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CITY OF CHICAGO
OFFICE OF INSPECTOR GENERAL

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ANNUAL FOLLOW-UP TO OIG'S AUDIT OF THE MUNICIPAL DEPOSITORY DESIGNATION PROCESS

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I | Introduction

Chicago City Clerk - Council Div.

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The City of Chicago Office of Inspector General (OIG) has completed a follow-up to its August 2021 audit of the Department of Finance's (DOF) administration of the process for designating municipal depositories. Banks designated as depositories hold and pay interest on funds deposited by the City and the Chicago Board of Education, essentially serving as the City's checking accounts. Based on the Department's responses, OIG concludes that DOF has partially implemented corrective actions related to the audit findings.

The purpose of the 2021 audit was to determine whether DOF ensured that banks applying for municipal depository designations submitted the required information, and whether DOF used the information to ensure that the City partners with institutions that not only have the capacity to fulfill its banking needs, but also provide inclusive and equitable financial services across Chicago's communities. OIG found that although DOF ensured that banks submitted all documentation required by the Request for Proposals (RFP), it did not evaluate whether the banks provided inclusive and equitable financial services throughout Chicago. Furthermore, OIG found that DOF, City Council, and the City of Chicago Treasurer's Office had not coordinated their roles in the municipal depository designation process to achieve the City's inclusivity and equity goals.

Based on the results of the audit, OIG recommended that DOF, in collaboration with City Council's Committee on Finance, develop and implement a process to evaluate banks' lending and deposit records for equitable financial services provision. OIG recommended that the process include provisions related to sharing evaluation results with Council and applicant banks. OIG also recommended that DOF collaborate with Council and the Treasurer's Office to develop a coordinated municipal depository designation process that aligns with the City's equitable banking goals and allows the City to deposit public funds with banks that share and live up to those goals. In its response to the audit, DOF described corrective actions it would take.

In September 2021, City Council passed an updated version of the Municipal Depositories Ordinance that expands applicant banks' reporting requirements and directs DOF to fulfill its related duties in a more transparent manner. The Committee on Finance held subject matter hearings in December 2021 and 2022, as required by the Ordinance. During the hearings, DOF shared information about applicant banks' lending performance and the Woodstock Institute shared its analysis of applicant banks' lending performance. The hearings allowed for public and aldermanic comment on persistent lending disparities in Chicago.

In June 2022, OIG inquired about corrective actions taken by DOF in response to the audit. Based on DOF's follow-up response, OIG concludes that DOF partially implemented corrective actions. Specifically, DOF formed an Evaluation Committee with staff from Council's Committee on Finance, the Treasurer's Office, and the City of Chicago Department of Housing (DOH) to ensure that RFP submissions are complete. Furthermore, DOF revised its RFP language to reflect Ordinance updates and published applicant banks' responses through the Chicago Data Portal. DOF has not, however, set targets for equitable lending and deposit activity or defined the goals of the municipal depository designation process.

Once fully implemented, OIG believes the corrective actions reported by DOF may reasonably be expected to resolve the core findings noted in the audit. OIG urges DOF to fully implement a designation process based on evaluation results and defined goals, and to substantively explore

and promote equitable lending opportunities throughout all of Chicago's communities. Below, OIG summarizes its two audit findings and recommendations, as well as DOF's response to the follow-up inquiry.

OIG thanks the staff and leadership of DOF for their cooperation during the audit and their responsiveness to the follow-up inquiries.

II | Follow-Up Results

In June 2022, OIG followed up on its August 2021 Audit of the Municipal Depository Designation Process.¹ DOF responded by describing the corrective actions it has taken and providing supporting documentation. Below, OIG summarizes the two audit findings, the associated recommendations, and the status of DOF's corrective actions. OIG did not observe or test implementation of the new procedures in this follow-up; thus, it makes no determination as to their effectiveness, which would require a new audit with full testing.

| Finding 1: Although DOF ensures that banks' municipal depository designation RFP submissions are complete, it does not evaluate their community investment and equitable lending efforts.

OIG Recommendation 1 |

OIG recommended that DOF, in collaboration with the City Council's Committee on Finance, develop and implement a process to evaluate the equitable service provision practices of banks seeking designation as municipal depositories. OIG recommended that, within the process, DOF

- identify the factors DOF would consider in assessing banking practices (e.g., characteristics of bank customers including race, geographical location, and median income);
- set targets for equitable lending and deposit activity;
- establish detailed procedures for evaluating RFP submissions; and
- explain how DOF would share results of the annual evaluations with City Council and the applicant banks.

State of Corrective Action 1 | Partially Implemented

DOF formed an Evaluation Committee with staff from Council's Committee on Finance, the Treasurer's Office, and DOH to ensure that RFP submissions contain all required items. The Evaluation Committee's work reflects increased data collection and communication with the Committee on Finance. Specifically, the Evaluation Committee reviews,

- "[the] financial strength of [the applicant bank's] local institution;
- rates offered on demand accounts, and certificates of deposit or time deposits;
- dollar volume and percent of total lending within the City;
- demonstrated commitment to support community and economic development within the City; and
- compliance with the requirements of [the] RFP."

¹ City of Chicago Office of Inspector General, "Audit of the Municipal Depository Designation Process," August 31, 2021, accessed September 14, 2022, <https://igchicago.org/wp-content/uploads/2021/08/Audit-of-the-Municipal-Depository-Designation-Process.pdf>.

Further, DOF has increased the transparency of the process by making applicant data collected through the RFP available through the City of Chicago Data Portal² and its departmental website.³ However, while DOF has defined evaluation factors, it has not set equitable lending and deposit targets or based designations on banks' community investment and equitable lending efforts. OIG encourages DOF to implement these actions, thereby aligning equitable lending principles with equitable investment outcomes.

| Finding 2: DOF, City Council, and the Treasurer's Office have not coordinated their roles in the municipal depository process to achieve the City's objective of encouraging equitable banking practices throughout Chicago.

OIG Recommendation 2 |

OIG recommended that DOF collaborate with City Council and the Treasurer's Office to develop a coordinated municipal depository designation process that aligns with the City's equitable investment goals and maximizes the City's ability to deposit public funds in banks that share those goals. OIG suggested that the process might include,

- defining the goals of the municipal depository designation process and the responsibilities of each stakeholder;
- determining how progress towards such goals will be measured and documented;
- setting the frequency and format for submission of documentation required of depository applicants; and
- exploring banking options that may better leverage the City's deposits for greater investment in Chicago's historically underserved communities (e.g., establishing a municipal bank or allowing credit unions to accept public deposits).

State of Corrective Action 2 | Partially Implemented

As noted, DOF formed an Evaluation Committee with the Committee on Finance, the Treasurer's Office, and DOH to ensure that RFP submissions are complete. DOF stated that the Evaluation Committee intends to review RFP submissions over several years to determine how to improve the Municipal Depositories Ordinance. Notably, the City has lowered its collateral requirements for the financial institutions that hold its investments from 102% to 100%.⁴ This could encourage participation by smaller financial institutions, such as community banks, that conduct more local lending than their larger counterparts.⁵ According to the Federal Deposit Insurance Corporation, "Despite holding a small share of total loans, community banks are a key provider of funding for many local businesses, most importantly by making [Commercial Real Estate] loans, small business loans, and agricultural loans. DOF reported that the next step in encouraging smaller institutions'

² City of Chicago, Chicago Data Portal, "Lending Equity," February 24, 2022, accessed October 19, 2022, <https://data.cityofchicago.org/browse?limitTo=datasets&q=%22Lending+Equity%22&sortBy=alpha>.

³ City of Chicago Department of Finance, "Municipal Depositories RFP," December 6, 2021, accessed October 19, 2022, https://www.chicago.gov/city/en/depts/fin/supp_info/municipal-depositories-rfp.html.

⁴ Collateral includes the assets or other financial instruments pledged by financial institutions to secure their investors' deposits. Government Finance Officers Association, "Collateralizing Public Deposits," September 20, 2019, accessed October 19, 2022, <https://www.gfoa.org/materials/collateralizing-public-deposits>.

⁵ Federal Deposit Insurance Corporation, "FDIC Community Banking Study," December 2020, p.VI, accessed October 19, 2022, <https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf>.

participation is proposing an ordinance to allow the designation of credit unions.⁶ Despite DOF's increased coordination with City stakeholders, however, it has not defined goals for the designation process. OIG urges DOF to continue formalizing its coordinated designation process by setting goals and measuring outcomes. The Department should also continue to explore and implement alternative banking options that better leverage the City's deposits for greater investment in Chicago's historically underserved communities (e.g., establishing a municipal bank or allowing credit unions to accept public deposits).

⁶ In 2019, a group of alderpersons proposed amending the Municipal Code Chapter 2-32 to designate credit unions as municipal depositories. City of Chicago, Office of the City Clerk, "O2019-4128," 2-32-400 (e), accessed October 19, 2022, <https://chicago.legistar.com/LegislationDetail.aspx?ID=3980223&GUID=BB61AA84-0467-4431-8189-9ADD75F96C27&Options=Advanced&Search=>.