OREGON STATE TREASURY

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TO: The Honorable Nancy Nathanson, Chair
House Committee on Revenue

FROM: Cora R. Parker, Director of Finance
Oregon State Treasury

SUBJECT: HB 2390 – Administration of Public Funds

Chair Nathanson and members of the committee, my name is Cora Parker, Director of Finance for the Oregon State Treasury. I am here today to provide information on the needs behind HB 2390 and the primary issues addressed in the bill.

In the 2017 legislative session, Treasury requested the establishment of a work group to study and develop a report on the provisions of state law relating to public funds, which primarily are set forth in ORS chapter 295. The request was driven by an increasing number of instances where state government encountered challenges regarding public funds requirements while pursuing partnerships with third party vendors to deliver modern and efficient governmental services. The establishment of the work group, and a call for proposed legislation, ultimately was included in HB 2779 (2017).

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. Public funds are defined as funds that a public official has custody of or controls by virtue of office, and the law applies broadly across all governmental entities.

The law protects public funds by providing that they may be deposited in any financial institution within Oregon up to the amount covered by federal deposit insurance (currently $250,000) or, when exceeding those limits, deposited at a financial institution that participates in the Public Funds Collateralization Program administered by Treasury. Under the program, qualified depositories are required to pledge collateral against 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. The program includes as a shared liability structure, which spreads risk across each of the two collateral pools—one for bank depositories and one for credit union depositories.

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Much in the world has changed since Oregon's public funds law was first enacted. 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, a public body—under existing law—must ensure that the third party vendor *at all times* segregates the public body's funds from all other funds; holds the public body's funds in a segregated account on behalf of the public body; and deposits the public body's funds with a qualified 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.

The work group identified two main challenges that public bodies encounter when evaluating partnerships with third party vendors. First, that the proposed or current vendor *does not* bank with a qualified depository. Second, that the proposed or current vendor *does* bank with a qualified depository but that the funds are not segregated or are not held in a segregated account on behalf of the public body (meaning funds are, effectively, not collateralized).

Based on those challenges, 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 first recommendation, contained in Section 29 of HB 2390, is to broaden the existing e-commerce exception contained in ORS 295.097 in order to provide Treasury greater authority to identify and implement alternative methods to protect public funds. This statutory change is the foundation of the recommended solution set and will allow Treasury to effect the other solutions for state agencies via policy. Section 30 of the bill similarly authorizes local governments to adopt alternative methods by policy.

Note that any alternative method adopted under these sections must be designed to *fully secure* public funds held or deposited by third party vendors. Under existing law, public funds are protected either by federal deposit insurance or by the collateral that qualified 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. Generally, under alternative methods, public funds would be secured by some form of collateral posted by third party vendors.

The remaining recommendations are alternative methods that Treasury would implement via policy. Local governments could choose to adopt the same alternative methods or could identify other methods best fitted to their individual needs.

The second recommendation is to allow third party vendors to post cash as collateral to protect public funds not held in a qualified 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. The collateral would be deposited in a qualified depository for the benefit of the public body and, under its contract with the third party vendor, the public body could seize the collateral if public funds were lost by either the vendor or the vendor's financial institution.

The third recommendation is to allow third party vendors to provide surety bonds as collateral to protect public funds not held in a qualified depository. A public body would make a claim against the bond if public funds were lost by either the third party vendor or the vendor's financial institution.

The fourth and final recommendation is to allow third party vendors to provide letters of credit as collateral to protect public funds not held in a qualified depository. A public body would draw against the letter of credit if public funds were lost by either the third party vendor or the vendor's financial institution.

These recommendations will protect public funds while also supporting modern and efficient business practices. And they will provide a way forward for both the state and local governments.

While working with stakeholders and legal counsel in drafting the proposed legislation to address the work group's recommendations, it became apparent that all parties would benefit from broader clarification and cleanup of ORS chapter 295. The bulk of the bill before you, outside of Sections 29 and 30, represent that effort. In working through the chapter with stakeholders and legal counsel, we have deliberately and determinedly avoided changes in policy. Instead, we have clarified and added defined terms; reorganized and clarified requirements; aligned statutory language with program practices and procedures and other controlling law; and removed duplicative and expired provisions.

For example, I testified earlier that existing law allows public officials to deposit public funds at *any* financial institution in Oregon—not just qualified depositories—up to federal deposit insurance limits. While this has long been the case, the actual wording of the statute made it difficult for public officials to recognize this option.

Similarly, throughout my testimony, I have used the term qualified depository when referring to a financial institution that participates in the Public Funds Collateralization Program. Treasury has long used that term in outreach and education efforts related to the program, and it is crucial in understanding the framework of ORS chapter 295, yet the term has never actually appeared or been defined in statute.

Lastly, in addition to the cleanup of ORS chapter 295, Sections 33 through 51 of the bill sets forth conforming changes to other statutes that reference the chapter.

Through the work group and broader cleanup of ORS chapter 295, Treasury has worked closely with stakeholders on the bill before you. We believe the bill is the right path forward to address the challenges that the state and local governments face in today's quickly changing world. And we urge adoption of the bill in order to modernize the critical public policy of protecting public funds.

We appreciate your consideration of HB 2390.