

## ARKANSAS STATE BOARD OF FINANCE

## RULE 2012-A

## 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.

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.**

A *Depository Collateral Agreement* must be executed before any deposits can be made. Prior to depositing any funds with a bank or financial institution operating within the borders of the State of Arkansas, the agency should review the financial condition of the bank or financial institution. 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. An agency should not deposit funds with a bank or financial institution if it would cause cash funds on deposit to exceed the capital of the bank or financial institution.

#### 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 a bank or financial institution. 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 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. 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.

1. 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 as identified in Ark. Code Ann. §23-47-401(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

3. 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 periodic collateral report to the agency. The frequency of the periodic collateral reports is to be agreed upon by the agency and bank or financial institution and written in the *Depository Collateral 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 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 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*.

4. 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:

- a. A custodian may be a Federal Reserve Bank, a Federal Home Loan Bank, a bankers' bank, the trust department, or similar safekeeping function, of a commercial bank or a trust company primarily located within the State of Arkansas.
- b. 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.
  - (1) A bank or financial institution may request permission from the Board of Finance to use a custodian primarily located outside the State of Arkansas. The Director of the Department of Finance and Administration, with advice of the State Bank Commissioner, will review such requests and make recommendations to the Board of Finance. The Director and Commissioner shall examine the potential custodian to determine whether it has the financial stability, experience, technical skill, and staffing levels necessary to properly carry out the duties of a custodian.
  - (2) A bank or financial institution may request permission from the Board of Finance to use a securities broker or dealer as a custodian. That request shall be made in accordance with the process outlined in paragraph E.4.d(1) of this rule.

5. Collateral shall not be released, substituted or compromised by a bank or financial institution or custodian unless approval is obtained from the agency to which the collateral was pledged prior to taking any such action. 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*. The percentage of coverage required by paragraph 2 of this section shall be recalculated upon substitution or release of collateral.

6. 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.

7. 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.

8. 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 providing the agency with a security interest in the collateral pledged by the bank or financial institution and compliance with all federal and state laws and regulations governing the establishment of an enforceable security interest. 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.

Perfection of a security interest in investment property such as securities, security accounts and security entitlements is achieved through control as provided in the Uniform Commercial Code. 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.

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*.
- c. A bank's or financial institution's standard resolution form is acceptable if it achieves the purposes of this Rule.
- d. A continuing resolution of the board or loan committee of the bank or financial institution that empowers certain bank or financial institution officials to execute security agreements related to public deposits and pledge collateral to secure those deposits, as well as ratifying all actions taken by the officials to secure the public deposits, is acceptable if the continuing resolution:
  1. Specifically identifies the bank or financial institution official or officials authorized to act on behalf of the bank or financial institution, and
  2. Specifically identifies the actions the bank or financial institution official or officials are authorized to take on behalf of the board or loan committee.

## 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 security interest in the collateral.
  - (3) The agreement must provide for a periodic recalculation of the fair 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 periodic statement of collateral, to verify the adequacy of the pledged collateral. The periodic statement of collateral must identify the deposit secured by the collateral, describe the collateral, and 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. 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 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.
- c. 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 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 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.
- (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: \_\_\_\_\_

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

Date: \_\_\_\_\_, 2012

**CERTIFICATE OF CORPORATE RESOLUTIONS**

At a duly constituted meeting of the Board of Directors or Loan Committee of

\_\_\_\_\_  
(Note: Use bank name as chartered) (“Bank”) held on \_\_\_\_\_, 20\_\_ at \_\_\_\_\_, the following Resolution was adopted:

**RESOLVED**, the Depository Collateral Agreement and/or Custodial Services Agreement (hereinafter “Agreement”) by and between Bank and \_\_\_\_\_ (“Public Depositor”), dated as of \_\_\_\_\_, 20 \_\_, (Note: Date must be the same date or earlier than the date of this Resolution) is hereby approved and the President and the Secretary of the Bank be, and they hereby are, authorized, empowered, and directed, for and in the name of and on behalf of the Bank, to execute such Agreement and deliver it to the Public Depositor; and

**FURTHER RESOLVED**, that during the term of the Agreement the Bank is hereby authorized and empowered to pledge and transfer as collateral thereunder such securities of the Bank as determined by a Duly Authorized Institution Officer; and

**FURTHER RESOLVED**, that the Secretary of the Bank be, and hereby is, authorized, empowered, and directed to maintain the Agreement as an official record of the Bank until its revocation, rescission, or termination; and

**FURTHER RESOLVED**, that the officers of the Bank be, and hereby are, authorized, empowered, and directed to take such actions and execute and deliver such documents and instruments as they may deem necessary to satisfy the obligations and covenants of the Bank under such Agreement and to carry out its intents, purposes, and objects of these resolutions; and

**FURTHER RESOLVED**, that the officers of the Bank listed below are hereby designated as the Duly Authorized Bank Officers under the Agreement, with full power and authority to determine the initial pledge of collateral thereunder and to approve all substitutions of collateral, releases of collateral, and additional pledges of collateral thereunder, and if needed, to designate representatives of the Bank to transact business with the Public Depositor.

Designated Duly Authorized Bank Officers

\_\_\_\_\_  
Name/Title

\_\_\_\_\_  
Name/Title

\_\_\_\_\_  
Name/Title

\_\_\_\_\_  
Name/Title

\_\_\_\_\_  
Name/Title

\_\_\_\_\_  
Name/Title



Exhibit A

**FURTHER RESOLVED**, that this Resolution shall be maintained as an official record of the Bank.

We, the undersigned, Secretary and President of Bank do hereby certify that the foregoing is a true, complete, and accurate copy of the Resolution duly adopted by the Board of Directors or Loan Committee at the meeting held on the aforementioned date, at which a quorum of the directors or members were present and do further hereby certify that the Resolution has not been altered, amended, repealed, or rescinded and is now in full force and effect.

**IN WITNESS WHEREOF**, We have hereunto subscribed our names this \_\_\_\_ day of \_\_\_\_\_, the year 20\_\_\_\_.

\_\_\_\_\_  
Secretary

\_\_\_\_\_  
President

**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-A, Management and Collateralization of Cash Funds (“*Rule 2012-A*”); and

WHEREAS, the Bank has agreed to secure the Public Deposits by granting to the Public Depositor a 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 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-A; (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.

## Exhibit B

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 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 securities and security entitlements, the custodian shall authenticate a record setting forth the securities pledged and acknowledging it holds them for the benefit of the Public Depositor, 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.

## Exhibit B

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.

### **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-A. 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 a custodian (“Custodial Services Agreement”) for the custody of the Collateral consistent with the terms of this Agreement. Any 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.**

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

## Exhibit B

4.2 If at any time the ratio of the 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 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-A. 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-A.

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 fair value of Eligible Collateral held in the Custody Account shall meet the requirements of this Agreement and Rule 2012-A, 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).)*

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 periodic statement of collateral, to verify the adequacy of the pledged collateral. The periodic statement of collateral must identify the deposit secured by the collateral, include a description and market value of the Collateral as determined within five business days prior to the report date, and provide or cite an independent source to verify the reported value. The fair value must be obtained from a securities pricing service, a primary dealer in securities, 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.)*

## **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 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

## Exhibit B

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.

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.

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 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.

Exhibit B

**BANK:**

Address for Notices:

\_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

**DEPOSITOR:** Department of Finance and Administration

Address for Notices:

\_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_



**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 depositary 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.

## Exhibit C

3. Upon receipt of Collateral from 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. 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

## Exhibit C

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.

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

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.)*

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.
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.
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.
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.

## Exhibit C

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

## Exhibit C

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.

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.

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

Exhibit C

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.

22. 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 Public Depositor and the Bank, then the Custodian may, at its election and without liability to either the Public Depositor or the Bank, interplead the securities constituting the Collateral in a court of competent jurisdiction, and the Public Depositor's and Bank's sole recourse shall be against each other and the securities constituting the Collateral so interpled.
23. 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.
24. This Agreement may be terminated thirty (30) days after receipt of written notice by Custodian or Public Depositor. The Bank cannot terminate this Agreement.
25. 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.
26. This Agreement shall be subject to and construed in accordance with the laws of the State of Arkansas.
27. This Agreement may be simultaneously executed in two or more counterparts, each of which shall be deemed to be an original.
28. 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.

Exhibit C

**PUBLIC DEPOSITOR:** Department of Finance and Administration

Address for Notices:

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By: \_\_\_\_\_

Signature: \_\_\_\_\_

Title: \_\_\_\_\_

**BANK:**

Address for Notices:

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By: \_\_\_\_\_

Signature: \_\_\_\_\_

Title: \_\_\_\_\_

**CUSTODIAN:**

Address for Notices:

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Exhibit C

By: \_\_\_\_\_

Signature: \_\_\_\_\_

Title: \_\_\_\_\_