

Legislative Analysis



CDARS INVESTMENTS: INCLUDE CREDIT UNIONS

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bills 4397 & 4398 as introduced
Sponsor: Rep. Jeff Mayes
Committee: Banking and Financial Services

First Analysis (3-16-09)

BRIEF SUMMARY: The bills would allow municipalities and school districts to invest in certificates of deposit issued by credit unions participating in programs such as CDARS.

FISCAL IMPACT: The bills would not immediately affect state revenue or expenditures, but could have a positive future impact on schools and local governments. A more detailed explanation follows in the analysis. See *FISCAL INFORMATION*.

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 in Michigan.

(The term "public corporation" means 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 \$250,000 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 \$250,000 cap. Known as CDARS, the program spreads an investor's funds among as many member institutions as necessary so that no more than \$250,000 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*.)

Public Acts 307 and 308 of 2008 allowed school districts, intermediate school districts, and public corporations to invest funds in certificates of deposit with financial institutions that participate in programs like the Certificate of Deposit Account Registry Service program, also known as CDARS.

Credit unions were not included in the 2008 legislation because they currently cannot participate in the CDARS system as their deposits are not insured by the FDIC. Instead, they are insured by the National Credit Union Administration (NCUA), which is also their federal regulator. However, CDARS may become open to participation by credit unions, or a parallel registry could be developed. If so, some feel state law should be changed now so that credit unions could be in position to accept deposits by municipalities and school districts and invest them in these higher yielding instruments.

THE CONTENT OF THE BILLS:

Public Acts 307 and 308 of 2008 allowed school districts, intermediate school districts, and public corporations to invest funds in certificates of deposit with financial institutions that participate in programs such as the Certificate of Deposit Account Registry Service program, also known as CDARS.

House Bills 4397 and 4398 would allow these entities to also invest in certificates of deposit issued by insured credit unions.]

House Bill 4397 would amend the Revised School Code (MCL 380.622 and 380.1223) to apply to school districts and intermediate school districts.

House Bill 4398 would amend Public Act 20 of 1943 (MCL 129.91) to address public corporations. The term "public corporation" means a county, city, village, township, port district, drainage district, special assessment district, or metropolitan district, or a board, commission, or another statutorily-created authority or agency.

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 \$250,000 (currently increased from the previous cap of \$100,000). A person with more than \$250,000 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, \$300,000 in a CD in an institution that is a member of the CDARS network, up to \$245,000 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 \$250,000 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 \$250,000 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:

The bills would have no fiscal impact on state revenue or expenditures. Additionally, the bills would have no immediate fiscal impact on school districts and other local units of government, as credit unions currently are not participating members of the Certificate of Deposit Account Registry Service (CDARS) program sponsored by the Promontory Interfinancial Network. The CDARS program sponsored by Promontory is, apparently, the only such program currently operating, and membership is currently limited to FDIC-insured financial institutions (banks).

However, to the extent that CDARS is expanded in the future to include credit unions or a similar program involving credit unions is established, the bills could have a positive fiscal impact on school districts and other local units of government. Allowing school districts and other local governments to invest in a CDARS-like program involving credit unions (separately from, or together with, other federally-insured financial institutions) would increase their investment flexibility and avoid the potential administrative costs of splitting investments among multiple institutions, while still insuring their investment through the NCUA.

ARGUMENTS:

For:

The bills would simply allow municipalities and school districts to invest funds with credit unions that participate in CDARS or a similar registry for credit unions should participation by credit unions be opened up in the future. Enactment of the legislation now, rather than waiting for credit unions to become eligible, would enable credit unions to offer school districts and local governments more investment options more quickly.

POSITIONS:

The Michigan Credit Union League supports the bills. (3-12-09)

The Michigan Department of Treasury is neutral on the bills. (3-12-09)

Legislative Analyst: Susan Stutzky
Fiscal Analyst: Mary Ann Cleary
Bethany Wicksall
Mark Wolf

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