

SUBJECT: Public Deposits

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INTRODUCTION

This release applies to all state-chartered and federal credit unions. It describes the rules applicable to accepting deposits from state or local governmental units or agencies.

EXECUTIVE SUMMARY

Wisconsin's state-chartered credit unions may accept public deposits from units of Wisconsin state or local government. Federal credit unions may accept public deposits from any state. A public depositor need not qualify for membership in order to place deposits in a credit union.

Federal credit unions and federally insured, state-chartered credit unions may receive public unit and nonmember shares (such as those that may be accepted by low-income credit unions) in an amount up to 50% of the credit union's net amount of paid-in and unimpaired capital and surplus less any public unit and nonmember shares, or \$3 million, whichever is greater. In addition, they must develop a plan detailing the intended use of any borrowings, public unit or nonmember shares, that taken together exceed 70% of the credit union's paid-in and unimpaired capital and surplus. They do not need to submit these plans for approval, but instead simply maintain the plans and make them available to examiners.

Additional protection for Wisconsin public depositors may be found in Wisconsin's Public Deposit Guarantee Fund, which may provide [\\$1 million](#) additional protection against losses. This fund is not replenished, except for interest and recoveries from federal insurers, so depositors should not fully rely upon it for protection.

Public deposits are procured through competitive bidding. Since large deposits may be withdrawn overnight at the end of a deposit term, it is important for credit unions to match the deposits to investments of like term.

The governmental unit must pass a resolution designating public depositories. Private vendors offer specialized forms for public deposits.

Although credit unions are generally exempt from income tax, Wisconsin taxes state-chartered credit unions on the income derived from public deposits. The compliance burden and expense of completing corporate tax returns discourages many credit unions from accepting public deposits.

DEFINITION

Wisconsin defines public deposits as public funds deposited into a financial institution by the treasurer of any Wisconsin state or local governmental unit, or any agency of such unit. Examples of local government units include towns, cities, counties, villages, school districts, sewer districts, etc. The term "public deposits" is similar to what the NCUA rules refer to as "public unit accounts." But the NCUA term also includes government deposits of other states.

AUTHORITY

Wis. Stats. § 186.113(20) authorizes Wisconsin's state-chartered credit unions to act as depositories of Wisconsin state and local funds. Wis. Stats. § 34.09 provides that any federal or state credit union may be designated as a public depository if it:

- Has a branch or main office in this state,
- Complies with Wis. Stats. Chapter 34 (Public Deposits), and
- Accepts periodic payments made by state agencies by direct deposit, ACH, etc.

Federal credit unions are not restricted to accepting deposits from Wisconsin units of government, except in regard to the benefits of the Public Deposit Guarantee Fund.

MEMBERSHIP

A public depositor need not become a member of the credit union, but is permitted to do so. However, membership is necessary if the public depositor seeks to borrow funds from the credit union.

Section 186.02(2)(em) provides that a public depositor that makes a public deposit in a state-chartered credit union may become a member if permitted by the credit union's bylaws. The standard language in the 2017 Model Credit Union Bylaws (and in earlier versions, as well) permits a public depositor to become a member. If your credit union is not using one of those models, an amendment may be necessary to permit membership, if desired.

Unlike most organization accounts, the public depositor is not required to qualify for membership or deposits based on the majority of its constituents qualifying for membership in the credit union. Thus, a credit union may accept public deposits from any public depositor in the state. Most public depositors will seek to invest their funds locally if rates and other terms are competitive.

NCUA LIMITATIONS ON PUBLIC DEPOSITS

As of Jan. 29, 2020, the NCUA allows federal credit unions (FCUs) and federally insured, state-chartered credit unions (FISCUs) to receive public unit and nonmember shares (such as those that may be accepted by low-income credit unions) in an amount up to 50% of the credit union's net amount of paid-in and unimpaired capital and surplus less any public unit and nonmember shares, or \$3 million, whichever is greater. See §§701.32(b)(1) and 741.204(a) of the NCUA Regulations.

Previously, the NCUA limited the maximum amount of all public unit accounts and nonmember shares (such as those that may be accepted by low-income credit unions) to the greater of \$3 million or 20% of the total shares of the credit union. The NCUA's regional director could grant exemptions. Such exemptions are no longer available. Waivers granted prior to Jan 29, 2020, should be considered expired as of that date, the NCUA has written.

FCUs and FISCUs must develop a plan detailing the intended use of any borrowings, public unit or nonmember shares, that taken together exceed 70% of the credit union's paid-in and unimpaired capital and surplus. They do not need to submit these plans for approval, but instead simply maintain the plans and make them available to examiners.

FEDERAL INSURANCE

The NCUSIF limits on insurance coverage for public deposits can be complicated. The NCUA's pamphlet, "*Your Insured Funds*," explains them as follows:

For insurance purposes, the official custodian of funds belonging to a public unit, rather than the public unit itself, is insured as the account holder. All funds belonging to a public unit and invested by the same custodian in a federally insured credit union are categorized as either share draft accounts or share certificate and regular share accounts. If these accounts are invested in a federally insured credit union located in the jurisdiction from which the official custodian derives his authority, then the share draft accounts will be insured separately from the share certificate and regular share accounts. Under this circumstance, all share draft accounts are added together and insured up to \$250,000 and all share certificate and regular share accounts are also added together and separately insured up to the \$250,000 standard maximum. If, however, these accounts are invested in a federally insured credit union located outside of the jurisdiction from which the official custodian derives his authority, then insurance coverage is limited to \$250,000 for all accounts regardless of whether they are share draft, share certificate or regular share accounts. If there is more than one official

custodian for the same public unit, the funds invested by each custodian are separately insured. If the same person is custodian of funds for more than one public unit, he is separately insured with respect to the funds of each unit held by him in properly designated accounts.

For share insurance purposes, a “political subdivision” is entitled to the same insurance coverage as any other public unit. “Political subdivision” includes any subdivision of a public unit or any principal department of such unit meeting the following factors:

- state statute authorized the creation of the unit;
- state statute allocated some functions of government to the unit; and
- a statute or ordinance provides for the unit to have funds for its exclusive use and control.

The pamphlet goes on to provide several examples that illustrate how the rules apply to different situations. Public depositors should be referred to the pamphlet and invited to contact the NCUA for additional clarification.

PUBLIC DEPOSIT GUARANTEE FUND

Wisconsin public depositors are eligible for some additional protection under the state’s Public Deposit Guarantee Fund for losses of up to \$1 million, above and beyond federal deposit insurance coverage. Wis. Stats. §34.08. This extra state protection is important, because some public depositors are limited in how much they can deposit, depending on coverage amounts.

Revisions to Wis. Stats. Ch. 34 prospectively abolished the Public Deposit Guarantee Fund in 1985. This means that the Guarantee Fund is no longer replenished. It is a “static” fund. Present funds, supplemented by interest earnings and reimbursements from the FDIC or NCUSIF, may be used to cover losses until exhausted. Public depositors located in Wisconsin may be protected by the fund for deposits at state or federal financial institutions with a main or branch office located in the state. Information on the status of the fund is published in the Division of Banking section of the State of Wisconsin Department of Financial Institutions’ website under *Public Deposit Guarantee Account*.

Claims against the Guarantee Fund are paid in the order in which satisfactory proofs of loss are received by the Division of Banking, at the Department of Financial Institutions. Thus, a public depositor has no firm assurance that the Guarantee Fund will be available at a future date when it may need to make a claim. For that reason, public depositors with questions about coverage eligibility or amounts should be advised to consult with their attorney.

The public depositor must file any claim against the Public Deposit Guarantee Fund with the Division of Banking within 60 days of the loss. The fund potentially covers claims up to \$1 million per public depositor, above and beyond federal insurance.

BUSINESS CONSIDERATIONS

The primary considerations governmental units have in awarding public deposits are solvency, liquidity, and yield. Community Reinvestment Act (CRA) ratings can also be a consideration, especially in urban areas. Credit unions are not subject to CRA, but do not let that interfere with your bid. Stand ready to supply Home Mortgage Disclosure Act data or other evidence of community involvement, if requested.

For the credit union bidding on municipal deposits, it is crucial to match short-term money to investments of similar maturity, or otherwise assure liquidity. Public funds are deposited for the short-term and will be moved if another institution offers better rates next time around. There is no loyalty.

A government unit sometimes offers a financial services package. The financial institution provides the package of services the governmental unit needs, in exchange for enough noninterest-bearing deposits to pay for the services. The package of services the government body needs will, of course, vary with its size and sophistication. But the credit union must take care, as providing all the services in the package may be beyond the credit union’s capability or legal authority. Most credit unions do not seek the contract for the financial services package.

RESOLUTIONS

The state banking association offers depository resolution forms for government deposits. The governing board of each public depositor is required to designate, by resolution, one or more qualifying financial institutions as public depositories in which the treasurer must deposit nearly all public monies. The governing board must also specify whether the funds are to be maintained in time deposits, demand deposits or savings deposits, and whether a surety or other security bond shall be required of the

financial institution to secure the repayment of the deposits. Resolutions often designate more than one public depository, so that the treasurer may take bids to secure the most favorable rate and other terms.

The credit union should obtain a certified copy of any resolution designating the credit union as a public depository, as it is the official authorization for the treasurer or other designee to open accounts of specified types, and make deposits or withdrawals.

In rare cases, the governing board might fail or refuse to designate any public depository. In such case, the treasurer may, after notice to each member of the governing board, take separate action to designate public depositories for no more than 90 days. The treasurer's designation is subject to further action by the governing board.

TRUTH IN SAVINGS

Public unit accounts are exempt from the requirements of Truth in Savings. Of course, the credit union will still need to have an agreement setting forth the terms of the account.

TAX ON INCOME FROM PUBLIC DEPOSITS

As an exception to their tax-exempt status, state-chartered credit unions must pay income tax on income derived from public deposits. *Wis. Stats. § 71.26(1)(a)*. A representative of the Wisconsin Department of Revenue (DOR) contends that the tax also applies to federal credit unions, while the NCUA states that those credit unions are exempt from any state income tax.

The credit union files the Form 4 *Wisconsin Non-Combined Corporation Franchise or Income Tax Return* or Form 6 *Wisconsin Combined Corporation Franchise or Income Tax Return*, and Schedule CU-1 *Credit Union Adjustment to Income*. The credit union may need to use Schedules V or W to show additions or subtractions to net income. Instructions are available for each of these forms and schedules on the Wisconsin DOR website at www.revenue.wi.gov.

In recent years, the Wisconsin Department of Revenue has imposed a requirement that the state corporate tax forms and schedules be filed electronically. So far, the DOR has indicated willingness to approve hardship exemptions requested by credit unions when vendor software is unable to complete the forms without also filing a federal corporate income tax return.

A state-chartered credit union that is engaged in business both in and outside Wisconsin must apportion its income between the states as provided in Wis. Admin. Code § Tax 2.49, using Form 4B-1.

The compliance burden and expense of properly completing corporate tax returns discourages many credit unions from accepting public deposits.

Wisconsin net income is computed under the federal Internal Revenue Code (IRC) as defined for Wisconsin purposes, with certain modifications. § 71.26(2)(a). The modifications are provided in § 71.26(3).

Deductions for Bad Debts

The IRC sections relating to treatment of bad debts generally apply in computing net income and are not modified for Wisconsin purposes. The IRC provides for a deduction of debts, which become worthless during the taxable year. IRC 166(a). Most taxpayers must use the direct write-off (or specific charge-off) method to deduct bad debts. However, "small banks," with assets of \$500 million or less, may claim a deduction for a reasonable addition to reserves, instead of actual charge-offs. IRC § 585.

Reserve Method

According to the Wisconsin Department of Revenue, a credit union with assets of \$500 million or less is treated as a "small bank" if it makes commercial loans or exercises trust powers. Credit unions generally do not have trust powers, so the key question is whether the credit union makes business loans. If so, the bad debt deduction may be based on transfers to reserves rather than actual charge-offs.

A credit union which chooses the reserve method must compute its bad debt deduction under IRC § 585(b). The credit union must base the addition to its reserve for bad debts on the experience method. Under the experience method, a credit union may add to its bad debt reserve the amount computed on the basis of its actual experience as shown by losses for the current year and the five preceding taxable years. The tax benefit from this provision is that financial institutions using the reserve method can deduct bad debts before they actually become worthless.

No Annual Election

The Wisconsin Department of Revenue cautions those credit unions fitting the definition of “small bank” that they do not have the option each year to elect the greater of the addition to reserves or the actual charge-offs. The method for computing and deducting bad debts is a method of accounting under the IRC. A credit union may change its method of accounting for bad debts only as specified under federal law. In doing so, it must make any adjustments necessary to prevent the omission or duplication of a deduction as required under IRC § 481.

Apportionment of Income Between States

A financial institution that is engaged in business both in and outside this state must apportion its income as provided in Wis. Admin. Code Tax 2.49 *Apportionment of apportionable income of interstate financial institutions*. It may result in tax savings for a credit union that is deemed to engage in business outside the state. However, the regulation and its computations are complicated. The Wisconsin Department of Revenue has informally advised The League that a credit union may simplify by choosing to treat all income as Wisconsin income if it is willing to pay the tax.

Credit Union Declaration Of Exempt Status (Form CU)

As explained earlier, Wisconsin Form 4 or Form 6 and Schedule CU-1 must be filed for any year a state-chartered credit union accepts public deposits. The *Credit Union Declaration of Exempt Status* (Form CU) is used to establish that a credit union is exempt from Wisconsin’s franchise or income tax, due to the credit union having had no public deposits during the taxable year. Most credit unions do not accept public deposits and so filed Form CU in 1985 when the form was first adopted. Once filed, Form CU remains in effect until the credit union accepts public deposits, if ever.

A state-chartered credit union that accepts public deposits must file the Wisconsin Form 4 or Form 6 and Schedule CU-1 at the end of the year. If the credit union holds no public deposits the following year, it files Form CU at the end of the year to re-establish its exempt status.

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Legal Affairs Department
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