Indiana Board for Depositories

<u>BFD Collateral Rules and Matrix Recommendations</u>
Tuesday November 10, 2020 at 10:00 a.m.
Virtual Special Board Meeting
One North Capitol 9th Floor, Indianapolis, IN

Proposed Changes to Collateralization Rules and Matrix

The goal of modifying the Indiana Board for Depositories' collateral system is to improve its capacity to address depository failure risk while balancing the risk of PDIF payments for depository failures and minimizing the collateralization requirements for depositories who do not pose a substantial risk of failure.

The proposed system relies upon Triggering and Terminating Events. It is intended to smooth the transition on and off of collateral for the majority of collateralizing depositories. As an example, the Triggering Event for transitioning from no collateral to the 50% collateral watch list requires two consecutive quarters of ratings above threshold to vest a requirement. This will afford most depositories at least one quarter's prior notice of a possible, future need to collateralize.

The other Triggering Events are designed to act as circuit breakers and automatically vest 100% collateralization requirements the following quarter. These ratings thresholds are designed to supplement the watch list structure to catch depositories whose condition is considered high risk regardless of how quickly the depository's rating declines.

All Triggering Events vest collateral requirements until a Terminating Event occurs. Terminating Events are a drop in a depository's ratings to another Collateral Class's rating thresholds for four (4) consecutive quarters. This means that a collateral requirement's minimum vesting period is one year.

The changes will also incorporate these standards into the body of the rules. The rules are being updated to clarify the information being collected during reporting and to include details on how that information needs to be presented.

Other changes being still being contemplated:

- Possibly create collateral requirements for balances in excess of specific amounts
    - E.g. public funds in excess of PDIF balance must be collateralized at 100%
    - Goal is to eliminate risk of a single failure event bankrupting the PDIF

Proposed Collateralization Matrix

Collateral Class	Collateral Basis	Bank Insight National Rating	FIS FedFIS Rating	Pledge or Pledge and Deliver
0%	N/A	N/A	N/A	N/A
50%	Average Daily Balance of Net Public Funds for the previous quarter	N/A	**$3.99 \leq n \geq 3.50$**	**Pledge**
100% (FedFIS)	Actual Daily Balance of Net Public Funds for previous day	N/A	**$n \geq 4.00$**	**Pledge and Deliver**
100% (Bank Insight)	Actual Daily Balance of Net Public Funds for previous day	**$0 \leq n \geq 10$**	N/A	**Pledge and Deliver**

<u>Collateralization Triggering Events</u>

- 100% Collateralization – any one (1) quarter
  - Bank Insight Rating ≤ 10; OR
  - FedFIS Rating ≥ 4.00
- 50% Collateralization – two (2) consecutive quarters
  - FedFIS Rating ≥ 3.50 and ≤ 3.99

<u>Collateralization Terminating Events</u>

- 100% to 50% – four (4) consecutive quarters
  - Bank Insight Rating > 10; AND
  - FedFIS Rating < 4.00 with any one (1) quarter or more with FedFIS Rating ≥ 3.50
- Any to 0% – four (4) consecutive quarters
  - Bank Insight Rating > 10; AND
  - FedFIS Rating < 3.50

Fourth Quarter (Oct – Dec) 2020 with the approved Matrix

- 100%: 5 Depositories, $244,224,044.00
- 50%: 1 Depositories, $0
- TOTAL: 6 Depositories, $244,224,044.00

Recommendation

The Collateral Rules Committee recommends:

(1) amending the Collateral Rules as presented in the draft rules; AND
(2) amending the Collateral Matrix to structure outlined in the draft matrix herein.

Action Needed

The Committee respectfully requests the Board approve the following resolution:

> RESOLVED, that the Board amend the Collateral Rules and Matrix to the structure outlined herein to more acutely address risk of failure, to diminish over-inclusion of depositories who do not pose a substantial or imminent risk of future failure, to create more transparency in the calculation of and rating used to create collateral requirements, and to provide more notice of the vesting of any collateral requirements, as recommended by staff.

Collateral Requirements at Quarter of Failure

Reviewed historical bank failures under Bank Insight National Rating and FedFIS Rating.

- 328 Total Failures back through 2010

	Ratings						Impact			
	Bank Insight		FedFIS Rating		Failure Levels		Collateralizers Q4 2020			
Collateral Rules	100%	50%	100%	50%	50%	Missed	100%	50%	Total	Amount
Historical	0-19	20-39	n/a	n/a	1	5	4	30	34	$ 2.8 billion
Historical (Ramps)	0-19	20-39	n/a	n/a	1	4	7	33	40	$ 4.1 billion
Cuspers	0-19	20-32, 33-39	n/a	> 3.25	1	5	4	17	21	$ 1.5 billion
Proposals	30	n/a	> 4.00	> 3.25	1	3	23	9	32	$ 2.0 billion
	20	n/a	> 4.00	> 3.25	1	3	8	9	17	$334 million
	20	n/a	> 4.00	> 3.50	1	3	8	1	9	$ 253 million
	10	n/a	> 4.00	> 3.25	1	3	5	10	15	$ 325 million
Recommended	**10**	**n/a**	**> 4.00**	**> 3.50**	**1**	**3**	**5**	**1**	**6**	**$244 million**
	10	n/a	> 4.25	> 3.50	1	4	5	1	6	$ 244 million
	10	n/a	> 4.25	> 3.25	1	4	5	10	15	$ 325 million

Updates to Collateral Rules
Executive Summary

(Comparing the 6/25/2020 version to the proposed 12/17/2020)

1. Adding Board discretion to accept other collateral in exigent circumstances.
2. Defining Matrix and incorporating the Matrix as an exhibit to the rules.
3. Including communications from the Board's electronic reporting system in the definition of Order.
4. Adding a reference to IC 5-13-4-7, the definition of deposit accounts, to further clarify what constitutes Public Funds on Deposit.
5. Eliminating provisions referencing the exemption of certificates of deposits placed prior to November 15, 2010.
6. Updating the verb tense of introductory sections.
7. Referencing Triggering Events and Terminating Events as thresholds for the Board's issuance of an Order establishing a Collateral Requirement.
8. Replacing Valuation Procedures section with a Daily Reporting section.
9. Clarifying that Daily Reporting figures reflect the totals from the close of the preceding Business Day.
10. Adding Board discretion to Deficiencies in collateral before triggering Default.
11. Adding Board discretion to revocation of a Defaulting Depository's approved status and mandating 100% collateralization of Public Funds on Deposit if approval is revoked.
12. Clarifying the information required to be reporting during Quarterly Reporting.
13. Technical corrections based on the edits above.

Updates as shown in the Red-Lined Version