

REICH & TANG

General Laws of Massachusetts

There is pending legislation that will amend this and related sections

Part I: ADMINISTRATION OF THE GOVERNMENT

Title VII: CITIES, TOWNS AND DISTRICTS

Chapter 44: MUNICIPAL FINANCE

Section 55B: INVESTMENT OF PUBLIC FUNDS

Section 55B. All moneys held in the name of a city, town, district or regional school district or any other account under the jurisdiction of a city, town, district, or regional school district or officer thereof, which are not required to be kept liquid for purposes of distribution, shall be invested in such a manner as to require the payment of interest on the money at the highest possible rate reasonably available, taking account of safety liquidity and yield. All officers of a city, town district or regional school district who control the investment of such funds shall invest them prudently, consistent with the provisions of sections fifty-four and fifty-five and, if the funds are the result of gift or grant or bequest, the terms of such gift or grant or bequest, so as to accrue the highest amount of interest reasonably available on such funds taking account of safety, liquidity and yield. The provisions of section sixty-two shall not apply to this section.

MEMORANDUM

TO: Joseph Jerkovich
Stable Custody Group II LLC
Reich & Tang Deposit Solutions, LLC

FROM: Oliver Ireland
Amanda Mollo
Morrison & Foerster LLP

DATE: March 21, 2016

RE: DDM Program—Massachusetts Public Agency Deposits

You have asked us to analyze the eligibility of Stable Custody Group II LLC's ("Stable") DDM Program for Massachusetts public deposits. As set forth in this memorandum, we believe that Massachusetts public deposits of municipalities should be able to be placed in the DDM Program under applicable Massachusetts law, subject to limited restrictions discussed below that should not interfere with the use of the DDM Program. As a practical matter, Massachusetts state and county funds may not be eligible for the DDM Program.

Background

It is our understanding that the relevant features of the DDM program are as follows. Stable operates the Program through its wholly owned subsidiary, Stable Custody Group II, LLC ("Stable"). Stable has entered into written agreements with an FDIC-insured intermediary bank ("Intermediary Bank") to establish and maintain a single demand deposit account ("DDA") held in the name of "Stable Custody Group II, LLC as Agent for its Demand Deposit Marketplace Participating Banks as Agent for Demand Deposit Marketplace Customers and for others" ("Control/Operating Account"). We further understand that Stable has entered into written agreements with participating FDIC-insured banks (each a "Sending Bank") to permit the Sending Banks and their participating deposit customers ("Customers") to participate in the DDM program. Sending Banks shall have designated deposits of Customers automatically swept into DDM program deposit accounts, either money market deposit accounts ("MMDAs") or interest-bearing DDAs, held at participating FDIC-insured banks (each a "Receiving Bank"), with no single Receiving Bank holding deposits of any single Customer in excess of the then-current FDIC standard maximum deposit insurance amount ("SMDIA"). It is our understanding that DDM program deposit accounts maintained at Receiving Banks are held in the name of "Stable Custody Group II, LLC as Agent for its Demand Deposit Marketplace Participating Banks as Agent for Demand Deposit Marketplace Customers and for others" ("Program Accounts").

Under the DDM program Terms and Conditions, it is our understanding that each Customer designates its Sending Bank to withdraw and deposit funds to or from DDM Program Accounts. We understand the DDM program's funds flow and process to be as follows. DDM program deposits originate in a Sending Bank and are allocated among Program Accounts at a number of Receiving Banks in a manner designed to provide maximum FDIC deposit insurance coverage to Customer deposits. The allocation of Customer deposits, to the extent possible, is based on a system of deposit reciprocity between the Sending Bank and the Receiving Banks (*e.g.*, a match of deposits on a dollar-for-dollar basis between Sending Banks and Receiving Banks) in order to contribute to a reliable source of deposits for both the Sending Banks and Receiving Banks. Specifically, on a manual or automated basis, any credit balances in a Customer's originating account (a non-Program account) held at a Sending Bank ("Originating Account") are swept into the Control/Operating Account at the Intermediary Bank on behalf of the Sending Bank. Based on the Receiving Bank allocation calculated by Stable, the funds are then transferred from the Intermediary Bank, per instructions from Stable and on behalf of the Sending Bank, to Program Accounts held at Receiving Banks in order to achieve the objective of providing FDIC deposit insurance coverage up to the maximum DDM Program deposit cap and, where applicable, reciprocity of Program deposits.

Funds, once swept from the Originating Account held at the Sending Bank, unless returned to the Originating Account, are held in FDIC-insured DDM Program Accounts at the Receiving Banks by Stable, on behalf of the Sending Bank, for the benefit of the Customers. We understand that Stable will maintain DDM program procedures to limit each individual Customer's interest in Program Accounts held at the Receiving Banks to below the SMDIA as defined in section 330.1(o) of the FDIC regulations.¹

Deposit of Municipal Funds

Pursuant to the Massachusetts General Laws, chapter 44, section 55, a city, town, district² or regional school district may have deposits in a bank, trust company or banking company as long as such deposits are below "an amount exceeding sixty per cent of the capital and surplus of such bank or trust company or banking company, unless satisfactory security is

¹ See 12 C.F.R. § 330.1(o). In the event a Customer's beneficial interest in the DDM Program Accounts held at the Receiving Banks exceeds the SMDIA when aggregated with funds held by the Customer in the Receiving Bank outside of the DDM program, the excess may not be insured. In addition, we understand that, because all funds flow through the Intermediary Bank when they are transferred to or from a Sending Bank or Receiving Bank, funds may be held in the Control/Operating Account at the Intermediary Bank on an intraday basis—between 9:00 AM and 2:30 PM eastern time—in amounts for an individual Customer in excess of the SMDIA. Such funds would only be held by the Intermediary Bank on an overnight basis in the rare event that an operational failure at Stable, the Intermediary Bank, or Fedwire would result in funds being transferred into the Control/Operating Account at the Intermediary Bank but not being able to be transferred out of that account. We believe that an operational failure of this type could result in funds deposited in a bank in excess of the SMDIA or in excess of available collateral under virtually any arrangement for the deposit of Customer funds.

² "District" means a "fire, water, sewer, water pollution abatement, refuse disposal, light, or improvement district, or any other district, howsoever named, formed for the purpose of carrying out any of the aforementioned functions, whether established under general law or special act." M.G.L.A. ch. 44 § 1.

given to it by such bank or trust company or banking company for such excess.”³ This section also provides that “[a] treasurer of a city, town, district or regional school district may invest . . . revenue⁴ cash . . . in term deposits or certificates of deposit, in trust companies, national banks, savings banks, banking companies or cooperative banks,” in addition to certain obligations and securities of the United States. Municipal deposits and investments are further regulated by chapter 44, section 55B of the Massachusetts General Laws, which provides that “[a]ll moneys held in the name of a city, town, district or regional school district or any other account under the jurisdiction of a city, town, district, or regional school district or officer thereof, which are not required to be kept liquid for purposes of distribution, shall be invested in such a manner as to require the payment of interest on the money at the highest possible rate reasonably available, taking account of safety liquidity and yield.” A separate statute provides for the deposit of municipal trust funds.⁵

Because the Program is designed to take advantage of the SMDIA, which is currently \$250,000,⁶ and the Program’s objective is to distribute a Customer’s funds such that no single Receiving Bank holds more than the SMDIA limit for any Customer, we do not believe any municipal funds in the DDM Program will exceed the sixty per cent of the capital and surplus limit in section 55. Section 55B also provides that, in depositing municipal funds, the municipality must consider safety, liquidity and yield. We note that DDM Program funds are insured by the FDIC and highly liquid. Accordingly, to the extent that Massachusetts local government funds deposited through the DDM program are offered competitive rates, we believe that the DDM Program should be a permissible investment for Massachusetts local government funds.

³ In addition, “[t]he treasurer of any city, town, district or regional school district shall not deposit funds for which he is accountable in any bank, trust company or banking company with which such treasurer is associated as an officer or employee or has been associated as an officer or employee at any time during the three years immediately preceding the date of any such deposit.”

⁴ “Revenue” means “receipts from (1) the exercise of governmental power of taxation and police control; (2) donations, gifts, grants and subvention for governmental use; (3) performing services for compensation and from the operation or management of productive enterprises, investments and properties of government. Receipts from the sale or disposal of capital assets, loans, refunds and various temporary transactions are in the nature of non-revenue.” M.G.L.A. ch. 44 § 1.

⁵ See M.G.L.A. ch. 44 § 54. A trust company, co-operative bank or savings bank, may accept municipal trust funds if it is “organized or exists under the laws of the commonwealth or any other state or may transact business in the commonwealth and has its main office or a branch office in the commonwealth.” Similarly, a national bank, federal savings bank or federal savings and loan association may accept deposits of municipal trust funds if it is authorized to “transact business and has its main office or a branch office in the commonwealth.” However, a state-chartered or federally-chartered bank that accepts municipal trust funds must be insured by the Federal Deposit Insurance Corporation or its successor unless it has certain other investments specified by the statute.

⁶ See 12 C.F.R. pt. 330. In-state deposits of government entities will be insured up to \$250,000 for the aggregate of all time and savings deposits per official custodians and, separately, up to \$250,000 for the aggregate of all demand deposits per custodian.

Deposit of County Funds

Under Massachusetts General Laws, chapter 35, section 10, “[a]ll monies held in the name of a county or a county retirement system, or any other account under the jurisdiction of a county government, or by a county officer, which are not required to be kept liquid for purposes of distribution for the thirty-day period next following, shall be invested in such a manner as to require the payment of interest on the money at the highest possible rate reasonably available. It shall be the fiduciary duty of all officers of a county government who control the investment of such funds to invest them prudently so as to accrue the highest amount of interest reasonably available on such funds.”

This authority is limited under Massachusetts General Laws, chapter 35, section 22, which provides that county treasurers and other county officials who have “more money in their hands than is required for immediate use” are required to deposit such money, “in their official names, in national banks or trust companies in the commonwealth or banking companies doing business in the commonwealth and qualified to receive demand deposits under the provisions of section six A of chapter one hundred and seventy-two A,⁷ at the best practicable interest rates. County treasurers may also deposit in time deposits in such national banks, trust companies or banking companies and invest in United States treasury bills.” Such county treasurers and other county officials are restricted from making such deposits with any institution “with which such treasurer or officer is associated as an officer or employee or has been associated as an officer or employee at any time during the preceding three years.”⁸

Under these provisions, it does not appear that Massachusetts county funds could be placed in the DDM Program to the extent that such funds would be deposited in Receiving Banks that are not doing business in Massachusetts. Additionally, because the language requiring county funds to be invested in such a manner as to require the payment of interest on the money at the “highest possible rate reasonably available” without any language requiring that safety be taken into account in evaluating the rate, the DDM Program might not satisfy the highest possible rate requirement under this section.

Deposit of State Government Funds

Under Massachusetts General Laws, chapter 29, section 34, “[s]tate officers, departments, institutions and other agencies may, with the written consent of the state treasurer, deposit a portion of the public monies in their possession in national banks, federal savings banks and federal savings and loan associations, lawfully doing business within the commonwealth, and in trust companies, savings banks and cooperative banks chartered under the laws of the commonwealth.” The Massachusetts state treasurer is required to publish a list of qualified

⁷ This provision was repealed in 2004. The relevant provision now appears to be M.G.L.A. ch. 167D § 3 (“A bank may receive demand, time and other types of deposits without limitation and upon such terms and conditions as may be agreed upon between the depositor and the bank.”).

⁸ M.G.L.A. ch. 35§ 22A.

banks at least once every 6 months.⁹ Under the provision, it does not appear that Massachusetts commonwealth funds could be placed into the DDM Program to the extent that such funds would be deposited in banks that are not on the list of qualified banks.

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We trust that this memorandum is responsive to your request. If we can be of additional assistance, please do not hesitate to contact Oliver Ireland at (202) 778-1614 or OIreland@mofocom or Amanda Mollo at (202) 778-1609 or AMollo@mofocom.

dc-822181

⁹ The most recent such list appears to be the one from October 2015:
<http://www.mass.gov/treasury/docs/cash/treasurer-bank-list-approved-10-22-2015.pdf>