



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

World Wide Web Site: <http://opacnmi.com>
2nd Floor J. E. Tenorio Building, Chalan Pale Arnold
Gualo Rai, Saipan, MP 96950

Mailing Address:
P.O. Box 501399
Saipan, MP 96950

E-mail Address:
mail@opacnmi.com

Phone: (670) 234-6481
Fax: (670) 234-7812

April 3, 2002

The Honorable Heinz S. Hofschneider
Speaker of the House
Thirteenth Northern Marianas
Commonwealth Legislature
Saipan, MP 96950

Dear Speaker Hofschneider:

Subject: Government Deposits in Banks and Financial Institutions

As part of a larger ongoing audit, the Office of the Public Auditor has conducted a survey of Commonwealth government deposits in banks and financial institutions as of December 15, 2001. Our survey indicates that over \$23 million of government funds are deposited by a number of government agencies in non-federally insured banks and financial institutions. This could place the CNMI government at potential financial risk if these non-federally insured banks do not have adequate alternative insurance. Consequently, OPA recommends that the Legislature as well as the Administration revisit the existing laws governing deposits of government funds.

Government Deposit Safety Act of 1984

On March 20, 1985, the Fourth Commonwealth Legislature enacted Public Law 4-33, also known as the "Government Deposit Safety Act of 1984", to address collateralization of government deposits held in banks and financial institutions. In this Act, the Legislature stated, "deposits of the Commonwealth are subject to unwarranted risk without full collateralization of deposits. By requiring collateralization, the Commonwealth will be in conformity with United States, state, county and municipal deposit safety practices."

Public Law 4-33 required that all government funds be deposited in federally insured banks. It also required that any funds deposited in excess of the insurance coverage be secured by bank assets valued, at all times, at 110% of these excess funds. Section 3 of the Act states:

No officer or employee of the Commonwealth Government and its agencies and public corporations shall deposit or cause to be deposited public funds in a bank whose

deposits of less than \$100,000 **are not insured** by an agency of the United States Government or by a U.S. Treasury listed surety agency. All of the deposited funds in excess of the insurance coverage of the funds **shall be secured** by bank assets valued at all times at 110% of these excess funds. Bank assets which serve as collateral under the Act shall be in the form of United States Treasury and the United States Government agency securities having readily ascertainable market value. The United States Government Agency securities are to be securities bearing the full faith and credit of the United States Government. (Emphasis added.)

On December 28, 1994, Public Law 4-33 was amended by Public Law 9-13, thereby allowing government funds to be deposited in *non-Federal Deposit Insurance Corporation (FDIC) banks*. Section 3 of Public Law 9-13 read as follows:

All funds in the commonwealth treasury may be deposited by the Secretary of Finance to the credit of the CNMI government **in any bank** which the Secretary may select pursuant to this Chapter and any sums so deposited shall be deemed to be in the commonwealth treasury; provided that the bank in which the money is deposited shall furnish and pledge security with bank assets valued at all times at 110% of these funds...

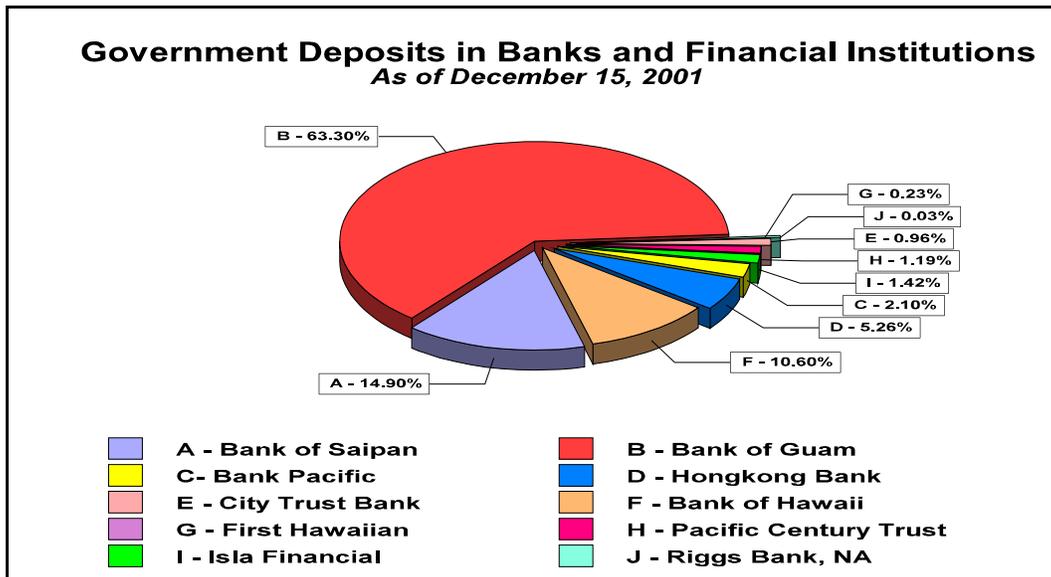
In removing the FDIC requirement, the Legislature explained that the Government Safety Deposit Act of 1984 limited the CNMI Government in its “choice of where to deposit public funds thus obligating the CNMI government to make its deposits with banks which have consistently and historically provided the depositor with lower interest rates.” The intent of the amendment was to allow the Secretary of Finance the option of depositing public funds in banks which are non-FDIC members, “provided that such banks fully secure or ‘collateralize’ government deposits against bank assets.”

The Government deposit requirement was again amended on August 6, 2001, by Public Law 12-61, which reduced from 110 percent to 100 percent the security that a bank must pledge in bank assets for the protection of CNMI Government deposited funds. In approving the amendment, the Governor explained that the measure would not adversely affect the protection of government funds. On the other hand, the reduction would allow the bank to re-invest the available money in the CNMI economy.

Public Law 4-33 was broader than Public Law 9-13 as its coverage also applied to “officer(s) or employee(s) of the Commonwealth Government and public corporations.” Public Law 9-13 narrowed its coverage changing the language to “all funds in the Commonwealth Treasury ... deposited by the Secretary of Finance.” Some autonomous agencies have explicit mandates to deposit their funds in federally secured banks. Among these agencies are: 1) the

Commonwealth Utilities Corporation (CUC), which under 4 CMC § 8155 requires that “the corporation shall deposit all funds received by it in **“insured or fully collateralized accounts”**; 2) the Commonwealth Ports Authority (CPA) which under 2 CMC §2175 mandates that **“funds on deposit on trustee banks shall be secured”**; and 3) the Commonwealth Development Authority (CDA), which by 4 CMC §10403 (d) is required to invest reserves and other funds in investment securities, such as **“deposits which are fully insured by FDIC, ... or any other federal deposit insurance program.”**

As of December 15, 2001, the CNMI government had deposits in banks and financial institutions amounting to \$105 million. This is comprised of Commonwealth Treasury funds totaling \$24.5 million, and various autonomous agency funds totaling \$80.5 million.



Government Funds Deposited in Non-FDIC Member Banks

Over \$23 million of government funds were deposited in non-FDIC member banks at December 15, 2001 (see **Schedule A**, attached, for a breakdown of these deposits). Government funds deposited in non-FDIC banks, other than Hong Kong and Shanghai Bank¹, totaled \$18,236,000, or 17 percent of total government deposits:

<u>Name of Bank/Financial Institution</u>	<u>Amount of Deposits</u>
Bank of Saipan	\$ 15,722,000
Isla Financial	1,500,000
City Trust Bank	<u>1,014,000</u>
	<u>\$ 18,236,000</u>

Bank of Saipan

The government had deposits with Bank of Saipan amounting to \$15.7 million as of December 15, 2001², representing 32 percent of the bank's deposit liabilities of \$48,646,000, and 30 percent of its total assets of \$54 million. Based on the bank's audited financial statements as of September 30, 2000, the bank was in compliance with Public Law 9-13 as 110 percent of its deposits were collateralized in the form of U.S. Government Securities. The bank's financial statements for FY 2001 were unavailable, and therefore we could not determine whether funds deposited as of September 30, 2001 were adequately collateralized.

¹Under 4 CMC §6228 of the Commonwealth Banking Code, Hongkong and Shanghai Bank is not required to obtain deposit insurance because it has assets in excess of \$100 billion.

²This is based on the Summary Reports prepared by Banking Division, Department of Commerce from quarterly reports submitted by banks.

As of December 15, 2001, the following government agencies had deposits with Bank of Saipan:

<u>Name of Agency/Office</u>	<u>Amount of Deposits</u>
Commonwealth Development Authority	\$962,110
Commonwealth Government Employees' Credit Union	535,990
Commonwealth Treasury	282,720
Marianas Public Lands Authority	8,006,300
Marianas Visitors Authority	250,000
Northern Mariana Islands Retirement Funds	5,569,210
Tinian Municipality	<u>115,730</u>
Total	<u>\$15,722,060</u>

Of the agencies cited above, some have express or implied requirements in their enabling legislation and regulations to deposit agency funds in FDIC member banks:

Agency/Office	CNMI Code/Law Applicable	Restriction	What the Code says:
Commonwealth Development Authority	4 CMC §10403 (d) (5)	Explicit	<p>§ 10403. Financial Prudence.</p> <p>(d) Reserves and other funds of the authority not currently needed for development activities or liquidity shall be reinvested by the authority to the extent permitted by law, in investment securities... Investment securities are defined to mean the following:</p> <p>(5) Deposits which are fully insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Share Insurance Fund or any other federal deposit insurance program;</p>

Commonwealth Govt. Employees' Credit Union	4 CMC § 6929	Explicit	§ 6929. Bank Deposit and Safety Requirements. The credit union may, as it deems appropriate, make deposits of cash or other monetary instruments in banks which meet the requirements of 1 CMC § 7723, and in banks which meet the requirements of 1 CMC §§ 7723, 7727 and 7728 (amended by P.L. 12-61)
Department of Finance - Treasury	1 CMC § 7723, 7727 and 7728 (as amended by P.L. 12-61)	Explicit	§ 7723. Deposit Safety Requirements All funds in the Commonwealth Treasury may be deposited by the Secretary of Finance to the credit of the Commonwealth government in any bank which the secretary may select... provided that the bank in which the money is deposited shall furnish and pledge security with bank assets valued at all times at 100 percent of these funds.
Marianas Visitors Authority	4 CMC § 2125	Explicit	All moneys received by the MVA from whatever source shall be deposited in the Fund and eligible banks as defined in the Commonwealth Code.

City Trust Bank

The government had deposits with City Trust Bank amounting to \$1,013,720 as of December 31, 2001. This represents only 7 percent of the bank's deposit liabilities of \$13,789,000. Based on the bank's audited financial statements for the year ending December 31, 2000, City Trust Bank had restricted Time Certificates of Deposits (TCD) valued at 110 percent of government deposits.

However, the Government Deposit Act, Public Law 9 - 13, in effect for that time period requires that pledges or securities must be "in the form of United States Treasury and the United States Government agency securities having readily ascertainable market value. The United States Government Agency securities are to be securities bearing the full faith and credit of the United States Government." The collaterals pledged by City Trust Bank do not conform to the requirement of the Act and may not be acceptable because Time Certificates of Deposits (TCDs) do not bear the full faith and credit of the United States Government. As of December 15, 2001, two government agencies had deposits with City Trust Bank, the Commonwealth Development Authority (CDA) and its subsidiary corporation, Northern

Marianas Housing Corporation. Their deposits amounted to \$1,013,720, broken down:

<u>Name of Agency/Office</u>	<u>Amount of Deposits</u>
Commonwealth Development Authority	\$675,417
Northern Marianas Housing Corporation	<u>338,303</u>
Total	<u>\$1,013,720</u>

In addition to not meeting Public Law 9-13's requirement, the CDA funds may not comply with CDA enabling legislation. 4 CMC 10403 (d) requires CDA to deposit reserve funds not currently needed for development activities or liquidity, in investment securities, which are defined, among other ways, in Subsection (d) (5), as "deposits which are fully insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Share Insurance Fund or any other federal deposit insurance program."

Isla Financial Services, Inc.

The government had deposits with Isla Financial Services, Inc. amounting to \$1,500,000 at June 30, 2001, according to the institution's latest financial statements. This represents 32 percent of the institution's deposit liabilities of \$4,646,383 and 22 percent of the institution's assets of \$6,746,332. The financial statements did not disclose whether bank assets were being pledged as collateral for the government deposits.

The Marianas Public Land Authority (MPLA) is the sole depositor of the \$1.5 million deposited in this institution. MPLA's enabling law does not explicitly prohibit the agency from investing funds in this institution.

Conclusion

Existing laws do not prohibit most CNMI government agencies from depositing their funds in non-FDIC member banks. The current weakened condition of the Commonwealth economy has a potential to impact local banks. The CNMI should strongly consider the rigid requirements and monitoring that the Federal Deposit Insurance Corporation imposes on its members. Although the non-FDIC banks utilized by the CNMI government may have pledged security, the CNMI has no guarantee that such securities are adequate. To address these concerns, we urge the following measures be taken to address possible unwarranted risk

to the CNMI Government.

1. The Legislature and the Administration should revisit the Government Safety Deposit Act of 1994, as amended by Public Law 12-61, and weigh the benefits of the Act against the risk to CNMI government funds.
2. The Legislature amend the law governing public funds to ensure that it applies to all autonomous agencies, including by not limited to those who do not currently have deposit requirements such as Marianas Public Land Authority, Marianas Public Land Trust, Northern Mariana Islands Retirement Funds, Northern Marianas College, Northern Marianas Housing Corporation, Public School System, and the Tinian Municipal Treasurer.
3. The Banking Division of the Department of Commerce be directed to conduct a thorough financial review of non-FDIC banks holding government deposits to determine the financial health of these banks and to ensure that government deposits are adequately collateralized in the form prescribed by law.

Please contact us if you would like to discuss this report and our recommendations.

Sincerely,

A handwritten signature in blue ink, appearing to read "MS Sablan", written in a cursive style.

Michael S. Sablan, CPA
Public Auditor

SCHEDULE A
GOVERNMENT DEPOSITS IN BANKS AND FINANCIAL INSTITUTIONS
AS OF DECEMBER 15, 2001

	Bank of Saipan	Bank of Guam	Bank Pacific	HongKong & Shanghai	City Trust Bank	Bank of Hawaii	First Hawaiian Bank	Pacific Century Trust	Isla Financial	Riggs Bank, NA	Total
1 Commonwealth Development Authority	\$962,110.29	\$59,023.63	\$414,481.79		\$675,417.36	\$1,511,984.00					\$3,623,017.07
2 Commonwealth Govt. Employees' Credit Union	535,986.38										\$535,986.38
3 Commonwealth Ports Authority		\$16,829,474.18						1,260,575.38			\$18,090,049.56
4 Commonwealth Utilities Corporation		14,684,101.43		5,315,323.85							\$19,999,425.28
5 Department of Finance - Treasury	282,722.59	23,776,594.19		100,000.00			246,895.49				\$24,406,212.27
6 Guam Liaison Office		17,322.25									\$17,322.25
7 Marianas Hawaii Office						66,789.21					\$66,789.21
8 Marianas Public Land Authority	8,006,301.09	5,765,408.48				2,816,788.56			1,500,000.00		\$18,088,498.13
9 Marianas Public Land Trust		108,050.34									\$108,050.34
10 Marianas Visitors Authority	250,000.00					16,540.44					\$266,540.44
11 Northern Mariana Islands Retirement Fund	5,569,209.75	4,080,579.72									\$9,649,789.47
12 Northern Marianas College		59,023.63				471,271.83					\$530,295.46
13 Northern Marianas Housing Corporation		206,408.86	1,806,147.13	137,561.34	338,302.76	2,799,863.45					\$5,288,283.54
14 Office of Resident Representative to Washington										29,116.69	\$29,116.69
15 Public School System		849,068.63				3,506,226.19					\$4,355,294.82
16 Tinian Municipality	115,730.08	377,044.27									\$492,774.35
TOTAL	\$15,722,060.18	\$66,812,099.61	\$2,220,628.92	\$5,552,885.19	\$1,013,720.12	\$11,189,463.68	\$246,895.49	\$1,260,575.38	\$1,500,000.00	\$29,116.69	\$105,547,445.26
% OF TOTAL	14.90%	63.30%	2.10%	5.26%	0.96%	10.60%	0.23%	1.19%	1.42%	0.03%	100.00%