

# Legislative Analysis

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## **CDARS: ALLOW AS INVESTMENT OPTION FOR SCHOOL DISTRICTS & PUBLIC CORPORATIONS**

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**House Bill 6297 as introduced**  
**Sponsor: Rep. Ed Clemente**

**House Bill 6298 as introduced**  
**Sponsor: Rep. Andy Coulouris**  
**Committee: Banking and Financial Services**

### **First Analysis (9-17-08)**

**BRIEF SUMMARY:** The bills would allow school districts, intermediate school districts, and public corporations to invest certain funds in certificates of deposit with financial institutions which participate in programs such as the Certificate of Deposit Account Registry Service program, also known as CDARS.

**FISCAL IMPACT:** The bills would have no state fiscal implications but could positively impact local governments as discussed later in the analysis.

### **THE APPARENT PROBLEM:**

Currently, school districts, intermediate school districts, and public corporations have authority to invest certain funds as specified in statute. One lawful investment option is to invest funds in certificates of deposits (CDs) issued by financial institutions that maintain a principal office or a branch office located in Michigan. (Public corporations are defined in the act to mean a county, city, village, township, port district, drainage district, special assessment district, or metropolitan district of the state, or a board, commission, or other authority or agency created by or under an act of the state legislature.)

One shortcoming to investing in CDs is that in order for the entire investment to be insured under the Federal Deposit Insurance Corporation, a school district or local government can invest no more than \$100,000 in a single financial institution. Since most of these public entities have more than this amount to invest at any given time, the public entity must either invest in CDs offered by larger banks (which often own enough smaller banks to spread out the investment), divide the amount to be invested among numerous local banks, or invest in other lawful investment options which may have lower yields and higher risk due to the lack of FDIC insurance.

Several years ago, a new investment tool was developed to enable investors wishing to invest in CDs through a single bank to do so and still have the total amount of the investment insured through the FDIC, even if the investment exceeded the \$100,000 cap. Known as CDARS, the program spreads an investor's funds among as many member institutions as necessary so that no more than \$100,000 is invested in any single institution -- thus allowing the investment to be fully covered by the FDIC insurance. (For more information on CDARS, see [Background Information](#) below.)

The problem is that since state law restricts schools and local governments to investing in CDs offered only by banks located in Michigan, these public entities cannot avail themselves of the investment opportunities offered by CDARS. According to an opinion issued by the Attorney General, "a Michigan public corporation may not participate in the CDARS program" because the investments are placed "with financial institutions that do not maintain a principal office or a branch office located in Michigan". (Opinion No. 7204, September 7, 2007).

At least 42 other states allow their local governments to invest in CDs offered by CDARS. Legislation requested by the Michigan Bankers Associations would do the same.

### ***THE CONTENT OF THE BILLS:***

House Bills 6297 and 6298 would allow school districts, intermediate school districts, and local governments to also invest funds in certificates of deposit in accordance with the following conditions:

- The funds were initially invested through a financial institution that was not ineligible to be a depository of surplus funds belonging to the state under Section 6 of Public Act 105 of 1855. (Section 6 requires the commissioner of the Office of Financial and Insurance Regulation, or OFIR, to make a determination whether additional surplus state funds shall or shall not be deposited in that institution for a period not to exceed two years, in cases involving a financial institution found to have engaged in an illegal discriminatory lending practice relating to a mortgage loan or home improvement loan application.)
- The financial institution arranged for the investment of the funds in certificates of deposit (CDs) in one or more insured depository institutions as defined in the Federal Deposit Insurance Act for the account of the public entity.
- The full amount of the principal and any accrued interest of each CD were insured by an agency of the United States (e.g., the Federal Deposit Insurance Corporation, or FDIC).
- The financial institution acted as custodian for the public entity with respect to each CD.
- At the same time that the funds of the public entity were deposited and the CD issued, the financial institution received an amount of deposits from customers of other insured depository institutions equal to or greater than the amount of the funds initially invested by the public entity through the financial institution.

House Bill 6297 would amend the Revised School Code (MCL 380.622 and 380.1223) to apply to intermediate school districts and school districts.

House Bill 6298 would amend Public Act 20 of 1943 (MCL 129.91), which pertains to the investment of surplus funds of political subdivisions and limits investments to certain instruments and depositories.

## ***BACKGROUND INFORMATION:***

The Certificate of Deposit Account Registry Service program, or CDARS, is a funding tool through which financial institutions, such as banks and credit unions, can offer customers insurance on deposits greater than \$100,000. Currently, the Federal Deposit Insurance Corporation (FDIC) insures a deposit from a single investor up to \$100,000 in a single institution. A person with more than \$100,000 to invest must divide the investment between two or more financial institutions in order to have the total amount of principal and accrued interest insured against loss under the FDIC insurance.

CDARS is a network of about 1,600 financial institutions. When Depositor A invests say, \$150,000 in a CD in an institution that is a member of the CDARS network, up to \$95,000 is invested in a CD at that institution. The rest (in this scenario, \$55,000) is deposited in a CD offered by one or more member institutions. In this way, the depositor's total investment, including accrued interest, will fall below the FDIC's cap of \$100,000 and be fully insured. At the same time, an equal amount of funds from the member institution receiving the excess investment (from Depositor B) will be placed in Depositor A's bank. Thus, both Depositor A and B will have their investments greater than \$100,000 that are invested in CDs fully insured. A complex computer program matches the institutions to be involved in the transaction.

The benefit to consumers and governmental entities is that larger sums of money can be invested in CDs at a single, local bank and be fully insured even though the total investment is more than \$100,000. The benefit to smaller, community banks is that CDARS attracts and retains otherwise uninsurable funds back to the local bank, thus making more revenue available to offer in loans to community members.

## ***FISCAL INFORMATION:***

House Bill 6297: The bill would have no fiscal impact on the state but would have a positive fiscal impact on school districts and intermediate school districts. Allowing districts to invest in financial institutions participating in CDARS would increase their investment flexibility and avoid the potential administrative costs of having to independently split investments among multiple institutions, while still insuring their total investment through the FDIC.

House Bill 6298: As written, the bill would have no impact on state revenues or expenditures. It could have a positive impact for those local units of government that elect to take advantage of the additional investment opportunities.

## ***ARGUMENTS:***

### ***For:***

In a time of economic instability, with stock market volatility and some banks failing, it is important for governmental entities to preserve capital while still maximizing interest. Certificates of deposit issued by banks and credit unions can offer safe havens, especially since investments up to \$100,000 by a single depositor in a single bank or credit union are insured against loss by the FDIC. For those with larger amounts to invest, CDARS offers the ability to invest an amount over the FDIC limit in a single institution yet still have the entire investment protected from loss. In addition, since CDARS handles the placement of funds among numerous institutions, and issues a single statement, time and administrative costs

associated with making multiple deposits in CDs in multiple institutions at different rates of return with multiple statements are eliminated. Though 42 other states allow public entities to invest in CDARS, schools and local governments in Michigan are prohibited by statute from doing so. The bills would lift that restriction.

Without the bills, many public entities will continue to be forced to choose other investments that may be riskier or have lower yields, such as money market funds. In addition, some of the other lawful investments are not restricted to Michigan-based institutions. Therefore, the bills would be good public policy. School districts and local governments could invest up to \$50 million in a single local institution, at a single rate, with a single statement. The investments would be protected against loss by the FDIC, and the amount of the original investment would stay local and usable by the institution for loans to other area businesses and individuals. Though investing in CDs through CDARS is not without cost, reportedly the cost is minute, especially considering the overall economic benefit to Michigan-based community banks and the communities they serve.

***POSITIONS:***

The Michigan Bankers Association (MBA) supports the bills. (9-16-08)

Representatives of Flagstar Bank and Capital National Bank testified in support of the bills. (9-16-08)

The CDARS program supports the bills. (9-16-08)

The Ingham County Treasurer submitted a letter in support of House Bill 6298. (9-15-08)

The Michigan Department of Treasury is neutral on the bills. (9-16-08)

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