

#18 - Response to comments

Deposit protection requires: (1) execution of a satisfactory depository collateral agreement (if banks want flexibility in form they need to take responsibility); (2) proper control of collateral by the agency or 3rd party custodian on its behalf (normally selected by the bank); and (3) compliance with relevant Federal rules (primarily internal approval by the bank and record keeping). The first two items are required to achieve perfection under the UCC. While the ultimate responsibility for the safety of public funds is borne by an agency, most of the actions and procedures required to achieve perfection and compliance with Federal rules are in the control of the bank. Therefore, banks should assume joint responsibility with agencies in this matter. The rule will be amended to add this clarification.

Comments Received via email
on 1/17/12 from Mr. Paul Young
with the Arkansas Municipal League.

John Theis

From: Paul Young [pyoung@arml.org]
Sent: Tuesday, February 28, 2012 2:59 PM
To: John Theis
Subject: RE: Collateralization Rule
Attachments: Cash Funds Collateralization Rule (1-12-2012a Markup) with PY suggestions.docx; AR Depository Collateral Agreement (1-12-2012 Markup) with PY suggestions.docx

John - attached are the rules and the collateral agreement with a few comments and suggestions. The only comments in the collateral agreement relate to adding reference to "securities entitlements". Such items are similar to uncertificated securities but actually involve certificates issued to DTC (Depository Trust Corp) which accounts for the interests of DTC member account owners who in turn account for the interests of their customers. Muni bonds are issued in this manner and are often used as collateral by Arkansas banks. As noted in the GFOA recommendations, anything other than short term muni bonds should have a higher collateralization ratio, such as 120%.

Paul Young
Finance Director
Arkansas Municipal League
501-978-6104
501-551-2033 (cell)

-----Original Message-----

From: John Theis [<mailto:John.Theis@dfa.arkansas.gov>]
Sent: Monday, February 06, 2012 11:25 AM
To: Paul Young
Subject: Collateralization Rule

Paul,

Attached are the clean and marked up copies of the proposed rule. This does not contain the one modification mentioned in the meeting on Friday related to changing "public funds" to "cash funds". Otherwise, this is the final rule. Let me know if you have questions.

John H. Theis
Assistant Commissioner of Revenue
Policy and Legal
(501) 682-7000

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DEPOSITORY COLLATERAL AGREEMENT

This Depository Collateral Agreement ("*Agreement*"), dated _____, is between _____ (the "*Bank*"), having an address at _____ and _____ (the "*Public Depositor*"), having an address at _____.

WITNESSETH:

WHEREAS, the Bank is authorized to accept public funds for deposit under Arkansas law; and

WHEREAS, Public Depositor from time to time makes deposits in the Bank (its "*Public Deposits*"), which Public Deposits shall from time to time aggregate in excess of Federal Deposit Insurance Corporation ("*FDIC*") insurance coverage; and

WHEREAS, the Public Depositor desires to have its Public Deposits secured by eligible collateral ("*Eligible Collateral*") as provided in Rule 2012-1, Management and Collateralization of Cash Funds ("*Rule 2012-1*"); and

WHEREAS, the Bank has agreed to secure the Public Deposits by granting to the Public Depositor a ~~perfected~~ security interest in certain collateral owned by the Bank, as permitted by 12 U.S.C. § 90 and Arkansas Code Annotated § 23-47-203;

NOW THEREFORE, in consideration of the Public Depositor depositing its Public Deposits as herein described, and for other good and valuable consideration, hereby acknowledged as received, it is hereby agreed between the Public Depositor and the Bank as follows:

Section 1. Pledge of Collateral.

1.1 In order to secure the Public Deposits the Bank hereby pledges, assigns, transfers, and grants to the Public Depositor a ~~perfected~~ first priority security interest in (a) such amounts of the Eligible Collateral to this Agreement to meet the collateral ratios and other requirements described in Rule 2012-1; (b) any Eligible Collateral that is delivered directly to the Public Depositor; and (c) the custody account (as provided in Section 3), any substitute account(s), and any and all investment property, as that term is defined in the Arkansas Uniform Commercial Code, from time to time held in, by, or for the benefit of the custody account (including without limitation the Eligible Collateral) and all proceeds thereof (collectively, the "*Collateral*"). The Collateral pledged to the Public Depositor and subject to the security interest granted by this Agreement is specified in Attachment A attached hereto, and as supplemented from time to time, and sets forth the type of Eligible Collateral pledged, as well as the type, CUSIP number, maturity date, interest rate, and par amount of each security pledged.

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1.2 The security interest granted herein shall secure not only such Public Deposits and accrued interest of the Public Depositor as are held by the Bank at the time of this Agreement, but also any and all subsequent Public Deposits made by the Public Depositor in the Bank regardless of the accounts in which such funds may be held or identified by the Bank.

1.3 The pledge of Collateral by the Bank shall be in addition to, and shall in no way eliminate or diminish, any insurance coverage to which the Public Depositor may be entitled under the rules and regulations of the FDIC or any private insurance carried by the Bank for the purpose of protecting the claims and rights of its depositors.

1.4 Bank agrees to take all actions necessary to ~~perfect~~ provide a security interest in the pledge of Collateral and confirm the same to the Public Depositor.

Section 2. Delivery and Possession of Collateral. The following procedures shall be followed for pledging Collateral to the Public Depositor.

2.1 Letters of credit, surety bonds, and private deposit insurance policies shall be delivered to Public Depositor. The instrument must identify the issuer of the instrument and the coverage amount. The instrument must permit Public Depositor to make a claim directly on the issuer of the instrument in the event of default, financial failure, or insolvency of Bank. Any surety bond pledged as collateral is irrevocable and absolute. The issuer of the surety bond cannot provide surety bonds for any one financial institution in an amount that exceeds 10 percent (10%) of the surety bond insurer's policyholders' surplus and contingency reserve, net of reinsurance. These instruments, when issued, must be delivered to Public Depositor at the address specified in this Agreement. The risk of loss is with the Bank until the instrument is actually received by Public Depositor. The Bank shall also require the company or agency issuing the instrument to forward a copy of notification of coverage or insured limit to the Public Depositor.

2.2 Certificated securities in bearer form must be delivered to the Public Depositor or other person acting on behalf of the Public Depositor other than a securities intermediary. Certificated securities in registered form must be delivered to the Public Depositor or other person acting on behalf of the Public Depositor other than a securities intermediary, and indorsed to the Public Depositor or in blank by an effective indorsement or registered in the name of the Public Depositor, upon original issue or registration of transfer by the issuer. A securities intermediary acting on behalf of the Public Depositor may acquire possession of the security certificate if the security is (i) registered in the name of the Public Depositor, (ii) payable to the order of the Public Depositor, or (iii) specially indorsed to the Public Depositor by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

2.3 ~~For Uncertificated-uncertificated securities, the custodian shall authenticate a record setting forth the securities pledged and acknowledging it holds them for the benefit of the Public Depositor. ~~must~~ be registered to the Public Depositor as the registered owner or a written confirmation that the issuer will comply with instructions by the Public Depositor without further consent by the Bank. In addition, the Bank shall identify on its books and records the pledge of such securities to the Public Depositor and the financial intermediary shall identify on its books and records the pledge of such securities to the Public Depositor.~~

Comment [py1]: and security entitlements

Comment [py2]: and security entitlements

Comment [py3]: and security entitlements

Comment [py4]: and security entitlements

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2.4 Securities held for account of the Bank by another financial intermediary must be delivered to a custodian (as provided in Section 3), in accordance with a custodial services agreement (as provided in Section 3) to hold under joint safekeeping receipts for the benefit of the Public Depositor. Delivery of the pledged securities to the custodian shall provide for the "control" of the pledged securities and the perfection of the security interest of the Public Depositor as provided in the Arkansas Uniform Commercial Code.

Comment [py5]: and security entitlements

Comment [py6]: and security entitlements

Comment [py7]: and security entitlements

Section 3. Custody Account and Custodial Service Agreement.

3.1 The Bank agrees to place the Collateral with a Federal Reserve Bank, a Federal Home Loan Bank, a bankers' bank, a trust department of a commercial bank, or with a trust company (the "Custodian") to hold in a joint custody account for the benefit of the Public Depositor. The Custodian must be unaffiliated with the Bank as defined in Rule 2012-1. The Bank grants a first priority continuing interest in favor of the Public Depositor in any and all of the Bank's existing and hereafter acquired rights to the following custody account(s) and any substitute account(s) into which any investment property is deposited:

Account Title and Number	Name/Location of Account
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[Additional accounts may be listed on separate paper and attached to this Agreement] (Collectively, the "Custody Account(s)").

3.2 The Bank shall execute a custodial services agreement with ~~the commercial bank or trust company~~ a custodian ("Custodial Services Agreement") for the custody of the Collateral consistent with the terms of this Agreement. Any ~~commercial bank or trust company~~ entity acting as a Custodian shall be a securities intermediary as defined in the Arkansas Uniform Commercial Code. The Custodial Services Agreement shall contain the Custodian's agreement to hold all Collateral in the Custody Account for the benefit of the Public Depositor and subject to the Public Depositor's direction and control and to comply with entitlement orders originated by the Public Depositor without the Bank's further consent. The executed Custodial Services Agreement is attached hereto as Attachment C. The execution by the Bank of the Custodial Services Agreement shall in no way relieve it of any of its duties or obligations hereunder.

3.3 The Bank has heretofore or will immediately hereafter deliver to the Custodian for immediate deposit into the Custody Account Collateral of sufficient value to meet the terms of this Agreement. Said Collateral, or substitute collateral, as herein provided for, shall be retained by the Custodian in the Custody Account so long as the Bank holds deposits of the Public Depositor. The Custodian should forward any letters of credit, surety bonds, or private deposit insurance policies to the Public Depositor.

3.4 Collateral held by any Custodian, as herein described, shall be deemed to be under the "control" and in possession of Public Depositor as provided in the Arkansas Uniform Commercial Code.

Section 4. Value of Collateral and Changes in Collateral.

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4.1 The Bank shall recalculate the ~~market-fair~~ value of individual securities comprising Collateral at least monthly.

Comment [py8]: and security entitlements

4.2 If at any time the ratio of the ~~market-fair~~ value of the Collateral to the Public Depositor's Public Deposits, plus accrued interest, is less than required by this Agreement, the Bank shall immediately, within twenty-four (24) hours, make such additions to the Collateral in such amounts such that the ratio of the ~~market-fair~~ value of the Collateral to the Public Depositor's Public Deposits, plus accrued interest, shall be at least equal to that required in Rule 2012-1. Such additions to the Collateral shall constitute an assignment, transfer, pledge, and grant to the Public Depositor of a security interest in such additional Collateral pursuant to this Agreement and Rule 2012-1.

4.3 At any time that the Bank is not in default under this Agreement, the Bank may substitute Eligible Collateral, provided that (a) the total ~~market-fair~~ value of Eligible Collateral held in the Custody Account shall meet the requirements of this Agreement and Rule 2012-1, and (b) the Public Depositor shall have approved the substitution and all documentation relating to such substitution before it becomes effective. *(Note: If other substitution procedures are used that would not require prior approval of the Public Depositor, they should be substituted for (b).)*

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4.4 Any additional pledge of Collateral hereunder, substitution of Collateral, or release of Collateral shall be approved by an officer of the Bank duly authorized by resolution of the Board of Directors to approve such additional pledges, substitutions, or releases of Collateral under this Agreement.

Section 5. Reports. Bank will provide Public Depositor with a ~~monthly-periodic~~ statement of collateral, ~~at no cost~~ to verify the adequacy of the pledged collateral. The ~~monthly-periodic~~ statement of collateral must identify the deposit secured by the collateral, include a description and market value of the Collateral ~~as of the last business day of the month as determined within five business days prior to the report date~~, and provide or cite an independent source to verify the reported value. The ~~market-fair~~ value must be obtained from a securities pricing service, a primary dealer in securities, ~~or a publication recognized as a reliable source of securities valuation or any other reliable source of securities valuation~~. If Collateral is held in a Custody Account, upon the initial transfer of Collateral to a Custody Account under this Agreement and monthly thereafter, the Bank shall cause the Custodian to report to the Public Depositor specifying the type and market value of Collateral being held in the Custody Account for the benefit of the Public Depositor. *(Note: The parties should agree upon the frequency and cost of the reports and memorialize that in this section, as appropriate.)*

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Section 6. Representations, Warranties, and Covenants.

6.1 The Bank hereby represents that (i) it is duly organized and validly existing under the laws of the State of Arkansas; (ii) it is authorized to accept public funds for deposit under Arkansas law; (iii) it has, or will have as of the time of delivery of any securities as Collateral under this Agreement, the right, power and authority to grant a security interest therein with priority over any other rights or interests therein; (iv) the execution and delivery of this Agreement and the pledge of securities as Collateral hereunder have been approved by resolution of the Bank's Board of Directors at its meeting on _____, and the approval of the Board of Directors is reflected in the minutes of that meeting, copies of which resolution and relevant portion of the minutes of said meeting are attached hereto as Attachment B and made a part hereof; (v) the execution and delivery

Comment [py9]: and security entitlements

Comment [py10]: and security entitlements

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of this Agreement and the pledge of securities as Collateral hereunder will not violate or be in conflict with the Articles of Incorporation or By-laws of the Bank, any agreement or instrument to which the Bank may be a party, any rule, regulation or order of any banking regulator applicable to the Bank, or any internal policy of the Bank adopted by its Board of Directors; and (vi) this Agreement shall be continuously maintained, from the time of its execution, as an official record of the Bank.

Comment [py11]: and security entitlements

6.2 The Bank warrants that it is the true and legal owner of all Collateral pledged under this Agreement, that the Collateral is free and clear of all liens and claims, that no other person or entity has any right, title or interest therein, and that the Collateral has not been pledged or assigned for any other purpose. Bank represents and warrants that no financing statement covering all or any part of the Collateral is on file at any public office. Should an adverse claim be placed on any pledged Collateral, the Bank shall immediately substitute unencumbered Collateral of equivalent value that is free and clear of all adverse claims.

Section 7. Event of Default.

7.1 In the event the Bank shall (a) fail to pay the Public Depositor any funds which the Public Depositor has on deposit, (b) fail to pay and satisfy when due any check, draft, or voucher lawfully drawn against any deposit of the Public Depositor, (c) fail or suspend active operations, (d) become insolvent, or (e) fail to maintain adequate Collateral as required by this Agreement, the Bank shall be in default, the Public Depositor's deposits in such Bank shall become due and payable immediately, the Public Depositor shall have the right to unilaterally direct the Custodian to liquidate the Collateral held in the Custody Account and pay the proceeds thereof to the Public Depositor and to exercise any and all other security ~~entitlements~~ with respect to the Custody Account and the other Collateral, to withdraw the Collateral, or any part thereof, from the Custody Account and deliver such Collateral to the Public Depositor or to transfer the Collateral or any part thereof into the name of the Public Depositor or into the name of the Public Depositor's nominee, and ownership of the Collateral shall transfer to the Public Depositor. The Bank authorizes the release, withdrawal, and delivery of the Collateral to the Public Depositor upon default by the Bank, and authorizes the Custodian to rely without verification on the written statement of the Public Depositor as to the existence of a default and to comply with entitlement orders originated by the Public Depositor without further consent of that Bank.

Comment [py12]: rights

7.2 In the event of default as described in Paragraph 7.1, the Public Depositor shall also have the right to sell Collateral at any public or private sale at its option without advertising such sale, upon not less than three (3) days' notice to the Bank and the Custodian. In the event of such sale, the Public Depositor, after deducting all legal expenses and other costs, including reasonable attorney's fees, from the proceeds of such sale, shall apply the remainder on any one or more of the liabilities of the Bank to the Public Depositor, including accrued interest, and shall return the surplus, if any, to the Bank, or its receiver or conservator.

Section 8. Continuing Security Interest/Termination. The security interest granted hereby shall continue to exist until either: (a) Bank provides written notification to Public Depositor of its intent to no longer act as a depository for Public Funds and termination of all accounts of Public Depositor with Bank and returns all funds deposited by Public Depositor; or (b) Public Depositor provides

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written notification to Bank of its intent to terminate its customer relationship with Bank and the removal of all of its Public Funds from deposit with Bank.

Section 9. General Terms.

9.1 During the term of this Agreement, the Public Depositor will, through appropriate action of its governing board, designate the officer, or officers, who individually or jointly will be authorized to represent and act on behalf of the Public Depositor in any and all matters arising under this Agreement.

9.2 The Public Depositor is under no obligation to maintain its deposits with the Bank and may withdraw them at any time without notice. It is agreed that when the Bank shall have paid out and accounted for all or any portion of the Public Depositor's Public Deposits, any Collateral pledged under this Agreement to secure such paid out Public Deposits shall be released from the security interest created hereunder.

9.3 All parties to this Agreement agree to execute any additional documents that may be reasonably required to effectuate the terms, conditions, and intent of this Agreement.

9.4 All of the terms and provisions of this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns.

9.5 This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same instrument.

9.6 This Agreement shall be governed by and construed in accordance with the laws of Arkansas and the laws of the United States, and it supersedes any and all prior agreements, arrangements, or understandings with respect to the subject matter hereof. In the event that any conflict of law issue(s) should arise in the interpretation of this Agreement, the parties agree that when Arkansas law is not preempted by laws of the United States, Arkansas law shall govern.

9.7 No provision of this Agreement may be waived except by a writing signed by the party to be bound thereby and any waiver of any nature shall not be construed to act as a waiver of subsequent acts.

9.8 In the event that any provision or clause of this Agreement conflicts with applicable law, such conflict shall not affect other provisions of this Agreement, which shall be given effect without the conflicting provision. To this end the provisions of this Agreement are declared to be severable.

9.9 Unless applicable law requires a different method, any notice that must be given under this Agreement shall be given in writing and sent by certified mail, return receipt requested or third party overnight priority mail carrier to the address set forth herein or such other place as may be designated by written notice in the same manner from one party to the other.

BANK:

Address for Notices:

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By: _____

Title: _____

Signature: _____

Date: _____

DEPOSITOR: Department of Finance and Administration

Address for Notices:

By: _____

Title: _____

Signature: _____

Date: _____

ARKANSAS STATE BOARD OF FINANCE

RULE 2012-1

MANAGEMENT OF CASH FUNDS

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.

A. GENERAL OVERVIEW.

The goal of cash management is to protect the principal while maximizing investment income and minimizing non-interest earning balances. Cash management considerations begin with the collection of funds and extend to the actual expenditure of those funds. Agencies should ensure that incoming funds are collected and deposited as soon as possible. Whenever possible, funds should be deposited in interest-earning accounts or invested in interest-earning investments. Interest income can be used to fund an agency's operating expenses and can reduce the necessity of increasing the fees levied on the public. An agency may use non-interest-earning accounts if they provide a greater rate of return. Agencies should utilize accounts and programs that maximize Federal Deposit Insurance Corporation (FDIC) deposit insurance coverage. A minimum of four bids should be obtained from approved banks or financial institutions in order to obtain the highest interest rate possible. If an agency determines it is unable to obtain four bids, the agency should provide a written explanation of that determination to the State Board of Finance, or its designee. If the State Board of Finance rejects the determination, it can direct the agency to re-bid. If the desired interest rate must be reduced due to collateral requirements or additional services being performed by the depository institution, the interest rate reduction should not exceed 25 basis points (.25bp) whenever possible.

Comment [A1]: When would a non-interest bearing account provide a greater return?

Comment [A2]: Agency might have to wait quite a while for final action.

Fund expenditures should be regularly reviewed for noticeable spending patterns. Expenditures should generally be consolidated into as narrow a time span as possible. Whenever possible, expenditures should be made at the time existing investments mature or new incoming funds are deposited. The Treasurer of the State of Arkansas and the Arkansas Department of Finance and Administration can assist agencies with cash management, investment and collateralization considerations. Each agency should develop a written plan for management of cash.

B. MANAGEMENT AND INVESTMENT OF CASH FUNDS.

~~Cash funds may be deposited with any bank or financial institution approved by the Arkansas State Bank Department to conduct business within the State of Arkansas. A Depository Collateral Agreement must be executed before any deposits can be made. Prior to depositing~~

~~any funds with an approved bank or financial institution operating within the borders of the State of Arkansas, the agency must contact the Treasurer of the State of Arkansas and obtain the Treasurer's most recent semi-annual certification for the bank or financial institution should review the financial condition of the bank or financial institution. 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. Certain quarterly financial reports are open for public inspection. The website of the FDIC provides additional public information that can be used to review the financial condition of the bank or financial institution. The agency shall thereafter obtain and review the Treasurer's certification for the bank or financial institution every six months so long as the agency has funds on deposit with the bank or financial institution. The agency is to use the certification to determine if the bank or financial institution is a financially sound depository for the agency's funds. An agency should not deposit funds with a bank or financial institution if it would cause the public funds an aggregate of all "public funds", as defined by Ark. Code Ann. §19-8-202, on deposit to exceed the capital of the bank or financial institution.~~

C. AUTHORIZED ACCOUNTS.

Cash funds may be deposited only in the transactional and non-transactional accounts defined in the *State of Arkansas Financial Management Guide*. The account must qualify for Federal Deposit Insurance Corporation deposit insurance coverage.

D. AUTHORIZED INVESTMENTS.

Cash funds may be invested only in the accounts and investment instruments authorized under Ark. Code Ann. §19-3-510 and §19-3-518. All noncash investment instruments must be held in safekeeping by ~~the a bank or financial institution with whom the investment was made.~~ Agencies should obtain safekeeping receipts for all investments.

E. COLLATERALIZATION OF CASH FUNDS.

Collateralization is necessary when an agency deposits cash funds with a bank or financial institution in excess of current FDIC insurance coverage. Securing deposits with assets pledged to an agency by a bank or financial institution protects the state from a loss of public cash funds in the event of a default or failure by the bank or financial institution. All collateral is to be valued at fair value when determining the amount pledged. Current market prices or current market value is also referred to as fair value. Fair value is the price at which the collateral could be sold in an "arms-length" transaction. The following collateralization provisions are minimum requirements for agencies. Additional collateralization requirements may be imposed at the discretion of the agency.

1. ~~Assets eligible to be pledged as collateral for deposits are set forth in Ark. Code Ann. §19-8-203. Specific types of collateral approved by the Board of Finance as acceptable for pledging are listed as items (a) through (j) in paragraph 2 of this section. Securities pledged as collateral shall be held by a third-party custodian that is unaffiliated with the bank or financial institution. The agency acts as the custodian for surety bonds, letters of credit and private deposit insurance pledged as collateral.~~

2. ~~Assets eligible to be pledged as collateral for deposits are those assets in which a bank or financial institution may invest without limitation identified in Ark. Code Ann. §23-47-101(a)~~

and those set forth in Ark. Code Ann. §19-8-203. The total fair value of the pledged collateral shall be at least equal to 105% of the total amount of cash funds on deposit with a bank or financial institution that is in excess of current FDIC insurance coverage

Option A: The total fair value of the pledged collateral shall be at least equal to the following percentages of the total amount of cash funds on deposit with a financial institution in excess of current FDIC insurance coverage:

- (a) ~~United States government bonds, notes and bills—103%~~ *
- (b) ~~Securities issued by Agencies agencies backed by the full faith and credit of the United States government—103%~~
- (c) ~~Arkansas school district bonds—120%~~ *
- (d) ~~Bonds of other Arkansas political subdivisions—120%~~
- (e) ~~Arkansas industrial development revenue bonds—120%~~
- (f) ~~Arkansas general obligation bonds—120%~~
- (g) ~~Arkansas municipal bonds—120%~~
- (h) ~~Surety bonds as allowed by Ark. Code Ann. §19-8-203(a)(2)—100%~~
- (i) ~~Private deposit insurance as allowed by Ark. Code Ann. §19-8-203(a)(3)—100%~~ *
- (j) ~~Irrevocable letters of credit issued by a Federal Home Loan Bank as allowed by Ark. Code Ann. §19-8-203(a)(4)—100%~~

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Option B: The total fair value of the pledged collateral shall be at least equal to 105% of the total amount of the cash funds on deposit with a financial institution in excess of current FDIC insurance coverage unless 50% or more of the pledged collateral's fair value consists of items (c) through (g), in which case the percentage shall be 110%.

- ~~(a) United States government bonds, notes and bills~~
- ~~(b) Agencies backed by the full faith and credit of the United States government~~ *
- ~~(c) Arkansas school district bonds~~
- ~~(d) Bonds of other Arkansas political subdivisions~~
- ~~(e) Arkansas industrial development revenue bonds~~
- ~~(f) Arkansas general obligation bonds~~
- ~~(g) Arkansas municipal bonds~~
- ~~(h) Surety bonds as allowed by Ark. Code Ann. §19-8-203(a)(2)~~
- ~~(i) Private deposit insurance as allowed by Ark. Code Ann. §19-8-203(a)(3)~~
- ~~(j) Irrevocable letters of credit issued by a Federal Home Loan Bank as allowed by Ark. Code Ann. §19-8-203(a)(4)~~

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~~3. The Board of Finance strongly discourages use of any bank investment assets allowed by Ark. Code Ann. § 10-8-203 other than those listed in paragraph 2 of this section as pledged collateral as these assets may require highly specialized technical skill in order to assess their quality and risk. To the extent an asset not listed in paragraph 2 of this section is used as collateral, the total fair value of the pledged collateral shall be at least equal to 130% of the total amount of cash funds on deposit with a financial institution in excess of current FDIC insurance coverage.~~

43. Monitoring the value of assets pledged as collateral is the responsibility of the agency making the deposit. The bank or financial institution shall provide a monthly periodic collateral report to the agency at no charge. The frequency of the periodic collateral reports is to be agreed upon by the agency and bank or financial institution and written in the *Custodial Services Agreement*. Costs associated with providing periodic collateral reports should be considered in submitting a bid for deposit of cash funds. The report shall include the fair value and description of the assets pledged as collateral as of the last business day of the month with pricing of the pledged collateral to be within five business days of the report date. The agency shall verify through an independent source the fair value reported by the bank or financial institution in its monthly periodic collateral report. A list of acceptable independent sources to be used by agencies for verifications shall be maintained in the *State of Arkansas Financial Management Guide*.

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Comment [A3]: Should be in the Deposit Collateral Agreement.

~~54. A *Custodial Services Agreement* shall be executed with each custodian for safekeeping of assets pledged to an agency by a bank or financial institution. Collateral pledged to secure deposits may be held only by a custodian that satisfies the following requirements:~~

Option A:

- ~~a. A custodian may be a Federal Reserve Bank, the trust department of a commercial bank or a trust company capable of maintaining book entry accounts with a Federal Reserve Bank and capable of safekeeping eligible collateral.~~
- ~~b. If the custodian is a financial institution chartered outside the State of Arkansas, it shall provide a legal opinion acceptable to the agency regarding the compatibility of Arkansas Code Title 4, Subtitle 1, with the Uniform Commercial Code of the state in which the financial institution is principally located. The legal opinion shall state and confirm that the agency's security interest is properly perfected under the law of the state in which the financial institution is principally located. The legal opinion shall be prepared by counsel licensed to practice in the state in which the financial institution is principally located. The legal opinion shall be reviewed and updated in conjunction with the renewal of the *Custodial Services Agreement* for which the opinion was rendered. Federal Reserve Banks are not required to provide the legal opinion.~~
- ~~c. A financial institution may not hold assets for safekeeping that it has pledged to an agency as collateral for a deposit. Collateral shall be placed for safekeeping with a custodian that is unaffiliated with the financial institution.~~
- ~~d. To be considered "unaffiliated," all of the following conditions must be met:~~

~~(1) 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 a financial institution including, but not limited to, ownership of voting securities.~~

~~(2) The 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.~~

~~(3) The custodian and financial institution are not owned directly or indirectly by the same parent corporation.~~

Option B:

a. A custodian may be a Federal Reserve Bank, a Federal Home Loan Bank, a bankers' bank, the trust department of a commercial bank or a trust company primarily located within the State of Arkansas.

b. A bank or financial institution may not hold assets for safekeeping that it has pledged to an agency as collateral for a deposit. 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:

(1) 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.

(2) 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.

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

(4) Voting securities of up to 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.

d. An agency may request permission from the Board of Finance to use a custodian primarily located outside the State of Arkansas.

65. Collateral shall not be released, substituted or compromised by a bank or financial institution or custodian unless ~~written~~ approval is obtained from the agency to which the collateral was pledged prior to taking any such action. Substitution may be allowed without prior authorization if the agency and the bank or financial institution agree to the substitution procedures and the types of securities allowable for substitution. Substitution procedures shall be addressed in the *Depository Collateral Agreement* and the *Custodial Services Agreement*.

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Comment [A4]: Could be complicated unless
there are only few and most likely candidate -BONY
- is prequalified when rule is adopted.

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The percentage of coverage required by paragraph 2 of this section shall be recalculated upon substitution or release of collateral.

76. 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. 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.

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

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

F. SECURITY INTEREST.

The bank or financial institution with whom cash funds have been deposited is responsible for perfecting the agency's providing the agency with a security interest in the collateral pledged by the bank or financial institution in accordance with the Uniform Commercial Code. 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 whom cash funds have been deposited. If the agency uses the agreement forms prescribed by the Board of Finance, it will be considered to have met this requirement. Forms used by a Federal Reserve Bank or Federal Home Loan Bank are acceptable and will be considered to have met this requirement. 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 Rule.

Comment [A5]: And compliance with all Federal laws and regulations governing the establishment of an enforceable security interest.

Perfection of investment property such as securities, security accounts and security entitlements is achieved through control as provided in the Uniform Commercial Code. Generally, control means that the secured party can exercise power over the investment property without further action or consent of the financial institution. Control is obtained through possession, registration or on the basis that the issuer or an intermediary will act on the instructions of the agency.

Comment [A6]: a security interest in

~~The following documents~~ The documents described in paragraphs 1, 2 and 3 below must be executed to collateralize agency deposits. Exhibits A, B and C attached to this Rule are sample agreements that may be used. However, the parties to the agreements may agree to other forms if they comply with the requirements of this Rule.

1. Depository Resolution.

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. 58 Fed. Reg. 16833, March 31, 1993.

- a. Attached as Exhibit A is a *Certificate of Corporate Resolutions* recommended by the Arkansas State Board of Finance for use by agencies.
- b. The *Certificate of Corporate Resolutions* shall not be dated after the *Depository Collateral Agreement*.
- ~~b.c.~~ A bank's or financial institution's standard resolution form is acceptable if it achieves the purposes of this Rule.

2. Depository Collateral Agreement.

- a. Attached as Exhibit B is a *Depository Collateral Agreement* recommended by the Arkansas State Board of Finance for use by agencies.
- b. *Depository Collateral Agreements* used to collateralize state funds shall contain the following provisions:
 - (1) The agreement shall provide the specific terms setting forth how funds not covered by FDIC insurance will be collateralized.
 - (2) The agreement must identify the specific type or types of collateral to be pledged and grant the agency with a perfected security interest in the collateral ~~and specify or outline the method of perfection necessary under the Uniform Commercial Code.~~
 - (3) The agreement must provide for a monthly periodic recalculation of the market value of pledged securities to ensure the value meets the collateralization ratios of Section E, paragraph 2. The agreement must provide that the bank or financial institution will provide the agency with a monthly periodic statement of collateral, at no cost, to verify the adequacy of the pledged collateral. The monthly periodic statement of collateral must identify the deposit secured by the collateral, describe the collateral, and provide or cite an independent source for verification of value. the collateral's current fair value. The agreement should specify the methods by which the fair value will be determined.
 - (4) The agreement must specify the collateralization ratio applicable to the pledged collateral.
 - (5) Letters of credit, surety bonds and private deposit insurance policies must identify the issuer of the instrument and the coverage amount. 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. 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. An agency should not deposit any funds with a bank or financial institution in excess of FDIC insurance limits until such time that the agency has received the collateral pledged by the financial institution for the funds. 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. 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 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.

- (6) 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. The agency, bank or financial institution, and custodian must execute a *Custodial Services Agreement*.
- (7) ~~The agreement must provide that the agency must approve any substitution of pledged collateral and that pledged collateral will not be released until the substituted collateral is received.~~ specify procedures for substitution or release of collateral. The collateralization ratio shall be recalculated upon the substitution or release of pledged collateral.
- (8) The agreement must provide that it will be governed by Arkansas law.
- (9) The agreement must be reviewed, updated and re-executed if the bank or financial institution undergoes a name change, merger, sale, change in ownership or any other material change to the bank or financial institution.

3. Custodial Services Agreement.

- a. Attached as Exhibit C is a *Custodial Services Agreement* recommended by the Arkansas State Board of Finance for use by agencies.
- b. Except for agreements required by a Federal Reserve Bank or Federal Home Loan Bank, Custodial Service Agreements used to collateralize ~~state-cash~~ funds shall contain the following provisions:
 - (1) The agreement must vest "control" of the pledged collateral in the agency as provided in the Uniform Commercial Code. 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".
 - (2) The agreement must provide that the custodian waives its right to a security interest in the pledged collateral and prohibit the custodian and bank or financial institution from further pledging the collateral subject to the agreement.
 - (3) 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.
 - (4) The agreement must provide that the custodian is ~~an~~ a custodial agent of the agency and will hold the pledged collateral solely for the benefit of the agency.
 - (5) The agreement must provide that the pledged collateral will not be held in a margin account and no margin or other credit will be extended to the bank or financial institution with respect to the pledged collateral.
 - (6) 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.
 - (7) The agreement must provide that the custodian will notify the agency if another person claims a property interest in the pledged collateral and immediately substitute unencumbered collateral of equivalent value that is free and clear of any adverse claims.

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- (8) The agreement must provide that the duties of the custodian shall continue in effect until the security interest has been terminated and the agency shall notify the custodian of the termination in writing within a reasonable period of time.
- (9) 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.
- (10) The agreement must provide that the bank or financial institution does not have the ability to terminate the agreement.
- (11) The agreement must provide that it will be governed by Arkansas law.

G. 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.

H. 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).

By: _____

Date: _____, 2012

Richard A. Weiss, Director
Arkansas Department of Finance and Administration
Executive Officer, Arkansas State Board of Finance

John Theis

From: Cook, Donnie [donnie.cook@baml.com]
Sent: Thursday, March 15, 2012 4:33 PM
To: John Theis
Subject: Management of Cash Funds Rule 2012-A

John below are a couple of comments in the revised version of the Management of Cash Funds Rule 2012-A that was discussed at your public meeting on 3-8-2012. We sincerely appreciate the opportunity to provide these and greatly appreciate your consideration in this regard.

They are as follows:

Under section 4 *Custodial Services Agreement* (d) regarding out of state custodian. In section d the proposed rule states: *An agency may request permission from the Board of Finance to use a custodian primarily located outside the State of Arkansas.*

We would request this be changed to not require the agency to receive this permission but to permit the Financial Institution who is accepting Public Deposits and that is using an Out of State Custodian to be allowed to request approval of this Custodian through the Board of Finance. This would eliminate the need for every Agency to have to request permission and would make the process cleaner by soliciting approval one time from the Board. This should streamline this process in both the time for the Board and would also remove an undue burden on the Agency to obtain this approval which would also create a disadvantage to the financial institution providing this service.

We sincerely appreciate your consideration to this

Donald J. Cook
President, Central Arkansas
Bank of America Merrill Lynch
(Phone) 501-378-1678 (Fax) 501-378-1445
Email: donnie.cook@baml.com

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March 1, 2012

Mr. John H. Theis, DFA Revenue Division
Ledbetter Building, Room 2440
P.O. Box 1272
Little Rock, Arkansas 72203-1272

Dear Mr. Theis:

Regions Bank appreciates the opportunity to comment again on Proposed Rule 2011-1 Management of Cash Funds. We believe that the revised version of the Proposed Rule reflects significant cooperation by all parties involved and we applaud the Board's and Staff's flexibility in working with the banking industry on this matter.

We have two points we would like to confirm relative to the Proposed Rule:

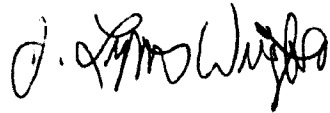
- (1) We read the Proposed Rule as allowing U.S. Agency Securities, such as those of FHLMC and FNMA, to qualify as collateral for public funds deposits. This is an important issue for Regions, and we would appreciate your confirming whether our reading is correct.
- (2) We obviously understand the requirement for Board or Loan Committee approval of the relationship. Attached is the resolution approved by the Regions Board that is intended to provide authority for the appropriate officers of Regions Bank to enter into agreements related to the pledging of collateral to secure public deposits. While this resolution has been deemed sufficient in other states within the Regions footprint, we would appreciate your reviewing this resolution and advising us if it is acceptable under these new rules. If you do not find it acceptable, we request the opportunity to discuss it with you. Regions Board only meets a few times a year, and it would be impractical for the Board to approve a separate agreement with every agency throughout the 16 states in which Regions operates.

Our third party custodian, Bank of New York Mellon, has been reviewing your proposed rules to determine if they can work within those guidelines. We have yet to receive a response from their Legal group, but we may need to contact you with a follow up response should they express concerns about issues that they cannot work around.

400 West Capitol Avenue
Little Rock, Arkansas 72201

Again, thank you for the opportunity to comment on the proposed rule. We look forward to continuing to work with you to ensure that all of the funds deposited to Regions Bank from public entities in the State of Arkansas remain safe and secure. If you would like to discuss any of our comments, please contact me at 501-371-7142.

Very truly yours,

A handwritten signature in black ink, appearing to read "J. Lynn Wright". The signature is written in a cursive, somewhat stylized font.

J. Lynn Wright
Arkansas Area President

Attachment

cc: Bill Holmes, President
Arkansas Bankers Association



SECRETARY CERTIFICATE

I, Pamela R. Welch, a duly elected and qualified Assistant Secretary of Regions Bank, an Alabama state banking corporation, hereby certify as follows:

1. That at a duly convened meeting held on **April 27, 2011**, at which a quorum was present, the Board of Directors adopted the following resolutions and the same are in full force and effect on the date hereof:

“WHEREAS, Regions Bank (“Bank”) serves as depository for numerous state and local governmental entities and other public bodies in the states in which the Bank maintains branches;

WHEREAS, the laws of various states require that deposit of public bodies be secured by adequate collateral to the extent such deposits exceed applicable FDIC insurance limits;

WHEREAS, the Bank desires to secure the funds deposited by public bodies with the Bank by granting to each such public body depositor a security interest in collateral acceptable to such public body and in connection therewith to enter into appropriate security agreements, custodial agreements, other related agreements; and

WHEREAS, the Board of Directors of the Bank desires to ratify and confirm all existing and prospective pledges of collateral to public bodies to secure their deposits and the agreements implementing the same;

NOW THEREFORE, BE IT RESOLVED, by the Board of Directors of Regions Bank, that the appropriate officers of the Bank holding the office of Vice President or above are hereby authorized, empowered and directed, on behalf of the Bank, in their discretion and acting within the scope of their authority, to accept deposits from any governmental body, agency, subdivision, or instrumentality, and if contemplated or required by any law or regulation of the applicable state, to pledge satisfactory collateral to secure the Bank’s liability for such deposits, and to enter into and execute and deliver any and all documents required by any such depositor to fulfill the purpose of this resolution, and to take all such other actions to fulfill the Bank’s obligations with respect to such deposits as such officers shall, in their sole discretion, deem necessary or desirable;

BE IT FURTHER RESOLVED, that the Board hereby adopts, approves, ratifies, and confirms any and all pledges, security agreements, custodian agreements, and related documents that the appropriate officers of the Bank holding the office of Vice President or above, acting within the scope of their authority, may execute and deliver under the authority of the foregoing resolution;

BE IT FURTHER RESOLVED, that the Board hereby adopts, approves, ratifies, and confirms any and all pledges, security agreements, custodian agreements, and related documents that the appropriate officers of the Bank, acting within their authority, have executed and delivered on behalf of the Bank to secure deposit accounts at the Bank established and

 **REGIONS**

maintained by any governmental body, agency, subdivision, or instrumentality as contemplated or required by any law or regulation of any state;

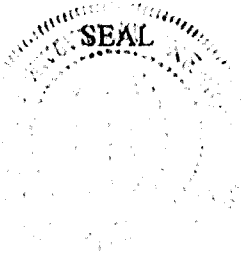
BE IT FURTHER RESOLVED, that the Board hereby adopts and incorporates by reference any form of specific resolution not inconsistent with these resolutions to carry out the purpose and intent of these resolutions, including forms of resolutions that may be required by any such depositor; such forms of resolutions shall be effective in their entirety as if fully stated herein; and the Secretary and any Assistant Secretary are authorized and directed to incorporate into and maintain such forms of resolutions in the minutes of the Board of Directors of the Bank, and to execute and deliver certified copies of these resolutions and any additional forms of resolutions adopted and incorporated by reference hereby; and


BE IT FURTHER RESOLVED, that these resolutions and any additional forms of resolutions adopted and incorporated by reference hereby shall be included in the minutes of the Board of Directors of the Bank, and such resolutions and all agreements that are subject to the resolutions shall constitute official records of the Bank in accordance with Section 1823(e) of the Federal Deposit Insurance Act, as amended.”

2. I further certify that the following individual is qualified to act as an officer of Regions Bank, with officer title as specified below:

<u>Name</u>	<u>Title</u>
Stan Williams	Vice President

IN WITNESS WHEREOF, have set my hand and affixed the seal of Regions Bank, an Alabama banking corporation, on this the 1st day of March, 2012.




Pamela R. Welch
Assistant Secretary

John Theis

From: Jim Franks [jfranks@bankers-bank.com]
Sent: Tuesday, March 06, 2012 8:03 AM
To: John Theis
Subject: Comment for revised proposed cash funds collateral rule

John – Just a heads up that I mailed to you yesterday a comment on the revised proposed collateral rule for cash funds. It only addressed two points and they both apply to the draft version of the Custodian Services Agreement (CSA).

Point 1 was to eliminate the appearance of a conflict in what the rule says (which we believe is correct) and what the CSA says. The issue is when it is permissible to allow for substitution of pledged collateral without the required consent of the public depositor. I think everyone would want the rule and CSA to be consistent.

Point 2 is a request to add a paragraph that is contained in the current CSA that the Treasurer's Office uses. It deals with the duties, responsibilities and liabilities of the Custodian (such as FNBB). I make reference that this is standard language and even site other states that use the identical or similar language.

Since I got longwinded again in what I mailed you yesterday, I thought I would summarize my two points to hopefully make things easier for you.

Trust all is well. And again, thanks so much for your leadership on this very important issue for bankers.

Have a great day.

Jim Franks
Executive Vice President
First National Bankers Bank
Arkansas Region
jfranks@bankers-bank.com
P 501.371.0535
P 800.737.0535
D 501.975.1249

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March 5, 2012

John H. Theis, Assistant Commissioner of Revenue
DFA Revenue Division
Ledbetter Building Room 2440
P. O. Box 1272
Little Rock, Arkansas 72203-1272

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FEB 6 2012

**ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL**

RE: Management of Cash Funds Proposed Rule; Rule 2012-A

Dear Mr. Theis:

First National Bankers Bank, Arkansas Region¹ (FNBB) is pleased to have the opportunity to present these additional written comments as to the State Finance Board's proposed amended Management for Cash Funds rule, now proposed Rule 2012-A.

As you are aware, FNBB is a specialty correspondent bank (a bankers' bank) with an office in Arkansas. We have over 100 Arkansas banks as customers, as well as several insurance companies that likewise use our bank's safekeeping and pledging services. We thus believe we are especially suited to make our comments and observations as to the proposed rule regarding the appropriate safekeeping of those securities and the collateralization of public deposits, and it is in this limited area that we make these additional comments

We believe that FNBB, Arkansas Region, and its predecessor Arkansas Bankers' Bank, is the largest safekeeping custodian in Arkansas. Currently FNBB, Arkansas Region, has over 135 safekeeping customers, specifically including the State Treasurer's office, with securities valued at over \$8 billion. It is common that for each safekeeping customer, there are many pledgee public depositors. A bank who has public deposits that require collateralization may well have several area school districts, counties, cities and municipalities, public housing authorities, water districts, as well as the State Treasurer's office. We recognize that while this proposed rule covers only cash deposits, it will most likely serve as a starting place for public deposits and State treasury deposits. FNBB welcomes this goal of consistency across the various types of

¹ First National Bankers Bank (FNBB), with headquarters in Baton Rouge, Louisiana, is a \$1 billion specialty correspondent bank having as customers primarily only other banks. Many of these customer banks are also stockholders of FNBB's parent holding company. FNBB's Arkansas office is the former Arkansas Bankers' Bank (ABB). ABB was chartered as an Arkansas state chartered bank in 1990. It became a part of the FNBB family as a wholly owned subsidiary of FNBB's parent holding company. Subsequently, ABB (along with three other state specific bankers' banks) were merged into FNBB. While the former ABB no longer exists as a separate entity, the office and staff continue as before the merger and consolidation so that there is a considerable physical presence in the State of Arkansas. There are over 100 Arkansas banks that are customers of FNBB, Arkansas Region. Almost 70 are stockholders of FNBB's parent holding company.

public funds. Our bank has the requisite specialized personnel, software and technical expertise to manage such a safekeeping and pledging operation. FNBB, Arkansas Region and its predecessor Arkansas Bankers' Bank, has been safekeeping the securities of Arkansas banks and accepting the pledges for their public depositor customers for over twenty (20) years. We value the trust that both our customer banks and the public bodies of Arkansas have placed in us.

FNBB's comments provided herein are totally applicable only to the suggested forms to be used by the various parties, specifically the Custodial Services Agreement, which is Exhibit C in the revised proposed rule. We believe that the tenor of the revised proposed rule that was modified by your staff and subsequently approved by the State Board of Finance for additional public comment in January 2012 is appropriate and we offer no further suggestions. We attempt by these comments to bring to your attention applicable practices in the industry that need to be considered for the suggested forms attached to the revised proposed rule.

Before I make our specific comments, I would be remiss if I did not express FNBB's sincerest thanks to you and your staff for the yeoman's work done on the revision of the original proposed rule. Thank you again. This is a classic example of the public and private sectors working hand-in-hand to benefit the citizens of Arkansas.

The general tenor of FNBB's comments is to first and foremost reasonably protect the public's deposits in banks doing business in Arkansas and eligible for these deposits. Additionally, those custodians like FNBB that are in the business of safekeeping our customers' securities and complying with their directives in the pledging of their securities to secure those public deposits have invested considerable in personnel, training, equipment and software. There must be a balance between the protection of these deposits and the operational requirements and efficiencies of the pledging bank, the public depositor and the safekeeping custodian.

There are two areas FNBB would like to address. They are; 1) substitution of collateral; and 2) the duties, responsibilities and rights of the custodian, and the consequences if there is a failure to adhere to these.

A. Substitution of pledged collateral.

There were certain issues, ambiguities and contradictions in the original proposed rule concerning the pledging bank's right to substitute collateral. We believe these have been appropriately addressed in the revised proposed rule which specifically allows for substitution of collateral under certain conditions without the need for any authorization of the public depositor. We are not sure that the similar issues have been addressed in the Exhibits, and are thus, contradictory. We believe it best to clear up any contradictions between the revised proposed rule and the Exhibits made a part of the rule.

Generally, pledging banks must be given operational latitude in unilaterally substituting securities being used as collateral in such cases where the collateral is being called, has matured, etc. There should be a set of guidelines and procedures as to how this

can happen so that while the bank is provided the operational latitude, the public depositor continues to be protected. The revised proposed rule, we believe, does this. However, any requirement that necessitates the written or verbal consent of the public depositor for a bank to substitute collateral under the strict substitution rules is operationally cumbersome, unnecessary and inefficient, and only adds to the cost of the system.

Specifically, paragraph number eight (8) states:

The Custodian will not release or transfer to the Bank any securities constituting the Collateral **without prior written instructions** from the Public Depositor, except that the Custodian may elect to release or transfer to the Bank securities constituting the Collateral upon receipt of verbal instructions from the Public Depositor, if: (i) the verbal instructions are electronically recorded and the Custodian has obtained independent and separate confirmation of the verbal instructions from an authorized officer of the Public Depositor; (ii) the Custodian provides immediate written confirmation of the verbal instructions to the Public Depositor; and (iii) the Public Depositor provides immediate written confirmation of the verbal instructions to the Custodian. The Public Depositor and the Custodian agree that in the case of any conflict between written and verbal instructions, the written instructions will be binding. (*Emphasis mine.*)

There is an "exception" aspect to the written instructions requirement above, but it is operationally burdensome and thus practically unworkable without added expense that will ultimately be borne by the public depositor.

It is also noted that paragraph number eight (8) in the proposed Custodial Services Agreement has a parenthetically added "Note:" that suggest the parties should agree to a substitution process, and make the appropriate changes to the referenced paragraph. The "Note:" states:

(Note: The parties should agree to the substitution procedure to be followed and prescribe those procedures in this paragraph, making changes as appropriate)

We believe that what will practically happen is that the pledgor and public depositor will not discuss this aspect of the Agreement, make no changes to the Agreement, and this will lead to operational issues for all concerned. We believe it advisable, and more efficient to modify paragraph number eight (8) so that it contains the requisite language that allows for substitution that is consistent with the revised proposed rule. FNBB would offer the following as a new paragraph number eight (8) (added language highlighted), to wit:

Other than for the substitution of securities constituting the Collateral, the Custodian will not release or transfer to the Bank any securities constituting the Collateral without prior written instructions from the Public Depositor, except that the Custodian may elect to release or transfer to the Bank securities constituting

the Collateral upon receipt of verbal instructions from the Public Depositor, if: (i) the verbal instructions are electronically recorded and the Custodian has obtained independent and separate confirmation of the verbal instructions from an authorized officer of the Public Depositor; (ii) the Custodian provides immediate written confirmation of the verbal instructions to the Public Depositor; and (iii) the Public Depositor provides immediate written confirmation of the verbal instructions to the Custodian. The Public Depositor and the Custodian agree that in the case of any conflict between written and verbal instructions, the written instructions will be binding.

In cases of authorized substitution of securities constituting the Collateral, the Custodian shall, on the first business day following receipt by the Custodian of prior written notice, allow the Bank to withdraw any of the securities constituting the Collateral, if the Bank shall simultaneously deliver to the Custodian as additional Collateral securities of the same type and having at least the same market value as the securities withdrawn.

The new second paragraph is identical to language in the State Treasurer's Custodial Service Agreement (except for the first part of the sentence and the reference to "Bank" rather than "Institution"). From an actual operational aspect, this is exactly what happens. We believe this time-tested methodology is in the overall best interests for all parties and meets the requirements of the revised proposed rule.

B. Custodial Services Agreement

The attached Exhibit C, Custodian Services Agreement, makes major changes to the same agreement used by the State Treasurer's Office. While the revised proposed rule does not mandate the use of the rules suggested documents, it is easy to understand why most banks and their public depositor customers would choose to do so. As has already been stated in this comment letter, FNBB welcomes consistency.

The agreement used by the State Treasurer has become the mainstay and generally accepted document for public deposits. FNBB's safekeeping department sees few agreements that are not essentially the documents provided by the Treasurer's Office. One omitted paragraph from the Exhibit Custodial Service Agreement that is part of the revised proposed rule, is as follows, and is included as part of the Treasurer's agreement. We believe that this paragraph is standard in nature and it, or one similar to it, should be included. The jest is that the duties and responsibilities of the Custodian are met so long as the Custodian acts in good faith, or in absence of bad faith. It further provides that if the Custodian gets in the middle of a disagreement between the bank and the public deposit, a "swearing match" so to speak, that the Custodian can avail itself of its common law rights by interpleading the funds into the registry of a court and then be relieved of any further duty and liability.

In the absence of bad faith on the part of the **Custodian**, the **Custodian** shall be permitted to rely upon the authenticity of, and the truth of the statements and the accuracy of the opinions expressed in, and will be protected in acting upon, any document believed by the **Custodian** to be genuine and to have been signed,

affixed or presented by the proper party or parties. The **Custodian** shall not be liable with respect to any action taken or omitted to be taken by it in accordance with any instruction or request of the **Depositor**. In addition, the **Custodian** shall not be liable for any error of judgment made in good faith by an officer of this **Custodian**, unless it shall be proved that the **Custodian** was grossly negligent in ascertaining the pertinent facts. In the event the **Custodian** receives substantially contemporaneously contrary written instructions from the **Depositor** and the **Institution**, then the **Custodian** may, at its election and without liability to either the **Depositor** or the **Institution**, interplead the securities constituting the **Collateral** in a court of competent jurisdiction, and the **Depositor's** and the **Institution's** sole recourse shall be against each other and the securities constituting the **Collateral** so interpled.

Several states that have similar language in their approved agreements:

Iowa - <http://www.treasurer.state.ia.us/pledging/MasterCustodialAgreement.pdf>

Nevada - <https://nevadatreasurer.gov/documents/pooled/Form-CustAgree.pdf>

FHLB - <https://www.fhfb.com/products/data/SKSG1209.pdf>

Oklahoma - <http://www.ok.gov/treasurer/documents/OST%202001-2.pdf>

New York - <http://www.osc.state.ny.us/localgov/model.pdf>

I again thank you for the opportunity to comment on your revised proposed rule. If you need clarification on any point made herein, please do not hesitate to let me know.

Sincerely,



Jim Franks
Executive Vice President

John Theis

From: Grace Hobbs [Grace.Hobbs@simmonsfirst.com]
Sent: Wednesday, March 14, 2012 12:34 PM
To: John Theis
Cc: InvArchive
Subject: Follow up comments on Rule 2012-A
Attachments: DOC.PDF

Importance: High

Mr. Theis,

Thank you for the opportunity to submit our follow up comments to the issues raised at the public hearing. We hope they will be considered when rule 2012-A is being finalized. Should you have any questions, please do not hesitate to contact us.

Best regards,

Grace Hobbs
Vice President
Simmons First Investment Group, Inc.
501-223-4350 or 800-762-3416

.....
Simmons First Investment Group, Inc. is a member of the FINRA and SIPC. It is a wholly owned subsidiary of Simmons First National Bank, an MSRB registered bank broker/dealer.

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SIMMONS FIRST NATIONAL BANK
INVESTMENT GROUP – LITTLE ROCK OFFICE

March 12, 2012

John Theis
Arkansas DFA
Transmitted via Email

Re: Arkansas State Agency collateral requirements-Public Hearing Follow-up

Mr. Theis;

Simmons First wants to thank you for the opportunity to expand on some of the issues raised at the March 8th, 2012 public hearing.

The first deals with holding securities at a broker dealer. Simmons First National Bank currently utilizes Morgan Keegan as its safekeeping agent. Securities sent to Morgan Keegan are delivered to Bank of New York, which is Morgan Keegan's clearing agent. Therefore, although our securities are "safe kept" at Morgan Keegan, they are in the possession of a commercial bank's trust division. We would like to receive a clear indication that security broker/dealer firms are acceptable custodian to hold pledged securities.

The second issue concerns wording in the proposal "trust division of a commercial bank". For example, Simmons First National Bank's safekeeping department is operationally under the Investment Division. Does this disqualify them from being a "qualified custodian" to hold pledged securities for non-affiliated banks or financial institutions?

Most of the commercial banks that provide security safekeeping for their downstream non-affiliated banks have such function handled by a designated department within their Investment Division. At Simmons First National Bank, all customers' securities are placed in a segregated account from the bank owned securities. Fed Book-Entry securities are held at Federal Reserve Bank and DTC Book-Entry securities are held at Northern Trust Company. The Safekeeping Department safeguards our customer's assets and handles their pledging securities in the same fiduciary manner as any trust division does. Our current practice meets all the requirements specified for a custodian in the proposed Depository Collateral Agreement and has been acceptable to the Arkansas State Treasurer.

To eliminate unnecessary changes to the general practice of holding pledged securities, we recommend that the proposed rule be modified to read as "a safekeeping department

of a commercial bank, or a trust company specialized in holding, accounting and handling such investment securities.”

Thank you again for taking into consideration of our comments. If you have any questions, please do not hesitate to contact us directly.

Sincerely,

Simmons First
Investment Banking Group

Wendy Spadoni

From: John Theis
Sent: Friday, March 09, 2012 3:18 PM
To: Wendy Spadoni
Subject: FW: State Board of Finance rules

Please print this out in color when you have a moment. Thanks.
John

From: John Theis
Sent: Friday, March 09, 2012 3:17 PM
To: 'Miller, Matthew B.'
Cc: Paul Louthian; Gerald Plafcan; Mike Wehrle; 'Brent Taylor'
Subject: FW: State Board of Finance rules

Matthew,
My responses to your questions are provided below. Please contact me if you have additional questions.
John

From: Miller, Matthew B. [mailto:miller@m@blr.arkansas.gov]
Sent: Thursday, March 08, 2012 9:21 AM
To: John Theis
Subject: State Board of Finance rules

John, I had a chance to review the State Board of Finance rules filed with the Legislative Council and had the following questions:

- (1) The rule provides that the Treasurer of the State of Arkansas and DFA shall act on behalf of the board to administer the rule. Is there a formal statutory requirement for these agencies to act for the board? There is no statutory requirement that DFA and the Treasurer to perform these functions. The Board of Finance is composed of the Governor, State Treasurer, State Auditor, Bank Commissioner, and DFA Director. Of these board members, the Treasurer and DFA Director have ongoing relationships and interactions with the various state agencies that make those agencies the logical offices to assist the Board of Finance in carrying out these rules.
- (2) Section A. – Just to verify, the selection of a bank or financial institution is not a procurement, correct? The bids required by this section are not part of a formal procurement process? The selection of a bank is not a procurement subject to the competitive bidding process in Ark. Code 19-11-228. That provision applies to contracts for the purchase of commodities or services. Placing funds on deposit with a bank or financial institution is not a “purchase” because no money is being spent by the state. Instead, the funds are placed with the bank or financial institution with the expectation that the state will continue to have every dollar of the deposited funds available for use and will, in fact, receive interest payments from the bank or financial institution based on the amount deposited.
- (3) Section C. – Is the “State of Arkansas Financial Management Guide” a rule that has been promulgated in the past? The Financial Management Guide has not been promulgated as a rule based on the definition of “Rule” in Ark. Code 25-15-202(8)(B). That provision excludes from the definition of “Rule” “Statements concerning the internal management of an agency and which do not affect the private rights or procedures available to the public”. The Financial Management Guide is a set of working policies and procedures for State agencies to follow in the conduct of their daily financial affairs and does not affect the rights of the public or the procedures for the public in dealing with state government. As such, the Financial Management Guide falls outside the definition of a rule.

(4) I compared the rule's requirements for a "depository collateral agreement" to the sample attached to the rule. I may have missed it, but I wasn't sure the sample contained the following prescribed requirements: **the collateralization ratio applicable to the pledged collateral (#4)** This provision is contained in paragraph 1.1(a) of the agreement. Rather than restating the collateralization ratios in the agreement, we simply referenced the rule requirements; **a provision that the agency should not deposit funds in excess of FDIC limits until the agency has received the collateral (part of #5)** This is not really a proper term for the agreement. Instead, it is an admonition to the agency. As such, it would probably make better sense to move this to Section E of the rule; **specifications for the release of collateral or a provision requiring the recalculation of the collateralization ratio upon the substitution or release of pledged collateral (#7)** These provisions are contained in paragraphs 4.3 and 4.4; **and a provision that the agreement will be reviewed after a material change to the bank or financial institution (#9)** This provision also provides direction to the agency and is not really intended to be a contract term. We will examine the rule to determine where this provisions might more appropriately fit.

(5) Similarly, I looked at the custodial services agreement and wasn't sure the following were included: **a waiver of the custodian's right to a security interest (#2)** This provision is contained in paragraph 12; **a requirement that copies of all statements and confirmations be sent simultaneously to the bank and the agency (#6)** This provision is contained in paragraph 9; however, it may be necessary to rewrite this provision to address the "simultaneously" requirement; **a requirement that the custodian notify the agency if another person claims an interest in the property and substitute unencumbered collateral (#7)** This is contained in paragraph 14. It may be appropriate to add language to address the "substitution of unencumbered collateral" requirement; **and a requirement that termination notification be made "within a reasonable period of time" (#8)** This language is in paragraph 23; however, a specific 30 day period was used rather than the less specific "within a reasonable time period" requirement.

The sample documents may well include all these provisions and I either missed them or didn't interpret them properly, but I wanted to bring them to your attention just to make sure there wasn't an oversight.

I plan to come over for the hearing today. If you have any questions, please give me a call.

Matthew B. Miller
Administrator, Administrative Rules Review
Bureau of Legislative Research
One Capitol Mall, 5th Floor
Little Rock, AR 72201
501-537-9122 (Direct)
501-682-1937 (Main)
501-683-1140 (Fax)



SIMMONS FIRST NATIONAL CORPORATION

January 27, 2012

John H. Theis, DFA Revenue Division
Ledbetter Building Room 2440
P.O. Box 1272
Little Rock, AR 72203-1272

RECEIVED

JAN 31 2012

ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

Re: RULE 2011-1 Management of Cash Funds

Mr. Theis;

In July of 2011, you presented an opportunity for Simmons First and other Arkansas banks to comment on Rule 2011-1 Management of Cash Funds.

I recently had a conversation with the Arkansas Bankers Association regarding the status of the proposed Rule 2011-1 Management of Cash Funds. Based upon this conversation, it is my understanding that DFA agreed to numerous changes to the proposal as a result of comments from Arkansas banks and we sincerely appreciate DFA's consideration and cooperation on these matters. It was also my understanding that DFA had determined not to change the proposed Rule 2011-1 Section E, Paragraph 5 – Custodial Services/Safekeeping of Pledged Collateral. This particular section will admittedly impact a small number of Arkansas banks. However, the eight community banks that comprise Simmons First National Corporation will be impacted. Simmons First National Bank presently serves as custodian for the corporation's other seven affiliate banks. As described in our original comment letter dated July 25, 2011 (a copy is attached for your convenient reference), as regulated financial institutions, there are safeguards in place to protect the interest of public funds depositors.

The purpose of this correspondence is to simply ask your office to please consider the checks and balances already in existence for regulated financial institution and consider amending the proposed rule as it pertains to "affiliates" providing custodial services for pledged collateral.

Thank you for this opportunity to comment.

Sincerely,

Marty Casteel
EVP

Simmons First National Corporation



SIMMONS FIRST NATIONAL CORPORATION

July 25, 2011

John H. Theis, DFA Revenue Division
Ledbetter Building Room 2440
P.O. Box 1272
Little Rock, AR 72203-1272

Re: RULE 2011-1 Management of Cash Funds

Mr. Theis;

Thank you for the opportunity to comment on the recent proposal concerning the management of cash funds held at Arkansas Banks.

Simmons First has two main concerns with the rule as recently modified. These concerns are as follows:

1. Section E Paragraph 2 – Composition of pledged collateral:

As written, the rule limits the ability of most banks to utilize significant portions of their investment portfolios as collateral for public monies. With regard to Agency securities, most banks' investment portfolios consist of securities issued by the government sponsored enterprises (GSE) including FHLB, FNMA, FFCEB, FHLMC and Farmer Mac that are not backed by the full faith and credit of the U.S. Government therefore would be limited in their use by the 130% over collateralization requirement imposed per Paragraph 3 of Section E.

The same decrease in utilization is also true for Arkansas Municipal Securities due to their 120% over collateralization requirement. An additional unintended consequence could be the possible negative impact on the overall market for Arkansas municipals.

By constricting the ability of a bank to use all of their securities as collateral for state funds, the result will be increased operational costs on the part of banks, and the effect will be lower yields on these state funds. Furthermore, these increased

Mr. Theis
July 25, 2011
Page 2

costs and requirements could reduce some bank's willingness to bid on public funds since these additional expenses will likely exceed the 25 BP yield reduction stipulated in Section A.

In summary, the proposed changes in collateral requirements will adversely impact a community bank's percentage of collateral available for public fund pledging resulting in decreased demand for public fund deposits.

2. Section E paragraph 5 – Custodial Services/Safekeeping of pledged collateral:

Although well intentioned, the requirement that pledged securities be held at a nonaffiliated custodian will increase operational costs at some larger institutions, while providing little if any additional safety. We see little risk in having a custodian regulated by a federal entity, regardless of whether it is affiliated or not.

When pledged securities are held by a safekeeping bank, affiliated or not, the assets are either held in a segregated account at a Federal Reserve Bank (FED Book-Entry securities) or in an upstream custodian (DTC eligible securities) of the said safekeeping bank. The safekeeping bank does not own the securities held in such accounts and will safeguard the pledged assets in according to the terms of the Custodial Service Agreement. Such practices have proven satisfactory in the past and we are unaware of any instances when public fund depositors have been compromised by the use of a third party custodian affiliated with a financial institution.

The subject Custodial Services/Safekeeping proposal is specifically an increased operational burden for multi-bank holding companies such as Simmons First National Corporation. Simmons First National Bank currently serves as custodian for collateral pledged by the holding company's other seven affiliate banks. The proposed changes will add real costs for our eight Arkansas based banks and would influence future decisions regarding the bidding for public funds.

Again, I want to thank you for the opportunity to comment on this revised regulation.

Sincerely,

J. Thomas May

JTM/rks

BONY Comments

John Theis

From: Hilary.McSkimmings@regions.com
Sent: Monday, March 19, 2012 10:44 AM
To: John Theis
Attachments: Arkansas Custodial Services Agreement EMM Comments.DOC; Arkansas Custodial Services Agreement EMM Comments Comparison.DOC

Good morning John,

To follow up on our visit and correspondence of earlier this month I have attached the following. The attachment is the marked up comments and recommendations drafted by the Bank of New York Mellon's legal team. As you recall Bank of New York Mellon is one of the primary third party custodial agents in the industry. Regions Bank utilizes BONYM for its Public Funds custodial support.

Please review and consider as you continue to revise the Rule 2011-1 language.

Do not hesitate to contact me if I can be of assistance.

Respectfully
William J. Jeffs
Senior Vice President
Public, Institutional, and Nonprofit Banking
Regions Bank
400 West Capitol
Little Rock, Arkansas 72201
501.371.7283
William.Jeffs@Regions.com

-DRAFT-

CUSTODIAL SERVICES AGREEMENT

This Custodial Services Agreement ("*Agreement*") is entered into this ___ day of _____
20__ by and between _____,
 ("*Public Depositor*"), with its principal office at _____
_____ and
_____, ("*Bank*"), with its principal office at _____, and
_____, ("*Custodian*") with its principal office at _____.

WITNESSETH:

WHEREAS, the Public Depositor has agreed to deposit funds with the Bank pursuant to the terms and provisions of the Depository Collateral Agreement ("*Collateral Agreement*") by and between the Public Depositor and the Bank dated as of _____, 20__;

WHEREAS, pursuant to the terms and provisions of the Collateral Agreement, the Bank has agreed to assign, transfer, pledge and convey to the Public Depositor a security interest in certain eligible securities owned by the Bank (the "*Collateral*"); and

WHEREAS, in order to perfect the Public Depositor's security interest in the Collateral, Public Depositor and Bank wish to appoint the Custodian, as agent for the Public Depositor, to take possession of and hold in custody solely for the benefit of the Public Depositor Collateral pledged to the Public Depositor by the Bank pursuant to the Collateral Agreement with the terms set forth below.

NOW THEREFORE, in consideration of the mutual covenants and premises herein contained, the parties do hereby, agree as follows:

1. The Custodian hereby accepts employment as the Public Depositor's Custodian and depository pursuant to the terms of this Agreement.
2. The Custodian shall accept and retain as Custodian solely for the benefit of the Public Depositor all securities tendered by the Bank as Collateral for its obligations under the Collateral Agreement. To perfect the security interest of the Public Depositor in the Collateral, the Bank shall place the Collateral in a joint custody account with the Custodian.

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3. Upon receipt of Collateral for the Bank for the benefit of the Public Depositor, the Custodian shall: (i) immediately notify the Public Depositor, by telephone or otherwise, of the Collateral pledged; and (ii) issue a simultaneous written receipt to the Bank and Public Depositor evidencing that the Bank has pledged and Custodian has received the Collateral. The Custodian should forward any letter of credit, surety bonds, or a private deposit insurance instrument pledged to secure the deposits of the Public Depositor to the Public Depositor.
4. The Custodian shall identify on its books and records as being pledged to the Public Depositor specific securities or a quantity of specific securities received by it for, or for the account of, the Public Depositor. Custodian agrees to hold the Collateral under joint safekeeping receipts and apply the same, or any substitutions therefore, or additions thereto, for the purposes set forth in the Collateral Agreement, upon the terms contained herein. The Custodian's records shall at all times show Public Depositor's security interest in the Collateral. The Custodian shall have no power or authority to transfer, assign, hypothecate, pledge or otherwise dispose of any such securities, except pursuant to instructions from the Public Depositor and pursuant to the terms of this Agreement.
5. This Agreement vests "control" of the Collateral in the Public Depositor as required under the Arkansas Uniform Commercial Code. 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 the Collateral originated by the Public Depositor without further consent of the Bank. The Custodian agrees not to take any act that would permit a person other than the Public Depositor to have "control" of the Collateral as that term is defined in the Arkansas Uniform Commercial Code.
6. It is intended that the Custodian act as a "securities intermediary" as such term is defined in the Arkansas Uniform Commercial Code with respect to the Collateral. In addition, the parties intend that the Collateral be treated as "financial assets" and that the Public Depositor is an "entitlement holder" as such terms are defined under the Arkansas Uniform Commercial Code.
7. Bank represents and warrants that it owns the Collateral free and clear of all liens, claims, security interests and encumbrances (except those granted herein and in the Collateral Agreement) and, subject to the terms hereof, hereby grants to Public Depositor a pledge and security interest in all of Bank's right, title, and interest in and to such Collateral, as security for Bank's obligations to Public Depositor pursuant to the Collateral Agreement. Bank represents and warrants that no financing statement covering all or any part of the Collateral is on file at any public office.
8. Public Depositor hereby represents and warrants, which representations and warranties shall be deemed to be continuing, that:

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- i. this Agreement has been legally and validly entered into, does not and will not violate any statute or regulation applicable to it and is enforceable against Public Depositor in accordance with its terms;
- ii. the appointment of Custodian has been duly authorized by Public Depositor and this Agreement was executed by an officer of Public Depositor duly authorized to do so;
- iii. it will not transfer, assign its interests in or the rights with respect to any Securities pledged pursuant to this Agreement, except as authorized pursuant to Section 3 of the Agreement;
- iv. all acts, conditions and things required to exist, happen or to be performed on its part precedent to and in the execution and delivery of this Agreement exist or have happened or have been performed.

9. ~~8.~~ The Custodian will not release or transfer to the Bank any securities constituting the Collateral without prior written instructions from the Public Depositor, except that the Custodian may elect to release or transfer to the Bank securities constituting the Collateral upon receipt of verbal instructions from the Public Depositor, if: (i) the verbal instructions are electronically recorded and the Custodian has obtained independent and separate confirmation of the verbal instructions from an authorized officer of the Public Depositor; (ii) the Custodian provides immediate written confirmation of the verbal instructions to the Public Depositor; and (iii) the Public Depositor provides immediate written confirmation of the verbal instructions to the Custodian. The Public Depositor and the Custodian agree that in the case of any conflict between written and verbal instructions, the written instructions will be binding.

(Note: The parties should agree to the substitution procedure to be followed and prescribe those procedures in this paragraph, making changes as appropriate)

10. ~~9.~~ The Custodian agrees to provide to the Public Depositor, at no charge, and Bank a periodic statement of holdings reflecting the securities pledged by the Bank and the market value price valuation of the securities constituting the Collateral. The market value must be obtained from a securities pricing service, a primary dealer in securities, or a publication recognized as a reliable source of securities valuation.

(Note: The parties should agree to the frequency and cost of the reports as well as how market value is to be determined and prescribe those terms in this paragraph, making changes as appropriate.)

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11. Public Depositor agrees that it shall promptly review all statements provided by Custodian and shall promptly advise Custodian by Oral or Written Instruction of any error, omission or inaccuracy in such statements. In the event that Custodian receives such a Written or Oral Instruction identifying a specific concern with respect to the Market Value or any other matter connected with the Account, Custodian shall undertake to correct any errors, failures or omissions, provided that Custodian determines in its sole discretion that such error, failure or omission actually occurred. Any such corrections shall be reflected on subsequent confirmation statements.
12. Custodian assumes no responsibility to determine or monitor whether or not any such Securities or cash originally deposited hereunder or substitute or additional Securities or cash hereafter deposited are eligible for deposit under applicable law, rule or regulation or whether the Market Value of the Securities and/or cash thereof meets the requirements of any law, rule or regulation applicable to the deposit hereunder. The determination of eligibility and whether the Market Value of the Securities and/or cash satisfies statutory or regulatory requirements will be the responsibility of Bank. Custodian shall be fully protected in relying on Written or Oral Instructions of either Bank or Public Depositor directing Custodian to release any of the Securities and/or cash to Bank. To the extent of any conflict in the instructions of Public Depositor and Bank, the instructions of Public Depositor shall control and Bank shall hold Custodian harmless for acting in accordance with Public Depositor's instructions.
13. Bank and Public Depositor agree that Securities delivered to Custodian for deposit in the Account may be in the form of credits to the accounts of Custodian at the Book Entry System or a Depository or by delivery to Custodian of physical certificates in a form suitable for transfer or with an assignment in blank to Public Depositor or Custodian. Bank and Public Depositor hereby authorize Custodian on a continuous and ongoing basis to deposit in the Book Entry System and/or the Depositories all Securities that may be deposited therein and to utilize the Book Entry System and/or Depositories and the receipt and delivery of physical Securities or any combination thereof in connection with its performance hereunder. Securities credited to the Account and deposited in the Book Entry System or Depositories or other financial intermediaries will be represented in accounts of Custodian that include only assets held by Custodian for its customers, including but not limited to accounts in which Custodian acts in a fiduciary, agency or representative capacity. Securities that are not held in the Book Entry System, Depositories or through another financial intermediary will be held in Custodian's vault and physically segregated from securities and other non-cash property belonging to Custodian.

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14. With respect to all Securities held in the Account, Custodian by itself, or through the use of the Book Entry System or the appropriate Depository, shall, unless otherwise instructed to the contrary by Bank: (i) collect all income and other payments reflecting interest and principal on the Securities in the Account and credit such amounts to the account of Bank; (ii) forward to Bank copies of all information or documents that it may receive from an issuer of Securities which, in the opinion of Custodian, is intended for the beneficial owner of the Securities including, without limitation all proxies and other authorizations properly executed and all proxy statements, notices and reports; (iii) execute, as Custodian, any certificates of ownership, affidavits, declarations or other certificates under any tax laws now or hereafter in effect in connection with the collection of bond and note coupons; (iv) hold directly, or through the Book Entry System or Depository, all rights issued with respect to any Securities held by Custodian hereunder; and (v) upon receipt of Written Instructions from Bank, Custodian will exchange Securities held hereunder for other securities and/or cash in connection with (A) any conversion privilege, reorganization, recapitalization, redemption in kind, consolidation, tender offer or exchange offer, or (B) any exercise, subscription, purchase or other similar rights.
15. ~~10.~~ The Collateral cannot be re-pledged by the Custodian or Bank until it has been substituted and released as provided in the Collateral Agreement.
16. ~~11.~~ Collateral shall not be held in a margin account and no margin or other credit will be extended to the Bank with respect to the Collateral.
17. ~~12.~~ The Custodian subordinates in favor of Public Depositor any security interest, lien, or right to setoff it may have, now or in the future, against the Collateral.
18. ~~13.~~ Custodian warrants and represents that it does not know of any claims to or interest in the Collateral except for those of the parties to this Agreement, and Custodian will not enter into any other control agreement with regard to the Collateral while this Agreement remains in effect.
19. ~~14.~~ Custodian warrants and represent that no third-party has a right to give an entitlement order regarding the Collateral and Custodian shall notify Public Depositor if another person claims a property interest in the Collateral.
20. ~~15.~~ Custodian warrants and represents that it is not, and shall not be at any time, an "affiliate" of the Bank as that term is defined in Rule 2012-1. In the event the Custodian

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becomes an affiliate of the Bank subsequent to the date of this Agreement, the Custodian shall immediately notify the Public Depositor.

21. 16-The Custodian is hereby authorized and directed to promptly distribute to the Bank any cash received by the Custodian as payment of accrued interest on any of the securities constituting the Collateral.
22. Custodian shall not be liable for any loss or damage, including counsel fees, resulting from its action or omission to act or otherwise, except for any loss or damage arising out of its own negligence or willful misconduct, and shall have no obligation hereunder for any loss or damage, including counsel fees, which are sustained or incurred by reason of any action or inaction by the Book Entry System or any Depository. In no event shall Custodian be liable to Public Depositor, Bank or any third party for special, indirect or consequential damages, or lost profits or loss of business, arising in connection with this Agreement. Custodian may, with respect to questions of law, apply for and obtain the advice and opinion of counsel and shall be fully protected with respect to anything done or omitted by it in good faith and conformity with such advice or opinion. Public Depositor and Bank agree, jointly and severally, to indemnify Custodian and to hold it harmless against any and all costs, expenses, damages, liabilities or claims, including reasonable fees and expenses of counsel, which Custodian may sustain or incur or which may be asserted against Custodian by reason of or as a result of any action taken or omitted by Custodian in connection with operating under this Agreement, except those costs, expenses, damages, liabilities or claims arising out of the negligence or willful misconduct of Custodian or any of its employees or duly appointed agents. This indemnity shall be a continuing obligation of Public Depositor and Bank notwithstanding the termination of this Agreement.
23. In performing hereunder, Custodian may enter into subcontracts, agreements and understandings with third parties (including subsidiaries of The Bank of New York Mellon Corporation), whenever and on such terms and conditions as it deems necessary or appropriate. No such subcontract, agreement or understanding shall discharge Custodian from its obligations hereunder.
24. Custodian shall have no duties or responsibilities whatsoever except such duties and responsibilities as are specifically set forth in this Agreement and no covenant or obligation shall be implied against Custodian in connection with this Agreement.

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25. ~~17.~~ The duties of the Custodian as provided in this Agreement shall continue in effect until the security interest has been terminated and the Public Depositor shall notify the Custodian of the termination in writing.
26. Custodian is authorized to utilize any generally recognized pricing information service (including brokers and dealers of securities) in order to provide Market Values hereunder, and Bank and Public Depositor agree that Custodian shall not be liable for any loss, damage, expense, liability or claim (including attorneys' fees) incurred as a result of errors or omissions of any such pricing information service, broker or dealer.
27. ~~18.~~ The Custodian acknowledges receipt of a copy of the Collateral Agreement governing the terms and conditions under which the Bank will receive and maintain deposits of the Public Depositor and provide Collateral to secure such deposits. This Agreement is subject to the terms, conditions, and provisions of the Collateral Agreement (including exhibits), which Collateral Agreement is expressly incorporated herein by reference.
28. ~~19.~~ The Custodian and Bank agree that if, upon termination of this Agreement, the Public Depositor's deposit requires collateral as provided in the Collateral Agreement, the Collateral will be transferred to an account under the exclusive control of the Public Depositor.
29. ~~20.~~ This Agreement shall further serve as a power of attorney, authorizing the Public Depositor to transfer or liquidate the Collateral in the event of a default, financial failure, or insolvency of the Bank. In the event of a default, failure or insolvency of the Bank, the Public Depositor shall be deemed to have vested full title to all securities pledged under this Agreement, and shall send a written demand to Custodian notifying Custodian of the nature of the Bank's default. After receipt from Public Depositor of a written demand, Custodian shall immediately deliver to Public Depositor the Collateral held hereunder, or such portion thereof as may be demanded, for the purpose of protecting Public Depositor against loss by reason of the default of Bank; and Custodian shall immediately disregard any further notice or instruction by or on behalf of Bank. Such demand shall state the dollar amount of the collected balance of Public Depositor's accounts with Bank as of the date of the demand and any costs or expenses for which Public Depositor is entitled to reimbursement, and the request that Custodian deliver to Public Depositor, for sale by Public Depositor, securities with a market value equal to or greater than such reported balance and costs and expenses. The Public Depositor is empowered to take possession of and transfer and or sell any and all securities. This power is in addition to other remedies which the Public Depositor may have under this Agreement and without prejudice to its rights to maintain any suit in any court for redress of injuries sustained by the Public Depositor under this Agreement.

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If and when a receiver or conservator is appointed for Custodian under federal and/or state banking or similar law, or there is commenced by or against Custodian any liquidation or dissolution proceeding, Custodian shall as soon as practicable transfer the Collateral to such other custodian as is designated by Public Depositor upon receipt of written demand by Public Depositor. If the Collateral is delivered to the Bank, the Bank shall hold the Collateral in trust as trustee on behalf of Public Depositor and Bank shall, as soon as practicable transfer the Collateral to such other custodian as is designated by Public Depositor.

30. ~~21.~~—In the event the Bank shall (a) fail to pay the Public Depositor any funds which the Public Depositor has on deposit, (b) fail to pay and satisfy when due any check, draft, or voucher lawfully drawn against any deposit of the Public Depositor, (c) fail or suspend active operations, (d) become insolvent, or (e) fail to maintain adequate Collateral as required by this Agreement, the Bank shall be in default, the Public Depositor's deposits in such Bank shall become due and payable immediately, the Public Depositor shall have the right to unilaterally direct the Custodian to liquidate the Collateral held in the Custody Account and pay the proceeds thereof to the Public Depositor and to exercise any and all other security entitlements with respect to the Custody Account and the other Collateral, to withdraw the Collateral, or any part thereof, from the Custody Account and deliver such Collateral to the Public Depositor or to transfer the Collateral or any part thereof into the name of the Public Depositor or into the name of the Public Depositor's nominee, and ownership of the Collateral shall transfer to the Public Depositor. The Bank authorizes the release, withdrawal, and delivery of the Collateral to the Public Depositor upon default by the Bank, and authorizes the Custodian to rely without verification on the written statement of the Public Depositor as to the existence of a default and to comply with entitlement orders originated by the Public Depositor without further consent of that Bank.

In the event of default, the Public Depositor shall also have the right to sell Collateral at any public or private sale at its option without advertising such sale, upon not less than three (3) days' notice to the Bank and the Custodian. In the event of such sale, the Public Depositor, after deducting all legal expenses and other costs, including reasonable attorney's fees, from the proceeds of such sale, shall apply the remainder on any one or more of the liabilities of the Bank to the Public Depositor, including accrued interest, and shall return the surplus, if any, to the Bank, or its receiver or conservator.

31. ~~22.~~—The Bank shall pay, without reimbursement by the Public Depositor, all fees, expenses, and costs charged by the Custodian in connection with the safekeeping and maintenance of the Collateral in its performance under this Agreement.

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32. ~~23.~~ This Agreement may be terminated thirty (30) days after receipt of written notice by Custodian or Public Depositor. The Bank cannot terminate this Agreement.
33. ~~24.~~ This Agreement may be amended at any time by written Agreement between the Public Depositor and the Custodian, with prior written notice to the Bank.
34. ~~25.~~ This Agreement shall be subject to and construed in accordance with the laws of the State of Arkansas. Bank, Public Depositor and Custodian hereby consent to the jurisdiction of a state or federal court situated in the State of Arkansas in connection with any dispute arising hereunder. Bank, Public Depositor and Custodian hereby irrevocably waive, to the fullest extent permitted by applicable law, any objection which it may now or hereafter have to the laying of venue of any such proceeding brought in such a court and any claim that such proceeding brought in such a court has been brought in an inconvenient forum. Bank, Public Depositor and Custodian each hereby irrevocably waives any and all rights to trial by jury in any legal proceeding arising out of or relating to this Agreement.
35. To the extent that in any jurisdiction any party may now or hereafter be entitled to claim, for itself or its assets, immunity from suit, execution, attachment (before or after judgment) or other legal process, each party irrevocably agrees not to claim, and it hereby waives, such immunity in connection with this Agreement.
36. Custodian shall not be responsible or liable for any failure or delay in the performance of its obligations under this Agreement arising out of or caused, directly or indirectly, by circumstances beyond its reasonable control, including without limitation, acts of God, earthquakes, fires, floods, wars, civil or military disturbances, sabotage, epidemics, riots, loss or malfunctions of utilities, computer (hardware or software) or communications service, labor disputes, acts of civil or military authority, or governmental, judicial or regulatory action; provided however, that Custodian shall use its best efforts to resume normal performance as soon as practicable under the circumstances.
37. ~~26.~~ This Agreement may be simultaneously executed in two or more counterparts, each of which shall be deemed to be an original.
38. ~~27.~~ Notices and other writings shall be delivered or mailed postage prepaid to the parties at the addresses set forth on the signature page hereof.

IN WITNESS WHEREOF, the parties hereto, have executed this Agreement as of the date indicated above.

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PUBLIC DEPOSITOR: Department of Finance and Administration

Address for Notices:

By: _____

Signature: _____

Title: _____

BANK:

Address for Notices:

By: _____

Signature: _____

Title: _____

CUSTODIAN:

Address for Notices:

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By: _____

Signature: _____

Title: _____