Collateralization of Public Funds

BACKGROUND

Oregon State University has a Treasury Banking Agreement with Oregon State Treasury (OST) for commercial banking services supporting operations. Beginning January 21, 2020, OST began transitioning select banking services related to payments and deposits to another financial institution. The transition to a different financial institution by OST prompted the university to evaluate its options for banking services and explore the potential benefits of an independent relationship with a financial institution as allowed by state statute. Through a formal request for proposal (RFP) evaluation, the university engaged JPMorgan Chase Bank, N.A (JPM) in an independent banking relationship as an additional service provider to the university for payment and deposit services.

COLLATERALIZATION FOR DEPOSITS WITH FINANCIAL INSTITUTIONS

As part of adding JPM as an additional banking service provider, the university reviewed its requirements for depositing public funds. Bank deposit balances that exceed the amount insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund of the National Credit Union Administration (NCUA)—currently limited to $250,000—are considered to be uninsured balances and can expose the university to potential losses should the financial institution fail. Oregon statutes require that a university governing board ensure that any amount of funds on deposit exceeding the FDIC or NCUA limits are secured by sufficient collateral.

Government entities are allowed to use the Public Funds Collateralization Program (PFCP) administered by the Oregon State Treasury. However, the PFCP does not extend to an independent banking relationship outside of OST banking services. Therefore, in order to comply with statute, the Board’s Liquidity Management Policy must be amended to define the university practice for collateralizing public funds maintained in independent banking institutions such as JPM.

PROPOSED CHANGES TO THE LIQUIDITY MANAGEMENT POLICY

These proposed amendments to the Liquidity Management Policy are shown in red text and strikethrough in Attachment 1.

The amendments define the university’s collateralization of public funds identifying eligible collateral and reporting and monitoring responsibilities. The proposed amendments reflect the staff recommendation of a minimum of 50% collateral margin. Minor housekeeping changes are also included to reflect this is no longer a new policy.

RECOMMENDATION

Staff propose that the Finance & Administration Committee recommend to the Board approval of the amendments to the Liquidity Management Policy as provided in Attachment 1.

Attachment 1

RESOLUTION NO. ____

Oregon State University
Liquidity Management Policy

Whereas, the Board of Trustees of Oregon State University (the "Board") is vested by law with the power and authority to govern the university; and

Whereas, the bylaws of the Board specify that the Board's governance responsibilities include ensuring the university's fiscal integrity, overseeing the university's financial resources and other assets, and preserving and protecting the university's assets for posterity; and

Whereas, the university has engaged an independent banking service provider for selected banking services as allowed by state statute; and

Whereas, the university is required by ORS 352.135 to ensure sufficient collateral secures funds on deposit that exceed depositories insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund of the National Credit Union Administration; and

Whereas, the proposed amendments to the Liquidity Management Policy define the univerity practice for collateralizing public funds to protect and secure uninsured public deposits maintained in any financial institution, now, therefore,

Be it resolved, that the Board of Trustees hereby approves the amendments to the Liquidity Management Policy, attached hereto as Exhibit A.

This Resolution is effective______________, 2020.

APPROVED by the Board of Trustees __________, 2020

 /   /2020____________________
Secretary to the Board   Date

Exhibit A

Liquidity Management Policy

I. PURPOSE

The Oregon State University's Board of Trustees (Board) ~~desires to~~ established a liquidity management policy~~. This policy~~ to serve~~s~~ an important governance function by identifying sources of liquidity, establishing and assigning responsibilities for managing the institution's liquidity needs, outlining the university's philosophy on liquidity management, and providing a framework for utilization of short-term debt.

II. SCOPE

Within the context of this document, liquidity is defined as cash and cash equivalents, liquid investment balances, access to cash (e.g. lines of credit, letters of credit), and the convertibility of assets to cash in order to meet operating and financial needs during the operating cycle. The liquidity management policy is meant to work in conjunction with the Board-approved Debt, Internal Bank, Investment, and other policies that impact financial risk management. This policy explicitly excludes quasi-endowment, endowment, retirement funds, and OSU Foundation funds, as these are not liquid and available for operating purposes.

III. OBJECTIVE

The objectives of this policy are to:

i. Outline the university's philosophy for optimum liquidity management,
ii. Define the university's primary objective for liquidity management,
iii. Define the university's collateralization of public funds practice, and
~~iii.~~ iv. Identify a framework for utilization of short-term debt.

IV. PHILOSOPHY

Optimal liquidity management will align financial decisions with the university's mission and will consider the following:

i. Does the action align to the university's mission?
ii. What is the overall level of financial health?
iii. Are resources sufficient and flexible enough to support the mission?
iv. Does financial asset performance support the strategic direction?
v. Do operating results indicate the university is operating within available resources?
vi. Is debt managed strategically to advance the mission?

V. OVERSIGHT

The university Vice President for Finance and Administration is responsible for policy compliance, periodic review, and all liquidity management activities for the university. On at least an annual basis, the Vice President for Finance and Administration is charged with reviewing the university's Board-approved financial metrics in conjunction with oversight of related policies and will report any issues to the Board's Finance & Administration Committee.

VI. LIQUIDITY MANAGEMENT

The primary objective of liquidity management is to maintain a cash position that allows the university to meet daily obligations without incurring the opportunity costs that arise from having excess cash. It is not uncommon for the university to experience a mismatch between the timing of expenditures and receipt of funds to pay those costs. The more unpredictable the university's cash flows are, the higher the required levels of liquidity that must be maintained.

Liquidity Sources

The university will attempt to diversify its various sources of liquidity by liquidity type. Diversification of cash and investments is managed pursuant to the Internal Bank Policy and the Investment Policy. Issuance of debt as sources of liquidity are managed by the Debt Policy to align with the university's strategic plan.

The university categorizes liquidity sources as committed or uncommitted. Committed funding represents funding available to the university as well as external funding sources where the provider has committed to providing funding, regardless of circumstance. Uncommitted funding are sources of liquidity where the provider is under no commitment to fund. The university further categorizes committed funding as restricted or unrestricted.

The university's liquidity sources include the following:

- Operating and non-operating revenues,
- Cash and liquid investment balances,
- External long-term debt proceeds,
- External short-term debt proceeds, and
- Gifts, in the form of cash or pledges.

Liquidity Uses

Uses of university liquidity are determined per the university fiscal management governance structure as approved within the budget approval process and delegations of authority. Approved use of liquidity is for operating and capital purposes. Operating expenses are paid using the appropriate funds aligned to the university mission and compliant with applicable statutes and university policies and standards. The Internal Bank Policy defines the funds available for internal lending through the Central Loan Program (Internal Bank Loan).

Liquidity Measures

The university must balance liquidity requirements with its investment objectives and its cost of external borrowing. The university intends to manage its liquidity needs by considering its entire asset and debt portfolio, rather than managing liquidity solely on an issue-specific basis. This approach permits institution-wide evaluation of desired liquidity requirements and exposure.

The Board has approved acceptable tolerance ranges for eight financial metrics, as follows:

1. Viability Ratio
2. Primary Reserve Ratio
3. Net Income Ratio
4. Return on Net Assets Ratio
5. Fund Balance
6. Debt Burden Ratio

7. Debt Service Coverage
8. Debt/Revenues (Income Statement Leverage Ratio)

Financial metrics provide a historical picture to compare current results and model expected future performance. The approved acceptable tolerance ranges provide the parameters of performance expectations. A trigger occurs when the metrics fall outside these ranges. Triggers are intended to provide warning signs of events that could adversely impact the university's liquidity. The Vice President of Finance and Administration will review trigger events when metrics fall outside of these ranges and develop a risk mitigation plan, if necessary.
Ratio analysis and financial metric ranges represent target capital structure measures. The capital structure is how an organization finances its overall operations and growth by using different sources of funds. Debt comes in the form of short- or long-term bonds issued or notes payable. The proportion of short- and long-term debt is considered when analyzing capital structure. Optimal capital structure lies somewhere between maximum profitability and financial burden. In practice, the optimal capital structure is a target to preserve financial flexibility.

Liquidity Risk Management
Liquidity risk is defined as an inability to meet payment obligations in a timely manner when they become due and the risk that assets may not be convertible into cash when needed.

Liquidity risk is divided into three categories:

1) Operating liquidity risk occurs when the university cannot fund its operating expenses due to insufficient liquid cash holdings.
2) Financing liquidity risk occurs as a result of external financing activities and the potential for those financings to come due before maturity.
3) Market liquidity risk occurs when the university is unable to convert assets into cash without significant losses.

Liquidity risk is addressed in part through annual monitoring and reporting of the Primary Reserve Ratio, which reflects expendable net assets to operating expenses.

The university recognizes that it may be exposed to interest rate, third-party credit, and other potential risks in areas other than direct university debt (e.g., counterparty exposure in the investment portfolio) and, therefore, exposures are considered on a comprehensive university-wide basis.

VII. COLLATERIZATION OF PUBLIC FUNDS

To protect and secure uninsured public deposits, each financial institution holding OSU deposits that are not protected by the Oregon State Treasury's Public Funds Collateralization Program shall at all times maintain, segregated from its other assets, eligible collateral in an amount equal to at least 50% of the amount held in deposits with the financial institution. The financial institution will be responsible for monitoring and maintaining collateral margins on a daily basis.

Eligible Collateral
The university permits the following securities to be eligible collateral to be used as security to ensure deposits:

(a) Obligations of the United States, including those of agencies and instrumentalities of the United States, and of government sponsored enterprises;

(b) Obligations of the International Bank for Reconstruction and Development;
(c) Bonds of a state of the United States that are rated in one of the three highest grades by a recognized investment service organization that has engaged regularly and continuously for a period of not less than 10 years in rating state and municipal bonds;
(d) Bonds of a county, city, school district, port district or other public body in the United States that are payable from or secured by ad valorem taxes if the bonds are rated in one of the three highest grades by a recognized investment service organization that has engaged regularly and continuously for a period of not less than 10 years in rating state and municipal bonds;
(e) Bonds of a county, city, school district, port district or other public body that are issued pursuant to the Constitution or statutes of the State of Oregon or the charter or ordinances of a county or city within the State of Oregon if the bonds are rated in one of the three highest grades by a recognized investment service organization that has engaged regularly and continuously for a period of not less than 10 years in rating state and municipal bonds;
(f) Bonds, notes, letters of credit issued not as assurance of payment or performance but as an investment or other securities or evidence of indebtedness constituting the direct and general obligation of a federal home loan bank or Federal Reserve bank.

Eligible collateral shall be held by an independent third-party custodian with whom OSU has a custodial agreement. A clearly-marked safekeeping receipt or evidence of ownership documentaton must be supplied to OSU. Collateral substitution by the custodian is permitted provided the substitute collateral meets the requirements of this Policy, with notification provided to the university contact, and the existing collateral is not released until the replacement collateral has been received.

<u>Reporting and Monitoring</u>
The custodian or financial institution shall provide reports, at minimum on a monthly basis, that describe the type and market value of each pledged security. The university recognizes its responsibilities to facilitate adequate collateralization amounts and will attempt to notify the financial institution of any planned significant fluctuations in bank balances to ensure sufficient collateral is pledged.

~~VII.~~ VIII. USE OF SHORT-TERM DEBT

A key goal of the university's Internal Bank is to manage available cash and investments to ensure that the university has sufficient cash to provide for routine and emergency operating expenses. The Internal Bank will align revolving debt paydown with the corresponding capital project's Internal Bank Loan repayments.

In order to maintain or increase liquidity, the university will use proceeds available from short-term debt for financing of capital projects under the following conditions:

1. The proceeds are used to provide interim financing for a capital project with a committed source of funding (e.g., in anticipation of issuance of long-term debt, receipt of certain philanthropic gifts, or grants for university projects);
2. The cost of the funds available under a line of credit are equal to or lower than
   a. the university's investment return (i.e., opportunity cost); and
   b. alternative funding options; and

3. The use of the proceeds is compliant with applicable statutes and university policies and standards.