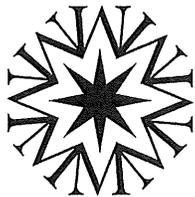


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# Report to the Minnesota Legislature:

## Local Bank Deposit Pilot

February 1, 2013



**Minnesota**  
STATE COLLEGES  
& UNIVERSITIES

## Report to the Minnesota Legislature: Local Bank Deposits Pilot

### Executive Summary

Minnesota Laws of 2010, Chapter 364, Section 33 established a two year pilot project aimed at increasing “the distribution of potential economic benefit of deposits of reserve funds of the institutions of Minnesota State Colleges and Universities” by permitting select colleges and universities to transfer General Fund reserve deposits from the state treasury to a community financial institution. The pilot project allowed for the transfer of deposits for no more than two years.

Participating colleges and universities were selected through application to the Minnesota State Colleges and Universities Board of Trustees. Three institutions were selected to work with two financial institutions, for a total of \$4.36 million in deposits.

Results from the pilot evaluation include:

- The financial institutions indicated that the funds deposited by the colleges and university enabled them to invest in locally owned businesses. Such investment provided short and long term employment opportunities within the communities and contributed to the tax base of each location.
- The financial institutions indicated that the paperwork required by the state for the transaction was lengthy and cumbersome, and could be simplified.
- The colleges and university realized greater returns on their investments by using local banks. This may be due in part to funds being invested during a declining interest rate environment.

The system appreciated the opportunity to explore this strategy.

## Background

Minnesota Laws of 2010, Chapter 364, Section 33 established a two year pilot project aimed at increasing “the distribution of potential economic benefit of deposits of reserve funds of the institutions of Minnesota State Colleges and Universities” by permitting select colleges and universities to transfer General Fund reserve deposits from the state treasury to a community financial institution. For the purposes of this pilot, a community financial institution was defined as “a federally insured bank or credit union, chartered as a bank or credit union by the state of Minnesota or the United States, that is headquartered in Minnesota and that has no more than \$2.5 billion in assets.”

Participating colleges and universities were selected through application to the Minnesota State Colleges and Universities Board of Trustees, which was authorized to choose up to eight colleges and universities to participate in the pilot, and was provided with legislative guidance to inform this selection, specifically regarding “the size of the institution’s reserves and the terms offered by the designated community financial institutions.” Additionally, unless prohibited by insufficient applications, both two and four year institutions were to be chosen and the majority of selected institutions were to be located in greater Minnesota.

The pilot project allowed for the transfer of deposits for no more than two years.

Five colleges and two universities indicated interest in participating, and as this was less than the maximum of eight stated in law, all interested institutions were allowed to be in the pilot.

A Request for Proposal (RFP) was prepared by staff in the system office with input from the participating institutions. The RFP required that the financial institution’s response include:

- 1) The rate of return (terms and time frames).
- 2) A description of the evaluation and report that they would provide regarding the effectiveness of this local deposit pilot project.
- 3) Evidence of financial strength.
- 4) All requirements set forth in the RFP.

The following colleges and universities, their respective campus locations, along with the amounts of budget reserve funds that could be deposited were included in the RFP issued on August 2, 2010 as listed below:

Minnesota West Community and Technical College (Canby, Granite Falls, Pipestone, Worthington, and Jackson)	\$2,100,000
Hibbing Community College (Hibbing)	\$1,000,000
Ridgewater College (Willmar and Hutchinson)	\$2,100,000
Northwest Technical College – Bemidji (Bemidji)	\$ 600,000
South Central College (Faribault and North Mankato)	\$ 500,000
Winona State University (Winona)	\$2,200,000
Bemidji State University (Bemidji)	\$1,600,000

A timeline for selection and implementation was included in the RFP:

**Selection and Implementation Timeline**

Monday, August 2, 2010	Publish RFP notice in <i>State Register</i>
Wednesday, August 18, 2010, 8:00 a.m. CST	Deadline for RFP proposal submissions
Wednesday-Friday, August 18-20, 2010	Review RFP proposals
Monday-Wednesday, August 23-25, 2010	Meet with top responder(s), if needed
Friday, August 27, 2010	Complete selection process
Friday, November 19, 2010	Deadline for executing contract

Individuals representing banking interests were notified that the RFP was posted and participating colleges and universities contacted their local financial institutions to inform them of the posting.

Four RFP responses were received proposing to serve three colleges and one university. Two responses were rejected: one because the rate of return offered was lower than what is currently earned and the second because they did not provide information as requested in the RFP. Three institutions were selected to work with two financial institutions, for a total of \$4.36 million in deposits:

Bemidji State University and Northwest Technical College-Bemidji worked with  
Security Bank USA

Minnesota West Community and Technical College worked with  
First State Bank Southwest

Legal agreements were drafted with each bank, and the deposit amount for each institution was transferred from the state treasury on January 2, 2011.

### Evaluation

The legislation establishing the pilot program also directed the Board of Trustees and the commissioner of Minnesota Management and Budget to “independently evaluate the effectiveness or harm of the local deposit pilot project in increasing the use of community financial institutions and providing wider distribution of the economic benefit of the deposit of postsecondary reserves” and to make a recommendation regarding future implementation of local bank deposit options.

In July 2012, system office staff in cooperation with staff from Minnesota Management and Budget began the process of developing surveys (Exhibits 1 and 2) to administer to the colleges, universities and the financial institutions participating in the pilot. Rather than ask the participants to respond to separate surveys with similar questions, the two agencies developed the questions and administered the surveys cooperatively, then evaluated the responses independently.

The financial institutions were given one set of questions and the colleges and universities another set. The surveys were designed to reflect the unique perspectives of each group as they revisited the local bank pilot experience. Both groups were asked about balances, terms and conditions, collateral requirements, how funds were invested in the community, what impact on local economic benefit resulted from this pilot, and if they would recommend continuing or expanding the program. Additionally, financial institutions were asked if the program was easy to institute and manage from an administrative and regulatory perspective. Colleges and universities were asked to describe how the program impacted them from a financial perspective.

The surveys were administered electronically, with a cover memo that described the reason for the survey and how the results would be used (Exhibit 3).

### Results and Recommendations

- The financial institutions indicated that the funds deposited by the colleges and university enabled them to invest in locally owned businesses. Such investment provided short and long term employment opportunities within the communities and contributed to the tax base of each location. It should be acknowledged that state investments similarly circulate, but the direct connection to receipts generated by the Minnesota State Colleges and Universities system is inextricable.
- The financial institutions also indicated that the paperwork required by the state for the transaction was lengthy and cumbersome, and could be simplified.

- The colleges and university realized greater returns on their investments by using local banks. This may be due in part to funds being invested during a declining interest rate environment. During the timeframe encompassing this pilot program, the average interest rate offered by the state treasury on invested funds was .045 percent (Exhibit 4). In contrast, the rates negotiated with the financial institutions were the highest rates available, and at one college ranged from a low of 0.28 percent to a high of 1.5 percent. The financial institutions' negotiated interest rates exceeded the amount that would have been generated had the funds remained in the state treasury.
- The colleges and university also noted that the personal banking relationship enjoyed with the local banks was "very conducive to conducting business." Conversely, because of the agreement termination language within the contract, the level of trust between one financial institution and its partner college/university was negatively impacted.

Responses to each survey were recorded on grids to allow easy comparison by institution (Exhibits 5 and 6).

### Summary

One of the colleges involved in the pilot expressed a clear desire to continue the program. The college and its partner financial institution saw the program as a positive contribution to the college and to the community. Additionally, the other college and university expressed interest if the requisite contracts and agreements can be simplified and made more equitable to both parties.

Banking Institution \_\_\_\_\_

Bank contact person \_\_\_\_\_

Telephone \_\_\_\_\_

Email \_\_\_\_\_

College/university partner \_\_\_\_\_

<p>1. What was the average daily balance(s) in the account(s)?</p>	
<p>2. What were the collateral requirements for the college/university deposits, and what collateral did your institution provide to meet these requirements?</p>	
<p>3. How were the funds deposited in your bank used? Were they compensating balances or were they invested in the community? If invested in the community, please provide details.</p>	
<p>4. Did the college/university deposits enable your bank to accomplish a wider distribution of local economic benefit? If so, how much and in what way? Please describe and quantify specific local economic benefit.</p>	
<p>5. How would you categorize your experience with the program from an administrative and regulatory perspective? Was it easy or difficult? How so?</p>	
<p>6. Would you recommend any changes to the program? Please provide details.</p>	
<p>7. Are there other things you would like to share about your experience with this pilot program?</p>	

College or University \_\_\_\_\_

Banking Institution \_\_\_\_\_

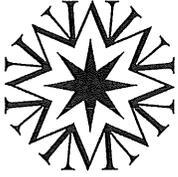
Bank contact person \_\_\_\_\_

Telephone \_\_\_\_\_

Email \_\_\_\_\_

<p>1. What were the terms of this pilot relationship with your local bank (length, negotiated rate, etc)?</p>	
<p>2. How much was your initial deposit and what was the average daily balance?</p>	
<p>3. How were the funds secured? What were the collateral requirements and how did your local bank meet them?</p>	
<p>4. How did this pilot impact the college/ university from a financial perspective? Could your institution have secured a higher return on investments by using another financial institution? What was the opportunity cost, if any, by using local financial institutions?</p>	
<p>5. How easy or difficult was the program to administer in comparison to the standard processes? Please explain.</p>	
<p>6. a. Do you believe the deposits allowed for wider distribution of economic benefit? If so, how much and in what way? Please describe and quantify specific local economic benefit.</p> <p>b. Did the financial institution communicate such information with your college/university?</p>	

7. Would you recommend changes to the program? Please provide details.	
8. Are there other things you would like to share about your experience with this pilot program?	



Minnesota  
STATE COLLEGES  
& UNIVERSITIES

SYSTEM OFFICE  
FINANCE DIVISION

WELLS FARGO PLACE  
30 7<sup>TH</sup> ST. E., SUITE 350  
ST. PAUL, MN 55101-7804

EXHIBIT 3

ph 651.201.1732  
www.mnscu.edu

October 17, 2012

Kenton Meier  
First State Bank Southwest

Dear Kenton:

Minnesota Laws of 2010, Chapter 364, Section 33 provided that the Minnesota State Colleges and Universities conduct a pilot for up to eight institutions for the deposit of reserve funds with community financial institutions to increase the distribution of potential economic benefits throughout the state. An RFP was issued to banks throughout the state, and three colleges and universities negotiated agreements with local banks:

Bemidji State University (Security Bank)  
Northwest Technical College-Bemidji (Security Bank)  
Minnesota West Community and Technical College (First State Bank)

The length of the pilot was specified as January 2, 2011, to December 31, 2012.

This law also required that at the conclusion of the pilot program, an evaluation of this relationship be conducted to determine "the effectiveness or harm of the local deposit pilot project in increasing the use of community financial institutions and providing wider distribution of the economic benefit of the deposit of postsecondary reserves."

The attached survey is a joint effort by the Minnesota State Colleges and Universities and Minnesota Management and Budget to evaluate this program. The data collected through this survey will be shared, and the agencies involved will independently evaluate and prepare reports for legislative review.

We request your cooperation in completing the attached survey and electronically returning it on or before Monday, November 5, 2012 to:

Kathy Hanon  
Financial Planning & Analysis  
[Kathy.Hanon@so.mnscu.edu](mailto:Kathy.Hanon@so.mnscu.edu)

This survey is also available in a non-electronic format if needed. If you have any questions or you would like to request a printed copy, please contact Kathy @ 651-201-1709.

Thanks for your attention to this matter.

Sincerely,

*Deb Bednarz*

Deb Bednarz  
System Director for Financial Planning and Analysis

Minnesota Management and Budget  
Monthly Interest Rates  
July 2011 through September 2012

MONTHLY INTEREST RATE	
YEAR/MONTH	MONTHLY INT RATE
11/07	0.000324802
11/08	0.000305976
11/09	0.000314366
11/10	0.000632935
11/11	0.000632935
11/12	0.000386022
12/01	0.000404192
12/02	0.000442998
12/03	0.000616269
12/04	0.000483364
12/05	0.000458293
12/06	0.000403181
12/07	0.000405404
12/08	0.000433215
12/09	0.000529711

# Banking Pilot Evaluation Survey

# EXHIBIT 5

October 2012

Question

Security Bank USA (BSU and NWTC)

Contact: Lois Anderson

[LoisA@SecurityBankusa.com](mailto:LoisA@SecurityBankusa.com)

First State Bank SW (MnWest)

Contact: Kenton Meier

[kmeier@firststatebanksw.com](mailto:kmeier@firststatebanksw.com)

<p>1. What was the average daily balance(s) in the account(s)?</p>	<p>\$1,630,879.88 (Bemidji State University) \$611,579.94 (Northwest Technical College)</p>	<p>\$2,118,900</p>
<p>2. What were the collateral requirements for the college/university deposits, and what collateral did your institution provide to meet these requirements?</p>	<p>100% coverage of the balances on deposit.  Security Bank<sup>USA</sup> used letters of credit through Federal Home Loan Bank as collateral.</p>	<p>The bank pledged collateral – FHLMC and FNMA. The agreement was to have 110% at all times. Early on the bank dipped below that level, but adjusted and has maintained 110% since.</p>
<p>3. How were the funds deposited in your bank used? Were they compensating balances or were they invested in the community? If invested in the community, please provide details.</p>	<p>Due to the economic conditions, the bank has experienced higher deposit levels and lower loan demand during the period of this pilot program. However, we did invest a portion of the dollars in the community. Please refer to the response to item #4.</p>	<p>First State Bank Southwest invested the funds from MN West Community and Technical College into the communities resulting in a number of new business startups and employment opportunities. Fortunately and totally unplanned, these projects were in Worthington and Pipestone, who happen to both have MNSCU campuses. One of our Worthington Projects was a \$632,000.00 new start up adult daycare service to the Southwest MN region. We were able to collaborate with the City of Worthington, Southwest Initiative Foundation, and SBA to make this project possible. The Pipestone project was a \$400,000.00 commercial building purchase and remodel project for a young entrepreneur to create new shared offices for an Abstracting business, his Real Estate Company and Insurance Agency.</p> <p>These are just a few examples of ways we invested the MNSCU deposits.</p>
<p>4. Did the college/university deposits enable your bank to accomplish a wider distribution of local economic benefit? If so, how much and in what way? Please describe and quantify specific local economic benefit.</p>	<p>The college/university deposits helped enable us to finance a local cooperative grocery store's large expansion and an independent manufacturing firm's expansion in our community.</p>	<p>Yes, First State Bank Southwest did provide additional economic development benefit to the area with these funds. In the Worthington example above, the project complete provided 2 full time and 5 part time jobs with an estimated annual payroll of approximately \$320,000.00. Local contractors did all the work providing a stimulus to the local economy. The new construction will provide an increased tax revenue to the local city, county and school district of over \$30,000.00.</p>
<p>5. How would you categorize your experience with the program from an administrative and regulatory perspective? Was it easy or difficult? How so?</p>	<p>The general banking agreement that we signed, was large and needed explanations. Bill Maki, VP for Finance and Administration helped work through that process, however consideration for a more simplified form would be helpful.</p>	<p>It was overall on the easy side. The process went well after all the paper work needed on the state side was completed.</p>

**Banking Pilot Evaluation Survey**

**EXHIBIT 5**

**October 2012**

Question	Security Bank USA (BSU and NWTC)	First State Bank SW (MnWest)
6. Would you recommend any changes to the program? Please provide details.	We would recommend a shorter time between the bid and closing of the agreement and a less cumbersome general banking agreement.	No, unless there could be less requirements or agreements needed on the state college part of the transaction.
7. Are there other things you would like to share about your experience with this pilot program?		

October 2012

RESPONSES FROM COLLEGES/UNIVERSITIES

Question

Bemidji State University and  
Northwest Technical College  
(Security Bank USA)

MnWest (First State Bank SW)

<p>1. What were the terms of this pilot relationship with your local bank (length, negotiated rate, etc)?</p>	<p>In January 2011, \$800,000 was invested for 2 years at 1.7% and \$800,000 was invested for 1 year at 1.4% for Bemidji State University and \$300,000 was invested for 2 years at 1.7% and \$300,000 was invested for 1 year at 1.4% for Northwest Technical College.</p> <p>The one year funds were renewed for an additional one year term at 1.05% in January 2012.</p>	<p>2 years – January 2, 2011 through December 31, 2012 with an option to renew; rate was set at 0.90% for 2 years</p>
<p>2. How much was your initial deposit and what was the average daily balance?</p>	<p>For Bemidji State University, \$1.6m was deposited in January 2011. Average daily balance due to compounded interest was \$1.615m through 6/30/12.</p> <p>For Northwest Technical College, \$600,000 was deposited in January 2011. Average daily balance due to compounded interest was \$607,000 through 6/30/12.</p>	<p>\$2.1 million; interest not added until end of first year (18,900), no additional interest added until the end of year two</p>
<p>3. How were the funds secured? What were the collateral requirements and how did your local bank meet them?</p>	<p>The bank covered the entire balance of the deposits with a FHLB letter of credit and the coverage has remained intact during the term of the certificates of deposit.</p>	<p>The bank pledged collateral – FHLMC and FNMA. The agreement was to have 110% at all times. At one time during the term, they attempted to use FDIC coverage which caused an under-collateralization issue; they subsequently resolved this and have maintained the balance in excess since then.</p>
<p>4. How did this pilot impact the college/ university from a financial perspective? Could your institution have secured a higher return on investments by using another financial institution? What was the opportunity cost, if any, by using local financial institutions?</p>	<p>The college and the university secured the highest rate available based on the responses to the RFP. With the declining interest rate environment, earnings exceeded the cash return rate of the State Treasury funds by 2-3 times the State Treasury average during that time.</p>	<p>The college invested local funds at rates that varied from 1.5% in March 2011 (the high) to the 0.28% in May 2012 (the low). The most recent rate we secured for a CD was 0.65% for 6 months on \$100,000. The rate obtained from this investment of state treasury funds was more than competitive in the long run. State treasury returns averaged .542 for the 15 months from July of 2011 through September of 2012. The locally obtained rate of 0.90% provided the college with \$15,360 of additional investment income for the two year period (based on the treasury’s average return for 15 months of that 24 month period). (0.90% - 0.542% X 2.1M X 2 years)</p>

October 2012

RESPONSES FROM COLLEGES/UNIVERSITIES

Question

Bemidji State University and  
Northwest Technical College  
(Security Bank USA)

MnWest (First State Bank SW)

<p>5. How easy or difficult was the program to administer in comparison to the standard processes? Please explain.</p>	<p>The personal banking relationship with Security Bank USA was very conducive to conducting business. Discussions relating to the status of the letter of credit as well as balance inquiries as needed for accruing interest were easily handled.</p>	<p>The college worked through the RFP process. As with all new processes, it compelled more human resources the first time than it would in repeat efforts. The process will now be ready for other System institutions as well. The college doesn't currently use an RFP process for local investments.</p>
<p>6. a. Do you believe the deposits allowed for wider distribution of economic benefit? If so, how much and in what way? Please describe and quantify specific local economic benefit.  b. Did the financial institution communicate such information with your college/university?</p>	<p>We are not sure as there was no direct communication from the financial institution that that was the case.  I believe the financial institution had concern that we might withdraw the funds unexpectedly based on the way the contract was written. Our termination notice for the agreement was 30 days notice while theirs was 181 days notice.</p>	<p>a. Yes, the funds invested in a banking institution provided access to residents and businesses in this region. The bank awarded is located in Worthington, MN, which is noted for its minority population and minority business ownership. The funds made available locally were then accessible to these groups of local citizens.  b. The agreement with the financial institution provides for communication of this information at the close of the pilot.</p>
<p>7. Would you recommend changes to the program? Please provide details.</p>	<p>Yes, I think the contract should be more balanced and not so much in MnSCU's favor. My perception was this imbalance created a reduced sense of trust with the financial institution.</p>	<p>No.</p>
<p>8. Are there other things you would like to share about your experience with this pilot program?</p>	<p>I think both the institution and the financial institution underestimated the complexity of the process and the contract to move the funds from the state treasury to the local bank.  Overall, the initial legislation was well-received as the local bank did appreciate the opportunity to be able to keep more university funds in a local financial institution.  The environment of interest rates since the pilot program was initiated was not favorable to the bank, but was to our institution. I think this external factor made it less of a win/win situation.</p>	<p>We were pleased to be a part of this pilot and hope that it will continue and expand in the future to provide the same opportunities across the state.</p>