Protecting Public Deposits & Public Depositaries

The Public Deposit Protection Commission (PDPC) was created in 1969 to protect all public funds deposited in public depositaries (PDs) against loss as provided for in Chapter 39.58 Revised Code of Washington (RCW). Under RCW 39.58.40, the PDPC has power and broad administrative discretion to make and enforce regulations necessary to complete performance of its functions.

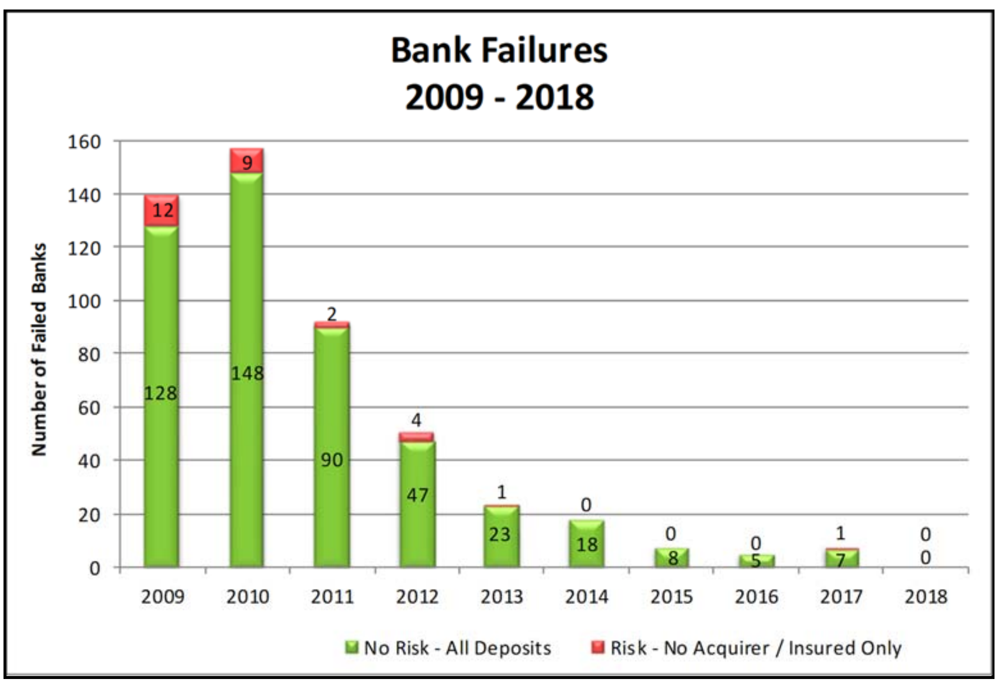
When it becomes clear a bank is failing, the government gives a bank 90 days to recapitalize itself or sell itself to another bank. If a bank is unable to do this, the Federal Deposit Insurance Corporation (FDIC) resolution process starts which entails the sale of the troubled bank's assets, deposits or both. The FDIC generally accepts the bid that is the least costly to its deposit insurance fund, which **may not** include the assumption of all deposits (i.e., insured and uninsured).

RCW 39.58.060 states that all PDs shall proportionately cover a public deposit loss that has occurred in a failed PD. Washington State had twenty-one (21) PDs fail from January 2009 through October 2015. All of those PDs had an acquiring institution. However, in one instance, the acquiring institution **only** assumed the <u>insured</u> deposits of the failed PD pursuant to its agreement with the FDIC.

As a result, other PDs were required to pay their pro-rata share of the $15.1 million in public funds on deposit that exceeded federal insurance and collateral pledged by the failed PD. To date, $7.8 million (52 percent) has been recovered and returned to PDs as the FDIC has sold assets of that failed PD.

In Washington, <u>the risk of other PDs covering a deposit loss does **not** occur when another PD simply fails. Potential risk happens when (1) a PD fails without an acquiring institution or (2) the acquiring institution does not assume all deposits through the FDIC's bid process</u>.

Historically, ninety-five (95) percent of PD failures in Washington did **not** result in risk to other PDs (i.e., 20 of 21), which is similar to the national average of ninety-four (94) percent. In the last ten (10) calendar years (2009-2018), 503 banks have failed. Of those failures, twenty-five (25) did not have an acquiring institution and four (4) did not include the acquisition of all deposits [See Chart Below].



Although the overwhelming majority of failed banks do **not** result in risk for other banks, the PDPC strives to ensure that a troubled PD pledges sufficient collateral to cover all uninsured public deposits in the event of its closure. RCW 39.58.040 allows the PDPC to require additional collateral or to restrict a PDs right to receive or hold public deposits if such actions are deemed necessary.

In response to the financial crisis (2009), the PDPC required all PDs to fully collateralize uninsured public deposits (i.e., 100 percent) to reduce / eliminate the likelihood of assessments as more PDs failed. In addition, the State Treasurer:

- Established a working relationship with the Washington State Department of Financial Institutions (DFI) recognizing the clear public interest and need for sharing information about the health of banks;
- Encouraged federal bank regulators to only accept bids from acquiring institutions that include the assumption of all deposits;
- Initiated a statewide outreach to county treasurers and other stakeholders to communicate the facts about the situation and identify issues of concern;
- Worked cooperatively with lawmakers to expeditiously put needed statutory changes in place;
- Updated rules and responsibilities for PDs;
- Enhanced monthly reporting of deposits, securities pledged (collateral), capitalization levels, loans and assets;
- Required semi-monthly reporting for the most challenged PDs, including depositor detail; and
- Monitored enforcement actions, call reports and ratings of PDs.

PDPC staff continue to use multiple sources to monitor the health of financial institutions and identify troubled banks as follows:

1. **Enforcement Actions (EA)** – Regulators issue Consent Orders, Orders to Cease and Desist, and Prompt Corrective Action Directives as a financial institutions condition deteriorates. PDPC staff monitor enforcement actions monthly to determine which financial institutions are operating under regulatory concern.

   In Washington, twenty (**20**) consecutive PDs received EA's prior to failure / closure [See Appendix A]. Seventeen (**17**) had been issued multiple EA's and eighteen (**18**) had received a Prompt Corrective Action Directive. The first PD that failed was closed by regulators due to extraordinary circumstances.

   On average, these twenty (**20**) PDs failed **405** days (or **13.3** months) after their regulator issued an EA. The minimum number of days for a PD to fail was **64**. As such, the PDPC had ample time to take appropriate action with these troubled PDs to securitize uninsured public deposits – thus eliminating risk to other PDs.

2. **Call Reports (CR)** – Banks are required to file CRs no later than 30 days after the end of each quarter. CRs contain information about a bank's income, assets, liabilities, deposits and changes in capital. PDPC staff review report data quarterly for insight regarding the health and welfare of PDs.

   In Washington, nineteen (**19**) consecutive PD's reported capitalization levels of Adequately Capitalized or worse prior to failure / closure [See Appendix A]. PDPC Resolution 2018-1 states that all PDs not categorized as Well Capitalized are required to fully collateralize uninsured public deposits. The first two PDs that failed were closed by regulators due to extraordinary circumstances.

On average, these nineteen (**19**) PDs failed **340** days (or **11.2** months) after reporting Adequately Capitalized or worse (i.e., nearly **one year** from the CR filing due date). The minimum number of days for a PD to fail was **97** from the report submission date. As such, the PDPC had ample time to take appropriate action with these troubled PDs to securitize uninsured public deposits – thus eliminating risk to other PDs.

3. **Ratings** – The PDPC subscribes to the services of a rating agency that publishes financial strength ratings for financial institutions. Their ratings measure the overall financial condition of an institution and its ability to meet its credit obligations. The highest rating (A) indicates strong financial condition while the lowest (E) identifies institutions likely to have financial problems. PDPC staff review ratings quarterly for insight regarding the health and welfare of PDs. Ratings are generally published within 100 days after quarter end.

   In Washington, all twenty-one (**21**) PDs had a rating of **C or worse** prior to failure / closure [See Appendix A]. Twenty (**20**) consecutive PDs had an **E** rating. The first PD that failed was closed by regulators due to extraordinary circumstances.

   On average, these twenty (**20**) PDs failed after six (**6**) consecutive quarters with an **E** rating (i.e., **1 ½ years**). The minimum number of quarters for a PD to fail was three (**3**) consecutive with an **E** rating.

   Furthermore, nineteen (**19**) PDs were also deemed as “Institutions of Concern” by the rating agency [See Appendix A]. As such, the PDPC had ample time to take appropriate action with these troubled PDs to securitize uninsured public deposits – thus eliminating risk to other PDs.

4. **Banking Regulators** – Bank regulators, such as the DFI, have extensive knowledge regarding the financial condition of banks that may not be available from other sources. It’s extremely important to establish communication protocols with regulators that allow for the mutual sharing of information with respect to the safety and soundness of PDs.

   In 2009, public deposit protection laws were revised to allow state and federal regulators to make information and data available to the PDPC with confidentiality protections. In addition, the State Treasurer and DFI Director executed a Memorandum of Understanding (MOU) providing for the communication and sharing of information related to any existing PDs of concern, and any threats of potential loss involving a PD.

   Throughout the financial crisis OST staff, on behalf of the PDPC, met regularly with DFI. Staff received valuable insight from banking regulators on various PDs, including all twenty (**20**) of the banks that failed after state laws were modernized and the MOU was established [See Appendix A]. The first PD that failed was closed by regulators prior to these initiatives.

The PDPC’s first and foremost responsibility is to ensure the protection of all public funds. That objective has been achieved without threatening the viability of any of Washington’s PDs.

APPENDIX A
SUMMARY OF FAILED PUBLIC DEPOSITARIES

		RISK		PRIOR TO FAILURE				
	Failed Bank	Successor Bank	Bid = All Deposits	Enforcement Action	Below Well-Capitalized	Rating (≤ C)	Institution of Concern	Regulator Insight
1	Bank of Clark County	Yes	No	No	No	Yes	No	No
2	Westsound Bank	Yes	Yes	Yes	No	Yes	Yes	Yes
3	Venture Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
4	United Commercial Bank	Yes	Yes	Yes	Yes	Yes	No	Yes
5	Horizon Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
6	Evergreen Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
7	Columbia River Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
8	American Marine Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
9	Rainier Pacific Savings Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
10	City Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
11	Frontier Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
12	Washington First International Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
13	Cowlitz Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
14	North County Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
15	Shoreline Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
16	Pierce Commercial Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
17	Summit Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
18	First Heritage Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
19	Bank of Whitman	Yes	Yes	Yes	Yes	Yes	Yes	Yes
20	Westside Community Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes
21	HomeTown National Bank	Yes	Yes	Yes	Yes	Yes	Yes	Yes