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Statement of Position

Custodial Credit Risk: Certificates of Deposit Obtained Through a Placement Service

The Government Accounting Standards Board (GASB) regularly issues a Comprehensive Implementation Guide for the purpose of providing assistance to those implementing GASB Statements.¹ According to the answer to Question 1.30.17 of the current Comprehensive Implementation Guide (Guides Issued Through June, 30, 2014), GASB has determined that Certificates of Deposit (CDs) issued by a “deposit placement service” are not subject to “investment” custodial credit risk. Instead, such CDs should be analyzed in terms of exposure to “deposit” custodial credit risk.

Deposit custodial credit risk is eliminated if the CDs meet FDIC requirements so that FDIC insurance coverage flows through from the issuing bank to the owner of the CD. These FDIC requirements include documentation and disclosure requirements at the custodian and sub-custodian levels. For example, CDs purchased by banks through programs such as CDARS (the Certificate of Deposit Account Registry Service) are CDs purchased through a deposit placement service. Such CDs would therefore be subject to analysis to determine custodial credit risk.²

Any amount on deposit at a bank in excess of FDIC coverage will be exposed to custodial credit risk. For this reason, GASB’s Answer to Question 1.30.17 cautions that deposit custodial credit risk will occur for amounts placed with a local bank prior to the issuance of the “deposit placement” CDs and, also, if funds are not immediately withdrawn upon the maturity of these CDs.³

From the language used in the Answer to Question 1.30.17, it appears that GASB assumes only banks will be acting as deposit placement services for government entities. However, both banks and non-banks can act as deposit placement services. For instance, in the CDARS program, both banks and non-banks participate.

¹ The Guide is organized in a question-and-answer format.

² In 2003, based on information provided by Promontory Interfinancial Network, the FDIC issued an opinion that “pass-through” deposit insurance would be available to CDARS CDs: <http://www.fdic.gov/regulations/laws/rules/4000-10220.html>.

³ CDs are usually purchased in amounts that do not exceed FDIC deposit insurance. Currently, FDIC coverage provides \$250,000 for time/savings accounts and \$250,000 for demand accounts for governmental deposits held in banks located in the same state. For a discussion of current FDIC rules, see <http://www.auditor.state.mn.us/default.aspx?page=20110607.006>.

Reviewed: November 2013

2009-1006

Revised: November 2013

This Statement of Position is not legal advice and is subject to revision.

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A deposit placement service involving only a non-bank entity, Rate Search, failed in 2007, causing a Minnesota to city suffer a \$2.1 million loss. Clearly, the city's CDs held by Rate Search had been exposed to investment custodial credit risk.

Based on the language in the Answer to Question 1.30.17 (which references banks) and the loss of public funds in the state from a "deposit placement service" that was not a bank, we interpret the Answer to Question 1.30.17 as applying only to a bank acting as "deposit placement service." For a non-bank acting as "deposit placement service," we will apply the analysis applicable to investment custodial credit risk.

Government entities using a bank "deposit placement service" still need to be cautious. In addition to verifying compliance with FDIC requirements, public entities should take steps to ensure that all of the CDs they own from any one bank do not exceed FDIC coverage. Further, since investment in CDs is authorized by Minn. Stat. § 118A.04, subd. 5, public entities must comply with subdivision 9 of this statute and obtain a signed broker certification form from the deposit placement service that "transfers, purchases, sells, or obtains securities for or on behalf of, a government entity."