ARKANSAS STATE TREASURY
Investment Policy

Adopted June 25, 1997

Amended September 25, 1997

Amended December 6, 2007

Amended March 24, 2015

Amended June 2, 2015

Amended September 24, 2015

Amended July 1, 2017

I. General Policy

A. Mission

The Mission of the Office of the Treasurer of the State of Arkansas is guided by the words of Henry Clay who stated,

> **"Government is a trust, and the officers of the government are trustees; and both the trust and the trustees are created for the benefit of the people."**

Henry Clay, Speech at Ashland, Kentucky (March 1829) in JOHN BARTLETT, FAMILIAR QUOTATIONS 444 (1980).

To fulfill the responsibility of trustee, the State Treasurer's Office shall, within constitutional and statutory constraints, provide the citizens of Arkansas uncompromising safety, operating liquidity, and wealth building yield in the collection, investment and disbursement of their money in the most cost effective manner attainable while maintaining, above all, the highest ethical standards.

B. Authority

The State Treasurer is an executive officer of the state, established by the Constitution of the State of Arkansas; and, is required pursuant to the Arkansas

Code to perform " all . . . duties which may be required of him or her by law." ARK. CONST. of 1874, art. VI, § 1, *amended by* ARK. CONST. amend. VI, § 1; ARK. CODE ANN. § 25-16-604.

In addition to any other function, power, or duty imposed by law, the State Board of Finance shall establish, maintain, and enforce all policies and procedures concerning the management and investment of funds in the State Treasury and the State Treasury Money Management Trust, including without limitation:

> (1) Record keeping and reporting requirements that reflect:
>
> > (A) Daily, monthly, and year-to-date balances of all funds, accounts, and groups of accounts within the State Treasury; and
> >
> > (B) The performance of all deposits and investments compared to the target rate of return established by the board;
>
> (2) A collateralization policy;
>
> (3) Eligibility requirements for a bank depository, an investment depository, a securities broker, and, before accepting an application to hire an investment consultant under subsection (c) of this section, an investment consultant;
>
> (4) An investment policy;
>
> (5) Liquidity requirements for the State Treasury; and
>
> (6) Qualifications, ethical standards, a conflict of interest policy, and criminal background check requirements that are no less stringent than the requirements of ARK. CODE ANN. § 19-3-705 for all employees of the board or Treasurer of State who handle State Treasury funds or participate in decisions concerning the deposit or investment of State Treasury funds.

ARK. CODE ANN. § 19-3-704.

C. Objectives

The objectives of the State Treasurer's investment practices, in priority order, will be safety, liquidity and return on investments. To meet these objectives, the State Treasurer and designated investment officers will:

- Seek to ensure the preservation of capital by adhering to all restrictions on the investment of funds established by law and by this policy.
- Maintain liquidity by seeking to match the maturity structure of the portfolio to reasonably anticipated cash requirements, as well as

maintaining an adequate portion of the portfolio in readily marketable securities.

- Optimize the return on investments by structuring the portfolio in such a way that a market rate of return is earned through budgetary and economic cycles within the existing constraints of safety and liquidity.

- Strive to meet the target rate of return as set by the State Board of Finance.

D. Definitions

This investment policy will use the following terms in the manner described in this section.

- **ARK. CODE ANN.** - Arkansas Code Annotated of 1987, replacements thereof, and supplements thereto.

- **ARK. CONST. of 1874** - Arkansas Constitution of 1874.

- **CDARS** - Certificate of Deposit Account Registry Service.

- **Total Portfolio -** as referenced in the Treasury Funds section (section II of this policy) means treasury funds available for investing. It does not include trust certificates of deposit, certificates of deposit purchased in accordance with the State Treasury Certificate of Deposit Investment Program, funds invested in accordance with the State Treasury Money Management Trust Act, or funds invested pursuant to the Tobacco Settlement Proceeds Act.

- **Authorized or designated investment officers** - means officers designated by the State Treasurer as being authorized to carry out investment functions on behalf of Treasury.

- **Authorized dealers** - means those dealers who are:

  A. Specifically approved by the State Board of Finance, or;

  B. Approved by the State Treasurer in accordance with eligibility requirements as established by the State Board of Finance.

- **Financial institution -** means a "bank" and/or "savings and loan association" as defined in ARK. CODE ANN. § 19-3-502.

E. Standards of Care

Prudence. The State Treasurer and designated investment officers will perform their duties in a manner consistent with the standard of a "prudent investor," as set forth by the Arkansas Code:

> The State Treasurer shall apply the prudent investor rule

> while serving in a fiduciary capacity for fund participants. The prudent investor rule means that, in making investments, the fiduciaries shall exercise the judgment and care under the prevailing circumstances that an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments entrusted to it, not for speculation but for investment, considering the permanent disposition of funds, and the probable safety of capital as well as probable income.

ARK. CODE ANN. § 19-3-605).

Ethics and Conflicts of Interest. The State Treasurer and investment officers authorized by Treasury shall seek to act responsibly as custodians of the public trust. They will refrain from personal business activity that could conflict with proper execution of the investment program or which could impair their ability to make impartial investment decisions. They will adhere to the laws regarding ethics, conflicts of interest, and disclosure requirements contained in Title 21, Chapter 8 of the Arkansas Code. ARK. CODE ANN. § 21-8-101 *et. seq*.

Authorized Financial Dealers and Institutions. The State Treasurer will select financial dealers and institutions authorized to provide investment services to the state. Authorized financial dealers or institutions will be qualified as one or more of the following:

- financial institutions authorized by ARK. CODE ANN. § 19-3-507 and;
- dealers who are:
  - A. specifically approved by the State Board of Finance, or;
  - B. approved by the State Treasurer in accordance with eligibility requirements as established by the State Board of Finance.

Each authorized dealer or institution will regularly submit semiannual and annual reports, including audited financial statements, and other information as determined by the State Treasurer.

F. Professional Services

The State Treasurer may contract for professional services as necessary for the efficient management of investments.

G. Internal Controls

The State Treasurer will maintain internal controls to protect against the loss of public funds arising from negligence, theft, or misuse. These controls will include, but not be limited to:

- the use of third party custody and safekeeping;

- the execution of all securities transactions on a delivery versus payment basis;
- the clear and limited delegation of investment authority;
- the separation of transaction authority from record keeping;
- frequent reconciliation of the investment ledger with the general ledger;
- the use of objective criteria in selecting financial institutions and dealers authorized to provide investment services to the state; and,
- the use of objective criteria in awarding investment purchases and sales to authorized financial institutions and dealers.

The State Board of Finance shall serve as the investment policy committee and shall review and approve revisions to this policy as necessary.

H. Reporting

The State Treasurer will prepare quarterly reports summarizing investment activity and performance. Reports and records shall be adequate to ensure that transactions are authorized and executed in accordance with this policy. Reports will be distributed to appropriate state officials and agencies and will be readily available upon request. The reports may include performance of invested funds, composition of invested funds, performance against appropriate benchmarks, investment activity, and any other report as may be deemed necessary.

II. Treasury Funds Policy

A. Authority

The State Treasurer, pursuant to ARK. CODE ANN. § 19-3-518, is authorized to invest treasury funds in the manner prescribed by the investment policy approved by the Board of Finance.

B. Scope

This section applies to the investment of all Treasury funds managed by the State Treasurer, with the following exceptions:

- the State Treasury Certificate of Deposit Investment Program, which is governed by ARK. CODE ANN. § 19-3-519, and section III of this policy;
- the State Treasury Money Management Trust, which is governed by ARK. CODE ANN. § 19-3-601 -606, ARK. CODE ANN. § 19-4-803, and the State Treasury Money Management Trust Policies and Procedures Manual; and,

- trust funds required to be invested in certificates of deposit as governed by ARK. CODE ANN. § 19-3-518 (a).

C. Eligible Investments

Eligible investments are limited to those securities and deposits authorized by ARK. CODE ANN. § 19-3-518 and ARK. CODE ANN. § 19-8-111. Eligible investments as outlined in the aforementioned statutes may include:

- direct obligations of the U.S. government;

- obligations of agencies and instrumentalities created by act of the United States Congress and authorized thereby to issue securities or evidences of indebtedness, regardless of guarantee of repayment by the United States Government;

- obligations the principal and interest of which are fully guaranteed by the United States Government or an agency or an instrumentality created by an act of the United States Congress and authorized thereby to issue such guarantee;

- obligations the principal and interest of which are fully secured, insured, or covered by commitments or agreements to purchase by the United States Government or an agency or instrumentality created by an act of the United States Congress and authorized thereby to issue such commitments or agreements;

- commercial paper with maturities not exceeding 180 days rated A1 or better by Standard and Poor's Ratings Services and P1 by Moody's Investors Service. No investment shall be made in commercial paper with maturity beyond 90 days which, at the time of investment, holds a rating below A1/P1 or is on negative credit watch by either aforementioned rating agency;

- commercial paper with maturities not exceeding 90 days rated A2 or better by Standard and Poor's Ratings Services and P2 or better by Moody's Investors Service. No investment shall be made in commercial paper which, at the time of investment, holds a rating below A2/P2 or is in negative credit watch by either aforementioned rating agency;

- corporate bond issues of maturity of one year or less and rated A- or A3 or better by at least two of the credit ratings agencies; S&P, Moody's, or Fitch, which rate the issue. No investment shall be made in bonds which hold the minimum A- or A3 rating if, at the time the investment is made, the issue is on negative credit watch by any aforementioned rating agency;

- corporate bond issues rated AA- or better by each of the credit ratings agencies; S&P, Moody's, or Fitch, which rate the issue. No investment

shall be made in bonds which have maturity beyond one year which hold the minimum AA- rating, if at the time the investment is made, the issue is on negative credit watch by any aforementioned rating agency.

- repurchase agreements as set forth in ARK. CODE ANN. § 19-3-518(b)(1)(B)(xii);

- the State Treasury Money Management Trust;

- prerefunded municipal bonds whose principal and interest are fully secured by the principal and interest of a direct obligation of the United States Government;

- securities of any open-end type investment company or investment trust registered under the Investment Company Act of 1940 and that is defined as a "money market fund " under 17 C.F.R. § 270.2a-7 whose portfolio is principally U.S. government obligations and repurchase agreements fully collateralized by U.S. government obligations and the collateral is either taken directly by the investment company or investment trust or through an authorized custodian;

- certificates of deposit, demand, or savings deposits with financial institutions provided they are fully insured by a federal deposit insurance agency for one hundred percent (100%) of the principal and accrued interest of the deposit;

- certificates of deposit pursuant to ARK. CODE ANN. § 19-8-111 (CDARS.);

- all or any part of the bonds of local industrial development corporations, authorized and issued under the Arkansas Industrial Development Act, § 15-4-101 et seq., and all or any part of the bonds of municipalities and counties, authorized and issued under the Municipalities and Counties Industrial Development Revenue Bond Law, ARK. CODE ANN. § 14-164-201 *et. seq.*;

- obligations issued by the State Board of Education under the authority of the State Constitution; and,

- warrants of a political subdivision or municipality of the State of Arkansas having maturities not exceeding one (1) year;

- general obligations of the states of the United States (if notes hold the rating of SP-2, or the equivalent or above, or if bonds hold the rating of A, or the equivalent, or above);

- obligations in which, the principal and interest are fully guaranteed, secured, insured, or covered by a commitment or agreement to purchase the obligation by the United States Government or an agency or an

instrumentality created by an act of the United States Congress and authorized by the United States to issue the guarantee, commitment, or agreement (if notes hold the rating of SP-1, or the equivalent, or above, or if bonds hold the rating of AA, or the equivalent, or above).

- Bonds from the State of Israel that are guaranteed and backed by the full faith and credit of the government of Israel as the sovereign debt of the State of Israel, pursuant to ARK. CODE ANN. § 19-3-523, effective August 1, 2017.

D. Investment Restrictions

To provide for the safety and liquidity of Treasury Funds, the investment portfolio will be subject to the following restrictions:

- the average maturity of the total portfolio will not exceed 10 years;
- the expected maturity of any security will not exceed 10 years, with the exception of the following:

  (a) securities used as collateral in repurchase agreements, Arkansas Capital Corporation Bonds, State Board of Finance and State Building Services Certificates of Indebtedness.

  (b) U.S. Agency mortgage-backed securities, collateralized mortgage obligations, and municipal bonds which return principal in scheduled payments prior to final maturity shall not have, at the time of purchase, an average life exceeding 10 years using average life assumptions while employing Prepayment Speed Assumption (PSA) and/or Conditional Prepayment Rate (CPR) analysis models. Average life at the time of purchase shall be used as opposed to maturity.

- No investment in corporate debt with a maturity longer than one week shall be made in any single issuer, which—at the time of purchase—exceeds 5% of the total assets of the Treasury, including both commercial paper and bonded debt of that issuer.
- The maturity of repurchase agreements will be calculated by the date of repurchase, not the maturity of the underlying instrument.

Investments in non-government securities having maturities beyond one week, exclusive of funds managed by a securities lending agent, will not exceed the following percentages of the total portfolio:

Total Debt of Corporations, including Bonds and Commercial Paper	30%
Certificates of Deposit*	10%

* Not including Certificates of Deposit purchased in accordance with ARK. CODE ANN. § 19-3-519.

Repurchase agreements will be subject to the following additional restrictions:

- transactions will be documented with master repurchase agreements;
- securities accepted as collateral will be readily marketable;
- repurchase agreements with any dealer or financial institution will not exceed 50% of the total portfolio; and,
- repurchase agreements will not exceed 180 days, and the share of the portfolio allocated to repurchase agreements with maturities beyond 30 days will not exceed 30% of the total portfolio.

Pursuant to ARK. CODE ANN. § 25-1-501 *et. seq.* (effective August 1, 2017), a public entity shall not invest in companies that boycott Israel. In a good-faith effort to comply with this law, the State Treasury may rely on the list of entities that boycott Israel. That list is published by the New York Office of General Services and may be located online at the following web address:

https://www.ogs.state.ny.us/eo/157/Docs/EO157_Institutions_Companies_List.pdf

E. Collateral

Securities delivered as collateral for a repurchase agreement with a maturity date longer than seven days will be priced at least weekly at 105% (one hundred and five percent) of market value, plus accrued interest.

Physical loans which qualify as eligible investments delivered as collateral for a repurchase agreement with a maturity date longer than seven days will be priced at least weekly at 108% (one hundred and eight percent) of market value, plus accrued interest.

F. Return on Investment

Pursuant to ARK. CODE ANN. § 19-3-518(d)(4), the State Board of Finance shall establish the method of computing participants' rate of return and earning to determine the distribution to each participant:

The State Treasurer shall distribute the monthly earnings of accounts whose monies are statutorily co-mingled in the Treasury General account, less any statutory deductions, on the second State business day after the 25th day of the following month. In order to determine the distribution to each account, the State Treasurer shall:

> (1) Compute the daily rate of return (ROI) of Treasury funds for the preceding month. The daily rate of return will be calculated as a monthly annualized yield assuming daily amortization/accretion of all fixed income securities held and any realized profits or losses; and,

(2) Calculate the daily earnings of each account by multiplying each account's daily balance on deposit in the Treasury by the daily rate of return.

The monthly sum of each account's daily earnings, less statutory deductions, shall be credited to each account on the distribution day as described above.

G. Professional Services

The State Treasurer may contract for professional services as necessary for the efficient management of investments. Services may include, but are not limited to, Master Custodian and Money Manager.

Master Custodian

The State Treasurer may select one or more firms to provide the state with master custodial services pursuant to a custodial services agreement. Master custodial services will include, but not be limited to:

- executing transactions involving all securities held in custody, including on-line security clearing, settlement of securities on a delivery-versus-payment basis, and settlement of physically-held securities;
- accounting for all transactions in accordance with generally accepted accounting principles and requirements of the state;
- providing regular reports on the activity and value of the securities in custody; and,
- providing for the safekeeping of all documents and financial instruments physically held in custody.

Money Manager

The State Treasurer may select one or more firms to provide money management services. These services may include, but not be limited to:

- recommending changes to the investment policy;
- providing advice on investment purchases and sales based on current market indicators and economic conditions;
- providing monthly accounting, performance, compliance, and management reports; and
- managing funds separately from other governmental funds and providing third-party safekeeping in Treasury's name.

The services of a master custodian, and money manager will be obtained through a competitive evaluation of proposals submitted to the Treasurer of State's Office.

III. State Treasury Certificate of Deposit Investment Program

A. Introduction

The investment of State of Arkansas (hereinafter referred to as "the State") funds is a function performed by the State Treasurer under the advice of the State Board of Finance. This policy has been developed in recognition of the fiduciary responsibility of the State Board of Finance and the State Treasurer to the people of Arkansas. The investment of funds is the responsibility of the State Treasurer. The intent of this policy is to establish guidelines and procedures for investment.

B. Authority and Scope

ARK. CODE ANN. § 19-3-519 (f) directs the State Treasurer to establish policies to be followed in the investment of money of the State, subject to review and approval by the State Board of Finance. This policy applies to the investment of state funds in certificates of deposit as directed by the State Board of Finance and outlined in ARK. CODE ANN. § 19-3-519.

C. Objectives

The State Treasurer seeks to benefit the State of Arkansas by depositing money with institutions located within the borders of Arkansas. The distribution formula may be weighted to give preference to institutions that have consistently invested in their community's economy through loans or state or local bonds.

The State Treasurer seeks safety of the deposits placed. As such, the State Treasurer will place deposits with institutions meeting capital requirements as set out in this policy.

D. Guidelines

In keeping with the stated objectives of this policy, the following guidelines are established.

- The State Board of Finance may, at its discretion, establish a cap on the amount of the total allocation any one institution may receive.
- In the event that a small group of institutions are receiving a disproportionate share of the total distribution, the State Board of Finance may set a cap on that group of institutions in order to provide for a more equitable allocation of deposits.
- The State Board of Finance may establish minimum capital requirements on Tier 1 regulatory capital as defined by federal banking regulatory agencies that an institution must meet to hold state deposits. The Board of Finance may establish a sliding scale of minimum regulatory capital requirements based on size.

E. Rates

The State Board of Finance has established the following minimum Certificate of Deposit Rates:

1 Month	0.20%
3 Months	0.30%
6 Months	0.40%
9 Months	0.50%

F. Allocation Process

The following process shall be carried out in the allocation of deposits among participating institutions.

- Each participating institution may receive a base deposit amount. This amount may be based on a sliding scale to be established by the State Treasurer.

- The aggregate amount will be removed from the total distribution amount. The remainder will be distributed as follows:

    1. A percentage will be allocated to each institution based on its percentage of Arkansas loans relative to the whole.

    2. The remaining percentage will be allocated to each institution based on its percentage of weighted Arkansas deposits to the whole.

        Arkansas deposits and loans are weighted using a factor determined by each institution's loan to deposit ratio, and the allocation shall be calculated using the weighted participating deposit and loan figures.

G. Professional Services

The State Treasurer may contract for professional services as necessary for the efficient management of investments. Services may include, but are not limited to, that of Master Custodian.

Master Custodian

The State Treasurer may select one or more firms to provide the state with master custodial services pursuant to a custodial services agreement. Master custodial services will include, but not be limited to:

- executing transactions involving all securities held in custody, including

on-line security clearing, settlement of securities on a delivery-versus-payment basis, and settlement of physically-held securities;

- accounting for all transactions in accordance with generally accepted accounting principles and requirements of the state;
- providing regular reports on the activity and value of the securities in custody; and,
- providing for the safekeeping of all documents and financial instruments physically held in custody.

H. Collateralization

Collateral is required for all deposits above the insured amount. Each institution will enter into an agreement with the State Treasury establishing the collateralization percentage and suitable collateral types pursuant to ARK. CODE ANN. § 19-8-203.