

Title 19. Public Finance

Chapter III. State Board of Finance, Treasurer of State

Subchapter A. Generally

Part 10. Management of Cash Funds

Codification Notes. This part as promulgated prior to codification into the Code of Arkansas Rules provided as follows:

"RULE 2012-A"

"The State Board of Finance hereby promulgates the following rule under Ark. Code Ann. §19- 3-101, §19-4-801 et seq. and §25-15-201 et seq. This rule is intended to address the management, investment and collateralization of cash funds deposited with banks or financial institutions by agencies of the State of Arkansas. The Treasurer of the State of Arkansas and the Arkansas Department of Finance and Administration are hereby authorized to act on behalf of the State Board of Finance to administer this rule. The purpose of this rule is to provide guidance for state agencies consistent with commonly recognized cash management, investment and collateralization practices. Cash funds are "public monies" subject to all applicable Arkansas code provisions."

Subpart 1. Generally

19 CAR § 10-101. General overview.

(a)(1) The goal of cash management is to protect the principal while maximizing investment income and minimizing non-interest-earning balances.

(2) Cash management considerations begin with the collection of funds and extend to the actual expenditure of those funds.

(3) Agencies should ensure that incoming funds are collected and deposited as soon as possible.

(4) Whenever possible, funds should be deposited in interest-earning accounts or invested in interest-earning investments.

(5) Interest income can:

(A) Be used to fund an agency's operating expenses; and

(B) Reduce the necessity of increasing the fees levied on the public.

(6) An agency may use non-interest-earning accounts if they provide a greater rate of return.

(7) Agencies should utilize accounts and programs that maximize Federal Deposit Insurance Corporation deposit insurance coverage.

(8) A minimum of four (4) bids should be obtained from approved banks or financial institutions in order to obtain the highest interest rate possible.

(9) If an agency determines it is unable to obtain four (4) bids, the agency should provide a written explanation of that determination to the State Board of Finance or its designee.

(10) If the State Board of Finance rejects the determination, it can direct the agency to rebid.

(b)(1) Fund expenditures should be regularly reviewed for noticeable spending patterns.

(2) Expenditures should generally be consolidated into as narrow a time span as possible.

(3) Whenever possible, expenditures should be made at the time existing investments mature or new incoming funds are deposited.

(4) The Treasurer of State and the Department of Finance and Administration can assist agencies with cash management, investment, and collateralization considerations.

(5) Each agency should develop a written plan for management of cash.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-102. Management and investment of cash funds.

(a) A depository collateral agreement must be executed before any deposits can be made.

(b) Prior to depositing any funds with a bank or financial institution operating within the borders of the State of Arkansas, the agency should review the financial condition of the bank or financial institution.

(c) The agency should periodically review the financial condition of the bank or financial institution so long as the agency has funds on deposit with the bank or financial institution.

(d) Certain quarterly financial reports are open for public inspection.

(e) The website of the Federal Deposit Insurance Corporation provides additional public information that can be used to review the financial condition of the bank or financial institution.

(f) An agency should not deposit funds with a bank or financial institution if it would cause cash funds on deposit to exceed the capital of the bank or financial institution.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-103. Authorized accounts.

(a) Cash funds may be deposited only in the transactional and nontransactional accounts defined in the State of Arkansas Financial Management Guide.

(b) The account must qualify for Federal Deposit Insurance Corporation deposit insurance coverage.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-104. Authorized investments.

(a) Cash funds may be invested only in the accounts and investment instruments authorized under Arkansas Code §§ 19-3-510 and 19-3-518.

(b) All noncash investment instruments must be held in safekeeping by a bank or financial institution.

(c) Agencies should obtain safekeeping receipts for all investments.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-105. Collateralization of cash funds.

(a)(1) Collateralization is necessary when an agency deposits cash funds with a bank or financial institution in excess of current Federal Deposit Insurance Corporation insurance coverage.

(2) Securing deposits with assets pledged to an agency by a bank or financial institution protects the state from a loss of cash funds in the event of a default or failure by the bank or financial institution.

(3) All collateral is to be valued at fair value when determining the amount pledged.

(4) Current market prices or current market value is also referred to as fair value.

(5) Fair value is the price at which the collateral could be sold in an "arms-length" transaction.

(6) The following collateralization provisions are minimum requirements for agencies.

(7) Additional collateralization requirements may be imposed at the discretion of the agency.

(8) An agency should not deposit any funds with a bank or financial institution in excess of Federal Deposit Insurance Corporation insurance limits until such time that the agency has received the collateral pledged by the financial institution for the funds.

(b)(1) Securities pledged as collateral shall be held by a third-party custodian that is unaffiliated with the bank or financial institution.

(2) The agency acts as the custodian for surety bonds, letters of credit, and private deposit insurance pledged as collateral.

(c)(1) Assets eligible to be pledged as collateral for deposits are those assets in which a bank or financial institution may invest without limitation as identified in Arkansas Code § 23-47-401(a) and those set forth in Arkansas Code § 19-8-203.

(2) The total fair value of the pledged collateral shall be at least equal to one hundred five percent (105%) of the total amount of cash funds on deposit with a bank or financial institution that is in excess of current Federal Deposit Insurance Corporation insurance coverage.

(d)(1) Monitoring the value of assets pledged as collateral is the responsibility of the agency making the deposit.

(2) The bank or financial institution shall provide a periodic collateral report to the agency.

(3) The frequency of the periodic collateral reports is to be:

- (A) Agreed upon by the agency and bank or financial institution; and
- (B) Written in the depository collateral agreement.

(4) Costs associated with providing periodic collateral reports should be considered in submitting a bid for deposit of cash funds.

(5) The report shall include the fair value and description of the assets pledged as collateral with pricing of the pledged collateral to be within five (5) business days of the report date.

(6) The agency shall verify through an independent source the fair value reported by the bank or financial institution in its periodic collateral report.

(7) A list of acceptable independent sources to be used by agencies for verifications shall be maintained in the State of Arkansas Financial Management Guide.

(e)(1) A custodial services agreement shall be executed with each custodian for safekeeping of assets pledged to an agency by a bank or financial institution.

(2) Collateral pledged to secure deposits may be held only by a custodian that satisfies the following requirements:

(A) A custodian may be a Federal Reserve bank, a Federal Home Loan bank, a bankers' bank, the trust department, or similar safekeeping function, of a commercial bank or a trust company primarily located within the State of Arkansas;

(B)(i) A bank or financial institution may not hold assets for safekeeping that it has pledged to an agency as collateral for a deposit.

(ii) Collateral shall be placed for safekeeping with a custodian that is unaffiliated with the financial institution;

(C) To be considered unaffiliated, all of the following conditions must be met:

(i) The custodian, or an affiliate, does not possess, directly or indirectly, the power to direct or cause the direction of the management and policies of the bank or financial institution, including, but not limited to, ownership of voting securities;

(ii) The bank or financial institution, or an affiliate, does not possess, directly or indirectly, the power to direct or cause the direction of the management and policies of the custodian, including, but not limited to, ownership of voting securities;

(iii) The custodian and bank or financial institution are not owned directly or indirectly by the same parent corporation; and

(iv) Voting securities of up to five percent (5%) of the outstanding voting securities of the bank or financial institution or the custodian, being a de minimus interest, will be considered unaffiliated for the purpose of acting as a custodian for safekeeping collateral pledged to an agency; and

(D)(i)(a) A bank or financial institution may request permission from the State Board of Finance to use a custodian primarily located outside the State of Arkansas.

(b) The Secretary of the Department of Finance and Administration, with advice of the Bank Commissioner, will review such requests and make recommendations to the State Board of Finance.

(c) The secretary and commissioner shall examine the potential custodian to determine whether it has the financial stability, experience, technical skill, and staffing levels necessary to properly carry out the duties of a custodian.

(ii)(a) A bank or financial institution may request permission from the State Board of Finance to use a securities broker or dealer as a custodian.

(b) That request shall be made in accordance with the process outlined in subdivision (e)(1)(D)(i) of this section.

(f)(1) Collateral shall not be released, substituted, or compromised by a bank or financial institution or custodian unless approval is obtained from the agency to which the collateral was pledged prior to taking any such action.

(2) Substitution may be allowed without prior authorization if the agency and the bank or financial institution agree to the:

- (A) Substitution procedures; and
- (B) Type of securities allowable for substitution.

(3) Substitution procedures shall be addressed in the:

- (A) Depository collateral agreement; and
- (B) Custodial services agreement.

(4) The percentage of coverage required by subsection (d) of this section shall be recalculated upon substitution or release of collateral.

(g)(1) Any violation of a depository collateral agreement or custodial services agreement by a bank or financial institution or a custodian, or any other action or circumstance deemed by an agency to put its funds at substantial risk, will make the funds subject to immediate withdrawal by the agency.

(2) In determining if its funds have been placed at substantial risk, the agency, at its discretion, may waive minor violations that are ministerial in nature if such violations do not result in risk to its cash funds.

(h) The State of Arkansas is authorized to conduct collateralization audits of agencies, banks or financial institutions, and custodians to ensure compliance with this part and Arkansas law.

(i) Agencies shall follow any other collateralization procedures set forth in the State of Arkansas Financial Management Guide not specifically addressed herein.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-106. Security interest.

(a)(1) The bank or financial institution with which cash funds have been deposited is responsible for providing the agency with a security interest in the collateral pledged by the bank or financial institution and compliance with all federal and state laws, rules, and regulations governing the establishment of an enforceable security interest.

(2) The agency is responsible for ensuring that any depository collateral agreement and custodial services agreement that it enters into creates an enforceable security interest in the collateral pledged by the bank or financial institution with which cash funds have been deposited.

(3) If the agency uses the agreement forms prescribed by the State Board of Finance, it will be considered to have met this requirement.

(4) Forms used by a Federal Reserve bank or Federal Home Loan bank:

(A) Are acceptable; and

(B) Will be considered to have met this requirement.

(5) Forms and agreements provided by a bank or financial institution or custodian, other than a Federal Reserve bank or Federal Home Loan bank, are acceptable if they comply with the requirements of this part.

(b)(1) Perfection of a security interest in investment property such as securities, security accounts, and security entitlements is achieved through control as provided in the Uniform Commercial Code, Arkansas Code § 4-1-101 et seq.

(2)(A) Generally, control means that the secured party can exercise power over the investment property without further action or consent of the financial institution.

(B) Control is obtained:

(i) Through possession;

(ii) Through registration; or

(iii) On the basis that the issuer or an intermediary will act on the instructions of the agency.

(c)(1) The documents described in subsections (d) – (f) of this section must be executed to collateralize agency deposits.

(2) Exhibits A, B, and C attached to this part are sample agreements that may be used.

(3) However, the parties to the agreements may agree to other forms if they comply with the requirements of this part.

(d) Depository resolution.

(1)(A) The Policy Statement of the Federal Deposit Insurance Corporation dated March 23, 1993, requires that security agreements pertaining to public deposits must be approved by either the bank's or financial institution's board of directors or loan committee.

(B) 58 FR 16833 (March 31, 1993).

(2) Attached as Exhibit A is a certificate of corporate resolutions recommended by the State Board of Finance for use by agencies.

(3) The certificate of corporate resolutions shall not be dated after the depository collateral agreement.

(4) A bank's or financial institution's standard resolution form is acceptable if it achieves the purposes of this part.

(5) A continuing resolution of the board or loan committee of the bank or financial institution that empowers certain bank or financial institution officials to execute security agreements related to public deposits and pledge collateral to secure those deposits, as well as ratifying all actions taken by the officials to secure the public deposits, is acceptable if the continuing resolution specifically identifies the:

(A) Bank or financial institution official or officials authorized to act on behalf of the bank or financial institution; and

(B) Actions the bank or financial institution official or officials are authorized to take on behalf of the board or loan committee.

(e) Depository collateral agreement.

(1) Attached as Exhibit B is a depository collateral agreement recommended by the State Board of Finance for use by agencies.

(2) Depository collateral agreements used to collateralize state funds shall contain the following provisions:

(A) The agreement shall provide the specific terms setting forth how funds not covered by Federal Deposit Insurance Corporation insurance will be collateralized;

(B) The agreement must identify the specific type or types of collateral to be pledged and grant the agency with a security interest in the collateral;

(C)(i) The agreement must provide for a periodic recalculation of the fair value of pledged securities to ensure the value meets the collateralization ratios of 19 CAR § 10-105(c).

(ii) The agreement must provide that the bank or financial institution will provide the agency with a periodic statement of collateral, to verify the adequacy of the pledged collateral.

(iii) The periodic statement of collateral must:

(a) Identify the deposit secured by the collateral; and

(b) Describe the collateral and the collateral's current fair value.

(iv) The agreement should specify the methods by which the fair value will be determined;

(D) The agreement must specify the collateralization ratio applicable to the pledged collateral;

(E)(i) Letters of credit, surety bonds, and private deposit insurance policies must identify the:

(a) Issuer of the instrument; and

(b) Coverage amount.

(ii) The instrument must permit the agency to make a claim directly on the issuer of the instrument in the event of default, financial failure, or insolvency of the bank or financial institution.

(iii) These instruments must be delivered to the agency, and the depository collateral agreement should provide that the risk of loss is with the bank or financial institution until the instrument is actually received by the agency.

(iv) The bank or financial institution shall also require the issuer of the instrument to forward a copy of notification of coverage or insured limit to the agency.

(v) As relevant to surety bonds, any surety bond pledged as collateral is irrevocable and absolute, and that the issuer of the surety bond cannot provide surety bonds for any one (1) bank or financial institution in an amount that exceeds ten percent (10%) of the surety bond insurer's policyholders' surplus and contingency reserve, net of reinsurance;

(F)(i) The agreement must provide that the collateral is held in safekeeping by a third party unaffiliated with the bank or financial institution with whom cash funds have been deposited.

(ii) The agency, bank or financial institution, and custodian must execute a custodial services agreement;

(G)(i) The agreement must specify procedures for substitution or release of collateral.

(ii) The collateralization ratio shall be recalculated upon the substitution or release of pledged collateral; and

(H) The agreement must provide that it will be governed by Arkansas law.

(3) The agreement must be reviewed, updated, and re-executed if the bank or financial institution undergoes:

(A) A name change;

(B) A merger;

(C) A sale;

(D) A change in ownership; or

(E) Any other material change to the bank or financial institution.

(f) Custodial services agreement.

(1) Attached as Exhibit C is a custodial services agreement recommended by the State Board of Finance for use by agencies.

(2) Except for agreements required by a Federal Reserve bank or Federal Home Loan bank, custodial service agreements used to collateralize cash funds shall contain the following provisions:

(A)(i) The agreement must vest control of the pledged collateral in the agency as provided in the Uniform Commercial Code, Arkansas Code § 4-1-101 et seq.

(ii) As an example, the agreement should contain a clause that is similar to the following:

“From and after the date of this agreement, the custodian will comply with all notifications and instructions it receives directing it to transfer or redeem any property subject to the agreement originated by the agency without further consent of the bank or financial institution.”;

(B) The agreement must:

(i) Provide that the custodian waives its right to a security interest in the pledged collateral; and

(ii) Prohibit the custodian and bank or financial institution from further pledging the collateral subject to the agreement;

(C) The agreement must provide that the custodian subordinates any security or lien it may claim in the pledged collateral to the agency’s security interest;

(D) The agreement must provide that the custodian is a custodial agent of the agency and will hold the pledged collateral solely for the benefit of the agency;

(E) The agreement must provide that:

(i) The pledged collateral will not be held in a margin account; and

(ii) No margin or other credit will be extended to the bank or financial institution with respect to the pledged collateral;

(F) The agreement must provide that the custodian will send copies of all statements and confirmations concerning the pledged collateral simultaneously to the bank or financial institution and agency;

(G) The agreement must provide that the custodian will:

(i) Notify the agency if another person claims a property interest in the pledged collateral; and

(ii) Immediately substitute unencumbered collateral of equivalent value that is free and clear of any adverse claims;

(H) The agreement must provide that the:

(i) Duties of the custodian shall continue in effect until the security interest has been terminated; and

(ii) Agency shall notify the custodian of the termination in writing within a reasonable period of time;

(I) The agreement must provide that upon termination, the custodian and bank or financial institution agree that if the agency's deposit requires collateral as provided in the depository collateral agreement, that the pledged collateral will be transferred to an account under the exclusive control of the agency;

(J) The agreement must provide that the bank or financial institution does not have the ability to terminate the agreement; and

(K) The agreement must provide that it will be governed by Arkansas law.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-107. Conflict of laws.

Arkansas law shall prevail over any other state or local laws relating to security for a deposit of cash funds to the extent of any conflict.

Authority. Arkansas Code § 19-3-704.

19 CAR § 10-108. Cash fund agency reporting requirements.

Agencies shall follow the reporting requirements set forth in the State of Arkansas Financial Management Guide (R1-19-4-805).

Authority. Arkansas Code § 19-3-704.

Appendix A. Certificate of Corporate Resolutions

Link:

<https://CodeOfARRules.arkansas.gov/docs/CARCodeAppendices/Appendices/72/19CARpt.10ExhibitA.pdf>

Appendix B. Depository Collateral Agreement

Link:

<https://CodeOfARRules.arkansas.gov/docs/CARCodeAppendices/Appendices/73/19CARpt.10ExhibitB.pdf>

Appendix C. Custodial Services Agreement

Link:

<https://CodeOfARRules.arkansas.gov/docs/CARCodeAppendices/Appendices/74/19CARpt.10ExhibitC.pdf>