1ST First Arkansas Bank & Trust Member FDIC

Larry T. Wilson
Chairman,
President and
Chief Executive Officer

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JUL 18 2011
ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

July 14, 2011

Mr. John Theis
Assistant Revenue Commissioner
Department of Finance and Administration, State of Arkansas
P O Box 1272
Little Rock, AR 72203-1272

Re: Collateralization of State and Municipal Funds in Arkansas Banks

Dear Mr. Theis:

As we discussed by phone recently, I am very concerned about proposed changes to the regulations regarding the collateralization of state and municipal monies in banks in the State of Arkansas. Thank you for the material concerning this issue that you sent me this week.

While the intent of the proposal is sound, no one bothered to get any input from the banks in the state which would be significantly affected by the these proposed changes. I am very confident that solutions to the concerns of the Legislative Joint Audit group can be found and implemented without creating more problems than will be solved.

I respectfully request that implementation of these proposed changes be delayed and that a task force, including all parties affected, be appointed to study this situation further so that a workable solution may be developed. Please contact Mr. Ken Hammonds at the Arkansas Bankers Association for assistance in getting input from the banking community on this. His number is 501-376-3741.

Thank you for your assistance in this matter.

Sincerely,

Larry T. Wilson

Larry T. Wilson
Chairman, President and CEO

Cc: Ken Hammonds
Arkansas Bankers Association

Candace Franks
Arkansas State Bank Department

1ST First Arkansas Bank & Trust Member FDIC

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August 25, 2011

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

RE: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

As we discussed by phone recently, I want to take this opportunity to express my concerns about the above proposed rule.

I have no problem with the intent of the proposed rule but I do think there are several issues that need to be discussed further so that all parties involved will find the rule to be workable.

I think that it is important that a meeting be held soon to further discuss the proposed rule and that all parties affected by the rule should be present. Because the banks of Arkansas want to be helpful and accommodating to our state government in managing their funds, representatives of the Arkansas Bankers Association should be included in the meeting that I suggested.

You are welcome to contact me if you have any questions or need additional information; my direct line is (501) 985-4001.

Sincerely,

Larry T. Wilson

Larry T. Wilson
Chairman, President and
Chief Executive Officer

Cc Mr. Ken Hammonds
Arkansas Bankers Association

Mr. Jim Franks
Arkansas Bankers Bank

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AUG 30 2011
ASSISTANT REVENUE COMMISSIONER
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August 29, 2011

Mr. John H. Theis
Assistant Commissioner of Revenue
DFA Revenue Division
Ledbetter Building, Room 2440
Little Rock, AR 72203-1272

Re: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

I offer comment on Proposed Rule 2011-1 relative to the management of cash funds. Upon review of the proposed plan I have three points of principal concern: (1) It appears that the Arkansas Bankers' Bank (ABB) would be effectively prohibited from serving as a custodian for pledged public funds. Our bank is a small stockholder in ABB and appears to fall in the classification of "affiliate," which would prevent us from using ABB for safekeeping custodial services when public agency deposits require pledging. I think the proposed rule needs to be revisited to clarify the eligibility requirements for custodians specifically addressing the "affiliate" issue. A small ownership stake should not be deemed to jeopardize the safekeeping practices of ABB. (2) I believe the proposed list of eligible securities used for collateralization of cash funds is overly restrictive possibly preventing our bank from being able to provide sufficient collateral coverage when required. I think the proposal needs to be revisited to expand the list of eligible securities as well as to reconsider the margin requirements. (3) I believe the proposed rule needs to reconsider the position relative to the substitution of collateral allowing the custodian to exercise needed substitutions to assure protection to the depositor through an efficient procedure.

I support the suggestion made by the Arkansas Bankers Association that a select committee composed of representatives from all interested participants in the management of public agency cash funds be assembled to address the above stated concerns in order to present a standardized policy that is effective, efficient, and equitable.

Thank you for the opportunity to offer comment on the referenced proposal.

Sincerely,

Joe Miles
President

FNBB
First National Bankers Bank

325 West Capitol Avenue, Suite 300 · Little Rock, AR 72201 · www.BANKERS-BANK.com

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August 29, 2011

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

RE: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

First National Bankers Bank, Arkansas Region[1] (until March 31, 2011, Arkansas Bankers' Bank) is pleased to have the opportunity to present these written comments as to the State Finance Board's proposed amended Management for Cash Funds rule, proposed Rule 2011-1.

As a specialty correspondent bank (a bankers' bank), with offices in Arkansas, and having over 100 Arkansas banks as customers, we feel especially suited to make our comments and observations as to the proposed rule regarding the collateralization of public deposits and the appropriate safekeeping of those deposits.

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. The bank has the requisite specialized personnel, software and technical expertise to manage such an operation. FNBB, Arkansas Region and its predecessor Arkansas Bankers' Bank, has been safekeeping the securities of Arkansas banks and 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.

This comment is being written based on the proposed revised rule published on June 10, 2011 by the Department of Finance & Administrations on its website, and located at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/asbf2011_1.pdf. (The

[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.

proposed revised rule is located on DF&A's "DFA Revenue Rules" page under "Proposed Rules.") There does appear to be some confusion in that there has been privately sent to various parties a slightly different version. The major differences between the two versions are the elimination of the "options" provided in the posted proposed revised rule. With that said, we believe the "options" selected are the correct ones, subject to the remaining issues addressed herein. Again, the competing versions of the proposed revised rule are confusing.

The bank has several specific issues with the proposed rule. First, it appears that the proposed rule would prohibit FNBB, Arkansas Region from being a custodian for safekeeping of pledged assets. There is also a requirement specific to out of state entities that qualify for being custodian for safekeeping of pledged assets. Second, the proposed rule significantly alters in certain instances the amount of collateral required for public deposits. Third, there are miscellaneous issues that will be addressed.

While the proposed revised rule appears to be technically for the use and benefit of State of Arkansas agencies over which the State Board of Finance has jurisdiction, it is well known that other political subdivisions (cities, counties, school boards, etc.) follow the State's procedures and practices to include the use of the forms produced by the State Board of Finance. FNBB welcomes the standardization of prudent and appropriate procedures and practices. Therefore, our comments are being provided based upon this practice of widespread use within the State of Arkansas.

Custodian for safekeeping of pledged assets.

A. Eligibility of FNBB, Arkansas Region to continue as a custodian for safekeeping of pledged assets.

While hopefully unintended, the proposed rule under Section E.5. (both Options A and B) would seem to exclude and prohibit our bank under any circumstances from continuing to be a custodian for safekeeping of pledged assets. Specifically, the proposed rule would allow only the following entities to be custodians, and because of other conditions in the proposed revised rule, we believe that the Federal Reserve Bank would be prohibited from acting as a safekeeping custodian in certain instances as discussed later:

1) a Federal Reserve Bank;
2) the trust department of a commercial bank; or
3) a trust company.

All of the above would be required to be able to maintain book-entry accounts with a Federal Reserve Bank and capable of safekeeping eligible collateral.

The draft depository collateral agreement attached (§ 3.2) to the proposed revised rule makes the same requirement as above.

FNBB, Arkansas Region, while a commercial bank regulated by the Office of the Comptroller of the Currency, OCC, (and formerly the Arkansas State Bank Department and the Federal Reserve Bank), does not have a trust department. It actually is not any of the above three allowed entities, even though the bank does and can meet the requirement of being able to maintain book-entry accounts with a Federal Reserve Bank and capable of safekeeping eligible collateral. After all, the bank has been doing this for over twenty (20) years. We are confident that our largest customer, the State of Arkansas' Treasurer's office, will attest to the competence and professionalism that our staff shows every day. (In conversations with certain staff of the Treasurer's office after the release of the proposed revised rule, our bank was told the Treasurer's office was very satisfied with not only the custodial service our bank provides the Treasurer's office, but in general, was likewise satisfied with the "way things were," speaking of the current safekeeping system.)

Frankly, the bank is at a loss as to why it will be excluded from providing this service which it has been doing, and doing well, for all these years. Again, we believe this was not intended by the rule-making authorities. If such is the intention, we specifically would ask that the bank be given the reasons for such and an additional opportunity to respond to these specific reasons.

On the other hand, Option B of Section E.5. expressly would prohibit FNBB, Arkansas Region from continuing as a custodian for safekeeping of pledged assets. The proposed rule does so by stating that the three approved entity types (Federal Reserve, trust department of a commercial bank or a trust company) must be "...primarily located within the State of Arkansas." ("Primarily located" is not defined. We are not sure how the Federal Reserve can be primarily located in Arkansas either.) It is difficult to see how this could be unintended. We believe that we are the largest custodian for safekeeping of pledged assets in Arkansas, and such a vacuum would create potential disruptions of service and potentially lead to adverse consequences in the unlikely event of a bank failure in Arkansas. After all, the proposed rule, and the rule currently in place is intended to protect the public deposits of the State, and not potentially hinder its safety.

B. Special requirement for financial institutions chartered outside the State of Arkansas.

Option A

Assuming the Board adopts Option A of § E.5. and allows custodians to be financial institutions chartered outside the State of Arkansas, we believe additional consideration should be given for what we think the purpose is for the language in E.5. Option A(b.). It is acknowledged that it is prudent on the part of the State Board of Finance to insure that any security interest given to the State or other public body by a depository bank for collateral securing public deposits held by that bank is a perfected security interest. However, we believe that this requirement is unnecessary and contradictory to your other requirements. Thus, we believe it should be completely eliminated from your proposed revised rule.

Your proposed revised rule specifically requires that Arkansas law shall apply. We believe this is the correct approach. See the following:

1) § G. Conflicts of Laws ("Arkansas law shall prevail...");
2) § F.3.(11) (Custodial Services Agreement. "The agreement must provide that it will be governed by Arkansas law.").

The proposed revised rule's attached "draft" agreements also require that Arkansas law shall apply. See the following:

1) Depository Collateral Agreement § 9.6 ("...governed by and construed in accordance with the laws of Arkansas...");
2) Custodian Services Agreement § 25 ("...subject to and construed in accordance with the laws of the State of Arkansas.").

Arkansas' version of the Uniform Commercial Code [(A.C.A. § 4-9-102(a)(49)] includes as investment property certificated and uncertificated securities and security entitlements. A.C.A § 4-9-305(a)(1), (2) and (3), which governs the perfection of a security interest in investment property, says in subsection (3) that for uncertificated securities (those mostly applicable to the issue at hand) the governing law for perfection is specified in A.C.A. § 4-8-110(e). This section, titled "Choice of law," states in (e)(1) of A.C.A. § 4-8-110 that an agreement governing the securities account can provide for a "particular jurisdiction" as being the jurisdiction of the securities intermediary for the purposes of the Uniform Commercial Code.

Therefore, is it not the case that because the proposed revised rule and its attached agreements require an Arkansas choice of law, and the UCC allows for such, that any requirement for an out of state chartered financial institution to have a legal opinion comparing the UCC for the non-Arkansas state with the UCC of Arkansas so as to be able to confirm that the State's security interest is properly perfected in the non-Arkansas state completely unnecessary? We believe it is not only unnecessary, but it is confusing. Why would you want an opinion as to the validity of something under the laws of a non-Arkansas state when you on multiple occasions in three separate documents specifically say only Arkansas law shall control?

C. Custodian must be "unaffiliated" with the depository financial institution.

Both Option A and B of § (E)(5.) state that a custodian must be "...unaffiliated with the financial institution." To be considered unaffiliated, the financial institution (1) may not have direct or indirect power to direct management or the policies of the custodian; and (2) may not own voting securities of the custodian. A "bankers' bank" is a special financial institution with very specific statutory and regulatory rules that set forth what a bankers' bank can and can not do. A bankers' bank, by its very name, is a correspondent bank that was legislatively created to address certain requirements of retail commercial banks that were in need of a correspondent bank that did not compete against that very retail commercial bank. Thus, in many instances, and with limited exceptions, a bankers' bank's only customer is a retail commercial bank. These specific and special rules also restrict ownership to only other retail commercial banks, with the maximum ownership of any one stockholder retail commercial bank being 5.0%. The legislative creation is designed to restrict the concentration of power and authority. It has been stated that a bankers' bank is akin to a cooperative arrangement in which banks gather together to help one another with correspondent banking needs.

A bankers' bank is FDIC insured, and regulated by its various Federal and state regulatory bodies. In the case of FNBB, its primary Federal regulator is the Office of the Comptroller of the Currency. There can only be minimal risk, if that, of the ownership issue mentioned above for a highly regulated financial institution. The safekeeping department of FNBB is a segregated department of the bank. The procedures, policies and practices used by our bank for custodian and safekeeping functions are industry standard. The ownership structure matters not as to how FNBB carries out its business, how it properly perfects the security interest of the public deposit body. If the proposed revised rule is passed with the unreasonable and unrealistic "unaffiliated" requirement, significantly more than one half of the retail commercial banks in Arkansas will be required to seek other safekeeping and custodian arrangements, not withstanding there have been zero complaints from any public body as to the current arrangement which has been in place for over twenty years. This would be overly burdensome to not only the Arkansas retail commercial banks, but the Arkansas public bodies that have come to know and trust FNBB and its predecessor, Arkansas Bankers' Bank. Simply put, the proposed requirement of an unaffiliated custodian should be either removed as a requirement, limited to non-financial institutions or institutions not regulated by a state or Federal bank regulatory agency, or implemented in cases where there is a significant ownership issue and not something as small as 5%, as is the case for bankers' banks. (It should be noted that only one of the 65 Arkansas stockholder banks in FNBB has an ownership position of more than 1.00% of the common stock, and that amount is 1.04%. Never mind the permissible 5%. Of the more than 300 bank owners across several states, only seven have ownership interests greater than 1%, and no bank owns more than 2.25% of FNBB.)

The same potential "unaffiliated" issue is present with the Federal Reserve and Federal Home Loan Bank acting as a custodian for those depository banks that are members of the Federal Reserve or FHLB. Fed and FHLB member banks are required to own voting stock in the Federal Reserve or Federal Home Loan Bank. There are many Arkansas banks that are members/stockholders of both the Federal Reserve and FHLB. The same "bankers' bank" argument made above as to the inapplicability of the "unaffiliated" requirement is appropriate for the Federal Reserve and FHLB as well. We repeat that such an "unaffiliated" requirement for de minimis voting stock ownership be removed from the proposed revised rule.

Amount of collateral required for public deposits.

As the proposed revised rule points out, the Arkansas legislature has specifically addressed certain aspects of the collateralization of public deposits. If it were not but for specific legislation, the collateralization of the public's deposits would be illegal. The general public does not have this protection. The legislature stated in 1975 (A.C.A § 19-8-201) that the then eligible securities for pledging were "inadequate" and "unduly restrictive." The types of securities that could be used for public deposit collateral should be expanded, the legislature said.

There are several legislative statues on the issue of what can and can not be used as collateral for pledging purposes. It is for the legislature to decide, and to what extent there is administrative "wiggle room." Generally, the list of eligible securities are those that can be purchased by an Arkansas state chartered bank. (*See* A.C.A. §§ 19-8-203 and 23-47-203; which both refer to § 23-47-401.) Both §§ 19-8-203 and 23-47-203, as these sections should, specifically grant to the public depositor "discretion regarding the suitability of the collateral." Therefore, just because a type of security is on the eligible list does not mean the public depositor has to accept it as collateral.

Notwithstanding the preceding paragraph, however, the legislature provided a starting point with a list of eligible securities that can be used as collateral, and then reserved unto the public depositor its right to accept or reject each type. Yet, the State Board of Finance, in its proposed revised rule, is attempting to limit or alter the legislature's authority by "strongly discourag[es]ing" the use of any investment type not listed in the proposed revised rule. The reason given is that these investments "may require highly specialized technical skill" in determining risk issues. Since the authorization of specific securities is codified as state law, the proposed revised rule only "strongly discourages" the use of these investments. The Board additionally says that if the public depositor still chooses to accept these securities as collateral, which they legally can, then an additional premium pledge totaling 130% is warranted. This is at a minimum *de facto* legislating on the part of the Board. If the Board wants to prohibit certain securities being used as collateral because of their real or perceived complexity, the Board should petition the legislature to remove these as eligible securities. Until that occurs, there should be no attempt on the part of the Board to *de facto* legislate.

Without argument, the purpose of the proposed revised rule is to protect the public's deposits, which come from taxpayers. Thus, the proposed revised rule is protecting the taxpayers, as it should. However, the legislature has granted to the State and its political subdivisions the authority to purchase these same securities. And the proposed revised rule (and its predecessor) allows for such in "D. Authorized Investments." So, how can it be that it is acceptable for the public depositor to invest (on a dollar-for-dollar basis) directly in the same securities that the proposed revised rule discourages from accepting as collateral for public deposits? This very question was initiated by Legislative Auditor Joey Buddenberg in his November 9, 2010 e-mail to John Theis, *et al.* Gerald Plafcan in his November 9, 2010 e-mail response directed to John Theis, *et al*, expanded on the issue by asking if the "...range of investments due to concerns about an agency's ability to manage them..." was restricted as Mr. Buddenberg's e-mail inquired, "...should we not also do the same for eligible collateral [?]" Logic, from a pure safety perspective, would suggest that Mr. Plafcan's rationale is right on. He concludes by saying "...it would seem to follow that we would restrict the types of securities that can be used for collateral due to concerns about expertise." But Mr. Theis in his November 10, 2010 e-mail said that this issue "...seemed to be outside the scope of what we were asked to do in this project." He concluded that it would be acceptable, at least to him, to limit these complex securities as collateral because of the lack of expertise, but at the same time still sanction the outright purchase of the same securities by the same political subdivisions that are "strongly discouraged" from accepting these securities as collateral. And this is what the proposed revised rule does.

Let's look at the immediately preceding paragraph another way. The proposed revised rule and its predecessor rule (the one currently in effect) recognize that the legislature, rightly or wrongly, has specifically authorized public bodies to purchase for their own ownership and investment purposes certain types of securities. Mr. Theis has given guidance in the above excerpted e-mail traffic that the issue of what is suitable for purchase by the respective public bodies is not at issue for this proposed revised rule. Therefore, if a public body determines that it is suitable for it to purchase a specific security that is legislatively authorized for its ownership, it receives no additional protection above its purchase price for value degradation due to either an increase in interest rates or the safety and soundness of the investment itself. The proposed revised rule says this is permissible. Yet, for collateral pledging purposes, the proposed revised rule wants to require at least a 20% premium protection (30% for "complex" investments) if the public body only accepts the security as collateral for public deposits. It can not logically be concluded that it is perfectly acceptable for a public body to purchase an investment for its own account at $1.00 and then require a bank to pledge to that very public body $1.20 or $1.30 of the identical security. The goal here is to protect, within commercially reasonable standards, the public's deposits. With the fair value reports obtained by the public depositor, what is the real likelihood of pledged collateral decreasing in value by more than 5% in the period between reports **AND** the bank failing? There have been only two Arkansas banks fail in this latest economic cycle, and in both cases, these failures were no secret. Even the extremely fast failure of First Southern in Batesville was widely reported and well known by everyone in the business community beforehand. If a bank or bank holding company is under a federally-issued regulatory order, that is information in the public domain. Why not require a higher premium for those banks rather than penalize all banks? I hate to repeat myself, but all of this collateral pledging only matters if a bank fails and a public depositor has uninsured deposits in that bank.

While almost all public depositor collateral statues do not state how much the collateral for the public deposits should be, each public body has the right to set its standards and requirements, including premiums of collateral required, and to bargain with the depository bank in all of these areas. Of course, the depository bank has an equal bargaining right to decline the deposit of the public depositor. Most political subdivisions (i.e., cities, counties, school boards, etc.) naturally look to the State for the appropriate guidance in these areas, especially the percentage premium of the pledged security that should be required. Currently, the Treasurer's guideline is 105% for all security types, with the additional 5% being a "cushion" for market variations. In the proposed revised rule, the Board is proposing to distinguish as to types of collateral by the Board's perceived "investment quality." In Option A, the Board proposes to slightly reduce the percentage for US "full faith and credit" obligations and significantly increase all other categories, mostly to 120%. (Option B is a nightmare calculation that is practically unworkable.) What is even more curious is that the State seems to be saying that its own bonds (State general obligations bonds that are backed by the full faith and credit of the State of Arkansas) are somehow of a lesser investment grade and thus, should demand a higher premium, 120%. We find this curious at best.

In either proposed Option A or B, from a practical point, there will be a requirement for the depository bank to increase its already over-100% collateral coverage. Why? Is this current system not working? Have there been issues with the current requirements? None that any bankers are aware of. The collateral values are to be monitored on a regular basis. There is only an issue if the bank fails. The State Bank Commissioner is a member of the State Board of Finance. She can lend to the Board her great deal of experience on banking in Arkansas so as to direct the Board on how reasonably the public's deposits can be protected while at the same time not having unreasonable and unrealistic collateral requirements. If properly perfected at 105% of value, there is little danger that any public depositor can loose public deposits. The State (and all of the State's political subdivisions that use the State's guidelines) may well find itself in a position that because of unrealistic requirements, there will be unintended consequences that actually cause more harm that the intended good. Banks are in the business to make money. By requiring unrealistic collateral pledging requirements, it will be unprofitable for banks to pay its local public depositors a sufficient return on those public deposits. Then where will the local public depositors go? The State and all of its political subdivisions need to insure that the public's deposits are protected. But this must be a reasoned process. The 105% requirement is working for the Treasurer, and has worked. It is the proper and appropriate benchmark notwithstanding the proposed revised rule is similar to the current 1990s rule. And certainly, it does not need to be made more complex. A good argument can be made that there is more chance for error, and loss due to errors, when something is made more complex.

While not always an appropriate measure, what are other states doing with this issue? A random, non-exhaustive Internet search of a few states was performed for state pledging and collateralization requirements. The results are contained on Exhibit A attached hereto.

It is apparent that the pledging and collateralization requirement for other states are as varied as there are states. At least one, Iowa, does not even allow for FDIC insurance.

Several states do not require more than 100% collateral. Some of these states recommend that the public depositing body negotiate with the bank and require more than 100% for market fluctuation in the value of the securities. Florida allows highly rated banks to collateralize at a rate as low as 25%. (Florida may have just recently amended its statutes to require a higher percentage.)

All states have a comprehensive list of eligible securities. There was some variance, but most appeared to be very liberal in what is allowed. One state (North Dakota) even allows for a letter of credit from another bank. Several states allow CDARS to count for FDIC coverage and thus, no collateral is necessary. (The CDARS allowance should be incorporated in this proposed rule. Even FDIC recognizes CDARS.)

While is it impossible to compare a state to the proposed Arkansas rule on a point-by-point basis, a fair reading of these randomly selected states would be that the proposed Arkansas rule is generally more restrictive. This is not to say that there are not states that are more restrictive than Arkansas. There are most likely such occurrences.

Miscellaneous issues.

A. Requirement for a minimum of four (4) bids to obtain highest interest rate possible.

In Section A. General Overview of the proposed revised rule, it is required ("should be obtained") that a minimum of four (4) bids be obtained from approved banks. This appears to be essentially the same requirement in the current 1990s rule. This section addresses, among other things, the "maximizing [of] investment income," so it is assumed that the four-bid requirement concerns the interest rate to be earned from the deposit. This is not stated, so clarification of exactly what the bid is for would be appropriate. It is respectfully submitted that such a four-bid requirement in many small communities is impractical. Furthermore, the interest rate on a particular account is but one component to an account and the bank – customer relationship. There are many things that should be considered by a prospective customer when deciding what account to select for a deposit. A long standing relationship, in banking as well as other businesses, is something that a price simply can not be placed on. A bid simply on an interest rate is incomplete. Additionally, if a quoted interest rate is so high, one is reminded that if it sounds to good to be true, it usually is. Not withstanding the special protection afforded government deposits, even if there is no loss of principal and interest, moving accounts from one bank to another is time consuming and unproductive. While it is important to "comparatively shop," a bid process for a banking relationship simply does not accomplish what the authors of the proposed revised rule think it does.

B. Substitution of pledged collateral.

The draft depository collateral agreement, in numerous sections, appears to allow for the depository bank to make substitutions of collateral. This is very important, and is the common practice today. However, in certain sections of the draft depository collateral agreement, it either implies or states that written permission or approval by the public depositor is required, most likely in advance. In the proposed revised rule (§ E.6.), it specifically requires written approval from the public depositor. In all cases, the draft depository collateral agreement requires that the substitution be collateral value neutral, as it should be. The responsibility for this is placed upon the depository bank, also as it should be. In § 4.3, the public depositor is required to "approve" any substitution "before it becomes effective." However, § 8 of the draft custodial service agreement states that the custodian will not release any pledged collateral to the depository bank without prior written instructions (except under certain circumstances which are prohibitive to the extent that only bank written instructions will be used).

The practice today is varied. Some follow strict rules of no substitution without written public depositor and depository bank approval. Most, however, allow for the depository bank to instruct (in writing) the custodian to substitute neutral value collateral. The Treasurer's Office allows this method.

FNBB, Arkansas Region can accommodate any scenario. However, the proposed revised rule is vague and contradictory in certain instances. There needs to be clarity and uniformity on this very important operational issue. It is suggested that the rule maker discuss this procedure with the stakeholders so that it can make an informed decision as to what operational practices it will put in place. Additionally, "written" needs to be clarified as to whether an e-mail is acceptable. We would suggest that an e-mail is acceptable as such written approval.

C. Custodian-provided valuations to the public depositor and depository bank.

Section E.4. of the proposed revised rule correctly asserts that value monitoring of the collateral is the duty of the public depositor. It further states that the depository bank shall provide to the public depositor, its customer, a monthly collateral report, at no charge to the depository bank's customer. However, in § 9 of the draft depository collateral agreement, the custodian is required to provide to both the depository bank (its customer) and the public depositor (the bank's customer) a monthly statement of the holdings being held by the custodian for the security purposes of the proposed revised rule. In addition to a statement that provides a listing of what securities are being held for the above mentioned purposes, the custodian is ***mandated*** to provide a market value of the securities held, to obtain these values from very specific valuation services, and to provide all of this ***at no charge*** to the public depositor. There just seems to be something inherently unfair about the government requiring a private, for-profit business to provide its services free of charge. Technically, there is no prohibition from the custodian assessing its costs and fees for this free service on the depository bank. However, the bank is likewise required to produce for the benefit and use of the public depositor its own statement of values on the same securities. Certainly the State Board of Finance is not serious in mandating that there be two separate and simultaneous valuations performed on the same set of securities.

Another issue is that a custodian for the safekeeping of pledged assets is just that – a custodian. The custodian is not a pricing or valuation service. It's not what custodians do. Pricing services are expensive, and the entity that is responsible for valuing the collateral, the public depositor (so states the proposed revised rule), should bear the cost.

Currently FNBB, Arkansas Region provides a monthly statement to its safekeeping customers. The same type report is provided to those public depositors who request such. Among other things, the monthly report does include a "market value." However, this value is obtained from a company that while we believe provides accurate data, is not on your suggested approved list and can not be relied upon for purposes for which it was not intended. Again, it's not for pricing purposes.

Again, FNBB, Arkansas Region appreciates the opportunity to comment on your proposed revised rule. Should you have any questions concerning our comments, or need clarification on any point made herein, please do not hesitate to let me know.

Sincerely,

Jim Franks

Jim Franks
Executive Vice President

Exhibit A

Iowa (http://www.idob.state.ia.us/public/publicFunds/faq_12_26_06.htm)
Pledging required for those public deposits that exceed the bank's capital.
There is no additional "premium" required to be pledged.
There is no credit given for FDIC insurance.
CDARS are allowed.

Oklahoma (http://www.ok.gov/treasurer/documents/CDARS%20Letter%20121708.pdf)
CDARS are allowed.
Pledging required for those public deposits that exceed the FDIC insurance.
Additional "premium" not required to be pledged, but greater than 100% may be negotiated between bank and public body.
http://www.ok.gov/treasurer/documents/OST%202001-1.pdf

North Dakota
Letters of credit from other banks are allowed as collateral for public deposits at bank.
http://www.banknd.com/treasury_services/letter_of_credit_pledge_for_public_deposits.html

Florida (https://apps.fldfs.com/CAP_Web/PublicDeposits/intro_major.aspx)
Each prospective public depository is rated by a rating service. The highest rated banks have to collateralize deposits at only 25%. The lowest rated banks pledge 125%. Ineligible banks may still participate, but must pledge at a 200% rate. (Florida may have just recently amended its statutes to require a higher percentage.)

Ohio (http://codes.ohio.gov/orc/135.18)
The amount to be pledged for public deposits is only the amount over the FDIC insured limit.

Missouri (http://www.treasurer.mo.gov/link/CollateralizationofDepositsOct72008.pdf)
Required to collateralize only 100% of the non-FDIC covered deposit. Suggests public entity negotiate with bank to receive premium

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SEP 1 2011
ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

August 29, 2011

FirstSecurity
Bank

Mr. John H Theis
Assistant Commissioner of Revenue
DFA Revenue Division
Ledbetter Building Room 2440
Little Rock, Ar 72203-1272

Dear Mr. Theis:

I have reviewed correspondence sent to you from Arkansas Bankers Assocation and First National Bankers Bank regarding the Management of Cash Funds Proposed Rule; Rule 2011-1.

I concur with both Mr. Hammonds and Mr. Franks and look forward to a meeting with you and the Arkansas Bankers Association in the near future.

Sincerely,

Reynie

Reynie Rutledge
Chairman

JRR/sb

ABA

ARKANSAS BANKERS ASSOCIATION

1220 West Third Street ◇ Little Rock, AR 72201 ◇ 501-376-3741 ◇ FAX: 501-376-9243 ◇ www.arkbankers.org

KEN D. HAMMONDS
PRESIDENT & CEO

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ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

August 24, 2011

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

RE: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

The Arkansas Bankers Association is pleased to have the opportunity to comment on the proposed Rule 2011-1. We present our comments on behalf of our membership and as the advocate for all of the FDIC insured financial institutions in Arkansas.

We fully support the intent of this Rule to set a uniform policy and procedure to secure the safety of deposited Cash Funds; however, we do also believe there are potential unintended consequences in the Rule. While this rule affects a relatively small percentage of the Public funds handled by our banks, we do have significant concerns that this would become the "model" rule for the many local government finance boards. These unintended consequences could well lead to the community banks of Arkansas exiting their relationships with the various and many Agencies of the state.

Our request is to have all parties come to a mutually agreeable set of policies for Public Funds, Treasury Funds and Cash Management Funds. It seems that the existing Treasury Fund policies would, by size, depth and complexity, be the best guide to work from. The use of the Arkansas State Treasury Investment Policy as the guide for the management of cash funds by all state agencies would give each agency a single source for documents, policies and process. The Treasurer's experience and guidance would help ensure the prudent management of risk when investing state monies.

The following comments highlight the major concerns brought forth by our banks:

I. Collateralization Of Cash Funds - General

The proposed list of eligible securities does not list GSEs, such as FHLMC and FNMA. In fact it "strongly discourages the use of any investment type not listed". We feel the legislature has spoken clearly in both A.C.A. 19-8-203 and 23-47-203 that generally list the eligible securities as those that can be purchased by an Arkansas chartered bank. We feel the proposed "list" is unduly restrictive and would greatly limit our banks' ability to provide sufficient collateral. Few banks in today's extremely low interest rate environment hold a large inventory of US Treasury notes and bonds. We also support the view that 130% margin required is excessive because the GSEs are almost 80% owned by the US Government and carry AAA ratings. Our fear would be that you will drive the rates down on Public funds, and that the competition for those funds in our community banks will also greatly decrease.

II. Collateralization Of Cash Funds – Custodial Services Agreement

Here we fully support the need for uniform documents to ensure the safety of the deposits, and compliance with updated laws. However under strict interpretation it would be virtually impossible for the largest custodian in the state, the Arkansas Bankers Bank, to be a custodian going forward. It will be almost impossible for a bank to use an upstream correspondent bank or national custodian, e.g. Bank of New York, and indeed it is possible our banks could not use The Federal Reserve Bank because of the need to be "unaffiliated with the financial institution" language. We recommend that there be several pre-approved forms that can accommodate the Federal Reserve, the large national custodians, the Arkansas Banker's Bank and our regional banks in Arkansas that are headquartered outside of Arkansas.

III. Collateralization Of Cash Funds – Custodial Services Agreement

Paragraph 6 requires that collateral cannot be substituted without prior written approval. The Banker's Bank, the Federal Reserve and the large national custodians have automated systems that assign new securities to customers every day based on the deposit levels of that customer. These substitutions are made by the custodians, not the bank, and provide a safe and efficient process to protect the depositor.

IV. Collateralization Of Cash Funds – Custodial Services Agreement

Paragraph F. requires a perfected interest under UCC rules in the specific security that has been pledged as collateral. Like the instances sited above in III., we believe that using a pool of eligible securities, to be substituted as needed by the Custodian, allows for the same safety but greatly maximizes efficiencies.

We appreciate the opportunity to comment and to bring to light the concerns of our bankers. The standardization of policies, processes and forms for the Agencies and Treasury

Funds will help to ensure the safety and efficiency of all public monies. And it will help to preserve the role of community banks in maintaining their local, county and state agency relationships.

We feel strongly that it is imperative to have a joint committee meeting before these proposed rules go any farther in the process. Legislative Audit, DFA, State Treasurer's office, Arkansas Bankers Association and a select group of bankers should get together, talk out the differences and formulate a mutually agreeable solution. This would be the surest way to create a set of rules and policies that cover all Public Funds investing, and ensures an efficient and effective program.

Sincerely,

Ken Hammonds

Ken D. Hammonds
President & CEO

KDH:dc

Cc: Arkansas Bankers Association Executive Committee:
Mr. Charles Blanchard, Chairman & CEO, First State Bank, Russellville
Mr. John Freeman, President, Liberty Bank of Arkansas, Jonesboro
Mr. David Bartlett, President & COO, Simmons First Nat'l Corp., Little Rock
Mr. Mark Ferguson, EVP, First Security Bank, Little Rock
Mr. Eddie Holt, President & CEO, First Nat'l Bank of Crossett

Arkansas Bankers Association Board of Directors

Mr. Larry Wilson, Chairman & CEO, First Arkansas Bank & Trust, Jacksonville
Mr. Reynie Rutledge, Chairman, First Security Bank, Searcy

ARKANSAS BANKERS ASSOCIATION
1220 West Third Street · Little Rock, AR 72201 · 501-376-3741 · 501-376-9243 www.arkbankers.org

MEMORANDUM

TO: The Honorable Martha Shoffner, Candace Franks, Richard Weiss and John Theis
FROM: Ken Hammonds, President & CEO
DATE: July 14, 2011
RE: Arkansas State Board of Finance, Rule 2011-1/Management of Cash Funds

---

Please accept this as a formal request to extend the comment period for the above referenced rule. In order to allow for a comprehensive review by the banking industry it has become clear that additional time is needed. As a representative of the bankers in Arkansas I ask that the deadline for comments be moved to September 1, 2011.
We are also willing to meet with whomever you designate, to offset many of the comments and concerns we have in these document, even before the comment period is over, if you so desire.

Thank you for consideration of this request.

President
Cole Martin
Clarksville

Vice President
George Worthen
Little Rock

Treasurer
Martin Carpenter
Ash Flat

Secretary
Sam Beller
Cave City

Past President
Milton Smith
Walnut Ridge

Executive Director
Richard Trammell
Hot Springs

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AUG 15 2011
ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

August 12, 2011

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

Re: Proposed Rule 2011-1 Arkansas State Board of Finance Management of Cash Funds

Dear Sir or Madam:

The Arkansas Community Bankers Association serves the interests of 128 independent community banks and thrifts across our state representing $55 billion in assets. On behalf of our member institutions, we respectfully offer the following comments on the proposed rule by the Arkansas State Board of Finance on Management of Cash Funds. We are grateful for the opportunity to have our position heard and hope that our comments may lead to improvements in the proposed rule.

1. ***Multiple Rules on Handling Public Deposits.*** We understand that the drafting of this proposed rule was undertaken in response to adverse comments by legislative audit. The proposed rule reflects an updating of the existing rules originally promulgated on September 1, 1990. However, a consolidation of the multiple sets of applicable rules for deposits of public funds by the various state and local governments and their agencies would be a welcome improvement. Multiple sets of rules applicable to different governmental units and types of public funds can lead to confusion and inadvertent compliance errors. We encourage you to consider the adoption of single uniform set of procedures for depositing public funds applicable to all types of funds held by all governmental units, subject to such modifications as are necessary to accommodate special circumstances affecting specific funds. The adoption of the Arkansas State Treasury Investment Policy for the management of cash funds by state agencies would unify the rules applicable to the deposit of State treasury funds and state agency cash funds.

2. ***Scope of the Proposed Rule.*** The scope of the Proposed Rule only involves "cash funds" of state agencies. This affects a relatively small segment of deposits by governmental agencies, however there is substantial concern from our members that this Proposed Rule may be utilized as a model by various local governmental finance boards. Certain aspects of the Proposed Rule raise additional concerns, if such rule were to be used as a model by local government finance boards. These specific concerns are discussed below in Comment 4.

3. ***Specific Comments on the Proposed Rule.*** The following comments apply to the Proposed Rules as applied to cash funds of state agencies:

a. ***Collateral Valuation.*** (1) ***Valuation method***. The selection of fair value, rather than par value of the securities held as collateral, requires the adoption of a process to determine fair value and to set the frequency of the valuation determination. The use of par value of the securities as the valuation criteria would eliminate the administrative burdens on banks and agencies from obtaining ongoing collateral valuations from third parties during the term of the deposit. As a consequence, costs associated with maintaining these deposits would be reduced allowing higher yields to the agencies. As a backstop to prevent substantial market movements from impairing the fair value of collateral, the rule could allow an agency to obtain a semi-annual valuation of the collateral and require the depository bank to provide additional collateral if the amount of the deposit exceeded the fair value of the collateral.

(2) ***Valuation Reporting Requirements.*** The use of fair value in determining collateral coverage ratios necessitates regular valuations of the collateral. The Proposed Rule requires the depository bank to provide a monthly collateral report at no charge to the agency. This is burdensome and adds additional administrative costs to the depository bank for accepting these deposits. Most banks, unless they are an active dealer in the bond market, will not be able to provide such a report internally. The depository bank will be required to obtain the valuation report from a third party at the bank's cost. The prohibition on the bank assessing a charge or recouping its expense for this report will require the bank to reduce the yield it is willing to pay to agency for the deposit. This added cost in combination with the other added costs may well exceed the 25 basis point allowance for collateralization costs and may have the effect of discouraging banks from seeking these deposits. This issue could be eliminated or minimized by (I) using par value rather than fair value to determine collateral coverage ratios, (II) allowing the bank to provide the agency what information it has regarding the fair value of the collateral at month end, without any duty to seek valuation information from outside parties, then the agency could determine whether an outside valuation, at its cost, is desired, (III) allowing the bank to recoup expenses paid to third parties for the preparation of monthly collateral valuation reports, or (IV) reducing the frequency of collateral valuation reports to annually or semi-annually.

b. ***Collateral Coverage Ratio for Listed Collateral***. The types of collateral and coverage ratios set forth in sub-paragraphs (a) through (j) of Paragraph 2 have not been revised from the existing rule. However, in the case of collateral described in sub-paragraphs (c) through (g) the collateral coverage ratios are significantly higher than are necessary to protect the funds on deposit owned by the state agency. Requiring a significant over-collateralization by the bank for these deposits increases the cost of the bank in holding these deposits, which adversely affects the interest rate that the Bank can offer and pay on these deposits. The added cost may well exceed the 25 basis point allowance for collateralization costs and may have the effect of discouraging banks from seeking these deposits, particularly during periods, as is the case now, when the local banking markets are experiencing low loan demand and have more than adequate deposit sources. A collateralization ratio of 105% for these types of collateral, similar to the coverage ratio utilized by the State Treasurer's office, would adequately protect the deposited funds and not unduly increase the cost to the bank in providing depository services.

c. ***Collateral Coverage Ratio for Unlisted Collateral.*** The prior rule does not have a provision comparable to Paragraph 3 of the Proposed Rule. While the concern about esoteric and unusual securities is understandable, Paragraph 3 applies to many types of securities that are ordinary and common and not by most definitions esoteric or unusual. The strong discouragement of the use of any eligible collateral not listed in Paragraph 2 of the Proposed Rule is unwarranted. Since the securities issued by U. S. Government sponsored enterprises ("GSEs"), such as FHLB, FNMA, FFCB, FHLMC, Farmer Mac and others are not backed by the full faith and credit of the United States government, these securities would fall into the unlisted eligible collateral requiring 130% collateral coverage. Many of the securities issued by these GSEs do not require any "highly specialized technical skill in order to assess their quality or risk". In many instances these are ordinary term debt obligations of the GSE, without any complicating factors. Applying the 130% collateral coverage ratio to these bonds is unduly burdensome and is not justified based upon the credit profile of the GSEs. Since many banks hold a substantial portion of their investment portfolio in GSE securities, also known as U. S. agency securities, applying the 130% collateral coverage ratio to ordinary debt securities of GSEs will substantially increase the cost to the depository banks of maintaining these deposits and significantly reduce the yield available to the state agency without any material increase in the safety or security of the deposit. A collateral coverage ratio of 105% for ordinary debt instruments issued by GSEs, would adequately protect the deposited funds and not unduly increase the cost to the bank in providing depository services.

d. ***Custodianship of Securities.*** (1) ***Limitation on Eligible Custodians.*** The Proposed Rule limits the custodians eligible to hold securities to a "Federal Reserve Bank, the trust department of a commercial bank or a trust company primarily located within the State of Arkansas." The securities owned by banks are commonly held in safekeeping with a Federal Reserve Bank, a licensed securities dealer, bankers bank or an upstream correspondent bank. The securities owned by depository banks and so held in safekeeping are routinely pledged with the safekeeping institution acting as the custodian. Pledged book entry securities held by a safekeeping institution are either held in a segregated account at a Federal Reserve Bank for U. S. Treasury and GSE Book-Entry securities or in the case of DTC eligible securities an upstream custodian of the safekeeping institution. Pledged securities that are certificated are physically held by either the safekeeping institution or an upstream correspondent institution. The safekeeping institution does not own the securities held in such accounts and will safeguard the pledged assets according to the terms of the Custodial Service Agreement. Historically, these practices have proven satisfactory in the protecting the securities held in safekeeping accounts.

We are not aware of any lapses in these practices which have caused funds held by public fund depositors to be compromised from safekeeping securities at a bankers bank, a licensed securities dealer or an upstream correspondent bank. The requirement that these securities be held by "Federal Reserve Bank, the trust department of a commercial bank or a trust company" rather than the safekeeping bank will cause significant additional administrative effort for some depository banks without increasing the safety or security of the collateral. Additionally, many of our member banks maintain securities safekeeping accounts at the First National Bankers Bank (formerly Arkansas Bankers Bank), the exclusion of bankers banks from the eligible custodian list will necessitate transfers of securities to an eligible custodian to comply with the Proposed Rule. We believe the proposed Rule should be amended to add commercial banks and licensed securities dealers as eligible custodians.

(2) ***Non-Affiliated Custodian.*** The requirement that pledged securities be held at a nonaffiliated custodian will increase operational costs at many banks, while providing little if any additional security for the deposited funds. There is, at most a nominal risk in having a custodian which is regulated by a federal financial regulatory agency, act as custodian, regardless of whether or not the custodian is affiliated with the depository bank. As discussed above, the securities safekeeping procedures as established by financial regulators, provide segregation of the collateral and security in holding the collateral so as to allow the perfection of a security interest under the UCC or Federal regulations as applicable. This procedure is the same regardless of the existence of an affiliation between the safekeeping bank and the depository bank. Historically, these practices have proven satisfactory in protecting the securities held in safekeeping accounts. We are not aware of any lapses in these practices which have caused funds held by public fund depositors to be compromised by the use of a third party custodian affiliated with the depository bank. As noted above, many of our member banks maintain securities safekeeping accounts at the First National Bankers Bank, formerly Arkansas Bankers Bank ("FNBB"). Additionally, many of our member banks have a small ownership interest in FNBB's parent company. The prohibition on the securities custodian being affiliated with the depository bank is unduly burdensome on depository banks and will either adversely affect the long standing business relationships of many of our member banks with FNBB or adversely affect the interest of depository banks in bidding on these agency deposits. We do not believe that this prohibition on affiliation is justified. So long as the agency's security interest in the collateral is duly perfected, the presence or absence of an affiliation between the custodian and the depository bank has no effect on the transaction. The implementation of this rule as proposed requiring an unaffiliated custodian, will require many of our member banks to open additional securities accounts at other institutions and pay additional costs to provide unaffiliated custodians to hold the collateral without increasing the security of the collateral.

4. ***Model for Local Government and Agency Finance Boards.*** As an updated and recently adopted guideline on funds management, we believe that the Proposed Rule, as adopted, may be reviewed and utilized as a model for local governments, schools boards and other local

governmental agencies in developing their own funds management policies. In addition to our comments above there are several aspects of the Proposed Rule which if applied to local governments or local governmental agencies that raise additional issues.

a. ***Collateral Coverage Ratios for Local Bonds.*** Local banks are one of the principal buyers of local government bonds, school district bonds and local industrial development bonds. In many instances, these investments are justified as an investment in the future of the local community, rather than a purely economic investment decision based upon the underlying credit quality of the issuer and the economics of the project being funded. In this situation, the imposition of a 120% collateral coverage requirement is burdensome and not appropriate. A requirement that a school district or other local government would require a 120% collateral coverage for its deposits if the collateral pledged were its own bonds cannot be justified. Such a result could adversely affect the willingness of banks to accept local deposits or to purchase local government bonds. The ability of a bank to take local deposits, including local government deposits, and invest these funds in local government bonds has benefitted many communities, however, the injection of a burdensome over-collateralization requirements for local government deposits could adversely affect the continuation of this practice. The application of a 105% collateral coverage ratio would protect the local government deposits without causing the adverse economic impact of over-collateralization.

b. ***Valuation of Collateral***. The selection of fair value as the valuation standard is difficult to apply to local bonds. These bonds are typically issued in relatively small amounts and trade very infrequently. The determination of a market value for such a security is very problematic if there were no trades during the preceding one or more months. The use of par value as the valuation standard for these bonds would remove the issues surrounding determination of fair value in a thinly traded market.

We appreciate the opportunity to provide these comments and are willing to discuss our comments with you if you so desire.

Sincerely,

Richard G. Trammell
Executive Director

John Theis

From: Paul Young [pyoung@arml.org]
Sent: Thursday, July 14, 2011 10:49 AM
To: John Theis
Cc: Don Zimmerman; David Schoen
Subject: Ark St Board of Pub Finance - prop rule 2011-1
Attachments: Buttry Article in C&T May 2010.pdf; GFOA recommended collateral ratios.pdf; Act619.pdf

John

As you requested, I am sending this message to summarize my comments at the public hearing held July 7 on the proposed rule. While these rules only apply to State agencies they will impact cities and towns as a result of Act 619 of 2011 (attached). The Act will likely require municipal governments to use the sample security and custodial agreements included in the rule. See Section 2 of the Act that amended ACA 19-8-107(a)(3). Also, it is likely that the rule will be referenced as appropriate policy for collateralizing deposits of all public entities in Arkansas.

I am attaching a copy of an article on deposit collateralization that appeared in our City & Town magazine in May 2010 that provides a summary of the relevant legal rules and practical implications.

My comments about the proposed rule are as follows:

1. Missing from the eligible collateral listing are US agencies that are not guaranteed by the US government. These securities are included in the list of eligible collateral identified in ACA 19-8-201(a) (1) and ACA 23-47-401(a)(2). Such securities are commonly pledged by banks and preferred by public depositors because of their implied or actual support by the US government.

2. The terms of the sample security and custodial agreements do not adequately deal with certificated securities in a manner consistent with current law and practice. In fact, it is highly unlikely that actual certificated securities would be used in today's "book entry" world. However, investments that are often considered uncertificated are actually "security entitlements" that represent indirectly owned certificated securities. Municipal bonds are this type of security and are being used by many Arkansas banks for deposit collateral. The documents should properly describe the manner of pledging these items. (see the attached City & Town article, page 3)

3. The collateral margin requirements do not take into account the maturity of the pledged securities which has a large impact on their potential market value. In some cases, the margin percentage could be too low for long dated securities (US government obligations) and too high for shorter dated securities (Arkansas public entity bonds). See the attached recommended guidelines prepared by the GFOA for monthly valuation. Also, since many banks have facilities to monitor collateral on a daily basis, recommendations should be included for application in those cases.

Please let me know if you have questions or need additional information.

Paul Young
Finance Director
Arkansas Municipal League
501-978-6104 (off)
501-551-2033 (cell)
pyoung@arml.org

Exhibit 1 • Suggested Collateralization Ratios to Be Used in a Monthly Mark-to-Market Program

Form of Pledged Collateral	Collateral Ratio
U.S. Treasury Bills, Notes, and Bonds	
Maturing in less than 1 year	102%
Maturing in 1-5 years	105%
Maturing in more than 5 years	110%
Zero-coupon Treasury securities (STRIPS etc.) with maturities exceeding 10 years	120%
Actively Traded U.S. Government Agencies	
Maturing in less than 1 year	103%
Maturing in 1-5 years	107%
Maturing in more than 5 years	115%
U.S. Government Agency Variable Rate	115%
GNMA Mortgage Pass-Through Securities	
Current issues	115%
Older issues	120%
Issues for which prices are not quotes	125%
Other Federal Agency or Mortgage Pass-Through Securities	125%
Collateralized Mortgage Obligations and Real Estate Mortgage Investment Conduit Securities	(*)
Municipal General Obligation Bonds	(**)
Maturing in less than 1 year	102%
Maturing in 1-5 years	107%
Maturing in more than 5 years	110%
Municipal Revenue Bonds	(***)
Maturing in less than 1 year	105-110%
Maturing in 1-5 years	110-120%
Maturing in more than 5 years	120-130%

Notes:

*Mortgage securities, such as CMOs and REMICS, carry a high degree of market risk and the market prices of these securities can be volatile in periods of rising interest rates. For this reason, high collateral ratios such as 125 percent should be considered.

**General obligation bonds refer to bonds issued by an in-state unit of government. Out-of-state municipal bonds may require a higher collateralization ratio unless their credit ratings are in the highest investment grades (e.g., AAA or AA).

***Lower investment grade revenue bonds (A or BBB) should be collateralized at higher ratios. Industrial development revenue bonds may not be acceptable due to credit quality, unless guaranteed by a third party. High credit ratings should be demanded if such bonds are pledged for collateral.

procedures can provide for independent control of collateral, and frequently two signatures are required before assets can be released in an event of default. (Note: Federal agencies and the Governmental Accounting Standards Board (GASB) have stated that they interpret this form of deposit pledging to be the equivalent of delivery to the investor.)

(2) Third-party collateral safekeeping can be arranged at another custodial facility. Most banks maintain "correspondent" relationships with independent commercial banks that can hold a government's deposit collateral in safekeeping. A written safekeeping agreement should document this safekeeping relationship. Such third-party safekeeping assures independence and reduces the chance for fraud. However, this arrangement may be more costly than safekeeping at a Federal Reserve Bank. Generally, third-party safekeeping should be held in a trust department through book-entry at the Federal Reserve (unless physical securities are involved).

Exhibit 2 demonstrates how collateralization is conducted, using an independent third-party safekeeping agent. First, the government places deposits with its depository bank and enters into a security agreement that formalizes the public entity's relationship with the bank. Second, the depository bank and the custodial bank enter into a custodial trust agreement that ensures the securities held by the custodial bank show the government as the owner of those securities. The custodial bank will send the government a monthly statement listing the securities being held as collateral and reporting the market value of those securities. Third, the depository bank transfers securities through the Federal Reserve System to a third-party bank that acts as custodian.

(3) The trust department of a commercial bank can hold the collateral in safekeeping. This procedure is usually cost-effective, but should be substantiated by a written trust agreement as a way to discourage fraud and to ensure the existence of an impenetrable boundary between the bank's operations and trust departments.

Substitution. If the depository wishes to substitute one form of collateral for another, the agree-

Securing bank deposits

By Jim Buttry

I last put together an article for *City and Town* on the securing of public deposits in 1993. I thought that I was finished with the matter. Indeed, I announced in the article that it was my "swan song" on the subject. With some trepidation, I have been drawn back into the matter, chiefly because of changes in state law and the request of my friend Paul Young, the League's finance director, who collaborated on and contributed greatly to this article. Also, the General Assembly made significant changes in the Uniform Commercial Code in 2001. I must acknowledge my reliance on Hawkland & Rogers UCC Series (Rev Art 8).

I repeat the disclaimers that I issued in 1993 and add one. Here are the disclaimers:

- The scope of this article is limited. It deals with the "perfection" and "control" of security interests in collateral pledged to secure public deposits. I have, for example, not attempted to deal with the details involved in the liquidation of collateral in the event of a bank failure.
- I have not attempted to deal with whether a particular deposit is of public funds, eligible for collateralization under federal and state law. Nonprofit entities associated with or supporting governmental purposes would be examples of entities that might not qualify.
- Any change in existing law or regulations can affect the conclusions or opinions expressed in this article.
- We are required by IRS Circular 230 to inform all readers of this article that any statements contained in it are not intended or written to be used, and cannot be used, by anyone for the purpose of avoiding any penalties that may be imposed under federal law.

Portions of this article repeat portions of the 1993 article. (I am confident that there is no risk of anyone's remembering the latter.)

I have used the term "municipality" herein to refer to all public bodies. This article is written as addressed to municipalities and, accordingly, the term "you" refers to them. References to the "UCC" are to the Arkansas Uniform Commercial Code. I have referred to "indorse" and "indorsement," as that is how it is spelled in the UCC.

Bond lawyers have been accused of having the mind of a "file cabinet." Being a bond lawyer, I am conservative in the opinions expressed here. Your lawyer may disagree with some of them (and in a lawsuit might be upheld). Bond lawyers look upon an "opinion" as a "conviction." This, basically, amounts to a reasonable doubt standard.

Some background

Securities were used to secure (or "collateralize") loans before there were any uniform or clear statutory rules covering such transactions. Banks lend on the basis of such collateral, of course, every day. In the typical deposit transaction (including a certificate of deposit) the parties are reversed. The bank is borrowing from the depositor, for our purposes here, the municipality. (But the same state laws are applied.) Because more than one person can claim to own a security, or an interest in it, the challenge has always been to determine which claimant has a prior right or interest. In the event of a bank failure, you want your collateral to protect your funds against the claims of other bank creditors, primarily the claims of the FDIC.

Under Arkansas law, a municipality's deposits in excess of FDIC insurance coverage ($250,000 until Dec. 31, 2013, when the amount will revert to $100,000) should be secured by a "perfected" pledge of certain eligible securities. This is set forth in Arkansas Code of 1987 Annotated at § 19-8-107 and § 19-8-203. It is not clear whether the requirement for an "eligible security" as collateral refers to both securities and to "security entitlements," which I will discuss below. This suggests that some consideration might be given to the amendment of our state statutes recognizing and confirming that eligible "securities" may be in the form of security entitlements.

Since 1993 the list of securities which are "eligible securities" for the securing of public funds has grown from a very short one (direct obligations of the United States or obligations guaranteed by the United States) to a very long one as found in ACA § 19-8-203, which by reference includes § 23-47-401. Some of the items to be used by Arkansas banks as deposit collateral are:

- Direct obligations of the United States;
- Obligations of agencies and instrumentalities created by act of the Congress and authorized thereby to issue securities or evidences of indebtedness, regardless of guarantee of repayment by the United States (such as government sponsored entities like Fannie Mae, Freddie Mac or the Federal Home Loan Banks);
- Obligations the principal and interest of which are fully guaranteed by the United States or an agency or an instrumentality created by an act of the Congress and authorized thereby to issue such guarantee;
- General obligations of the states of the United States and of the political subdivisions, municipalities, commonwealths, territories or insular possessions thereof (provided the issuer has not had a default in the past 10 years);
- Surety bonds issued by insurance companies licensed under the laws of the state of Arkansas that meet the statutory rating requirements or are listed on the then-current United States Department of the Treasury Listing of Approved Sureties;
- Irrevocable standby letters of credit issued by Federal Home Loan Banks; or
- Revenue bond issues of any state of the United States or any municipality or any political subdivision thereof.

Some of the above, such as state or municipal revenue bonds, will only be suitable as collateral if they have very strong credit quality and short to intermediate maturity. (The statute which authorizes state bank investments in them limits to 20 percent the portion of a bank's capital base that may be so invested.)

In addition to the changes in eligible securities, the General Assembly enacted major amendments to the UCC, in 2001. These include, in particular, amendments to those provisions dealing with the creation and perfection of security interests.

In order to be protected, a depositing municipality must comply both with (1) the federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 (so called "FIRREA") and (2) the UCC.

A look at FIRREA

Congress enacted FIRREA in response to the savings and loan turmoil of the 1980s. Among other things, it included additional requirements for the validity and enforceability of security interests against the FDIC in a takeover.

The requirements of FIRREA, which are set forth in 12 United States Code § 1823(e), are that there be an agreement, which agreement must be in writing,

(a) executed contemporaneously with the acquisition of the collateral,
(b) maintained, continuously from the time of execution, as an official record of the bank, and
(c) approved
  (i) by the board of directors or loan committee of the bank,
  (ii) which approval must be shown in the minutes of the board or the committee.

It is instantly obvious that, of the FIRREA requirements, (b) is difficult and (a) would be worse. Happily the FDIC has recognized the difficulties with (a), and has announced that it will not seek to avoid a security interest, otherwise perfected and legally enforceable, solely because the agreement does not meet the "contemporaneous" requirement. The FDIC policy was enacted into law in 1994 but the security agreement must still be adopted in the ordinary course of business, and not in the contemplation of insolvency. If you fail to

see **Bank deposits**, page 16

Bank deposits, continued from page 15

have a security agreement in place prior to when you have reason to fear insolvency of a bank, it will likely be too late.

Also, to be effective, the security agreement should include a description of the eligible collateral and how specific collateral is to be identified at any point in time, such as by a confirmation from the third party custodian of the collateral. After all, one reason for the agreement requirement is to permit examiners to identify any claims against the assets of the bank.

Now we consider state law

When I began practicing law, nearly all securities were in the form of paper certificates which were held (physically) by the true, or beneficial, owner. In order to pledge a security to secure a debt, the certificates were delivered to the lender and endorsed by the owner. There was rarely any doubt about who owned the security or who had a security interest in it. If the security was in registered form, instructions were given to the registrar. In the event of a default, the securities could be instantly liquidated. But there was a terrible problem. By the 1970s the volume of traded certificates was overwhelming the markets. At one point, the New York Stock Exchange closed on Wednesdays in order to allow market participants to catch up with the paperwork.

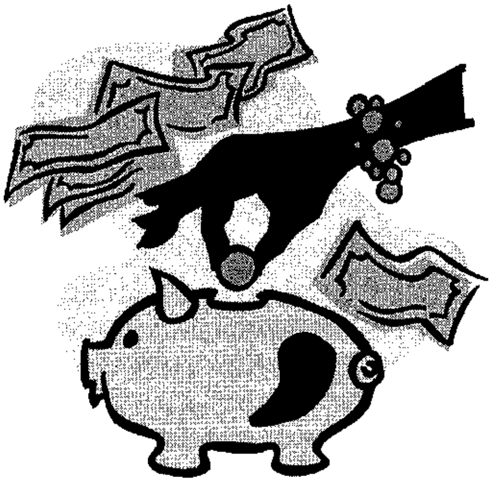
The Uniform Commercial Code was rewritten to authorize uncertificated securities. The issuer's registrar made an entry on its books reflecting the identity of the owner and reflecting any security interest granted by the owner. But the markets had gotten ahead of the change in the UCC and had already established a system that utilized certificates. But these certificates were "jumbo" or immobilized and held by a single registered owner, today The Depository Trust Company or DTC. If you buy a security today, other than a U.S. treasury or agency obligation, it is almost certainly registered to the nominee of DTC, and DTC reflects on its books not you as the owner but a "securities intermediary" (typically a broker or bank) which holds the security for you. Therefore, today almost all securities are held in one of two ways:

- Uncertificated—For the most part, only U.S. treasury or agency obligations are held in this way. For them the registrar is a Federal Reserve Bank, and there is a direct relationship between the owner and the issuer. That is, the identity of the owner is reflected on the book maintained by the issuer's registrar. Transfers are made by notification to the registrar.
- Certificated but "indirect"—DTC maintains records which reflect ownership by a "participant" which is a "securities intermediary" and what you own is not a security but is a package of rights and interests against your securities intermediary. This package is called a "security entitlement." This is the "indirect system," and it is now the system for the holding and transfer of almost all municipal bonds and corporate securities.

Now, we get to "perfection," which primarily requires "control" of the pledged collateral. The Government Finance Officers Association recommends the use of a custodian, which is typically a bank and is preferably a separate trust or safekeeping department. In most cases, this will be accomplished by having a custodian hold the bank's pledged collateral in its name on your behalf pursuant to an agreement so that nothing can be done with the collateral unless you approve. Also, the agreement should permit you to sell the collateral if necessary to satisfy your deposits without the consent of the bank or the FDIC. Typically, the custodian will be an independent party that regularly holds your bank's securities or security entitlements for this and other business purposes. In order to establish properly the arrangement and protect your interest, you will need to enter into a three party agreement among you, the custodian and your bank in which the parties will acknowledge these terms and that the collateral is held on your behalf. This is in addition to the security agreement required by FIRREA, discussed above.

In the uncertificated system, a security interest can be perfected in a security by having your custodian reflected as the owner of the securities on the books of the registrar. This amounts to perfection even against a "protected purchaser." (More on that below.)

In the indirect system, your custodian will not own a security or an interest in a security. The custodian will own an interest in an account held by your bank. Your security interest in a security entitlement is perfected when the securities intermediary maintaining the account indicates by book entry that the securities entitlement has been credited to an account in the name of your custodian (and you, the bank and your custodian enter into the agreement described above). Based on this arrangement, the intermediary will comply with orders originated by you and your custodian without the consent of the bank. Bear in mind: A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary (e.g., broker) and the property held by the intermediary. (Uniform Commercial Code Official Text and Comments, § 8-503.) The UCC makes clear the priority of a protected purchaser of a security over the holder of a security entitlement. A protected purchaser is one that acquires a security for value without the notice of another claim. It is theoretically possible for a protected purchaser to trump the interest of a public depositor's claim to a security entitlement that is maintained by the DTC system. However, that would clearly require a very unusual security transfer to a holder other than DTC. Surprisingly, there is little precedent and guidance in that regard. But logic would suggest that the FDIC, as receiver of the depository bank, should recognize a properly perfected security interest in a security entitlement as a perfected security interest in the underlying securities, as the depository bank has lost control of those securities.



No magazine article can cover every transaction or serve as a substitute for consultation with your counsel. For your reference, the GFOA's Recommended Practice on this topic accompanies this article (see pages 18 and 19). It has similar information on the requirements of FIRREA and also includes some recommendations on related matters such as collateral valuation. In fact, officials charged with the responsibility of securing deposits in excess of FDIC coverage should, as appropriate, consult with the municipality's banker, lawyer or accountant (or some or all of them). The list of eligible securities is now long and the requirements of both state and federal law are strict. You want to be secure against an FDIC claim and be able to liquidate your securities without FDIC consent. It would be hard to be too careful. Remember that your League is available to assist.

Jim Buttry is a partner in the Friday, Eldredge & Clark, LLP law firm. He has practiced municipal bond law since 1967. He is a graduate of the University of Arkansas (LL.B., 1963) and Georgetown University (LL.M., 1966). He is a member of the National Association of Bond Lawyers and has been recognized in Best Lawyers in America and in Chambers USA 2010 as among "Leaders in Their Field."

BEST PRACTICE

Collateralization of Public Deposits (1984, 1987, 1993, 2000, and 2007) (TIM)

Background. The safety of public funds should be the foremost objective in public fund management. Collateralization of public deposits through the pledging of appropriate securities or other instruments (i.e. surety bonds or letters of credit) by depositories is an important safeguard for such deposits. The amount of pledged collateral is determined by a public entity's deposit level. Some states have established programs for the pooling of collateral for deposit of public funds.

Federal law imposes certain limitations on collateral agreements between financial institutions and public entities in order to secure public entity deposits. Under certain circumstances, the Federal Deposit Insurance Corporation (FDIC) may void a perfected security interest and leave the public depositor with only the right to share with other creditors in the pro rata distribution of the assets of a failed institution.

Recommendation. The Government Finance Officers Association (GFOA) recommends the use of pledging requirements as protection for state or local government's deposits. GFOA encourages state and local governments to establish adequate and efficient administrative systems to maintain such pledged collateral, including state or locally administered collateral pledging or collateral pools. To accomplish these goals, GFOA recommends the following:

1. Public entities should implement programs of prudent risk control. Such programs could include a formal depository risk policy, credit analysis, and use of fully secured investments. In the absence of a state program for pooling collateral, public entities should establish and implement collateralization procedures, including procedures to monitor their collateral positions. Monitoring informs a public entity of undercollateralization, which may threaten the safety of an entity's deposits, and overcollateralization, which may increase the cost of banking services.

2. State and local government depositors should take all possible actions to comply with federal requirements in order to ensure that their security interests in collateral pledged to secure deposits are enforceable against the receiver of a failed financial institution. Federal law provides that a depositor's security agreement, which tends to diminish or defeat the interest of the FDIC in an asset acquired by it as receiver of an insured depository, shall not be valid against the FDIC unless the agreement:

   - is in writing;
   - was approved by the board of directors of the depository or its loan committee; and
   - has been, continuously, from the time of its execution, an official record of the depository institution.

3. Public entities should have all pledged collateral held at an independent third-party institution, and evidenced by a written agreement in an effort to satisfy the Uniform Commercial Code (UCC) requirement for control. The UCC states that the depositor does not have a perfected interest in a security unless the depositor controls it. Control means that swaps, sales, and transfers cannot occur without the depositor's written approval.

   - The value of the pledged collateral should be marked to market monthly, or more frequently depending on the volatility of the collateral pledged. If state statute does not dictate a minimum margin level for collateral based on deposit levels (e.g., Georgia and Minnesota statutes require 110 percent), the margin levels should be at least 102 percent, depending on the liquidity and volatility of the collateral pledged. State statutes also govern whether minimum margin levels apply to principal only or to accrued interest as well. Public entities should review applicable state statutes and confirm compliance.

- Substitutions of collateral should meet the requirements of the collateral agreement, be approved in writing prior to release, and the collateral should not be released until the replacement collateral has been received.

4. The pledge of collateral should comply with the investment policy or state statute, whichever is more restrictive.

5. Public entities that use surety bonds in lieu of collateral should limit the insurers to those of the highest credit quality as determined by a nationally recognized insurance rating agency.

6. The public entity should review the terms and conditions of any letters of credit, including those issued by a federal agency or government sponsored enterprise.

Note: As a result of the court case North Arkansas Medical Center v. Barrett, 963 F.2d 780 (8th Cir. 1992), the FDIC issued a policy statement in March 1993 indicating that it would not seek to void a security interest of a federal, state, or local government entity solely because the security agreement did not comply with the contemporaneous execution requirement set forth in Section 13(e) of the Federal Deposit Insurance Act 12 U.S.C.1823(e). The policy statement was officially enacted by Section 317 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Public Law 103-325).

References

- Sample Security Agreement (long and short forms), GFOA, 2001.
- Sample Custodial Trust Agreement, GFOA, 1995.
- *Investing Public Funds*, Second Edition, Girard Miller with M. Corinne Larson and W. Paul Zorn, GFOA, 1998.
- *An Introduction to Collateralizing Public Deposits for State and Local Governments, Second Edition,* M. Corinne Larson, GFOA, 2006.

Approved by the GFOA's Executive Board, October 23, 2007.

ARVEST®

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PAUL L.
JOHN T.

July 21, 2011

Mr. Richard A. Weiss, Director
Arkansas Department of Finance and Administration
1509 West 7th Street
Little Rock, Arkansas 72201

COMMENTS ON PROPOSED RULE 2011-1: MANAGEMENT OF CASH FUNDS

Dear Mr. Weiss:

Please accept this letter as our comments regarding the proposal rule to be issued by the Arkansas State Board of Finance.

Arvest Bank is an Arkansas-chartered commercial bank, supervised by the Arkansas State Bank Department and the Federal Reserve Bank of St. Louis. Arvest Bank had total banking assets of about $11.9 billion at June 30, 2011 and operates 245 retail branches, including 115 in Arkansas.

We recognize the importance of State Agencies having good policy and procedures when exercising stewardship over taxpayer and other state monies. Standard guidelines for use by Agencies should be helpful in managing the risk associated with management of cash funds and in helping financial institutions better know what is expected.

Our comments are set forth in Exhibit 1 attached hereto. Should you have any questions, please do not hesitate to call me at 479-750-1400.

Sincerely,

J. Robert Kelly

J. Robert Kelly
Executive Vice President and
Chief Risk Officer

cc: Ms. Candace Franks, Bank Commissioner
Mr. Ken Hammonds, Arkansas Bankers Association

EXHIBIT 1

ARVEST BANK
COMMENTS ON PROPOSED RULE 2011-1
MANAGEMENT OF CASH FUNDS
ISSUED BY ARKANSAS STATE BOARD OF FINANCE

1. GENERAL OVERVIEW – MINIMUM NUMBER OF BIDS

The proposed rule states that a minimum of four bids should be obtained. It is not clear how to proceed if less than four bids are actually perceived. Presumably the Agency would have some level of discretionary authority to address cases where fewer bids are obtained.

2. GENERAL OVERVIEW – MAXIMUM RATE REDUCTION

The proposed rule states that the interest rate should not be reduced more than 25 basis points for the cost of collateralization or additional services provided. While a fixed adjustment factor may be a useful tool in general for management, we believe the focus should be on the net rate offered by the financial institution. Public funds in their very nature differ from other commercial accounts and "posted rates" often do not apply due to expected amount of deposits, transactional volumes, seasonability and other factors. In short, public fund deposits are usually negotiated based on the totality of the account characteristics and the relationship with the public entity.

We believe a fixed adjustment factor could be difficult to enforce in reality and possibly dissuade some financial institutions from bidding on funds.

3. AUTHORIZED INVESTMENTS – SAFEKEEPING

The proposed rule states that "... all noncash investment instruments must be held in safekeeping by the financial institutions with whom the investment was made".

We are not clear as to what this means. It is not uncommon to purchase an investment security through a broker or other since and have the instrument delivered to a central safe keeper independent of the broker who sold the security.

4. COLLATERALIZATION – OPTION A – INVESTMENTS NOT INCLUDED

Item (b) in Option A allows Agency Securities backed by the full faith and credit of the U.S. Government to be acceptable at collateralization with a 103% margin. However, securities of government-sponsored enterprises ("GSEs") are not listed at all. Further, Sub-item 3 actually discourages use of any securities as collateral other than those listed in sub-item 2.

A.C.A. 19-8-203 (a)(1) specifically allows an Agency to accept as collateral any investment in which a bank may invest pursuant to A.C.A. 23-47-401. This statute allows Arkansas banks to invest in GSES (as well as other securities).

Note that the "full faith and credit" requirement in sub-item (b) is very restrictive and would greatly limit eligible collateral. In today's markets, it is not uncommon for banks to hold very small amounts of U.S. Treasury securities due to the very low yields which subjects the bank to significant risk of valuation depreciation should interest rates increase. As a result, many banks have made greater use of GSEs and other highly liquid securities that have greater yields and much less exposure to loss from rising interest rates.

Furthermore, the 130% margin requirement stated in Sub-item 3, in our view, is excessive and not reflective of the high degree of liquidity GSEs and certain other bank-eligible securities possess.

We believe the proposed rule should make clear that any investment that Arkansas law allows an Arkansas-charted bank to carry on its balance sheet be allowable as collected for public deposits. To not allow use of GSEs or other bank-eligible investments may unnecessarily and significantly restrict the available securities eligible as collected, thus, lessening competition for public funds deposits or result in lower rates offered to compensate for 130% margin requirement.

5. COLLATERALIZATION – MONTHLY REPORT AT NO CHARGE

Sub-item 4 under this section states that the financial institution shall provide a monthly collateral report at no charge.

Just as for the previous discussion of the "maximum rate reduction", Agencies should consider the net yield on the funds in context of the total service provided. A bank that pays a higher rate but offers account reporting options for a fee, may still offer the higher net rate. To prohibit payment of certain fees for services provided may cause some banks not to bid at all.

6. COLLATERALIZATION – GENERAL

The proposed rule mandates the Agency involved to obtain acceptable collateral for amounts in excess of FDIC insurance limits. While collateral clearly provides added protection, there are also clear costs involved which likely reduces the rate offered.

We recommend Agencies be allowed to waive collateral up to a reasonable dollar amount in situations where bank capital exceeds federal capital standards to be well-capitalized and the Agency believes the net rate offered to be paid compensates the Agency for the lack of collateral. The amount above the FDIC coverage list not required to be collateralized might be set at 1% of bank shareholder's equity not to exceed $10 million.

7. COLLATERALIZATION – CUSTODY OPTIONS

Sub-item 5 sets forth an Option A and an Option B for custodial services.

It is not clear why there is a separation between Option A and Option B. The only apparent difference is that Option A includes "(b)" which adds additional documentation in the event the custodial services are provided by financial institution chartered outside Arkansas.

We suggest restricting this section for clarity and not having two options but rather the guidelines accompanied by the "outside of Arkansas" documentation requirement. We also suggest that the bank bidding on the funds be allowed to provide any needed legal opinion from outside counsel rather than requiring the out of state firm providing custodial services to do so.

8. COLLATERALIZATION – VIOLATION OF AGREEMENT

Sub-item 7 states that "... Any violation" of a Depository Services Agreement or Custodial Services Agreement or " ... any other action or circumstance deemed by an agency to put its funds at risk ..." results in the funds being subject to immediate withdrawal.

We suggest language be added that the Agency may waive the immediate withdrawal for any violation that is ministerial in nature or do not, in the opinion of the Agency, place the funds at greater risk.

9. SECURITY INTERESTS – PERFECTED INTERESTS

The proposed rule requires a perfected interest under UCC rules in the specific securities pledged as collateral.

While this level of interest perfection is certainly more protective to the Agency, it will cause higher cost to provide collateral than use of a pool of securities. The higher cost may discourage some banks from bidding on public funds, especially in light of the 25 basis point "margin rate adjustment" issue previously discussed. Furthermore, a security-level perfected interest would not allow use of commonly available "repo sweep" products which may provide the Agency a better yield than a traditional deposit account while providing a high level of safety.

We recommend that pooled securities be allowed, at least in cases of the more common and liquid securities such as Treasuries, Agencies and the more liquid GSEs.

July 21, 2011

BancorpSouth®

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ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

August 29, 2011

Department of Finance and Administration, Revenue Division
John H. Theis
Ledbetter Building Room 2440
Little Rock, AR 72203-1272

Re: Proposed Rule 2011-1, Management of Cash Funds

Mr. Theis:

Kindly accept this letter in reply to your request for comment as to proposed Rule 2011-1, Agency No. 045.00, as to "Management of Cash Funds." On behalf of BancorpSouth Bank, we appreciate the opportunity to comment on this important matter. In that the proposal raises significant issues and concerns, we thank you in advance for your consideration of our comments.

BancorpSouth Bank, a wholly-owned subsidiary of BancorpSouth, Inc., operates approximately 312 commercial banking, mortgage, insurance, and trust and broker/dealer locations in Alabama, Arkansas, Florida, Louisiana, Mississippi, Tennessee and Texas. From an Arkansas perspective, BancorpSouth's corporate history has a long Arkansas history. BancorpSouth acquired First United Bancshares of El Dorado, Arkansas, in 2000. First United's history in Arkansas goes back two decades before that, with subsidiary banks throughout Arkansas, from El Dorado to Fort Smith and many locations in between, with even greater years of Arkansas business history. BancorpSouth's growth in Arkansas also includes an acquisition of First Federal in Texarkana in late 2000; acquisition in 2001 of Pinnacle Bank in Little Rock; plus the acquisition of American State Bank in the Jonesboro area in 2005.

BancorpSouth's current Arkansas operations consist of over 50 community banks and average total public funds deposits in the State of Arkansas of over $200,000,000. As can be seen, BancorpSouth has continued the long history of First United, Pinnacle, and American State in valuing public funds deposit relationships and desires to continue those efforts. BancorpSouth is therefore currently, and historically has been, an approved bank for public funds and meets all criteria for the Treasurer's Semi-Annual Certification for an Arkansas public funds approved bank.

Initially, we laud the Board for its goal of cash management and funds protection. We therefore readily concur that it is important to protect the principal of public funds while maximizing investment income and minimizing non-interest earning balances. Our institution is an active cash management services organization through its Treasury Management Division and offers and can offer to agencies of the State of Arkansas cash management products and services to meet these worthy goals.

That said, as we trust you can appreciate, the issues which warrant our comments for your consideration primarily concern Section E, Collaterization of Cash Funds. We urge you to revisit the proposal in this regard, believe these issues are not solely ones for the financial institution industry (and certainly not for just BancorpSouth), as we earnestly believe that the proposed changes, while lofty and appropriate in their goals, will create additional burden and expense to the very entities which the proposal endeavors to protect.

Specific concerns include:

Issue 1: The required coverage of 120% of cash funds on deposit for Arkansas municipal bonds in paragraph E, 2, (c) – (g) will be counterproductive to the protection intended. A 120% requirement will result in less demand for Arkansas municipal bonds causing Arkansas municipal borrowing costs to rise. Also, due to the higher pledging requirements, depository institutions will either be forced to offer no interest, or if offering interest, only able to pay lower interest rates for public funds and/or charge higher fees for the services they provide. The 120% requirement also places too large of a burden on many of the same depository institutions that provide financing for Arkansas municipal projects. We would ask you to note that your contiguous sister states of Texas and Louisiana have required coverage of 100% of cash funds. We therefore believe that a collateral requirement of 103% for all acceptable securities would be appropriate.

Issue 2: While as stated above, we believe a collateral requirement of 103% is appropriate, we likewise believe that this 103% level is appropriate for *all* acceptable securities. From an acceptable securities standpoint, we note that Paragraph E, 2 does not include debt instruments issued by Government Sponsored Enterprises (i.e., Federal Home Loan Bank, Federal Farm Credit Bank, TVA, Ginnie Mae, Freddie Mac, Fannie Mae, Farmer Mac, and Sallie Mae) as acceptable collateral. We trust this is not your intent, as these otherwise appropriate and safe investment vehicles would fall under the very high 130% coverage requirement in Paragraph 3.

A primary driver of the safety and soundness of financial institutions and their income producing capacity involves interest rate spreads. With historically low interest rates, the need to have otherwise safe, secure, and highly rated investments in their investment portfolio in this current environment results in savvy institutions such as BancorpSouth simply not currently holding a large inventory of U.S. Treasury notes and bonds. Thus, by carving out GSEs, the rule will unduly restrict and greatly limit our bank's ability to potentially provide sufficient collateral. We therefore urge Paragraph E, 2 to be amended to include GSEs. Otherwise, requiring such a large additional percent of coverage for GSEs than Arkansas municipals strikes an uneven balance in comparing these otherwise comparable investments.

We also appreciate the power of the Board related to rule-making, but with the utmost respect, believe that such rule-making cannot constitute the equivalent of legislative action, nor override existing legislation. We therefore are concerned that the proposal attempts by rule to usurp the domain of the Legislature, i.e., Arkansas Code Annotated §§ 19-8-203 and 23-47-208. We therefore urge an amendment to Paragraph E,2 accordingly.

Issue 3: Rather than assist the goals intended by the proposed rule, the substitution of collateral rule in paragraph E, 6 would actually hinder a depository institution's ability to manage its portfolio. The fluid nature of an institution's portfolio is currently addressed by the Federal Reserve, who has an automated system that allows new securities to be assigned to entities during any banking day based upon the deposit levels of that entity. Interjecting prior written consent would certainly slow down, if not negate, the technological advances and pluses occasioned by this automated system, which in and of itself serves as an efficient process to protect public depositories.

As such, the requirement to have written approval prior to substituting collateral fails to take into account this fluid nature of a depository institution's bond portfolio. Depository institutions will be constrained from normal trading activities due to the requirement of prior written approval. As a result, depository institutions will pay lower interest rates for public funds and charge higher fees for the services they provide.

Issue 4: The security interest perfection requirements, as well as the concept of a custodial agreement and depository agreement contemplated by Paragraph F are beyond usual and customary procedures for a public funds deposit concept in a very important area: the process established by the Federal Reserve Bank. As noted above, the Federal Reserve Bank conveniently holds securities and acknowledges pledges, but we know of no circumstance where the Fed has been requested to execute an actual agreement in any of the other seven states wherein we do business, nor would we expect the Fed to do so for the State of Arkansas. With such a recognized process, this would potentially eliminate the Fed as the most common and easily available source for holding securities. This in turn would leave only private entities and/or other institutions' trust departments as providers with resultant extra burden and expense arising therefrom. We therefore urge that the Federal Reserve Bank be carved out from the actual requirement of custodial agreement execution and let the recognized process with the Fed, which is common practice in Arkansas, continue. [Notwithstanding no executed document with the Fed, in an unlikely event of failure and a need to call on securities, we know of no historical instance wherein the Fed has ever failed to recognize the securities it shows on its system as pledged and linked to a particular governmental agency for public funds, therefore no loss has ever been suffered to our knowledge by utilization of the Federal Reserve System.]

Issue 5: Related to issue 4, collateral reports are currently provided by a Federal Reserve Bank, yet they do not currently provide market values. The requirement in paragraph E, 4 to provide each depositor a monthly statement containing the market value would place an additional burden on the depository institution or require the depository institution to use another custodian that will surely charge higher fees. These additional fees would result in higher fees charged to the depositor and lower rates paid on the deposited funds.

Issue 6: Due to maturities, calls, and sales of securities, the requirement in paragraph F, 2, (b, 2) to identify specific collateral in the depository collateral agreement is unnecessarily burdensome. As mentioned in Issue 3 above, this requirement ignores the fluid nature of the depository institution's bond portfolio.

Issue 7: Trusting that the Federal Reserve Bank will be a recognized exception to the custodial agreement concept, for those instances wherein a custodial agreement requirement will remain, requiring a specific form could cause unnecessary delays when financial institutions, be it their trust departments or otherwise, are required to be outside their normal concepts and agreements, and instead utilize someone else's standard form. This could result in extra expense, and certainly will require heightened due diligence by trust departments or other custodial servicers, and resultant extra fees, time, delays and expense.

Issue 8: Again, with a Federal Reserve carve-out, the basic concept of a custodial agreement that acknowledges the pledge, assures that same will be honored and honored timely, is appropriate. Yet adding thereto concepts of Uniform Commercial Code perfection, without parameters of specificity and with overbroad definitions, i.e., "proceeds," investments, and the like, make the pledging concepts more convoluted than necessary, potentially overlapping and serving to potentially add priority issues unnecessarily, only solved by having specific pledges of specific securities for specific amounts only. We therefore urge you to abandon concepts of UCC-type perfection and focus solely (with an appropriate carve-out of the Fed) of more tailor-made, security specific, custodial arrangements for private entity/trust department relationships.

Issue 9: While listed herein as a separate issue, this comment is one important example of how Issue 7 needs to be revisited substantially as to custodial agreement terms and conditions. As a critical example, the requirement in paragraph F, 3, (b, 8 & 10) for the depository institution to maintain the custodial agreement until the agency provides a written termination request is unreasonable. If the depository institution requests the termination of the agreement, there should be a timeframe within which the depositor would be required to respond. If not, this rule would require that the depository institution continue to pay custodial fees simply due to a lack of a response by the depositor.

In conclusion, we thank you in advance for considering the issues we have identified with the proposed rule. We believe the issues we have identified will have negative consequences in the form of lower demand for Arkansas municipal bonds and reduced appetite for depository institutions to hold Arkansas public funds. We therefore urge a rewrite or resubmission to address these important concerns.

Alternatively, we believe the otherwise appropriate goals of your efforts can be addressed by other means, such as via concepts of a collateral pool. In the BancorpSouth footprint, other states have adopted collateral pool arrangements. These serve as "win win" situations for governmental entities, regulatory agencies, financial institutions, and custodial parties alike; while more importantly serving as reasonable, least burdensome, and more than adequate protection for the most important constituency, the tax payers. In that representatives of BancorpSouth have been intricately involved in the development of collateral approval concepts in other jurisdictions, we welcome that opportunity to present these concepts to you at an appropriate time. Otherwise, if you would like to address our concerns expressed in this letter directly, please do not hesitate to give me a call me at (662) 680-2136.

Sincerely,

Fred G. Keen

Fred G. Keen
First Vice President
BancorpSouth Bank

Bank of Prescott

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AUG 19 2011
ASSISTANT REVENUE COMMISSIONER
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August 15, 2011

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

RE: Proposed Rule 2011-1 in regards to Management of Cash Funds

Dear Mr. Theis:

It is my hope and desire that under this proposed rule Bank of Prescott will be able to continue to use the safekeeping services of Arkansas Bankers Bank of Little Rock (ABB) and the Federal Home Loan Bank of Dallas.

We have done business with Arkansas Bankers Bank for many years with ABB providing us excellent service and we do ninety percent (90%) of our safekeeping with ABB.

We do the rest of our safekeeping with the Federal Home Loan Bank of Dallas as they require us to pledge and safekeep a equal amount of securities with them for the Home Loan Bank advances we acquire from time to time to the benefit of small business in the Prescott trade area.

In addition, I believe the 105% collateralization rule is adequate for US Treasury obligations, agencies of the United States, and Arkansas municipal bonds.

I trust that the State Board of Finance will delve into the details of this proposed regulation to see the real impact for community banks in the state before making a final ruling in this matter. I will be glad to discuss this should the need arise and I am called on to do so. Thank you.

Sincerely,

John Brannan, Jr.
President

BANK of the OZARKS®

August 29, 2011

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POLICY & LEGAL

John H. Theis, DFA Revenue Division
Ledbetter Building Room 2440
P.O. Box 127
Little Rock, AR 72203-1272

Dear Mr. Theis,

Bank of the Ozarks (Bank) serves the banking needs of many State agencies as a trusted partner. Recently, we completed a thorough review of the *Rule for Management of Cash Funds* proposed by the Arkansas State Board of Finance (Board). We identified changes that will negatively impact banking services we provide to various State agencies.

Specifically, our concern relates to changes proposed in Section E, *Collateralization of Cash Funds*. The proposed increase in the fair value of pledged collateral, in both Option A and B, for Arkansas municipal bonds seems unfounded and unnecessary. One of the primary risks that can impact the fair value of pledged collateral is credit risk. Credit risk is the risk that an issuer will not be able to repay the bonds as agreed. The State of Arkansas currently holds a "AA" rating from *Standard & Poor's* and a "Aa3" rating from *Moody's*. The historical default rate for all municipal bonds with those ratings is 0.01%. Effectively, a zero percent default rate, which is the same as a United States government bond. Requiring a 120% fair value collateral pledge in comparison to the 103% requirement for a government backed bond appears overly cautious. We believe that a pledge of 105% of the fair value of municipal bonds backed by the full faith and credit of the State of Arkansas, including but not limited to, Arkansas School District Bonds, Arkansas General Obligation Bonds or bonds of other Arkansas Political Subdivisions, is sufficient.

Our Bank often buys or sells bonds to reduce the exposure of not only credit risk, but interest rate risk and market risk. These decisions are often part of an overall strategy to strengthen the Bank's balance sheet. It would be unfortunate if changes to the pledge requirements were enacted that limited the amount of State agency deposits the Bank could hold while executing needed strategies. This seems unnecessary given the previously discussed low loss profile of these high-quality Arkansas bonds.

An alternative the Bank would support is the establishment of a graded collateral requirement using the financial strength of each institution. In this scenario, the banks with more financial strength could pledge bonds at a lower collateral coverage. This alternative is beneficial for two reasons: i) it would provide more transparency regarding the financial strength of the bank in which an agency chooses to deposit funds. Of course, the goal of collateralizing deposits is protection against bank failure and a grading system would help identify potential financial institution risk, and ii) the system does not force an institution to pick between an optimal investment strategy and holding State agency deposits.

As the Board continues to make important decisions regarding the collateralization of agency funds, we ask that you consider our comments and the impact that the proposed changes will have on all parties.

Please feel free to contact me for further discussion and thank you for your time and consideration.

Sincerely,

Lisa Guerra

Lisa Guerra
Vice President Public Funds

cc: Ken Hammonds

Bank of America

August 29, 2011

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

Re: Proposed Rule 2011-1, Management of Cash Funds

Dear Mr. Theis:

On behalf of Bank of America, N.A. (the "Bank"), I appreciate the opportunity to provide the Bank's comments and suggestions with respect to Proposed Rule 2011-1, Management of Cash Funds (the "Rule"), of the Arkansas State Board of Finance (the "Board"). We understand and appreciate the necessity of the Board providing clear guidance concerning this matter, and hope our comments will be helpful to the Board.

Applicability to all public funds. In the introductory paragraph, the Rule refers to "agencies of the State of Arkansas" and there are references throughout the Rule to "state agencies" and "agency". Since the Rule will be equally applicable to almost all public entities in the State, including cities and counties, the Board might consider changes to reflect that fact.

The first sentence of the Rule references Ark. Code Ann. §19-4-401 et seq., which only applies to "cash funds". "Cash funds" are defined as limited only to state agency funds. There are references throughout the Rule to "cash funds". In fact, the Rule would apply to all "public funds", as defined in Ark. Code Ann. §19-8-101. Similarly, there are references in the Rule to state statutes and regulations that only apply to state agencies, and not to cities and counties. For example, Paragraph C. Authorized Accounts, and Paragraph D. Authorized Investments, are not applicable to cities and counties. This lack of precision may be confusing to city and county officials and others who attempt to comply with the Rule.

We would suggest that the language of the entire Rule be reviewed and revised to clarify specifically which public funds are intended to be governed by the Rule, and which statutes are applicable. Our specific comments are set forth below, using the section headings and titles contained in the Rule.

A. GENERAL OVERVIEW. The last sentence of the first paragraph provides, "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." We suggest that this is a market function, not properly subject to an arbitrary limit. We fear that some depositors will treat this guideline as a ceiling or floor, as the case may be, when the proper amount might be higher or lower, depending on the circumstances and market conditions.

The General Overview also directs that public funds be deposited into interest bearing accounts "whenever possible". In the current rate environment, the depositor in many cases can receive a larger return through a non-interest bearing deposit account, with an associated earnings credit that can be used to offset fees. The earnings credit granted by the depository bank is often set at a level higher than current interest rates, which would result in a greater net return to the depositor as fees are offset.

B. MANAGEMENT AND INVESTMENT OF CASH FUNDS. This section of the Rule provides that "cash funds" may only be deposited in financial institutions certified by the State Treasurer. This is in direct conflict with Ark. Code Ann. §19-8-104 and Ark. Code Ann. §19-8-105, which provide that "public funds" must be deposited in financial institutions contained in the list prepared and distributed by the State Bank Commissioner.

As a practical matter, it is our understanding that the list of institutions certified by the State Treasurer contains only those institutions choosing to participate in the State Certificate of Deposit Program, which is not relevant to the purpose of the Rule. While this list currently does include the Bank, we understand that many Arkansas financial institutions do not elect to participate.

Finally, the last sentence of this section provides, "An agency should not deposit funds with a bank or financial institution if it would cause public funds on deposit to exceed the capital of the bank or financial institution. Again, while this would not be an issue to the Bank, it is in direct conflict with Ark. Code Ann. §19-8-105, which contains a different restriction on the amount of deposits.

E. COLLATERALIZATION OF CASH FUNDS. This is the Section of the proposed Rule that raises the most serious questions for the Bank.

1. This Section, while acknowledging that Ark. Code Ann. §19-8-203 prescribes the types of lawful deposit collateral, narrows the permissible deposit collateral significantly beyond what the General Assembly has deemed necessary. Similarly, Section 3 strongly discourages the use of any investments which, while lawful, are not on the list approved by the Board. As a practical matter, public bodies and financial institutions are likely to view the Board's suggestion as mandatory. It could be argued that this is an overreaching on the part of the Board, in contravention of the applicable State Statute.

2. Section 2 contains the list of Board approved deposit collateral and the required collateral margin levels. The list contained in the Rule no longer contains Fannie Mae and Freddie Mac securities. These are probably the most common types of deposit collateral currently utilized by the Bank and other financial institutions nationwide. We know of no other State that prohibits them. The elimination is confusing, given that Ginnie Mae securities, which are given identical investment ratings by S&P, Moody's and Fitch, are permitted. Further, it is hard to understand the rationale of allowing public bodies to invest directly in these investments, which they can do under Arkansas law, while discouraging their use as collateral for deposits. There is currently a shortage of available collateral in the market, and this change could create significant challenges for banks willing to accept public deposits.

We encourage the Board not to change the current rule permitting the use of Fannie Mae and Freddie Mac securities, at a collateral margin level similar to Ginnie Mae securities.

5. Subparagraph (a) of this section prescribes the permissible financial institutions which may serve as custodian of the investments. It prohibits out-of-state institutions from participating. We believe there might be serious questions as to whether or not such an outright prohibition is lawful under federal banking laws and the United States Constitution, but regardless of any legal implications, we question the purpose of this exclusion. There are several national financial institutions which are engaged in this business and which are not "primarily located within" Arkansas. Many Arkansas public bodies are currently utilizing custodians which would become

disqualified under the proposed Rule, thus disrupting longstanding and successful relationships. The size and sophistication of some are such that they are able to provide a whole range of services to the public bodies that are not available at the Federal Reserve and with smaller banks. For example, many of these institutions mark to market daily, thus providing the public body with a much more accurate valuation of the collateral. Many large public depositors have significant amounts of cash moving in and out of their accounts on a daily basis. Some of the non-Arkansas based custodians have developed systems with the depository banks that monitor the balances of public fund deposits and increase or decrease(pursuant to strict rules contained in the custodial services agreement) to match the market value of the pledged collateral to the uninsured deposit balances of the public entity. These more automated collateral management processes can also require the custodian to ensure that only eligible collateral, as defined by the public fund depositor in the Custodial Agreement, be used by the pledging bank. The Federal Reserve Bank, on the other hand, will not assume this responsibility and it falls to the public entity to monitor the pledging activity of the depository bank.

While some public fund depositors may not want these enhanced services, they should remain as an available option for those that would opt for the benefit of more automated, monitored and responsive collateral systems.

F. SECURITY INTEREST.

The first sentence of this Paragraph provides, "The financial institution with whom cash funds have been deposited is responsible for perfecting the agency's security interest in the collateral pledged …". Actually, it is the public entity's responsibility to perfect its security interest, and it should be. It is not appropriate to place the responsibility of perfection of a security interest in the hands of the entity against whom the security interest is granted. The manner of perfection of security interests in public deposit collateral, and the required procedures in relation thereto, are set forth in 12 U. S. C. §1823(e), enacted as part of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"). Much of Paragraph F is essentially a confusing and in some cases incorrect summary of the requirements of FIRREA and several different applicable state statutes.

Paragraph F would require the use of specific forms of Depository Resolution, Depository Collateral Agreement and Custodial Services Agreement prepared by the Board. While the plain language of the Rule would make use of such forms discretionary, as a practical matter they will be treated by public bodies as mandatory. We are concerned that the draft documents, which were provided with the proposed Rule, lack sufficient flexibility and comprehensiveness necessary to accomplish the purposes for which they are intended. In addition, the forms provided by the Board are different from, and in some instances conflict with, the forms currently approved by the Arkansas State Treasurer for use in connection with deposit accounts of state agencies. We do not believe it was the intent of the Board to implement a system where state agencies, counties and municipalities are required to use specific, yet differing forms.

The only applicable statute, Ark. Code Ann. §19-8-107, provides that "All county and municipal depository agreements shall be entered into using standardized forms provided by the State Board of Finance." With respect to the form of Depository Collateral Agreement provided by the Board, Section 2 of that agreement is particularly troublesome and confusing. Section 2.2 and Section 2.3 of the form document require that securities be delivered to the public depositor, or registered in the public depositor as registered owner. The public depositor is not the owner of the securities: they are assets of the depository institution until such time as the depository institution is in default. It is not proper for the public depositor to assume the attributes of an owner absent a default or failure on the part of the depository institution. Perhaps the Board intended this Section to only be applicable in the event of a failure by the depository institution. If so, we ask that the Board make that clear.

There is no similar statutory requirement of standardized forms with respect to the form of the Depository Resolution or the Custodial Services Agreement. Most financial institutions have internal requirements relating to authorizing resolutions which might, or might not, be satisfied by the form suggested by the Board.

Particularly problematic is the form of Custodial Services Agreement provided by the Board. With respect to the Federal Reserve, compliance is impossible: they will not sign it. The Federal Reserve has its own, different form and will not execute anything else. In addition, should the Board reconsider its exclusion of non-Arkansas based institutions and allow the public bodies to utilize the more comprehensive services available, the prescribed form would be inadequate to address all of the features that would be provided. The applicable statutes, the Rule, and federal banking law clearly prescribe the necessity of a custodial agreement and the requirements which must be contained therein. We believe it would be preferable for the Board to permit these agreements to be negotiated and tailored to fit the needs of the particular depositor, within the statutory and regulatory requirements.

Finally, it is not clear from the Rule and from the form of the Custodial Services Agreement whether or not collateral can be substituted without amending the Agreement. Specifically Subsections b.(2) and b.(4) of the Rule make the ability to substitute collateral without amendment questionable. In order for the custodial arrangement to function properly, the parties must have the ability to add, remove and substitute collateral, within the legally prescribed parameters, with a minimum of time and effort. We urge the Board to reconsider these sections and the form of the Custodial Services Agreement with this concern in mind.

Given the inherent complexities of applicable state and federal banking laws, and the various individual needs of the affected public depositors, we suggest that the Board rewrite and simplify Paragraph F, both to avoid conflicts with applicable law and to provide sufficient flexibility to the particular depositors. We would suggest that the Board simply require the depositors to secure the deposits and perfect their liens in accordance with FIRREA, then refer depositors to the GFOA forms and provide a link to the GFOA website.

We thank you for giving us the opportunity to provide our views and suggestions with respect to the proposed Rule. We would be happy to visit with you or any other public officials to discuss these matters further.

Cordially yours,

Bank of America, N.A.

Donald J. Cook
President, Central Arkansas

cc: Sally Brown
Director and Assistant General Counsel

CITIZENS BANK
Member FDIC

July 12, 2011

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JUL 13 2011
ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

Mr. John Thesis
Assistant Commissioner of Revenue
DFA Revenue Division
Ledbetter Building, Room 2440
P. O. Box 1272
Little Rock, AR 72203-1272

Re: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Thesis:

The proposed changes to the rules governing the collateralization of public funds in Arkansas are a concern to our bank. Like most community banks in Arkansas, we are a depository for public funds, reinvesting them in both loans within our community and in the municipal bonds of the state's municipalities.

A reduction in the pledge value of municipal securities could hamper our ability to accept public deposits that require pledging, and also may reduce demand for the bonds of the state's municipalities.

While we understand the concern for improvement district bonds, we would urge reconsideration of the proposed haircut on the state's public school and general obligation bonds. Historically, these Arkansas bonds have had extremely low failure rates, and hold their value well in times of rising interest rates such that the present 105% of the deposit amount requirement should be adequate.

Any consideration you could give to maintaining the present pledging values for Arkansas' general obligation and public school bonds for collateralization purposes would be appreciated. Thank you.

Sincerely,

John Dews,
President and CEO

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MEMBER FDIC

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

R. E. Management of Cash Funds Proposed Rule- Rule 2011-1

Dear Mr. Theis

It is my understanding that the above proposed rule would prohibit or is likely to prohibit Arkansas Bankers Bank as well as the Federal Reserve and the Federal Home Loan Bank from acting as the safekeeping custodian for securities and or other collateral pledged against public fund deposits. I understand that this may be unintended in the proposed rule but I do think that this must be rectified and clarified so that those entities are able to serve as custodian. This would impose a heavy burden to community banks state wide if we were forced to find another way to provide safekeeping on those securities used as collateral.

The second issue that concerns me with the proposed rule is the idea that "complex" investments should be pledged at a 130% of face value. I believe that the legislature and the public fund owner should be able to dictate what investments are appropriate as well as what level of value is necessary.

I am also concerned about the provision that addresses collateral not guaranteed by the full faith and credit of the United States. Again I am of the opinion that the depositor of the public funds should be able to dictate as to the suitability of the collateral and the valuation.

As I stated before I am concerned about the possible limitation of the use of the Arkansas Bankers Bank as the safekeeping custodian for public agency deposits and the fact that banks who are shareholders might be penalized because of their ownership will cause a large burden to many of Arkansas's community banks. I consider it vital that the Bankers Bank continue to be able to safe keep securities as collateral for public funds.

Thank you for your consideration.

Sincerely

Bruce Timmons

Bruce Timmons
EVP & CFO Delta Trust & Bank

FEDERAL HOME LOAN BANK OF DALLAS

8500 Freeport Parkway South
Irving, Texas
75063-2547

P.O. Box 619026
Dallas, Texas
75261-9026

214-441-8500
fax 214-441-8888
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August 23, 2011

Via Email to: John.Theis@dfa.arkansas.gov

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

Re: Arkansas State Board of Finance Rule 2011-1, Management of Cash Funds

Dear Mr. Theis:

The Federal Home Loan Bank of Dallas ("FHLB Dallas") appreciates the opportunity to comment on Arkansas State Board of Finance's (the "Board") proposed changes to the rule governing the management of cash funds (the "Proposed Rule"). This letter does not necessarily reflect the views of any other FHLBank.

FHLB Dallas is one of twelve Federal Home Loan Banks (each, individually, an "FHLBank" and collectively, the "FHLBanks") that Congress created in 1932 through the Federal Home Loan Bank Act. Each FHLBank is a cooperative and is owned by its member financial institutions. Entities eligible for membership in an FHLBank include federally-insured commercial banks, savings banks, savings and loan associations, and credit unions, as well as insurance companies and community development financial institutions.

FHLB Dallas provides its members with a variety of safekeeping services, including, but not limited to, acting as a third-party custodian. FHLB Dallas, acting as a custodian, accepts the receipt of securities from member financial institutions, and allocates or issues custodial standby letters of credit for member financial institutions as collateral for the benefit of third parties. Typically, a member financial institution enters into these types of arrangements to collateralize uninsured deposits that a public or municipal entity has on deposit at such member financial institution.

FHLB Dallas is sensitive to and supportive of the Board's need to protect the security interests of collateral pledged for Cash Funds (as defined in Arkansas Code Annotated Section 19-4-801). Keeping in mind those needs, we believe that the following comments will assist the Board in crafting a final rule that will faithfully and most effectively implement the rules governing the management of Cash Funds.

Approved Custodian

Section E(5) of the Proposed Rule sets forth the requirements that must be met for an entity to serve as a custodian of assets pledged to a State Agency (as defined in Arkansas Code Annotated Section 19-4-801) as collateral for Cash Funds held by a financial institution. Section E(5) provides that the custodian may be (i) a Federal Reserve Bank, (ii) the trust department of a commercial bank, or (iii) a trust company primarily located within the State of Arkansas. In addition to the above, Section E(5) further requires that the custodian be unaffiliated with the financial institution.

Under the current rule, there are no requirements that address whether an entity named as a custodian by a financial institution is an acceptable custodian. For this reason, FHLB Dallas understands that in adding baseline requirements for an entity to serve as custodian, it was the intent of the Board to further protect the public's interest in Cash Funds. However, FHLB Dallas is not a Federal Reserve Bank, a commercial bank, nor is it a trust company. Thus, the Proposed Rule, as written, would preclude FHLB Dallas from having the ability to serve as custodian for its member financial institutions. FHLB Dallas does not think this was the intent of the Board.

FHLB Dallas currently serves in the capacity as custodian for securities pledged to the Arkansas State Treasurer in an amount in excess of $83MM. Under the Proposed Rule, these securities would be required to be transferred to a new custodian that meets the above-referenced requirements. Given the current working relationship with the member financial institutions and the Arkansas State Treasurer, we feel that such a transfer would be unnecessary and would create an undue burden on both the member financial institutions and on the Arkansas State Treasurer. Further, FHLB Dallas understands that in drafting the Proposed Rule, the Board surveyed several other state's statutes and rules concerning the securitization of public funds. For this reason, FHLB Dallas respectfully notes that other states in FHLB Dallas's district have explicitly provided that a federal home loan bank is an approved custodian.[1] The precedent in other states, coupled with the fact that FHLB Dallas is currently serving as the custodian of a significant amount of collateral for Arkansas funds, provides strong support for the modification of Section E(5)(a) to expressly provide that a custodian may be a federal home loan bank.[2]

Custodial Services Agreement

Section F(3)(b) of the Proposed Rule delineates certain provisions that a Custodial Service Agreement must contain to be acceptable for use by a state agency. Specifically, Section F(3)(b)(3) provides the following:

> "The agreement must provide that the custodian is an agent of the agency and will hold the pledged collateral solely for the benefit of the agency."

FHLB Dallas requests that the provision be modified to read as follows:

[1] *See* Texas Government Code, Title 10, Section 2257.041(d)(4) and Louisiana Revised Statute, Title 6, Section 748.1.

[2] The change to Section E(5) for which FHLB Dallas is advocating would also trigger changes to the Board's draft form of Depository Collateral Agreement, specifically Section 3 of the Depository Collateral Agreement.

> "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"

The reason for this request is FHLB Dallas's concern that the use of term "agent", when used alone, will open up the common law floodgates for interpreting a broad agency relationship between the state agency and FHLB Dallas. FHLB Dallas does not think that such an interpretation is the intent of the Board. Accordingly, in an effort to provide clarity and ensure that the agency relationship is one in which FHLB is serving solely in its role as custodian under and pursuant to the Custodial Service Agreement, FHLB Dallas requests the insertion of "custodial" before "agent", as noted above.[3]

If you have any questions or need clarification regarding any of our comments, please let us know. Thank you for your consideration of our comments

Sincerely,

Sandra C. Damholt

Sandra C. Damholt
General Counsel

[3] The change to Section F(3)(b) for which FHLB Dallas is advocating would also trigger changes to the Board's draft form of Custodial Services Agreement, specifically the third paragraph in the recitals.

First Service Bank

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POLICY & LEGAL

August 29, 2011

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

RE: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

We at First Service Bank have several concerns regarding the proposed rule, specifically the prohibition of First National Bankers' Bank, Arkansas Region (formerly Arkansas Bankers' Bank) from being a custodian for safekeeping of pledged assets, the changes to the amount of coverage required for certain public deposits, and the prohibition of using First National Bankers' Bank (FNBB) as a custodian if we are considered "affiliated" with the safekeeping custodian.

We currently utilize FNBB as a safekeeping custodian for a significant portion of our pledged assets. We also pledge assets to Federal Home Loan Bank and the Federal Reserve Bank; however, FNBB comprises over 1/3 of our custodian services with a very small portion to the Federal Reserve Bank. It would be an undue burden on our institution to shift that amount of pledged assets to another custodian if we were unable to use FNBB. We are very satisfied with the customer service of the FNBB safekeeping department. They are knowledgeable, friendly, and professional, and we are confident in their abilities to serve as a safekeeping custodian for our bank. This portion of the rule-making may have been unintended, but it is important that we address this issue before the final ruling.

Second, the proposed rule outlines two options for amending the amounts of collateral required for public deposits. We feel that both options would be inappropriate considering the following:

- The legislature decides the list of eligible securities that can be purchased by a state-chartered bank and to what extent of pledging is required. The public depositor has its own discretion regarding the suitability of the collateral and does

www.1stservicebank.com

LOCATIONS				PHONE	FAX	24HR TELE.BANKER
CLINTON	P.O. Box1589	486 Hwy 65 North	Clinton, AR 72031	501-745-7200	501-745-7454	501-745-7949
DERMOTT	P.O. Box 800	114 East Peddicord	Dermott, AR 71638	870-538-3221	870-538-3246	870-538-3500
FLIPPIN	P.O. Box 1086	311 North First	Flippin, AR 72634	870-453-7300	870-453-7301	870-453-7332
GREENBRIER	P.O. Box 190	134 Broadview	Greenbrier, AR 72058	501-679-7300	501-679-6461	501-679-3200
MARSHALL	P.O. Box 858	500 Highway 65	Marshall, AR 72650	870-448-2100	870-448-2030	870-448-3100
MOUNTAIN VIEW	P.O. Box 1106	410 Sylamore	Mountain View, AR 72560	870-269-7200	870-269-7211	870-269-7249
SHIRLEY		9667 Hwy 16 E, Ste 4	Shirley, AR 72153	501-723-7200	501-723-7250	
YELLVILLE	P.O. Box 966	Highway 62/412 E.	Yellville, AR 72687	870-449-7300	870-449-7301	870-449-7333

not have to accept it or can negotiate the coverage amount. Most public depositors mirror the State for appropriate guidance for coverage, which is currently 105% for all security types. The State Board of Finance is attempting to limit the legislature's authority by strongly discouraging the use of any security not listed in the proposed rule because they "may require highly specialized technical skill" in determining risk issues. If the depositor accepts the security, then it would be required to pledge 130% instead. This additional premium, we believe, may cause our public depositors to seek pledging elsewhere and even out of state as we may be unable to provide a sufficient return to the public depositor.

- It is unclear why it would be permissible in the proposed rule for public depositors to directly invest in the same securities that the State Board of Finance deems too risky for them to accept as collateral. If these securities are deemed too complex to serve as collateral to a public depositor, why is the same rule sanctioning the direct investment of the same security by the same political subdivision?

- Since the collateral is monitored monthly and most political subdivisions have looked to the State for accepting 105% of public deposits, it seems impractical to require additional collateral with certain types of securities. That would make the process more complex in nature.

Finally, the proposed rule states that a custodian must be "unaffiliated" with the depository financial institution. Considering that the safekeeping department of FNBB is a separate department of the bank, and FNBB is highly regulated, ownership issues should not be taken into account in this ruling. Our bank would be required to look for a new safekeeping custodian even though we own less than 1% of FNBB stock.

Thank you for the opportunity to present these comments in regards to the proposed rule.

Sincerely,

Tom Grumbles, President/CEO
First Service Bank

LIBERTYBANK
OF ARKANSAS

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August 15, 2011

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

Re: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

I am very much opposed to the proposed rule for many reasons. First of all, we keep most all of our securities at Arkansas Bankers Bank and under the proposed Rule they would be prohibited from serving as a safekeeping custodian. It would be a great inconvenience and costly to move the securities and hire someone else to serve in this capacity.

We see no need to increase the collateral coverage of securities that are not U.S. Treasury securities from 105 percent to 120 percent. This will put an additional expense on Community banks.

Sincerely,

Roy Reaves

Roy Reaves
Chairman and CEO, Central Division

RR/hw

Logan County Bank

Scranton Branch
600 Main St. P.O. Box 85
Scranton, Arkansas 72863
Tel. No. 479/938-2511
Fax No. 479/938-7084

Subiaco Branch
57 E. St. Hwy. 197
Subiaco, Arkansas 72865
Tel. No. 479/934-4203
Fax No. 479/934-4623

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August 31, 2011

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

Dear Mr. Theis:

Re: Management of Cash Funds Proposed Rule 2011-1

I work at Logan County Bank, a small community bank in Logan County, AR. We are being faced with more and more complex rules and regulations, which quite frankly is becoming more and more costly. So when I reviewed the above proposed rule, I found several items of concern.

Currently, the Arkansas Office of Treasurer only requires collateral pledged at 105% of the fair market value for any deposits not covered by FDIC insurance. We feel this is sufficient as the market value of the security is updated monthly. The value of a security should not change drastically in one month without some warning. If there is a big decline for some reason, we can replace that security with another. When we purchase an Arkansas bond, we pay at least 100% for the bond. Having to pledge 120-130% of that same bond to a state agency seems unfair.

Arkansas Bankers' Bank (now First National Bankers Bank) has been the safekeeping custodian for our investment securities for several years. They have a good relationship with both the agency the bonds are being pledged to and the bank pledging the securities. We own only a small amount of stock in First National Bankers Bank. Since it is not enough to significantly impact any decisions in the operation of First National Bankers' Bank, we feel we should be able to continue using them as a safekeeping custodian for bonds pledged to a state agency. Why do we need to change something that has been working well for years for both us and the state agency?

Please consider revising the proposal to make pledging to state agencies more convenient and fair for small banks who invest in many Arkansas State school district and municipal bonds. Thanks for taking the time to read my comments.

Sincerely,

Jane Scrivner

Jane Scrivner
Loan Officer

js

Merchants & Farmers
BANK OF DUMAS
Member F.D.I.C.

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August 23, 2011

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

Re: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

This letter is in reference to the State Finance Board's proposed amended Management for Cash Funds rule, proposed Rule 2011-1. Merchants and Farmers Bank has the following issues with the proposed rule:

1. The main issue would be our interpretation that the proposed rule would prohibit First National Bankers Bank, Arkansas Region (until March 31, 2011, Arkansas Bankers' Bank) from serving as a safekeeping custodian for pledged public agency deposits. Merchants and Farmers Bank has used Arkansas Bankers Bank's safekeeping custodian service over the last fourteen (14) years. We have been pleased and very satisfied with ABB's expertise in handling this service for us. We understand that Arkansas Bankers' Bank is the largest safekeeping custodian in the state, and an abrupt prohibition from ABB serving as a safekeeping custodian for pledged public agency deposits would, we believe, not be in the best interest for our bank, and for other Arkansas banks who have counted on their years of experience.

2. The next issue has to do with collateral being placed for safekeeping with a custodian that is "unaffiliated" with the financial institution. Merchants and Farmers Bank is affiliated with Arkansas Bankers Bank, First National Bankers Bank, Arkansas Region (since March 31,2011) as a stockholder and thus would prohibit us from using their safekeeping custodian services when public agency deposits are involved. We understand from First National Bankers Bank, Arkansas Bankers Bank, that one-half of the banks in Arkansas fit this scenario. We believe that such a de minimis ownership percentage as Arkansas banks have in no way places the current safekeeping practice in jeopardy.

3. The legislature dictates what investments are allowed for pledging purposes, subject to the public body agreeing to such. The proposed revised rule attempts to circumvent the legislature's authority by deeming certain investments as "complex" and thus requiring 130% coverage. We believe the legislature and the public body requiring collateral is best suited in determining what is appropriate as collateral.

4. The proposed revised rule dictates that collateral coverage for investments not guaranteed by the full faith and credit of the United States will be 120%. We understand the Treasurer's Office only requires 105%. We believe with the required monthly fair market value reporting, 105% is sufficient.

We ask that you take these comments under consideration concerning the proposed rule changes. Please do not hesitate to contact me at (870)382-4311 if you should have any questions concerning our comments.

Sincerely,

Ashton Adcock

Ashton Adcock
Chairman of Board/Chief Financial Officer

Metropolitan National Bank

P.O. Box 8010
Little Rock, Arkansas 72203
(501) 377-7600

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ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

August 31, 2011

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

RE: Management of Cash Funds Proposed Rule; Rule 2011-1

Dear Mr. Theis:

Metropolitan National Bank appreciates the opportunity to present comments regarding the Management of Cash Funds Proposed Rule 2011-1. We have reviewed the proposed rule and there are several items that we would like to address.

Currently, the types of eligible securities that are allowed as collateral are listed under Ark. Code Ann. 19-8-203. Under the proposed rule Section E(3), the State Board of Finance, "strongly discourages use of any bank investment assets allowed by Ark. Code Ann 19-8-203 other than those listed in paragraph 2 of this section." Banks have relied on this statute when determining the types of collateral to pledge to our public fund customers and have not been notified that certain types of collateral were "strongly discouraged." If there are certain types of securities that should not be used as collateral, then the statute should be changed. State governmental agencies and public entities always have the option to have more restrictive policies as it relates to the types of securities that they will accept as collateral.

The proposed rule under Section E(2), states that securities used as collateral not guaranteed by the full faith and credit of the United States government would require the total fair value of the collateral to be at least 120% of the total amount of cash funds on deposit at the financial institution. Other collateral that is allowed under the statute, but strongly discouraged by the State Board of Finance would have to have a fair value of 130%. The State Treasurer's office currently only requires 105% for all collateral. The 105% level provides protection to the depositor by giving the value over and above the fair market value of the collateral.

Most of the banks in Arkansas currently use the Arkansas Bankers Bank, now First National Bankers Bank, as the custodian for the securities used as collateral for public fund depositors. Metropolitan National Bank, along with many other Arkansas banks, is a shareholder in this institution. Under the proposed rule Section E (5) Option A (d) (2), Metropolitan National Bank could be considered to be "affiliated" because we are a shareholder in the Arkansas Bankers Bank. The proposal states that to be considered "unaffiliated" 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 shares." The phrase could be interpreted to mean that any shareholder in the Arkansas Bankers Bank would be unaffiliated and thus would not be able to use them as a custodian.

Because the Arkansas Bankers Bank (ABB) is chartered in Louisiana, it could be interpreted from the proposed rule that they would be prohibited from serving a safekeeping custodian under Section E(5), Option A . The ABB is the largest safekeeping custodian in the state and has worked with many public fund depositors around the state. If the ABB was not allowed to handle safekeeping functions, it could be prove to be disruptive to many public fund customers and banks alike as they would have to find another custodian to handle these duties.

Under Section E(6), it states that, "collateral shall not be released, substituted or compromised by a financial institution or custodian unless written approval is obtained from the agency to which the collateral was pledged prior to taking such action." Currently, when collateral is substituted no written authority needs to be obtained from the customer. Written approval is only obtained prior to collateral being released, but not when it is substituted. It will be difficult and cumbersome for a bank to obtain written authority in every instance when collateral needs to be substituted. As long as the collateral meets the collateral guidelines of the entity then the bank should be able to substitute without prior written approval.

Another provision under the proposed rule is that public entities must obtain a minimum of four bids from banks in order to earn the highest interest rate on their funds. It is prudent for state agencies to receive bids from several banks in order to compare rates and look for the highest interest rate on their money. Public fund depositors should make a reasonable effort to obtain rates from other banks instead of being forced to get four bids. This could prove to be difficult for entities that operate in smaller markets.

Also, it was stated in Section A that interest rate reductions should not exceed .25% due to collateral requirements for public funds. Banks can chose to bid or not bid on public fund deposits, but should not be given guidelines on interest rates that they should pay on public fund deposits.

Thank you following allowing Metropolitan National Bank to share these comments. If you have any questions, please do not hesitate to contact me at 377-7611.

Sincerely,

John Monroe
Senior Vice President
Business Development

PEOPLES BANK

SHERIDAN, ARKANSAS www.peoplesbankar.com

July 18, 2011

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

Re: State Board of Finance - Management of Cash Funds
Ark. Code Ann. 19-3-101, 19-4-801 et seq. and 25-15-201 et seq.

Dear Mr. Theis,

I have recently received and read a copy of the above proposal in order to re-write how the State of Arkansas manages the return and collateralization of its Cash Funds. I understand that the re-write of all guidelines may not please everyone, but I do take issue with not giving all banks the opportunity for deposits. Regulations that allow only four banks to make bid on State funds may prove to be unfair to those left out of the process plus there is no stipulation on those banks being Arkansas chartered banks, as well.

The types of assets acceptable for pledging and the percentages allowed due to current market values is certainly understandable but again it seems unfair that the State of Arkansas is setting itself up for a 25 basis reduction due to certain collateralization when one would think the bid should automatically adjust for collateral requirements. Would the adjustment mean that possibly some banks would pay a different quoted rate than others due to a different type of collateral pledged? If so that hardly seems fair to the bank that pays a higher rate.

I believe the community banks in the State of Arkansas have always been willing to re-invest its deposits back into our community through loans and the purchase of bond issues. As you know, this provides help to our local economies and the infrastructure of our local governments and schools. The State of Arkansas is no different and should always do the same by spreading funds statewide and making those deposits available to all local banks. I hope my comments prove to be positive help in the formation of final regulations.

Sincerely yours,

John D. Manatt

John D. Manatt
President/CEO

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PBNB

Pine Bluff National Bank

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July 25, 2011

Thank you for the opportunity to comment on the proposed AR State Board of Finance Proposed Rule 2011-1. We appreciate your time in taking into consideration Pine Bluff National Bank's concerns regarding the proposed rule changes.

The proposed rule as recently modified concerns Pine Bluff National Bank as follows:

1. Section E, Paragraph 2. Option A and B

   Within both Option A and Option B, Government Sponsored Enterprises (GSE), such as bonds issued by the FHLB, FNMA, FFCB, FHLMC, and Farmer Mac, are not listed as an asset eligible to be pledged as collateral for deposits in paragraph 2; therefore, requiring the fair value of the pledged collateral to be 130% or more. This poses a concern for Arkansas banks as a significant portion of our investment portfolios consists of securities that are GSEs. Since GSEs have an implied guarantee of the US and carry a AAA rating, we feel that 105% of market value is sufficient. These securities will be limited in their use by the 130% over collateralization requirement imposed in Section E, Paragraph 3. The same decrease in utilization is true for Arkansas municipal securities due to their 120% over collateralization requirement stipulated in Option A.

   By effectively decreasing the pledging value of a significant portion of bank's investment portfolios, it is possible that banks will begin to bid public funds deposits in an uncompetitive manner due to the fact that banks must hold a higher percent of their assets in lower yielding securities (than a loan, for example) to pledge the same dollar amount of public deposits as were previously pledged under former state rules.

2. Section E, Paragraph 4.

   The rule states that "the report shall include the fair value and description of the assets pledged as collateral as of the last business day of the month." This poses a problem as the third party pricing service (which is required) that supplies PBNB's monthly investment accounting reports, report a market value that is not the market value on the last business day of the month. In order for these reports to be generated and supplied to us in a timely manner, the market value for each pledged security is typically taken 2 business days prior to the last business day of each month. There will also be slight variances in the pricing from one dealer to the next, although minimal.

3. Section E, Paragraph 5

The requirement that pledged securities be held at a nonaffiliated third party will provide little, if any, additional security but will increase operational cost as some larger institutions. When pledged securities are held by a safekeeping bank, affiliated or not, the assets are either held in a segregated account at the Federal Reserve, FED book-entry) 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 accordance with the terms of the custodial agreement.

4. Section E, Paragraph 6

The requirement to have authorization from the agency to which the collateral is pledged prior to releasing, substituting, or compromising the collateral adds an unnecessary operational step to banks, which only increases the costs to banks and lowers yields to the public depositor. Banks know the established pledging requirements, have agreed to these requirements in the agreements, and understand the consequences of not abiding by these requirements; therefore, to say that banks must have prior authorization to replace a security being called or matured adds an unnecessary operational step. Banks have invested personnel, infrastructure, time, etc. to acquire and keep these deposits and do not want to do anything that will risk losing them. I will add that having the agency authorize the release of collateral when it is not being substituted/replaced is a practice that PBNB and our safekeeping institution practice and is a prudent measure in our opinion.

If you have any questions, please contact me at 870-535-7222.

Thank you,

John Wall
Assistant Vice President

REGIONS

July 18, 2011

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ASSISTANT REVENUE COMMISSIONER
POLICY & LEGAL

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

Dear Mr. Theis:

Regions Bank appreciates the opportunity to comment on Proposed Rule 2011-1 Management of Cash Funds. Regions supports the general thrust of the Rule in seeking to ensure that all public funds are invested and otherwise handled appropriately, and wishes to continue to serve as a depository for such funds. We have noted, however, some issues that we believe should be brought to your attention that affect Regions, but that we believe may be common to other banks as well.

1. The list of securities available to be pledged does not include FHLMC or FNMA securities. Regions may not always have a sufficient amount of the securities listed in items (a) through (j) of the Rule to be able to fully support its pledging requirements. We suggest that FHLMC and FNMA securities be added to the approved list. U. S. Agency securities are considered by the market to carry an implicit guarantee by the U.S. Government. In September 2008, the U. S. took a 79.9% stake in both entities, thereby further bolstering the market's confidence in the safety and soundness of securities issued by these institutions. Both Freddie Mac and Fannie Mae enjoy AAA ratings from Moody's and S&P on the securities they issue, and the markets trading these securities are active and highly liquid.

2. In numbered paragraph 6 in the "Collateralization of Cash Funds" section, there is a requirement that collateral cannot be substituted unless prior written approval is obtained from the agency to which the collateral is pledged. Regions generally uses a large, national custodian. They have an automated system that assigns new securities to customers every day based on deposit levels. We believe this is an efficient system that ensures the collateral levels are always maintained. However, it would not allow for prior written consent in each instance. These substitutions are made by the custodian and not the bank. The custodian

maintains control of the collateral at all times. This process is permitted in all of the other states in which Regions does business.

3. Paragraph 3.b. in the "Security Interest" section lists the provisions required in the Custodial Services Agreement. In our experience, the large national custodians, who otherwise provide efficient service, are not always willing to agree to all of the provisions in a custodial services agreement used by a particular state. These custodians deal with many states and it is not practical for them to administer numerous different forms of agreements. Also, we know that the Federal Reserve will only use its form of agreement, which follows the terms of Fed Operating Circular No. 7, Appendix C. We recommend that there be some flexibility allowed in the form of agreement.

4. We obviously understand the requirement for Board or Loan Committee approval of the relationship. Regions Board has approved a broad resolution authorizing the appropriate officers of Regions Bank to enter into these types of agreements. We assume this would meet the Rule's requirement. 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.

Again, we appreciate the opportunity to comment. If you would like to discuss any of our comments, please contact me at 501-371-7142.

Very truly yours,

J. Lynn Wright

J. Lynn Wright
Arkansas Area President

Cc: Ken Hammonds, President
Arkansas Bankers Association

SIMMONS FIRST NATIONAL CORPORATION

J. THOMAS MAY
Chairman of the Board
Chief Executive Officer

July 25, 2011

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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, FFCB, 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 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

Southern Bancorp
Building communities. Changing lives.

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August 15, 2011

Mr. John H. Theis
Assistant Commissioner of Revenue
DF&A Revenue Division
Ledbetter Building
1816 W. 7th St., Ste 2440
P. O. Box 1272
Little Rock, AR 72202-1272

RE: Proposed Revision of Rule 2011-1 for Arkansas State Board of Finance

Dear Mr. Theis:

On behalf of Southern Bancorp Bank, I want to applaud the State Board of Finance in its efforts to seek standardization of public deposit collateralization procedures. However, it is our belief at Southern Bancorp Bank that the rules of the State Treasurer's office more normally fit the business model for most Arkansas banks. We are concerned with several issues raised by the proposed rule including the following, to-wit:

- We are a small stockholder of Arkansas Bankers' Bank (now First National Bankers' Bank) and use them for our safekeeping. Since 50% of the banks in Arkansas helped fund the original creation of the Arkansas Bankers' Bank, it is easy for you to see that most of us will be prohibited from accepting deposits under the affiliate rule if Arkansas Bankers' Bank is our safe keeper. We were forced to create the Arkansas Bankers' Bank as the large banks had both priced us out of the market and refused to give us the latest technology to perform clearing functions. Since nearly every bank in Arkansas owns less than 1% or 2% of Arkansas Bankers' Bank, this small ownership percentage should not place our safekeeping practice in jeopardy.

- We believe that the legislature and the public body requiring collateral should determine what is appropriate as collateral and that the "complex" rule requiring 130% of coverage is excessive and not needed.

- The rules should not be written so as to inadvertently exclude Arkansas Bankers' Bank (now First National Bankers' Bank) from serving as safekeeping custodian for pledged agency deposits. It is the largest safekeeping custodian in the state and it would not be in the best interest of the public bodies or bankers that their years of experience be counted for nothing.

- The rule requiring 120% collateral coverage for investments not guaranteed by full faith and credit of the United States is excessive. We understand that is the current rule, but the Treasurer's Office only requires 105%. We believe with the required monthly fair market value reporting, 105% is sufficient.

We appreciate your willingness to consider our comments. Best personal regards.

Sincerely,

SOUTHERN BANCORP BANK

Scott

Scott Fife, CEO

SMF/dhc