



TOWN OF NORTH EAST

Honorable Dereck E. Davis, Chair
Honorable Kathleen M. Dumais, Vice-Chair
Senate Finance Committee

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Support for H.B. 1489 Governmental Entities – Authorization to Bank With Credit Unions

The Town of North East is a municipality in Cecil County, incorporated in 1850 by the Maryland General Assembly, with a population of 3,632. We strongly support H.B. 1489 to allow local governments the discretion to deposit public funds in federally insured credit unions.

Currently, State law requires local governments to deposit public funds in a bank, trust company or savings bank, or a savings and loan association incorporated under the laws of the State or the United States. Missing from that authority is the ability to deposit funds in credit unions (Local Government Article 17-101).

As a public finance officer, my primary responsibility is to ensure the safety of public funds. In North East we have two commercial banks. One is a small local bank that has been under the supervision of the Federal Reserve and FDIC for not maintaining adequate balance sheet ratios and being in immediate risk of closure. That supervision has ended, however, the bank's call reports are still weak. So weak, in fact, that bank ratings websites which try to recreate FDIC and Federal Reserve stress tests cannot give the bank a rating as it falls below their minimum criteria. Additionally former members of its C-Suite are under indictment for federal bank fraud charges. This bank may in the future be a great bank for public funds, however at this point, it still has some work to do.

The other commercial bank in North East is a large national bank. This bank while currently financially strong routinely failed to properly collateralize Town deposits. The bank refused to collateralize deposits received electronically on the day they were received. This left the Town exposed to the risk that if the bank failed overnight, the Town would not be able to recoup those funds. Somedays, the uncollateralized balance was hundreds of thousands of dollars. This risk while remote, is unacceptable. It was also a violation of existing state statues and the Town's investment policy. No one should be putting public funds at risk of loss.

Many banks would say that the strength of the bank should not matter because the funds are collateralized. Collateralization is not always a perfect tool to ensure the safety of public funds. As in the

Town of North East

H.B. 1489 Governmental Entities – Authorization to Bank with Credit Unions

House Economic Matters Committee – 1:00 pm March 6, 2020

Page 2

case of the national bank in Town, the bank may not pledge collateral at the appropriate time. Another concern is that if the bank has not followed the federal law regarding collateralization to the letter, the FDIC can pierce the collateralization agreement and claw the pledged collateral back in the event of a bank failure. This would leave a local government with only \$250,000 in FDIC insurance, the rest of the balance would be lost. In the event that a bank were to fail and the collateralization was “perfected”, the local government would have to take possession of the collateral and then try to sell it to regain its funds, this might still result in a loss of principal depending on the type of collateral.

Both the strength of the financial institution and their collateralization policies are important to ensuring the safety of public funds.

In lieu of daily collateralization by a bank’s trust department, a bank could also pledge a block of collateral to be held by an independent third party in the government’s name. This ensures that the local government can manage its cash balances to keep them under a predetermined level. These agreements tend to be harder for the FDIC to pierce because there are fewer transactions to evaluate to make sure all the federal requirements have been met. This is the current collateralization structure the Town has with our existing bank. However, it is not an arrangement other banks were willing to entertain.

After discovering the collateralization issues with national bank in town, we solicited bids from all the banks in Cecil County. The larger banks all had a similar collateralization policy as the national bank in town. They would not commit to collateralizing deposits on the day they were received. We chose the bank we did because they offered a letter of credit or a block of collateral, as well as significantly lower fees.

With our current bank, I have to send a staff member out of the office for an hour each day just to make a deposit. This is an hour that they cannot spend helping residents of the Town with their concerns and issues. An hour that is not spent on Town priorities, or otherwise adding much value to the Town. While this arrangement is working currently, I’m not sure how much longer it will be sustainable. This bank recently closed a branch in the county and the branch we use is their only branch in the area, we are concerned they may close this branch in the future. Additionally, all the other commercial banks in the County are located the same distance away so switching banks would not help our situation, and as stated above, could expose the Town to the risk of an imperfect collateralization.

There are two federally insured credit unions only a couple of minutes from our offices and who are heavily invested in the town and surrounding area. These institutions are financially strong, could offer competitive fees for services, and potentially offer services/products more customized to our needs. However, because of the limitations of the existing statute we could not consider these institutions when soliciting bids for banking services.

I want to also be clear, if this legislation were to pass I am not saying that on October 1st we would move our accounts to a credit union. Our existing banking relationship is working well for us, for now. Also, the time, effort, and expense of changing financial institutions is significant and is not something that should be taken lightly.

Town of North East

H.B. 1489 Governmental Entities – Authorization to Bank with Credit Unions

House Economic Matters Committee – 1:00 pm March 6, 2020

Page 3

If changing financial institutions in the future were something the Town wanted to pursue, or investigate, we would issue an RFP to solicit services from all qualified institutions. As I tell the Mayor and Commissioners of the Town with every procurement, cheaper is not always better. Just because a credit union may quote a lower fee, does not guarantee they would be awarded the contract. Other issues that would be weighted more heavily than the fees would include the strength of the institution, history of financial problems, type of collateralization offered, commitment to the community, and what fits best into the Town's current operational structure.

Ultimately, where a local government conducts its banking is a local issue that is best decided by the stakeholders closest to the issues. Local governments should have the option of conducting business with financial institutions that are safe, and have a physical presence in the community.

Credit unions have been proven to be as safe or safer than commercial banks. Since they do not have a profit motive, or shareholders to answer to, these institutions do not take the same risks as commercial banks. The type of risks that lead to financial institutions failing. As I stated earlier, the safety of public dollars should be the primary concern of local officials, and the General Assembly. Allowing credit unions to be a depository of public funds does not run counter to that overarching concern. In fact, it may enhance the safety of public funds.

Thank you for this opportunity to submit written testimony on this important issue.