



City Deposits and Investments

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I. Introduction

The purpose of this memo is to give an overview of the deposit and investment laws as they pertain to cities. However, this memo does not apply to investments of retirement plans or relief association pension funds. The scope of permitted investments for these entities is typically broader than those for cities in general. For further information on investments of pension funds, contact the League or the state auditor.

[Minn. Stat. Ch. 118A](#)

The deposit and investment laws were recodified in 1996 and became effective Jan. 1, 1997. While the 1996 law was designed to apply to all cities, there are also some older laws with requirements that may need to be considered. Where the 1996 law is mentioned, it refers to the statutes that were codified in Minn. Stat. Ch. 118A.

Home rule charter cities may also need to consider the individual requirements of their charter provisions.

II. Deposits

A. General authority for deposits

Virtually all government entities, including cities, have authority to safely deposit funds in a variety of financial institutions.

1. Designating a depository

[Minn. Stat. § 118A.02, subd. 1](#)

All city councils must designate one or more financial institutions as a depository of city funds. Typically, this is done on an annual basis, though, there is no general requirement for annual designation. A city may also change its depository at any time during the year.

a. Types of depositories

[Minn. Stat. § 118A.01, subd. 3](#)

Cities may designate one or more of the following types of financial institutions as a depository of public funds:

- Savings associations
- Commercial banks
- Trust companies
- Credit unions
- Industrial loan and thrift companies

NOTE: Cities that have checking accounts through the 4M Fund will need to designate the bank where the checking account is located as a depository.

[Minn. Stat. § 427.01](#)

The above general requirements apply to all cities. But home rule charter cities with populations below 10,000 and all statutory cities may be more limited in their choices of a depository. An older statute states these cities must choose “national, state, or private banks” as depositories

[Minn. Stat. § 118A.08](#)

The requirements of the older statute may need to be considered because the 1996 law contains language that says it will not supersede any already existing laws. However, a more liberal interpretation can also be given, namely that the 1996 law offers supplemental authority for additional depository selections.

[Minn. Stat. § 469.052](#)

[Minn. Stat. § 469.099](#)

A similar concern exists for the biannual depository designation of a port authority or economic development authority (EDA). A narrow interpretation suggests that these entities would be limited to designating a national or state bank within Minnesota as a depository.

[Minn. Stat. § 118A.01, subd. 3](#)

Again, the 1996 law might be given a more liberal interpretation. It is at least arguable that the 1996 law gives a port authority and EDA supplemental authority to select from the other types of financial institutions listed under the more general rule.

b. How designated

[Minn. Stat. § 427.01](#)

See Part IV. Model resolution designating depository.

Although not explicitly required for most cities, depositories are usually designated by council resolution. And the designations *must* be made by a council resolution if it is a statutory city or fourth class home rule charter city. The resolution must state the terms and conditions of deposit and be filed with the city clerk.

In situations where the treasurer has been delegated the responsibility for designating the depository, it may not be possible to designate the depository by council resolution.

c. When designated

[Minn. Stat. § 427.01](#)

[Minn. Stat. § 427.02](#)

Many cities annually redesignate their depositories at the first council meeting of the new year. There is no specific requirement that a city designate its depositories on an annual basis. Although an argument can be made that an annual designation is required for statutory cities and some home rule charter cities, it is not specifically required.

[Minn. Stat. § 469.052, subd. 1](#)

[Minn. Stat. § 469.099, subd. 1](#)

Every two years, port authorities and EDAs must name depositories. There does not appear to be anything that prohibits these entities from designating new depositories or changing to different depositories at other times.

Home rule charter cities may have additional requirements in their charters.

d. Delegation

Minn. Stat. § 118A.02, subd. 1

The governing body may authorize the treasurer or chief financial officer to designate the depositories of the funds, make investments of funds authorized by law such as sections 118A.01-.06, or both. Although not specifically required by statute, such authorization is usually done by resolution.

e. Other considerations in choice of depository

Minn. Stat. § 471.88, subd. 2

See League information memo
Official Conflict of Interest

A bank or savings association may be designated as a depository even if one of the councilmembers has a financial interest in it. However, the designation must be by unanimous vote of the council, and the councilmember must disclose his or her interest in the official city council minutes before the depository is designated. The interested member should also abstain from discussing and voting on the matter.

A.G. Op. 140-c-7 (November 7, 1951)

Interest rates are an important consideration. An older attorney general opinion states that “good business judgment” dictates a city should secure the highest rate of interest offered. And while competitive bidding is not required to choose a depository, the attorney general has opined that if competitive bidding is used, the city is obligated to accept the bid offering the highest interest rate for the deposit.

A.G. Op. 140-b-6 (January 22, 1963); A.G. Op. 140-b-6 (March 8, 1965)

f. Failure to designate

Minn. Stat. § 427.09

If the council of a statutory city or a fourth class home rule charter city fails to designate a depository within 30 days after the beginning of the fiscal year, the treasurer *must* select a depository. The treasurer may select up to four depositories. There is no general rule for other public entities concerning the failure to designate depositories.

2. Liability for deposits

Minn. Stat. § 118A.02, subd. 2

Neither the city treasurer, chief financial officer, nor any other official responsible for the custody of funds will be personally liable for any loss sustained from deposits or investments that are made in accordance with applicable law.

Minn. Stat. § 427.03

Minn. Stat. § 427.10

An older statute states that city treasurers of statutory cities or fourth class home rule charter cities are exempt from all liability for the loss of any funds deposited in accordance with Minn. Stat. §§ 427.02-.07 if the loss is caused by the failure, bankruptcy, or any other act of default of the depository. Likewise, the treasurer is not liable for the loss of money while deposited within the specified limits occasioned by the closing or insolvency of a designated depository unless the treasurer is negligent.

[Minn. Stat. § 427.04](#)

However, if a statutory or fourth class home rule charter city council fails to designate a depository, it does not relieve the treasurer or the sureties of the treasurer's bond from liability for the deposit.

[Minn. Stat. § 469.052, subd. 2](#)

[Minn. Stat. § 469.099, subd. 3](#)

When a port authority or EDA treasurer deposits the authority's funds in a bonded depository, the treasurer and the surety on the treasurer's official bond are exempt from liability for the loss of deposits because of the failure, bankruptcy, or any other act or default of the depository.

B. FDIC insured deposits

1. Generally

[12 U.S.C. § 1821\(a\)\(1\)](#)

[12 U.S.C. § 1813\(l\)](#)

[12 C.F.R. Part 330](#)

Deposits received at a bank insured by the Federal Deposit Insurance Corporation (FDIC) are insured dollar-for-dollar for each depositor up to a coverage limit. The insurance covers principal and any accrued interest through the date of the insured bank's closing.

Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 136 (2008); Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 204(a) (2009).

In October 2008 and again in May 2009, Congress enacted a temporary increase in the coverage limit from \$100,000 to \$250,000. ***The coverage limit is currently scheduled to return to \$100,000 after December 31, 2013.***

[FDIC Deposit Insurance Coverage \(www.fdic.gov\)](#)

Check banks for FDIC coverage at ([Bank Find](#)) or (877) 275-3342

See FDIC publication [Your Insured Deposits](#)

FDIC insurance covers deposits in checking and savings accounts, money market deposit accounts, and time deposits such as certificates of deposit (CDs). However, some banks are not covered by FDIC insurance. Cities should be certain of whether or not a deposit will be FDIC-insured before making a deposit. Any amounts that are not covered by the FDIC must be protected by the financial institution posting a bond or collateral.

[12 C.F.R. § 330.15\(a\)\(2\)](#)

See FDIC factsheet "[Deposit Insurance for Accounts Held by Government Depositors](#)"

Accounts of a political subdivision that are in a FDIC member bank will be separately insured in the following amounts:

- Up to \$250,000 total for all time and savings deposits and,
- Up to \$250,000 total for all demand deposits.

[12 C.F.R. § 330.15\(a\)\(2\)](#)

In addition to these limits, deposits in an insured institution outside of the state in which the city is located are insured up to \$250,000. But this amount is the total for all out-of-state deposits that are kept at the same financial institution or a branch of the same institution, whether the deposits are time and savings deposits or demand deposits.

For example, a city could have a non-interest bearing checking account with \$250,000 in it and a time and savings deposit account with \$250,000 in it at the same bank. Both accounts would be insured by the FDIC for their respective amounts if the bank is located in Minnesota. In addition, the city could put another \$250,000 in a bank that is a branch of the same institution if it is outside of Minnesota, and this would also be covered by the FDIC. But if the city chose to reverse the situation and keep both the checking account and the time and savings account in a bank outside of Minnesota, the two accounts would *not* be separately guaranteed.

12 U.S.C. § 1821(a)(1)(B) and (C)

Generally, the maximum amount of FDIC coverage is \$250,000 per depositor, not per separate account. Cities should also be careful regarding the aggregate limits as they apply to banks that are part of the same financial institution. Simply putting money in accounts at separate banks will not give additional FDIC coverage if the banks are part of the same financial institution.

Minn. Stat. § 118A.03

Minn. Stat. § 427.01

See Part II-C. Collateral.

Amounts on deposit at the close of the financial institution's banking day in excess of the \$250,000 insurance limit must be protected by collateral or a corporate surety bond for all cities. If the institution is a nonmember bank (not covered by FDIC insurance), a city must get collateral or a corporate surety bond even if the deposit is less than \$250,000.

2. Common questions

There are several questions that often arise when considering whether a deposit will be covered by FDIC insurance. Some of the more common ones are discussed below.

a. Separate department funds

12 U.S.C. § 1821(a)(1)(B), (C), and (D)

Generally, all statutory city funds will be controlled by the city council. Different funds would not be eligible for separate FDIC insurance coverage simply because the funds are kept in separate accounts. Thus, if a city has a special account for its municipal liquor store, an account for the police department, and an account for the general fund, these accounts would be totaled together if kept at the same financial institution. If the total amount exceeded \$250,000, this excess would not be covered by the FDIC. In short, putting money in separate accounts within the same bank is *not* a way to get around the aggregated limit.

Likewise, if separate accounts were kept in a different bank that is part of the same financial institution, these accounts would be combined into a total amount that would be covered by FDIC insurance only up to \$250,000. In short, the \$250,000 limit of FDIC coverage is calculated based on the amount per depositor at the same financial institution (or a branch that is owned by them).

Separate FDIC coverage may be available to a home rule charter city if it has a charter provision that gives the control of different funds to different individuals. However, cities in this type of situation should verify the amount of FDIC coverage on a deposit before making such a deposit. Incorrectly assuming a deposit will not be subject to the aggregate limits just because another city officer is in charge of the deposit could prove costly if a depository should fail and the FDIC denies the additional amount of insurance. The state auditor routinely checks to see that cities have the proper bond or collateral protection for their money.

b. Insurance on interest amounts

12 C.F.R. § 330.3(i)
Minn. Stat. § 118A.03
Minn. Stat. § 427.01

FDIC regulations state that, in general, a deposit includes the balance of the principal and interest credited to an account plus the amount of interest accrued to date. Therefore, the interest earned on a deposit until and through the day an insured bank defaults would be included as part of the FDIC insured amount. However, if the interest causes the total amount to exceed the \$250,000 total limit, any amounts above this would not be covered.

See Part II-C. Collateral.

Amounts on deposit at the end of a banking day in excess of the \$250,000 insurance limit must be protected by collateral or a corporate surety bond. But unlike the FDIC insured amount, which includes both credited interest and interest accrued through the day of an insured bank's default, the amount of collateral necessary to cover amounts over and above the insured deposit is calculated looking only at credited interest.

To ensure this protection is in place, many \$250,000 certificates of deposit (CDs) can be purchased at a discount so that the insured limit will not be exceeded. Note, however, the FDIC insures the original purchase price of the discounted CD plus the amount of accrued earnings.

12 C.F.R. § 330.3(i)(2)

c. Pension plan funds

12 U.S.C. § 1821(a)(3)
12 C.F.R. § 330.14

Although pension plan deposits and investments are not within the scope of this memo, there are some exceptions to the FDIC coverage limits that should be mentioned. Certain types of retirement funds have FDIC coverage up to \$250,000 for each trustee or beneficiary. (This coverage amount will not revert to \$100,000 in 2010.) This "pass-through" coverage means employers that offer certain types of retirement savings plans will be able to have FDIC coverage for up to \$250,000 for each beneficiary. The following types of retirement accounts are eligible for this type of FDIC coverage:

26 U.S.C. § 408(a)

- Qualified individual retirement accounts (IRAs);
- Qualified 457-deferred compensation plans for state and local governments;

26 U.S.C. § 457

26 U.S.C. § 401(d)

- Qualified trusts forming part of a pension or profit-sharing plan that benefits self-employed individuals (Keogh plans);

29 U.S.C. § 1002(34)

- Individual accounts or defined contribution pension plans that provide individual accounts for each participant and for benefits based solely upon the amounts contributed to the particular account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account (including 401(k) plans).

Some of the above exceptions have limited application to Minnesota cities. And, although one might argue that some of these apply to a volunteer firefighters' relief association, it is unclear whether or not a firefighters' relief pension plan would be eligible for this type of "pass-through" coverage. Depositors of these funds should check carefully to ensure their plans will be eligible before depositing an amount in excess of \$250,000. At the same time, as a practical matter, most retirement funds are invested rather than deposited to ensure greater returns for the beneficiaries.

C. Collateral

Minn. Stat. § 118A.03, subd. 1

If the funds on deposit at the close of a financial institution's banking day exceed the FDIC coverage limit amount, a city must require the financial institution to furnish either a corporate surety bond executed by a company authorized to do business in the state or collateral security.

Minn. Stat. § 118A.03, subd. 1
12 C.F.R. § 229.2(f)

Minn. Stat. § 336.4-108

"Banking day" is defined as that part of any business day in which an office of a bank is open to the public for carrying on substantially all of its banking functions. The banking day ends at "cutoff," an hour of 2 p.m. or later set by the bank as a final hour for the handling of money and items and the making of entries in its books. Items or deposits received after the bank's cutoff hour may be treated by the bank as being received at the opening of the next business day.

Minn. Stat. § 118A.03, subd. 3

The total amount of the collateral computed at its market value must be at least 10 percent more than the amount on deposit at the close of the financial institution's banking day, except when the collateral is irrevocable standby letters of credit issued by Federal Home Loan Banks. In that case, the amount of collateral must at least equal the amount on deposit at the close of the financial institution's banking day. The financial institution may furnish both a surety bond and collateral aggregating the required amount.

Minn. Stat. § 427.01

Under the older statute, statutory cities and fourth class home rule charter cities have special collateral requirements. The financial institution must provide a bond to these cities in at least double the amount of the deposit if the deposit is neither FDIC insured, nor protected by collateral or corporate surety bond under Minn. Stat. § 118A.03.

Minn. Stat. § 118A.03, subd. 1

While some banks are not FDIC insured, most are covered by FDIC insurance. But again, deposited amounts in excess of the \$250,000 insurance limit must be protected by collateral or a corporate surety bond.

Minn. Stat. § 469.052, subd. 1

Note that all funds belonging to a port authority or EDA must be bonded or collateralized, regardless of whether deposit insurance applies.

Minn. Stat. § 469.099, subd. 1

1. Ensuring the city will receive the collateral

If collateral is required from one depository, the collateral is held by a second unrelated depository. If the first depository fails, then the city doesn't have a right to the collateral unless it has "perfected its interest in the pledge of collateral."

12 U.S.C. § 1823(e)(1)

Generally, the following steps must be taken to perfect a security interest in pledged collateral under federal law:

- The assignment must be in writing;
- The assignment must have been executed at the same time the deposit was received by the depository;
- The assignment must have been approved by the depository's board of directors or loan committee, and the approval must be reflected in the minutes of the board or committee; and
- The assignment must have been continuously, from the time of its execution, an official record of the depository.

North Ark. Med. Ctr. v. Barrett,
962 F.2d 780 (8th Cir. 1992).

In 1992, a federal court awarded a public depositor's collateral to the FDIC because the interest in the collateral was not perfected by following those steps. This prompted Congress to amend federal law to provide an exemption from some of these requirements for public deposits. The current law says an agreement to provide for collateralization of a city's deposit will not be deemed invalid solely because the agreement was not executed at the same time the collateral was acquired. Nor will the agreement be invalid because of pledges, delivery, or substitution of the collateral made in accordance with such agreement.

12 U.S.C. § 1823(e)(2)

2. Securities that may be pledged as collateral

See Part III for a detailed description of these instruments.

The following forms of securities collateral are allowed in lieu of a corporate surety bond:

- United States government treasury bills, treasury notes, and treasury bonds;

Minn. Stat. § 118A.03, subd. 2(1)

Minn. Stat. § 118A.03, subd. 2(2)

- Issues of U.S. government agencies and instrumentalities as quoted by a recognized industry quotation service available to the government entity;

Minn. Stat. § 118A.03, subd. 2(3)

- General obligation securities of any state or local government with taxing powers which is rated A or better by a national bond rating service, or revenue securities of any state or local government which is rated AA or better by a national bond rating service;

Minn. Stat. § 118A.03, subd. 2(4)

- General obligation securities of a local government with taxing powers may be pledged as collateral against funds deposited by that same local government entity;

Minn. Stat. § 118A.03, subd. 2(5)

- Irrevocable standby letters of credit issued by Federal Home Loan Banks to a municipality accompanied by written evidence that the bank's public debt is rated AA or better by Moody's Investor's Service, Inc., or Standard & Poor's Corporation;

Minn. Stat. § 118A.03, subd. 2(6)

- Time deposits that are fully insured by any federal agency

United States treasuries and government agencies are most common. These instruments are usually preferred because they are liquid, safe, and easily traded.

3. Assignment of collateral

Minn. Stat. § 118A.03, subd. 4

Any collateral that is pledged must be accompanied by a written assignment to the city from the financial institution. The assignment must state that, upon default, the financial institution must release to the city on demand, free of exchange or any other charges, the pledged collateral.

Minn. Stat. § 118A.03, subd. 4

Interest earned on assigned collateral will be remitted to the financial institution as long as it is not in default. The city may sell the collateral to recover the amount due. Any surplus from the collateral must be paid to the financial institutions, its assigns, or both.

4. Excess collateral

Minn. Stat. § 118A.03, subd. 5

A financial institution may withdraw excess collateral or substitute other collateral after giving written notice to the governmental entity and receiving confirmation. The authority to return any delivered and assigned collateral rests with the government entity.

5. Default of financial institution

Minn. Stat. § 118A.03, subd. 6

Default of a financial institution includes, but is not limited to, any of the following:

- Failure to make interest payments when due;

- Failure to promptly deliver upon demand all money on deposit (less any early withdrawal penalty that may be required in connection with the withdrawal of a time deposit); or
- Closure of a depository.

See *North Ark. Med. Ctr. v. Barrett*, 962 F.2d 780 (8th Cir. 1992), mentioned above.

If a financial institution closes, all deposits are immediately due and payable. However, it is not a default to require prior notice of withdrawal if such notice is required as a condition of withdrawal by federal law or regulation.

[Minn. Stat. § 118A.03, subd. 4](#)

Interest earned on assigned collateral will be remitted to the financial institution as long as it is not in default. The city may sell the collateral to recover the amount due. Any surplus from the collateral must be paid to the financial institutions, its assigns, or both.

6. Safekeeping collateral

[Minn. Stat. § 118A.03, subd. 7](#)

All collateral must be placed in safekeeping. The city council must approve the selection. The council may select from among the following places to keep the collateral:

- A restricted account at a Federal Reserve Bank, or
- An account at a trust department of a commercial bank or other financial institution that is *not* owned or controlled by the financial institution furnishing the collateral.

Some representatives of financial institutions maintain they do not own or control other branches of the same institution. Cities should not assume that placing collateral in a different branch of the same bank would be appropriate.

7. GASB considerations

See [Facts about GASB](#).

See the [State Auditor's factsheet on GASB Statement 34](#).

[Minn. Stat. § 6.47](#)

The Government Accounting and Standards Board (GASB) is an independent organization that establishes standards of accounting and financial reporting for local governments. The state auditor regards GASB as the “acknowledged authoritative body in setting generally accepted accounting principles (GAAP) for local and state agencies.” And, since the state auditor prescribes suitable systems of accounts and budgeting for all cities, the statements promulgated by GASB require some attention.

GASB Statement No. 40
See State Auditor's Statement of
Position on Custodial Credit
Risk.

See Part V. Outline of an
investment policy.

According to the state auditor, GASB Statement No. 40 requires notes to financial statements to disclose a public entity's investment policy provision regarding custodial credit risk and the extent to which city deposits are exposed to custodial credit risk. Compliance with Minnesota Statutes eliminates custodial credit risk for deposits, but the state auditor still recommends language for a city investment policy. The auditor's recommended language is included in the investment policy outline at the end of this memo.

III. Investments

Many cities invest idle funds in order to gain the best returns from their money. Generally, investments see higher returns than the amount of interest normally given on deposits. Although the primary goal should always be to safeguard the principal, another goal is to achieve returns that keep up with inflation and provide a market rate of return. Given high enough returns, the city can actually make a profit. However, higher returns often mean greater risks.

A. Authority for investments

Minn. Stat. § 118A.04, subd. 1

Any public funds may be invested if not needed for other purposes or restricted for other purposes. Such investments are subject to certain conditions, depending upon the instrument that is used.

B. Broker's annual notification and certification

Minn. Stat. § 118A.04, subd. 9(b)

Cities must annually give all brokers a written statement of investment restrictions and notification that all future investments are to be made in accordance with Minnesota statutes governing the investments of public funds. The broker must also annually acknowledge the receipt of the investment restrictions.

Minn. Stat. § 118A.04, subd. 9(c)

Minn. Stat. § 118A.04, subd. 9

A "broker" includes any broker, broker-dealer, or agent of a government entity who transfers, purchases, sells, or obtains securities for or on behalf of a government entity.

State Auditor's Broker
Notification Form

A city cannot enter into a transaction with a broker until the form has been completed by the broker and returned to the city. The state auditor is responsible for preparing this notification form.

C. Permitted investments

Cities are authorized to invest in a number of different types of investments. Many of these instruments must meet certain criteria, which are discussed in detail in the following sections.

1. United States government securities

[Minn. Stat. § 118A.04, subd. 2](#)

Cities may invest public funds in the following direct debt issues of the federal government:

- Government bonds;
- Notes;
- Bills;
- Mortgages (except for high-risk mortgage-backed securities);
- Other securities that are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress.

By implication, a certificate of deposit secured by a letter of credit from a home loan bank is *not* permitted as a direct investment.

2. State and local municipal securities

[Minn. Stat. § 118A.04, subd. 3](#)

Cities may invest funds in the following types of state and local securities:

- A general obligation of any state or local government with taxing powers, which is rated A or better by a national bond rating service;
- A revenue obligation of any state or local government with taxing powers, which is rated AA or better by a national bond rating service;
- A general obligation of the Minnesota Housing Finance Agency which is a moral obligation of the state of Minnesota and is rated A or better by a national bond rating agency.

3. Commercial paper

[Minn. Stat. § 118A.04, subd. 4](#)

Essentially short-term unsecured promissory notes, commercial paper is usually issued by corporations. Cities may invest in commercial paper issued by U.S. corporations or their Canadian subsidiaries. These must be rated in the highest quality category by at least two nationally recognized rating agencies and must mature in 270 days or less.

4. Time deposits

Minn. Stat. § 118A.04, subd. 5
See Part II. Deposits.

Time deposits include savings accounts or certificates of deposits that are made for a fixed term but can be withdrawn early with notice. Funds may be invested in time deposits that are fully insured by the FDIC or in bankers acceptances of United States banks.

Minn. Stat. § 118A.04, subd. 2

As noted previously, a certificate of deposit secured by a letter of credit from a home loan bank is not permitted as a direct investment.

5. Temporary general obligation bonds

Minn. Stat. § 118A.04, subd. 7

These are temporary bonds that are guaranteed by the full faith and credit of a public entity. Cities may invest funds in general obligation temporary bonds of the same governmental entity issued under certain statutes. This includes the following types of bonds:

Minn. Stat. § 429.091, subd. 7

- General obligation temporary improvement bonds;

Minn. Stat. § 469.178, subd. 5

- Temporary bonds issued for tax increment financing economic development purposes that mature within three years. These bonds must have been issued in anticipation of the issuance of other types of bonds. These other types of bonds include general obligation bonds of a city. Also included are revenue bonds and general obligation bonds of an EDA, HRA, port authority, and other similar entities;

Minn. Stat. § 475.61, subd. 6

- Temporary obligations issued for any lawful purpose that mature in three years or less. These bonds must have been issued in anticipation of the issuance of permanent obligations.

6. Debt service funds

Minn. Stat. § 118A.04, subd. 8

Money held in a debt service fund may be used to purchase general or special obligations of an issue that is payable from the fund. The price may include a premium. Alternatively, debt service funds may be used to redeem any obligation of such issue prior to maturity in accordance with its terms. The securities representing this type of investment may be sold by the city at any time, but the money received must remain part of the fund until used for the purpose for which the fund was created. Any obligation held in a debt service fund from which it is payable may be canceled at any time unless prohibited by a resolution or other instrument securing obligations payable from the fund.

D. Permitted investment contracts and agreements

Cities may enter some types of investment contracts and agreements. These include certain types of repurchase agreements, reverse repurchase agreements, securities lending agreements, Minnesota joint powers investment trusts, and guaranteed investment contracts. Certain criteria must be met in order to use these instruments.

1. Repurchase agreements

A repurchase agreement is the sale of a government security by a banker or dealer who agrees to buy it back later. An investor who buys the security is paid interest for the time he or she holds the security. The security usually does not reach its maturity date until after the bank or dealer repurchases the security.

[Minn. Stat. § 118A.05, subd. 2](#)
[Minn. Stat. § 118A.04](#)

Repurchase agreements may be entered into if they consist of collateral that is allowed as a direct city investment. The agreement can only be made with one of the following entities:

- A financial institution qualified as a city depository;
- A financial institution which is a member of the Federal Reserve System and whose combined capital and surplus is \$10,000,000 or more;
- A primary reporting dealer in United States government securities to the Federal Reserve Bank of New York; or
- A securities broker-dealer licensed pursuant to chapter 80A, or an affiliate of it, regulated by the Securities and Exchange Commission (SEC) and maintaining a combined capital and surplus of \$40,000,000 or more exclusive of subordinate debt.

2. Reverse repurchase agreements

[Minn. Stat. § 118A.05, subd. 2](#)

A reverse repurchase agreement is very similar to a repurchase agreement. But with a reverse repurchase agreement, the city is the one selling the government security to the bank or dealer and buying it back later. Reverse repurchase agreements are often used to make cash available without suffering a penalty for early withdrawal of the investment. Reverse repurchase agreements may only be made with the entities that are permitted to make repurchase agreements with cities (see previous section).

A reverse repurchase agreement may only be entered into for a period of 90 days or less and only to meet short-term cash flow needs. In no case may the proceeds from a reverse repurchase agreement be used for investments except for securities lending agreements.

3. Securities lending agreements

Minn. Stat. § 118A.05, subd. 3

Securities lending agreements are similar to reverse repurchase agreements. For example, a securities lending agreement may provide the city's securities held by a bank to be "loaned" to a third party. The third party then provides cash or securities to the bank to collateralize the loan, and the city and bank split the interest received on the loan.

Securities lending agreements may be entered into with a financial institution that has its principle executive office in Minnesota and is either of the following:

Minn. Stat. § 118A.05, subd. 2(1)

- A financial institution qualified as a "depository" of public funds of the government entity, or

Minn. Stat. § 118A.05, subd. 2(2)

- A member of the Federal Reserve System with combined capital and surplus equal to at least \$10,000,000.

Minn. Stat. § 118A.05, subds. 2, 3

Securities lending transactions may also be entered into with the same type of entities that can make repurchase agreements and reverse repurchase agreements with cities.

Minn. Stat. § 118A.05

Minn. Stat. § 118A.04

Again, any collateral instruments must meet the same criteria that must be met to be a direct city investment. The collateral for securities lending agreements are, therefore, restricted to the following types of securities:

- Repurchase agreements,
- Reverse repurchase agreements,
- Other securities lending agreements,
- Minnesota joint powers investment trusts,
- Guaranteed investment contracts,
- U.S. securities,
- State and local securities,
- Commercial paper,
- Time deposits,
- Temporary obligation bonds,
- Debt service funds.

4. Minnesota joint powers investment trusts

[Minn. Stat. § 118A.05, subd. 4](#)

Cities may enter into agreements or contracts for shares of a Minnesota joint powers investment trust, units of a short-term investment fund, and shares of registered investment companies. These entities must meet certain criteria.

Contact Pat Harris of Voyager Asset Management at (612) 376-7017 or 1-800-553-2143 for information about the 4M Fund and 4M Plus Fund.

The League's 4M Fund and 4M Plus Fund are joint powers investment trusts. The 4M Fund is a short-term investment option designed specifically for Minnesota municipalities to provide safety, daily liquidity, and a competitive yield. The 4M Plus Fund is a complementary money market option designed to provide safety and an enhanced yield when compared to the traditional 4M Fund. The 4M Plus Fund requires deposits be maintained for at least 30 days with a 24-hour advance withdrawal notice.

a. Investment trust shares

[Minn. Stat. § 118A.05, subd. 4\(1\), \(2\)](#)

Cities may enter agreements for shares of a Minnesota joint powers investment trust if the trust investments are restricted to the following:

[Minn. Stat. § 118A.04](#)

- U.S. securities,
- State and local securities,
- Commercial paper,
- Time deposits,
- Temporary obligation bonds,
- Debt service funds,
- A money market fund or investment company shares as described below.

[Minn. Stat. § 118A.05, subd. 4](#)

b. Money market funds

[Minn. Stat. § 118A.05, subd. 4](#)

Cities may invest in shares of an investment company that is registered under the Federal Investment Company Act of 1940 and holds itself out as a money market fund if both of the following conditions are met:

[17 C.F.R. § 270.2a-7](#)

- It is a money market fund meeting the conditions of rule 2a-7 of the Securities and Exchange Commission (SEC); and
- It is rated in one of the two highest rating categories for money market funds by at least one nationally recognized statistical rating organization.

c. Investment company shares

Minn. Stat. § 118A.05, subd. 4

Cities may also enter into agreements or contracts for shares of an investment company that meet both of the following criteria:

- It is registered under the Federal Investment Company Act of 1940, and
- Its shares are registered under the Federal Securities Act of 1933.

In addition, the investment company's fund must meet all of the following criteria:

- The fund receives the highest credit rating
- The fund is rated in one of the two highest risk categories by at least one nationally recognized statistical rating organization, and
- The fund is invested in financial instruments with a final maturity no longer than 13 months.

5. Guaranteed investment contracts

Minn. Stat. § 118A.05, subd. 5

Agreements or contracts for guaranteed investment contracts may be entered into if they are issued by or guaranteed by any of the following:

- United States commercial banks,
- Domestic branches of foreign banks,
- United States insurance companies or their Canadian subsidiaries,
- Domestic affiliates of any of the foregoing.

Minn. Stat. § 118A.05, subd. 5

The credit quality of the issuer's or guarantor's short-term and long-term unsecured debt must be rated in one of the two highest categories by a nationally recognized rating agency. Should the issuer's or guarantor's credit quality be downgraded below A, the government entity must have withdrawal rights.

E. Safekeeping of investments, contracts, and agreements

Minn. Stat. § 118A.06

Investments, contracts, and agreements may be held in safekeeping by any of the following:

- Any Federal Reserve Bank
- Any bank authorized under the laws of the United States or any state to exercise corporate trust powers including, but not limited to, the bank from which the investment is purchased

- A primary reporting dealer in United States government securities to the Federal Reserve Bank of New York
- A securities broker-dealer having its principal executive office in Minnesota, licensed under chapter 80A, or an affiliate of it, and regulated by the Securities and Exchange Commission, provided the government entity's ownership of all securities is evidenced by written acknowledgments identifying the securities by the names of the issuers, maturity dates, interest rates, CUSIP number, or other distinguishing marks

See [State Auditor's Statement of Position on Qualified Safekeepers](#).

Some brokers purchase securities through the Depository Trust Company (DTC), contending the DTC satisfies these safekeeping requirements. However, according to the state auditor, the DTC does not itself hold or keep these securities as contemplated by state law. Therefore, cities must still ensure that the broker or bank used by the DTC to hold the securities falls into one of the categories above.

F. Additional investment authority for certain cities and counties

[Minn. Stat. § 118A.07](#)

Cities with populations over 200,000 and counties that contain such cities have some additional investment authority regarding repurchase agreements, reverse repurchase agreements, and options and futures. This additional authority is currently available only to the cities of Minneapolis and St. Paul and to Hennepin and Ramsey counties. Certain criteria must be met in order to utilize this added authority. The government entity must have written investment policies and procedures, as well as an established oversight process.

1. Investment policies and procedures

[Minn. Stat. § 118A.07, subd. 2](#)

If a city with the requisite population or its resident county wishes to use the additional authority, it must first have a written investment policy and procedures governing the following:

- The use of, or limitation on, mutual bond funds or other securities authorized or permitted as investments under law;
- Specifications for and limitations on the use of derivatives;
- The final maturity of any individual security;
- The maximum average weighted life of the portfolio;
- The use and limitations on reverse repurchase agreements;

- Credit standards for financial institutions with which the government entity deals;
- Credit standards for investments made by the government entity.

2. Oversight process

Minn. Stat. § 118A.07, subd. 3

The oversight process must provide for review of the city’s investment strategy and the composition of the financial portfolio. This process must include at least one of the following:

- Audit reviews,
- Internal or external investment committee reviews, or
- Internal management control.

In addition to this process, the council must pass a resolution that authorizes the treasurer to use the additional investment authority within their prescribed limits and in conformance with the written limitations, policies, and procedures of the city.

The treasurer must report annually to the governing body on the findings of the oversight process. The governing body must adopt a resolution by Dec. 1 of each year if it intends to continue to use this additional investment authority for the following calendar year.

3. Additional permitted investments

The following investments may be made by the cities of St. Paul and Minneapolis, and by Hennepin and Ramsey counties, if they have adopted the previously described investment policy and procedures and oversight process:

Minn. Stat. § 118A.07, subd. 4

- **Additional repurchase agreements.** In addition to the earlier mentioned repurchase agreements, these entities can also use repurchase agreements with “high-risk mortgage-backed securities” if the margin requirement is 101 percent or more.

Minn. Stat. § 118A.07, subd. 6

- **Options and futures.** A qualifying governmental entity can enter into futures contracts, options and futures contracts, and option agreements to buy or sell securities authorized under law as legal investments for counties, but only with respect to securities owned by the government entity. This includes securities that are the subject of reverse repurchase agreements authorized only for counties that expire at or before the due date of the option agreement.

Minn. Stat. § 118A.07, subd. 5

See Part V. Outline of an investment policy.

G. Investment policies

Although Minneapolis, St. Paul, Hennepin County, and Ramsey County are required to have investment policies in order to use some additional investment authority, all cities should have a written investment policy. Determining when and how to invest and in what to invest requires specialized knowledge of techniques and market operations, which is outside the scope of this memo. However, the following are some general criteria to consider when making investment decisions and to include in a city investment policy.

1. General investment objectives

The following general principles are commonly considered when making city investments:

- ***Safety of principal.*** Protecting the principal amount of the investment is essential, and speculation with the principal is never justified. Therefore, fully insured bank and savings deposits are generally the safest. At the same time, deposits as an investment often appear less favorable when one considers the other elements of investing such as yield and liquidity.
- ***Liquidity.*** The city must be able to obtain cash if an emergency arises. Thus, the investment must be sufficiently liquid so the city can obtain money if needed. Most investments may be sold to a dealer bank or securities dealer prior to maturity. When this happens, the city selling the investment usually will retain the interest for the time held and, depending upon the market, may gain or lose on the principal by the sale. Some banks have service charges, and some securities dealers charge commissions for buying and selling securities.
- ***Diversification of investments.*** In short, a city should not put all its eggs in one basket. Investing in a variety of investments can mean that if one investment loses money, the other investments may not be affected or may make up for the loss.
- ***Diversification of maturity dates.*** This concept is similar to the previous one and can go hand-in-hand with the liquidity objective. Generally, diversifying the maturity dates of investments will help ensure the city has money available when it needs it. While long-term investments will pay a higher rate of interest, a high interest rate is worthless if the funds are not available when needed or if a loss must be taken in order to sell earlier than expected. If funds might be needed prior to an issue's maturity, they should be bought only if the principal will be protected and the sale can be made when necessary.

- **Competitive yield.** Once all of the above criteria have been considered, the city can look at the investment's potential yield. The yield is the amount that the investment is expected to earn. Generally, long-term investments have higher yields than short-term investments. Likewise, riskier investments have the potential for higher yields.

2. Making a cash forecast

Clerks and finance officers can use a cash forecast to determine the expected receipts and expenditures of their city over a projected period of time. Effective use of a cash forecast can help a city match investment materials with cash needs. A cash forecast can be made for a city's fiscal year or for several fiscal years. This information may be gathered by utilizing the following:

- The city's annual budget,
- Prior years' financial statements,
- Departmental budget requests,
- Engineering and construction timetables,
- Trends and other data.

The time to prepare a cash forecast is the beginning of the projected period or the beginning of the fiscal year. The actual receipts and disbursements determined each month should be compared with the projections, and adjustments should be made as needed.

If a city finds its first projections are missing the target by a wide margin, it may want to consider investing in instruments that have more liquidity until it has more experience making an accurate cash forecast. The yield for these types of investments, however, will be less than it might be with other investments. The ratio of investments to cash in the bank should improve with experience.

3. Accountability

Accountability and an evaluation of the results of an investment program can be accomplished in various ways. The same care and prudence should be used in the accountability for investments as would be used for cash or any other asset of the city.

Investments should be shown at cost, amortized for any premium or discount. An annual investment report might appropriately show, first, a year-end portfolio indicating the following:

- Purchase and maturity date of each investment,
- Type of each investment,
- Amortized cost,
- Market value of each investment and any unrealized gains or loss,
- Yield of each investment and the portfolio as a whole.

Second, the annual report might have a summary of the year's investment results that include the following:

- Interest earned for the year,
- Realized gains for the year,
- The overall rate of return for the year including unrealized gains or losses,
- Comparison of returns to appropriate benchmarks.

H. GASB considerations

See [GASB Statement No. 31](#)
[Minn. Stat. § 6.745](#)

GASB Statement No. 31 requires cities to report investments at market value in their financial statements. Under this statement, as well as state law, unrealized gains and losses must be reported in the financial statements.

The results of any investment program should be easily obtainable from the city's accounting records once the program is under way. The finance officer should maintain a schedule of maturities of investments in order to keep funds properly re-invested when necessary. In addition, he or she should keep a written record of each purchase and sale of securities in order to provide the evidence of securities and deposits received.

[GASB Statement No. 40](#)
See [State Auditor's Statement of Position on Custodial Credit Risk](#).

GASB Statement No. 40 requires notes to financial statements to disclose a city's investment policy provision regarding custodial credit risk for its investments, as well as the extent to which its investments are exposed to custodial credit risk. Analysis of custodial credit risk for investments requires knowing how the investment is being held and, in some cases, whether the holder has adequate insurance.

See Part V. Outline of an investment policy.

The auditor has also provided sample language for an investment policy, which is included in the investment policy outline at the end of this memo.

I. Conclusion

Many cities use professional financial services to help them with their depository and investment choices, but all city officials should seek to learn as much as possible about the type of investments they are making on behalf of their cities. If you have a question not addressed in this memo, contact the League of Minnesota Cities at (800) 925-1122 or the Office of the State Auditor at (651) 296-2551.

IV. Model resolution designating depository

SECTION 1. RESOLVED, That the (name of institution) is hereby designated as a depository for the funds of the city of (name of city). The city treasurer is authorized to deposit city funds therein to the amount of (amount) Dollars (\$___).

SECTION 2. RESOLVED ALSO, That before any deposits are made that exceed the amount that is guaranteed by the Federal Deposit Insurance Corporation (FDIC), the depository must supply to the city a corporate surety bond in the amount of at least 10 percent more than the amount on deposit at the depository's cutoff hour. The bond is subject to the approval of the city council. The surety bond must be conditioned to repay the above amount or any part thereof upon proper demand therefore and to perform such other duties in connection with the deposit as the council may require.

Comment: The amount of collateral is established by Minn. Stat. § 118A.03, subd. 3. If a statutory city or fourth class home-rule charter city the following language can be used if the depository is not an FDIC member institution:

(Alternate) **SECTION 2.** RESOLVED ALSO, That the depository must provide a bond in at least double the amount that is authorized to be deposited under any of the following circumstances:

If the depository is not an FDIC member; or,

If the depository does not provide collateral in accordance with Minn. Stat. § 118A.03.

The bond is subject to the approval of the city council. The surety bond must be conditioned to repay the above amount or any part thereof upon proper demand therefore and to perform such other duties in connection with the deposit as the council may require. Collateral securities may not be substituted for the bond.

Comment: The amount and type of collateral required for FDIC non-member depositories of statutory cities and fourth class home- rule charter cities is established by Minn. Stat. § 427.01.

SECTION 3. RESOLVED FURTHER, That, in lieu of the above bond, the depository may furnish collateral in the manner and to the extent permitted by law. All such collateral must be approved by the council and accompanied by a written assignment providing that, upon default, the financial institution shall release to the city on demand, free of exchange or any other charges, the collateral pledged.

Comment: Collateral securities are permitted in lieu of a bond under Minn. Stat. § 118A.02, subd. 2. Note that these may not be allowed if a bond is required in double the amount of the deposit under Minn. Stat. § 427.01 (see alternate SECTION 2.)

SECTION 4. RESOLVED FURTHER, All collateral must be placed in safekeeping in a restricted account at either a Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution that is not owned or controlled by the financial institution that is furnishing the collateral. The selection must be approved by the city council.

In case of default upon the part of the depository, the council of the city shall have full power and authority to sell such collateral or as much as may be necessary to realize the full amount due the city over such federal guarantee.

Comment: The requirement of where collateral can be kept is established by Minn. Stat. § 118A.03, subd. 7.

This designation is effective until (date and year).

Dated (date and year).

Approved

Attest:

Mayor

Clerk

V. Outline of an investment policy

Note: This outline is designed to show some of the typical sections that are often found in public investment policies. See the discussion in Part III F and G of this memo for a more detailed discussion. There are also special requirements for Minneapolis, St. Paul, Hennepin County, and Ramsey County that are not included in this outline (see Part III F of this memo). Contact the League for examples of investment policies from other cities.

Section 1. Purpose

(Comment: This section lists the general purposes of the investment policy)

The purpose of this policy is to establish the city's investment objectives and establish specific guidelines that the City of (city name) will use in the investment of city funds. It will be the responsibility of (treasurer/chief financial officer) to invest city funds in order to attain a market rate of return while preserving and protecting the capital of the overall portfolio. Investments will be made, based on statutory constraints, in safe, low risk instruments.

Section 2. Scope/Funds

(Comment: This section generally identifies the specific city funds to which the investment policy applies, such as the general fund, debt service fund, special funds, etc. It may also specify particular funds that are excluded from the policy, such as pension funds.)

Section 3. Delegation of authority

(Comment: This section identifies the officer who is responsible for the management of the investment program. In cities, the treasurer or chief financial officer is usually the person given this function.)

Section 4. Investment objectives

(Comment: This section generally identifies in detail the primary objectives of the investment policy and ranks the objectives in order of importance. Some examples of common objectives are listed.)

- A. Safety of principal.** Safety of the principal is the foremost objective of the city. Each investment transaction must seek to first ensure that losses are minimized.
- B. Liquidity.** The investment portfolio must remain sufficiently liquid to meet all operating costs that may be reasonably anticipated. The portfolio must be structured so that securities mature concurrent with cash needs to meet anticipated demands. Cash needs will be determined based on cash flow forecasts prepared during the budget process.
- C. Diversification of instruments.** A variety of investment vehicles must be used so as to minimize the exposure to risk of loss. The investment portfolio must be diversified by individual financial institution, government agency, or by corporation (in the case of commercial paper) to reduce the exposure to risk of loss.
- D. Diversification of maturity dates.** Investment maturity dates should vary in order to ensure that the city will have money available when it needs it.
- E. Yield.** The investment portfolio must be maintained so as to attain a market-average rate of return.

Section 5. Oversight

(Comment: This section can specify the internal review and audit practices to ensure that the policy is being followed.)

Section 6. Investment instruments

(Comment: This section lists the specific investment vehicles that the city will allow. Many policies may establish a percentage of funds that can be invested in each type of instrument. The city may be more restrictive than state law regarding the types of investments that it allows. See Part III C for details on investments that state law allows cities to make.)

Section 7. Prohibited investments

(Comment: Some policies may contain a provision to identify those investment vehicles that the city does not want utilized.)

Section 8. Prudence

(Many policies contain provisions that provide a standard of judgment for the investment official. Most often, this is referred to as the “prudent person” standard. This standard is usually defined as the type of judgment that a prudent person would use with his or her own investments in accordance with the adopted policy.)

Section 9. Ethics

(Comment: Most policies outline some ethical standards and prohibit conflicts of interest or the appearance of such conflicts. Some require disclosure of any situations that could relate to the city’s investments.)

Section 10. Internal controls, audits, external controls

(Comment: This type of provision is generally intended to ensure that the policy is being followed and that investments are being made properly and records are being kept. Typically this provision creates a system of checks and balances. The specifics of such a system can vary from city to city.)

Section 11. Deposit custodial credit risk [State Auditor model language]

The city will minimize deposit custodial credit risk, which is the risk of loss or failure of the depository bank (or credit union), by obtaining collateral or bond for all uninsured amounts on deposit, and by obtaining collateral or bond for all uninsured amounts on deposit, and by obtaining necessary documentation to show compliance with state law and a perfected security interest under federal law.

Section 12. Investment custodial credit risk [State Auditor model language]

The city will eliminate investment custodial credit risk by permitting brokers that obtained investments for the city to hold them only to the extent there is securities investor protection corporation (SIPC) and excess SIPC coverage available. Securities purchased that exceed available SIPC coverages shall be transferred to the city’s custodian.

[OR

The city will allow no more than (some acceptable maximum) percent of its securities to be exposed to custodial credit risk.]