—and looks forward to working with the House Committee on Revenue and the Senate Committee on Finance and Revenue to address this important public policy.

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