Tennessee Comptroller of the Treasury

A Guide to Investing Idle County Funds

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In response to requests for further clarification of what investments are authorized for county governments, the Division of Local Government Audit has prepared this guide to address some of the most common investment choices available to trustees.

Statutory Authority for Investments

Trustees should be familiar with provisions of the *Tennessee Code Annotated (TCA)*, which establish authority and limitations for investments made by county governments. Applicable statutes include the following sections of the *TCA*:

5-8-301.	Authorized Investments This section details specific investment choices available to county governments and limitations on the maturity for the various investments.
5-8-302.	Investment Committee This section provides that the county legislative body may appoint a committee with authority to designate the types, amounts, and maturity of investments authorized by 5-8-301.
9-1-107.	Investments or deposits in federal savings banks or pooled investment fund. This section provides for investments in federal savings banks whose deposits are insured by FDIC. Further provides for non-delinquent, first mortgages to be pledged as collateral at 150% of deposits. Also approves investment in local government investment pool (as does 5-8-301(b)(4)).
9-1-118.	Depositing, investing or placing for deposit funds held by state and government entities. This section authorizes and establishes limitations for an alternate investment mechanism (including CDARS and ICS) through which counties may purchase federally insured certificates of deposit in banks whether or not located inside the state of Tennessee.
9-4-105.	Required Collateral. This section establishes the minimum market value of collateral required to protect uninsured county deposits.
9-4-107.	State Depository. This section establishes what qualifies as a state depository.

9-4-111.	Applicability of this part and parts 3 and 5 of this chapter -- "State treasurer" construed. These two statutes define which depositories are authorized for the deposit of state funds and stipulate that the criteria also applies to deposits of county governments.
9-4-501, et. seq.	Collateral Pool for Public Deposits Act of 1990. This part establishes the state collateral pool as an alternative method of securing county deposits.

Common Types of Investments

Certificates of Deposit

Certificates Purchased by the Trustee

Certificates of deposit are authorized investments for Tennessee counties within certain limitations. Those limitations include the type of charter and the location of the depository. As discussed below, the choice of depositories is generally limited to those having a Tennessee charter or those having a federal charter with their main office located within the state of Tennessee. Certain exceptions to this criteria are provided in the statutes, but those exceptions require action of the state treasurer, governor, and commissioner of finance and administration.

Section 5-8-301(b)(2), TCA, authorizes investments in "certificates of deposit and other evidence of deposit at Tennessee state chartered banks and savings and loan associations and federally chartered banks and savings and loan associations". Sections 9-4-111 and 9-4-107 TCA, further limit depositories of county funds to those meeting the definition of a "state depository". A state depository is defined in section 9 -4-107(a) (1) as:

A. Any savings bank (savings institution), or any bank chartered by the state of Tennessee;
B. Any national bank, or federal savings institution that has its main office located in this state; or
C. Any national or state bank, or any federal or state savings institution that has its main office located outside this state and that maintains one (1) or more branches in this state which are authorized to accept federally insured deposits;

that has been designated by the state treasurer, the governor and the commissioner of finance and administration as a state depository.

Required Collateral

Section 5-8-301(b)(2) requires that all certificates of deposit be either: (a) federally insured (FDIC coverage); (b) collateralized with eligible collateral whose market value is at least 105 percent of the uninsured deposit as required by section 9-4-105, TCA; or, (c) be in a depository which is a member of the state collateral pool established by section 9-4-501, et. seq., TCA.

Considerations if Using a Third-party to Purchase Certificates of Deposit

(Please note that many people commonly refer to these as "brokered CDs". A broker, as used here, is any third-party other than the issuing bank itself that purchases a legal deposit investment on your behalf.)

If a third-party "deposit broker" is used to purchase certificates of deposit, **<u>those investments must meet the criteria discussed above regarding which banks are authorized for deposit (generally limited to those having a Tennessee charter or those having a federal charter with main offices located within the state of Tennessee)</u>**. In addition, other safeguards are necessary to ensure that the county's investment is federally insured. The following excerpt was taken from the Spring 2013 issue of FDIC Consumer News in an article titled "When a Broker Offers a Bank CD: It Pays to Do Some Research"

> *Make sure all of your deposit will be fully insured. To protect your brokered CD from loss if the bank fails, follow these steps to confirm that your money is placed in a properly titled deposit account at an FDIC-insured bank and that all of it is within the deposit insurance limits. First, get the name of the bank where your money is to be deposited and verify that it is FDIC-insured by calling the FDIC toll-free at 1-877-275-3342 or searching BankFind, the FDIC's database of insured institutions at http://research.fdic.gov/bankfind.*
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> *Second, ask your broker to confirm that the deposit account records for its brokered CDs reflect the broker's role as an agent for its clients (for instance, by titling the account "XYZ Brokerage, as Custodian for Clients"). That way, each client who owns the CD can qualify for up to at least $250,000 in deposit insurance. This coverage is generally referred to as "pass-through" insurance because it bypasses the broker and is calculated based on the ownership interests of the individual depositors.*
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> *Also with pass-through insurance, a consumer's brokered deposits are added to any traditional deposits he or she has at the same bank for purposes of calculating coverage. So, if your combined brokered and traditional deposits at a single bank exceed $250,000, you should call the FDIC to discuss your coverage.*

The full text of this article can be found on the FDIC website at https://www.fdic.gov/consumers/consumer/news/cnspr13/cdsfrombrokers.html.

If the third-party cannot document that the accounts are properly titled for FDIC insurance coverage, then the instruments would not be appropriate investments for county governments.

Certificates Purchased Through CDARS, ICS, and Similar Programs Authorized by Section 9-1-118, TCA

Section 9-1-118, TCA, provides an alternate means under which counties may invest in FDIC insured certificates of deposit in banks wherever located. This statute requires the deposit to first be made in a bank or savings and loan association, selected by the government entity, with a branch in the state of Tennessee that is authorized to accept county deposits (the depository bank). The depository bank then arranges for the transfer of the moneys into one or more federally insured banks or savings and loan associations, wherever located (secondary depositories), for the account of the county. In turn, the depository bank receives funds from customers of the secondary depositories equal to or greater than the amount initially invested by the county. The balance of county funds with each secondary depository must not exceed FDIC insurance limits so that all funds are fully insured.

Under this program, the trustee must provide the depository bank with a listing of all banks and savings and loan associations holding county funds under the same federal employer identification number (FEIN). To prevent deposits from exceeding FDIC coverage, the depository bank is prohibited from using any of those listed banks or savings and loan associations as secondary depositories.

The use of this program must be approved by the county investment committee or finance committee as appropriate for the specific county. Further, the investment committee or finance committee must establish policies and procedures for the investments, including the establishment of controls to ensure that full FDIC insurance coverage is obtained.

Service providers used by depositories must be approved by the state treasurer upon concurrence by the commissioner of financial institutions and finance and administration. There are currently only two eligible programs that have been approved by the state treasurer: the Certificate of Deposit Account Registry Service (CDARS) and the Insured Cash Sweep (ICS), which operate through Promontory Interfinancial Network, LLC.

Government Securities

Securities of the United States Government

Investments backed by the full faith and credit of the United States government are authorized investments and do not require minimum credit ratings. These include treasury bonds and notes. Securities of the Government National Mortgage Association are also backed by the full faith and credit of the U.S. government.

Securities of Government Sponsored Enterprises

Securities of United States government sponsored enterprises, including the Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Federal Home Loan Mortgage Corporation, are authorized investments only if the securities have credit ratings that are in the highest category of at least two nationally recognized rating services. That has not been the case for many of these entities in recent years. The debt of those agencies is not explicitly backed by the full faith and credit of the U.S. government. Therefore, if you intend to invest in securities of these enterprises, you must document that they have the highest credit rating from at least two of the credit rating services. The following table lists the highest categories for Fitch, Moody's and Standard and Poor's for long-term and short-term securities.

	Fitch	Moody's	Standard and Poor's
Long-Term	AAA	Aaa	AAA
Short-Term	F1	P-1	A-1

Securities of States and Political Subdivisions

Section 5-8-301(b)(7) authorizes counties to invest in their own bonds and notes that have been issued in accordance with Title 9, Chapter 21 of the TCA (the Local Government Public Obligations Act of 1986).

Bonds of the state of Tennessee and its political subdivisions, as well as bonds of other states and their political subdivisions are generally authorized investments under section 5-8-301(b)(5), TCA. Those bonds are required to have a minimum credit rating of A by any nationally recognized rating service in order to qualify as authorized investments for counties.

Investment Pool

The Local Government Investment Pool is an authorized investment pursuant to section 5-8-301(b)(4), TCA. The pool is maintained by the state treasurer who collectively invests deposits from all pool members. Balances are available for withdrawal with minimal notice. Details of the pool operation are available at http://treasury.tn.gov/lgip/.

Other Investments

Section 5-8-301, TCA, authorizes certain other less common investments. These include repurchase agreements as well as prime banker's acceptances, and commercial paper. Details of conditions under which those are allowed are discussed in subsection (b)(3) and subsection (d) of the statute. Additionally, Sections 9-4-602 and 9-4-608 provide for counties to invest in other funds maintained by the state treasurer. These authorizations have rarely been utilized by counties.

Maturity Limitations

Section 5-8-301 TCA, establishes limitations on the maturity of authorized investments. That limit is generally two years. However, with the approval of an investment committee appointed by the legislative body, certain amounts as detailed in section 5-8-301(c) may be invested for longer periods. Investments in commercial paper may have shorter maturity limitations as described in section 5-8-301(d), TCA.