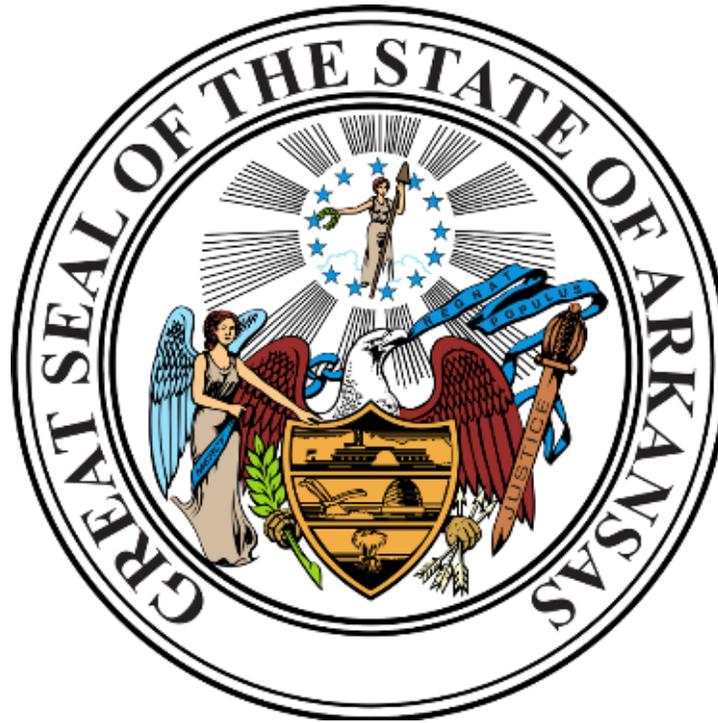


# ARKANSAS STATE BOARD OF FINANCE



## ARKANSAS STATE TREASURY Investment Policy

Adopted June 25, 1997

Amended September 25, 1997

Amended December 6, 2007

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## I. General Policy

### A. Mission

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

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

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

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

### B. Authority

The Treasurer of State is an executive officer of the state, established by the Constitution of the State of Arkansas; and, is required pursuant to the Arkansas Code to perform “all . . . duties which may be required of him or her by law.” ARK. CONST. of 1874, art. VI, § 1, *amended* by ARK. CONST. amend. VI, § 1; ARK. CODE ANN. § 25-16-604.

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

- (1) Record keeping and reporting requirements that reflect:
  - (A) Daily, monthly, and year-to-date balances of all funds, accounts, and groups of accounts within the State Treasury; and
  - (B) The performance of all deposits and investments compared to the target rate of return established by the board;
- (2) A collateralization policy;
- (3) Eligibility requirements for a bank depository, an investment depository, a securities broker, and, before accepting an application to hire an

investment consultant under subsection (c) of this section, an investment consultant;

(4) An investment policy;

(5) Liquidity requirements for the State Treasury; and

(6) Qualifications, ethical standards, a conflict of interest policy, and criminal background check requirements that are no less stringent than the requirements of Arkansas Code § 19-3-705 for all employees of the board or Treasurer of State who handle State Treasury funds or participate in decisions concerning the deposit or investment of State Treasury funds.

ARK. CODE ANN. § 19-3-704.

### **C. Objectives**

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

- Seek to ensure the preservation of capital by adhering to all restrictions on the investment of funds established by law and by this policy.
- Maintain liquidity by seeking to match the maturity structure of the portfolio to reasonably anticipated cash requirements, as well as maintaining an adequate portion of the portfolio in readily marketable securities.
- Optimize the return on investments by structuring the portfolio in such a way that a market rate of return is earned through budgetary and economic cycles within the existing constraints of safety and liquidity.

### **D. Definitions**

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

- **ARK. CODE ANN. or "Arkansas Code"** - Arkansas Code Annotated of 1987, replacements thereof, and supplements thereto.
- **ARK. CONST. of 1874** - Arkansas Constitution of 1874.
- **CDARS** - Certificate of Deposit Account Registry Service.
- **Total Portfolio** - as referenced in the Treasury Funds section (section II of this policy) means treasury funds available for investing. It does not include trust certificates of deposit, certificates of deposit purchased in accordance

with the State Treasury Certificate of Deposit Investment Program, the State Treasury Money Management Trust Act (except for the amount of any Treasury funds deposited therein pursuant to Ark. Code Ann. § 19-3-603(3)), or funds invested pursuant to the Tobacco Settlement Proceeds Act.

- **Authorized or designated investment officers** - means officers designated by the State Treasurer as being authorized to carry out investment functions on behalf of Treasury.
- **Authorized dealers** - means those dealers who are:
  - A. Specifically approved by the State Board of Finance, or;
  - B. Approved by the Treasurer of State in accordance with eligibility requirements as established by the State Board of Finance.
- **Financial institution** - means a “bank” and/or “savings and loan association” as defined in ARK. CODE ANN. § 19-3-502.
- **NRSRO** – means “Nationally Recognized Statistical Rating Organizations.” These are credit rating agencies approved by the Securities and Exchange Commission to provide information that financial firms must rely upon for regulatory purposes and credit analysis. The current list of NRSROs can be found at: <https://www.sec.gov/ocr/ocr-current-nrsros.html>
- **Investment Grade** – means the quality of an issuer’s credit as rated by an NRSRO. Each NRSRO uses different nomenclature. In the context of long-term debt instruments, to be considered an investment grade issue, an issuer must be rated at BBB (or the equivalent) or higher. In the context of short-term debt instruments, to be considered an investment grade issue, an issuer must be rated at A2/P2 (or the equivalent) or higher.

## **E. Standards of Care**

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

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

ARK. CODE ANN. § 19-3-605.

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

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

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

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

The Treasurer of State shall maintain the approved list of authorized dealers.

## **F. Professional Services**

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

## **G. Internal Controls**

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

- the use of third-party custody and safekeeping;
- the execution of all securities transactions on a delivery versus payment basis;
- the clear and limited delegation of investment authority;
- the separation of transaction authority from record keeping;

- frequent reconciliation of the investment ledger with the general ledger;
- the use of objective criteria in selecting financial institutions and dealers authorized to provide investment services to the state; and,
- the use of objective criteria in awarding investment purchases and sales to authorized financial institutions and dealers.

The State Board of Finance shall serve as the investment policy committee and shall review and approve revisions to this policy. The State Board of Finance shall review this policy as often as necessary, and no less than annually.

## **H. Reporting**

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

## **II. Treasury Funds Policy**

### **A. Authority**

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

### **B. Scope**

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

- the State Treasury Certificate of Deposit Investment Program, which is governed by ARK. CODE ANN. § 19-3-519, and section III of this policy;
- the State Treasury Money Management Trust, which is governed by ARK. CODE ANN. § 19-3-601 -606, ARK. CODE ANN. § 19-4-803, and the State Treasury Money Management Trust Policies and Procedures Manual; and,
- trust funds required to be invested in certificates of deposit as governed by ARK. CODE ANN. § 19-3-518 (a).

### **C. Eligible Investments**

Eligible investments are limited to those securities and deposits authorized by ARK. CODE ANN. § 19-3-518 and ARK. CODE ANN. § 19-8-111. Eligible investments

as outlined in the aforementioned statutes may include:

- direct obligations of the U.S. government;
- obligations of agencies and instrumentalities created by act of the United States Congress and authorized thereby to issue securities or evidences of indebtedness, regardless of guarantee of repayment by the United States Government;
- obligations the principal and interest of which are fully guaranteed by the United States Government or an agency or an instrumentality created by an act of the United States Congress and authorized thereby to issue such guarantee;
- obligations the principal and interest of which are fully secured, insured, or covered by commitments or agreements to purchase by the United States Government or an agency or instrumentality created by an act of the United States Congress and authorized thereby to issue such commitments or agreements;
- commercial paper that is readily marketable and investment grade as indicated by at least two (2) NRSROs. No investment shall be made in commercial paper which, at the time of purchase, holds the minimum rating and is on negative credit watch by either of the NRSROs used to rate the paper;
- corporate bond issues that are investment grade as indicated by at least two (2) NRSROs. No investment shall be made in bonds which have maturity beyond ten (10) years. No investment shall be made in bonds which hold the minimum rating if, at the time of purchase, the issue is on negative credit watch by either of the NRSROs used to rate the issue;
- repurchase agreements as set forth in ARK. CODE ANN. § 19-3-518(b)(1)(B)(xii);
- the State Treasury Money Management Trust;
- prerefunded municipal bonds whose principal and interest are fully secured by the principal and interest of a direct obligation of the United States Government;
- securities of any open-end type investment company or investment trust registered under the Investment Company Act of 1940 and that is defined as a “money market fund ” under 17 C.F.R. § 270.2a-7 whose portfolio is principally U.S. government obligations and repurchase agreements fully collateralized by U.S. government obligations and the collateral is either taken directly by the investment company or investment trust or through an authorized custodian;

- certificates of deposit, demand, or savings deposits with financial institutions provided they are fully insured by a federal deposit insurance agency for one hundred percent (100%) of the principal and accrued interest of the deposit;
- certificates of deposit pursuant to ARK. CODE ANN. § 19-8-111 (CDARS.);
- all or any part of the bonds of local industrial development corporations, authorized and issued under the Arkansas Industrial Development Act, § 15-4-101 et seq., and all or any part of the bonds of municipalities and counties, authorized and issued under the Municipalities and Counties Industrial Development Revenue Bond Law, ARK. CODE ANN. § 14-164-201 *et. seq.*;
- obligations issued by the State Board of Education under the authority of the State Constitution; and,
- warrants of a political subdivision or municipality of the State of Arkansas having maturities not exceeding one (1) year;
- general obligations of the states of the United States and of the political subdivisions, municipalities, commonwealths, territories, or insular possessions of the states of the United States which are investment grade;
- obligations in which, the principal and interest are fully guaranteed, secured, insured, or covered by a commitment or agreement to purchase the obligation by the United States Government or an agency or an instrumentality created by an act of the United States Congress and authorized by the United States to issue the guarantee, commitment, or agreement (if notes hold the rating of SP-1, or the equivalent, or above, or if bonds hold the rating of AA, or the equivalent, or above).
- Bonds from the State of Israel that are guaranteed and backed by the full faith and credit of the government of Israel as the sovereign debt of the State of Israel, pursuant to ARK. CODE ANN. § 19-3-523.
- Investment pools or funds comprised exclusively of assets or securities that the Treasurer is permitted to purchase directly.

#### **D. Investment Restrictions**

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

- the weighted average maturity of the total portfolio shall not exceed ten (10) years;
- the expected maturity of any security shall not exceed ten (10) years, with

the exception of the following:

- (a) securities used as collateral in repurchase agreements, Arkansas Capital Corporation Bonds, State Board of Finance and State Building Services Certificates of Indebtedness, direct obligations of the U.S. government, and obligations of agencies and instrumentalities created by act of the United States Congress and authorized thereby to issue securities or evidences of indebtedness, regardless of guarantee of repayment by the United States Government.
- (b) U.S. Agency mortgage-backed securities, collateralized mortgage obligations, and municipal bonds which return principal in scheduled payments prior to final maturity shall not have, at the time of purchase, an average life exceeding fifteen (15) years using average life assumptions while employing Prepayment Speed Assumption (PSA) and/or Conditional Prepayment Rate (CPR) analysis models. Average life at the time of purchase shall be used as opposed to maturity. U.S. Agency mortgage-backed securities and collateralized mortgage obligations which have an average life greater than 10 years shall not exceed 5% of the total portfolio at the time of purchase.

- No investment in corporate debt shall be made in any single issuer, which— at the time of purchase—exceeds five percent (5%) of the total portfolio of the Treasury, including both commercial paper and bonded debt of that issuer.
- The maturity of repurchase agreements shall be calculated by the date of repurchase, not the maturity of the underlying instrument.

Investments in non-government securities shall not exceed the following percentages of the total portfolio:

Total Debt of Corporations, including Bonds and Commercial Paper\* 30%

\*Second-tier Commercial Paper—including but not limited to Commercial Paper rated A2 by Standard and Poor's Ratings Services, and P2 by Moody's Investors Service—shall not exceed five percent (5%) of the Total Portfolio.

Repurchase agreements are subject to the following additional restrictions:

- transactions shall be documented with master repurchase agreements;
- securities accepted as collateral shall be readily marketable;
- repurchase agreements with any dealer or financial institution are not to exceed fifty percent (50%) of the total portfolio; and,
- repurchase agreements are not to exceed one hundred eighty (180) days, and

the share of the portfolio allocated to repurchase agreements with maturities beyond thirty (30) days are not to exceed thirty percent (30%) of the total portfolio.

Pursuant to Arkansas Code § 25-1-501 *et. seq.*, a public entity shall not invest in companies that boycott Israel. In a good-faith effort to comply with this law, the State Treasury may rely on the list of entities that is published by the New York Office of General Services and may be located online at the following web address: [New York OGS - Israel Boycott List](#)

All purchases and sales of securities shall be made with the goals of: (a) obtaining the optimal price and value for securities, and (b) not showing preference for any securities broker.

Pre-trade analysis shall be performed for all bond purchases and sales. Where appropriate, that analysis should include market conditions, how the security fits the Treasury's investment strategy, and any other securities reviewed at the time of execution.

For asset classes where quotation bids are applicable and appropriate, purchases and sales of securities by the Treasurer of State shall be made upon receipt of not less than three (3) quotation bids from securities brokers.

For asset classes where quotation bids are inapplicable or inappropriate, the Treasurer of State shall retain documentation sufficient to indicate that broker selection was competitive and met the spirit of Ark. Code Ann. § 19-3-518(b)(3)(B).

## **E. Collateral**

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

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

## **F. Return on Investment**

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

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

the State Treasurer shall:

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

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

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

## **G. Professional Services**

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

### ***Master Custodian***

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

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

### ***Money Manager***

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

- recommending changes to the investment policy;
- providing advice on investment purchases and sales based on current market indicators and economic conditions;
- providing monthly accounting, performance, compliance, and management reports; and

- managing funds separately from other governmental funds and providing third-party safekeeping in Treasury's name.

The services of a master custodian, and money manager will be obtained through a competitive evaluation of proposals submitted to the Treasurer of State's Office. The money manager's advice on investment purchases and sales must be limited to approved investments as defined above.

### **III. State Treasury Certificate of Deposit Investment Program**

#### **A. Introduction**

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

#### **B. Authority and Scope**

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

#### **C. Objectives**

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

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

#### **D. Guidelines**

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

- The State Board of Finance may, at its discretion, establish a cap on the amount of the total allocation any one institution may receive.
- In the event that a small group of institutions are receiving a disproportionate share of the total distribution, the State Board of Finance

may set a cap on that group of institutions in order to provide for a more equitable allocation of deposits.

- The State Board of Finance may establish minimum capital requirements on tier one (1) regulatory capital as defined by federal banking regulatory agencies that an institution must meet to hold state deposits. The Board of Finance may establish a sliding scale of minimum regulatory capital requirements based on size.

## **E. Allocation Process**

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

- Each participating institution may receive a base deposit amount. This amount may be based on a sliding scale to be established by the Treasurer of State.
- The aggregate amount will be removed from the total distribution amount. The remainder will be distributed as follows:
  1. A percentage will be allocated to each institution based on its percentage of Arkansas loans relative to the whole.
  2. The remaining percentage will be allocated to each institution based on its percentage of weighted Arkansas deposits to the whole.

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

## **F. Professional Services**

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

### ***Master Custodian***

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

- executing transactions involving all securities held in custody, including on-line security clearing, settlement of securities on a delivery-versus-payment basis, and settlement of physically-held securities;
- accounting for all transactions in accordance with generally accepted accounting principles and requirements of the state;

- providing regular reports on the activity and value of the securities in custody; and,
- providing for the safekeeping of all documents and financial instruments physically held in custody.

### **G. Collateralization**

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

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