

CHAPTER 2257. COLLATERAL FOR PUBLIC FUNDS

SUBCHAPTER A. GENERAL PROVISIONS

Effective as of September 1, 2011

§ 2257.001. Short Title

This chapter may be cited as the **Public Funds Collateral Act**.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993, Acts 2003, 78th Leg, eff Sept 1, 2003.

§ 2257.002. Definitions In this chapter:

- (1) "Bank holding company" has the meaning assigned by Section 31.002(a), Finance Code.
- (2) "Control" has the meaning assigned by Section 31.002(a), Finance Code.
- (3) "Deposit of public funds" means public funds of a public entity that:
 - (A) the comptroller does not manage under Chapter 404; and
 - (B) are held as a demand or time deposit by a depository institution expressly authorized by law to accept a public entity's demand or time deposit.
- (4) "Eligible security" means:
 - (A) a surety bond;
 - (B) an investment security;
 - (C) an ownership or beneficial interest in an investment security, other than an option contract to purchase or sell an investment security;
 - (D) a fixed-rate collateralized mortgage obligation that has an expected weighted average life of 10 years or less and does not constitute a high-risk mortgage security;
 - (E) a floating-rate collateralized mortgage obligation that does not constitute a high-risk mortgage security; or
- (5) "Investment security" means:
 - (A) an obligation that in the opinion of the attorney general of the United States is a general obligation of the United States and backed by its full faith and credit;
 - (B) a general or special obligation issued by a public agency that is payable from taxes, revenues, or a combination of taxes and revenues; or
 - (C) a security in which a public entity may invest under Subchapter A, Chapter 2256.
- (6) "Permitted institution" means:
 - (A) a Federal Reserve Bank;
 - (B) a clearing corporation, as defined by Section 8.102, Business & Commerce Code;
 - (C) a bank eligible to be a custodian under Section 2257.041; or
 - (D) a state or nationally chartered bank that is controlled by a bank holding company that controls a bank eligible to be a custodian under Section 2257.041.
- (7) "Public agency" means a state or a political or governmental entity, agency, instrumentality, or subdivision of a state, including a municipality, an institution of higher education, as defined by Section 61.003, Education Code, a junior college, a district created under Article XVI, Section 59, of the Texas Constitution, and a public hospital.
- (8) "Public entity" means a public agency in this state, but does not include an institution of higher education, as defined by Section 61.003, Education Code.
- (9) "State agency" means a public entity that:
 - (A) has authority that is not limited to a geographic portion of the state; and
 - (B) was created by the constitution or a statute.
- (10) "Trust receipt" means evidence of receipt, identification, and recording, including:
 - (A) a physical controlled trust receipt; or
 - (B) a written or electronically transmitted advice of transaction.

§ 2257.0025. High-Risk Mortgage Security

- (a) For purposes of this chapter, a fixed-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
- (1) has an average life sensitivity with a weighted average life that:
 - (A) extends by more than four years, assuming an immediate and sustained parallel shift in the yield curve of plus 300 basis points; or
 - (B) shortens by more than six years, assuming an immediate and sustained parallel shift in the yield curve of minus 300 basis points; and
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.
- (b) For purposes of this chapter, a floating-rate collateralized mortgage obligation is a high-risk mortgage security if the security:
- (1) bears an interest rate that is equal to the contractual cap on the instrument; or
 - (2) is price sensitive; that is, the estimated change in the price of the mortgage derivative product is more than 17 percent, because of an immediate and sustained parallel shift in the yield curve of plus or minus 300 basis points.

§ 2257.003. Chapter Not Applicable to Deferred Compensation Plans This chapter does not apply to funds that a public entity maintains or administers under a deferred compensation plan, the federal income tax treatment of which is governed by Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Sections 401(k) and 457).

§ 2257.004. Conflict With Other Law This chapter prevails over any other law relating to security for a deposit of public funds to the extent of any conflict.

§ 2257.005. Contract Governs Legal Action A legal action brought by or against a public entity that arises out of or in connection with the duties of a depository, custodian, or permitted institution under this chapter must be brought and maintained as provided by the contract with the public entity.

SUBCHAPTER B. DEPOSITORY; SECURITY FOR DEPOSIT OF PUBLIC FUNDS

§ 2257.021. Collateral Required A deposit of public funds shall be secured by eligible security to the extent and in the manner required by this chapter.

§ 2257.022. Amount of Collateral

(a) Except as provided by Subsection (b), the total value of eligible security to secure a deposit of public funds must be in an amount not less than the amount of the deposit of public funds:

- (1) increased by the amount of any accrued interest; and
- (2) reduced to the extent that the United States or an instrumentality of the United States insures the deposit.

(b) The total value of eligible security described by Section 45.201(4)(D), Education Code, to secure a deposit of public funds of a school district must be in an amount not less than 110 percent of the amount of the deposit as determined under Subsection (a). The total market value of the eligible security must be reported at least once each month to the school district.

(c) The value of a surety bond is its face value.

(d) The value of an investment security is its market value.

§ 2257.023. Collateral Policy

(a) In accordance with a written policy approved by the governing body of the public entity, a public entity shall determine if an investment security is eligible to secure deposits of public funds.

(b) The written policy may include:

- (1) the security of the institution that obtains or holds an investment security;
- (2) the substitution or release of an investment security; and
- (3) the method by which an investment security used to secure a deposit of public funds is valued.

§ 2257.024. Contract for Securing Deposit of Public Funds

(a) A public entity may contract with a bank that has its main office or a branch office in this state to secure a deposit of public funds.

(b) The contract may contain a term or condition relating to an investment security used as security for a deposit of public funds, including a term or condition relating to the:

- (1) possession of the collateral;
- (2) substitution or release of an investment security;
- (3) ownership of the investment securities of the bank used to secure a deposit of public funds; and
- (4) method by which an investment security used to secure a deposit of public funds is valued.

§ 2257.025. Records of Depository

(a) A public entity's depository shall maintain a separate, accurate, and complete record relating to a pledged investment security, a deposit of public funds, and a transaction related to a pledged investment security.

(b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a depository maintains under this section.

§ 2257.026. Change in Amount or Activity of Deposits of Public Funds A public entity shall inform the depository for the public entity's deposit of public funds of a significant change in the amount or activity of those deposits within a reasonable time before the change occurs.

SUBCHAPTER C. CUSTODIAN; PERMITTED INSTITUTION

§ 2257.041. Deposit of Securities With Custodian

- (a) In addition to other authority granted by law, a depository for a public entity other than a state agency may deposit with a custodian a security pledged to secure a deposit of public funds.
- (b) At the request of the public entity, a depository for a public entity other than a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds.
- (c) A depository for a state agency shall deposit with a custodian a security pledged to secure a deposit of public funds. The custodian and the state agency shall agree in writing on the terms and conditions for securing a deposit of public funds.
- (d) A custodian must be approved by the public entity and be:
 - (1) a state or national bank that:
 - (A) is designated by the comptroller as a state depository;
 - (B) has its main office or a branch office in this state; and
 - (C) has a capital stock and permanent surplus of \$5 million or more;
 - (2) the Texas Treasury Safekeeping Trust Company;
 - (3) a Federal Reserve Bank or a branch of a Federal Reserve Bank; or
 - (4) a federal home loan bank.
 - (5) a financial institution authorized to exercise fiduciary powers that is designated by the comptroller as a custodian pursuant to Section 404.031(e).
- (e) A custodian holds in trust the securities to secure the deposit of public funds of the public entity in the depository pledging the securities.

§ 2257.042. Deposit of Securities With Permitted Institution

- (a) A custodian may deposit with a permitted institution an investment security the custodian holds under Section 2257.041.
- (b) If a deposit is made under Subsection (a):
 - (1) the permitted institution shall hold the investment security to secure funds the public entity deposits in the depository that pledges the investment security;
 - (2) the trust receipt the custodian issues under Section 2257.045 shall show that the custodian has deposited the security in a permitted institution; and
 - (3) the permitted institution, on receipt of the investment security, shall immediately issue to the custodian an advice of transaction or other document that is evidence that the custodian deposited the security in the permitted institution.

§ 2257.043. Depository as Custodian or Permitted Institution

- (a) A public entity other than a state agency may prohibit a depository or an entity of which the depository is a branch from being the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds.
- (b) A depository or an entity of which the depository is a branch may not be the custodian of or permitted institution for a security the depository pledges to secure a deposit of public funds by a state agency.

§ 2257.044. Custodian as Bailee

- (a) A custodian under this chapter or a custodian of a security pledged to an institution of higher education, as defined by Section 61.003, Education Code, whether acting alone or through a permitted institution, is for all purposes the bailee or agent of the public entity or institution depositing the public funds with the depository.
- (b) To the extent of any conflict, Subsection (a) prevails over Chapter 8 or 9, Business & Commerce Code.

§ 2257.045. Receipt of Security by Custodian

- (a) On receipt of an investment security, a custodian shall immediately identify on its books and records, by book entry or another method, the pledge of the security to the public entity.
- (b) For a deposit of public funds under Subchapter F, the custodian shall issue and deliver to the Comptroller a trust receipt for the pledged security.
- (c) For any other deposit of public funds under this chapter, at the written direction of the appropriate public entity officer, the custodian shall:
 - (1) issue and deliver to the appropriate public entity officer a trust receipt for the pledged security; or
 - (2) issue and deliver a trust receipt for the pledged security to the public entity's depository and instruct the depository to deliver the trust receipt to the public entity officer immediately.
- (d) The custodian shall issue and deliver the trust receipt as soon as practicable on the same business day on which the investment security is received.

§ 2257.046. Books and Records of Custodian; Inspection

(a) A public entity's custodian shall maintain a separate, accurate, and complete record relating to each pledged investment security and each transaction relating to a pledged investment security.

(b) The comptroller or the public entity may examine and verify at any reasonable time a pledged investment security or a record a custodian maintains under this section. The public entity or its agent may inspect at any time an investment security evidenced by a trust receipt.

(c) The public entity's custodian shall file a collateral report with the comptroller in the manner and on the dates prescribed by the comptroller.

(d) At the request of the appropriate public officer, the public entity's custodian shall provide a current list of all pledged investment securities. The list must include, for each pledged security:

- (1) the name of the public entity;
- (2) the data the security was pledged to secure this public entity's deposit;
- (3) the Committee on Uniform Security Identification Procedures (CUSIP) number on the security;
- (4) the face value and maturity date of the security; and
- (5) the confirmation number on the trust receipt issued by the custodian.

§ 2257.047. Books and Records of Permitted Institution

(a) A permitted institution may apply book entry procedures when an investment security held by a custodian is deposited under Section 2257.042.

(b) A permitted institution's records must at all times state the name of the custodian that deposits an investment security in the permitted institution.

§ 2257.048. Attachment and Perfection of Security Interest

(a) A security interest that arises out of a depository's pledge of a security to secure a deposit of public funds by a public entity or an institution of higher education, as defined by Section 61.003, Education Code, is created, attaches, and is perfected for all purposes under state law from the time that the custodian identifies the pledge of the security on the custodian's books and records and issues the trust receipt.

(b) A security interest in a pledged security remains perfected in the hands of a subsequent custodian or permitted institution.

SUBCHAPTER D. AUDITS AND EXAMINATIONS; PENALTIES

§ 2257.061. Audits and Examinations As part of an audit or regulatory examination of a public entity's depository or custodian, the auditor or examiner shall:

- (1) examine and verify pledged investment securities and records maintained under Section 2257.025 or 2257.046; and
- (2) report any significant or material noncompliance with this chapter to the comptroller.

§ 2257.062. Penalties

(a) The comptroller may revoke a depository's designation as a state depository for one year if, after notice and a hearing, the comptroller makes a written finding that the depository, while acting as either a depository or a custodian:

- (1) did not maintain reasonable compliance with this chapter; and
- (2) failed to remedy a violation of this chapter within a reasonable time after receiving written notice of the violation.

(b) The comptroller may permanently revoke a depository's designation as a state depository if the comptroller makes a written finding that the depository:

- (1) has not maintained reasonable compliance with this chapter; and
- (2) has acted in bad faith by not remedying a violation of this chapter.

§ 2257.063. Mitigating Circumstances

(a) The comptroller shall consider the total circumstances relating to the performance of a depository or custodian when the comptroller makes a finding required by Section 2257.062, including the extent to which the noncompliance is minor, isolated, temporary, or nonrecurrent.

(b) The comptroller may not find that a depository or custodian did not maintain reasonable compliance with this chapter if the noncompliance results from the public entity's failure to comply with Section 2257.026.

(c) This section does not relieve a depository or custodian of the obligation to secure a deposit of public funds with eligible security in the amount and manner required by this chapter within a reasonable time after the public entity deposits the deposit of public funds with the depository.

§ 2257.064. Reinstatement The comptroller may reinstate a depository's designation as a state depository if:

- (1) the comptroller determines that the depository has remedied all violations of this chapter; and

(2) the depository assures the comptroller to the comptroller's satisfaction that the depository will maintain reasonable compliance with this chapter.

SUBCHAPTER E. EXEMPT INSTITUTIONS

§ 2257.081. Definition In this subchapter, "exempt institution" means:

- (1) a public retirement system, as defined by Section 802.001; or
- (2) the permanent school fund, as described by Section 43.001, Education Code.

§ 2257.082. Funds of Exempt Institution An exempt institution is not required to have its funds fully insured or collateralized at all times if:

- (1) the funds are held by:
 - (A) a custodian of the institution's assets under a trust agreement; or
 - (B) a person in connection with a transaction related to an investment; and
- (2) the governing body of the institution, in exercising its fiduciary responsibility, determines that the institution is adequately protected by using a trust agreement, special deposit, surety bond, substantial deposit insurance, or other method an exempt institution commonly uses to protect itself from liability.

§ 2257.083. Investment; Selection of Depository This chapter does not:

- (1) prohibit an exempt institution from prudently investing in a certificate of deposit; or
- (2) restrict the selection of a depository by the governing body of an exempt institution in accordance with its fiduciary duty.

SUBCHAPTER F. POOLED COLLATERAL TO SECURE DEPOSITS OF CERTAIN PUBLIC FUNDS

§ 2257.101. Definition In this subchapter, "participating institution" means a financial institution that holds one or more deposits of public funds and that participates in the pooled collateral program under this subchapter.

§ 2257.102. Pooled Collateral Program

- (a) As an alternative to collateralization under Subchapter B, the comptroller by rule shall establish a program from centralized pooled collateralization of deposits of public funds and for monitoring collateral maintained by participating institutions. The rules must provide that deposits of public funds of a county are not eligible for collateralization under the program. The comptroller shall provide for a separate collateral pool for any single participating institution's deposits of public funds.
- (b) Under the pooled collateral program, the collateral of a participating institution pledged for a public deposit may not be combined with, cross-collateralized with, aggregated with, or pledged to another participating institution's collateral pools for pledging purposes.
- (c) A participating institution may pledge its pooled securities to more than one participating depositor under contract with that participating institution.
- (d) The pooled collateral program must provide for:
 - (1) participation in the program by a participating institution and each affected public entity to be voluntary;
 - (2) uniform procedures for processing all collateral transactions that are subject to an approved security agreement described by Section 22.57.103; and
 - (3) the pledging of a participating institution's collateral securities using a single custodial account instead of an account for each depositor of public funds.

§ 2257.103. Participation in Pooled Collateral Program A financial institution may participate in the pooled collateral program only if:

- (1) the institution has entered into a binding collateral security agreement with a public agency for a deposit of public funds and the agreement permits the institution's participation in the program;
- (2) the comptroller has approved the institution's participation in the program; and
- (3) the comptroller has approved of provided the collateral security agreement form used.

§ 2257.104. Collateral Required: Custodian Trustee

- (a) Each participating institution shall secure its deposits of public funds with eligible securities the total value of which equals at least 102 percent of the amount of the deposits of public funds covered by a security agreement described by Section 2257.103 and deposited with the participating institution, reduced to the extent that the United States or an instrumentality of the United States insured the deposits. For purposes of determining whether collateral is sufficient to secure a deposit of public funds, Section 2257.022(b) does not apply to a deposit of public funds held by the participating institution and collateralized under this subchapter.

(b) A participating institution shall provide for the collateral securities to be held by a custodian trustee, on behalf of the participating institution, in trust for the benefit of the pooled collateral program. A custodian trustee must qualify as a custodian under Section 2257.041.

(c) The comptroller by rule shall regulate a custodian trust under the pooled collateral program in the manner provided by Subchapter C to the extent practicable. The rules must ensure that a custodian trustee depository does not own, is not owned by, and is independent of the financial institution or institutions for which it holds the securities in trust, except that the rules must allow the following to be a custodian trustee:

- (1) a federal reserve bank;
- (2) a banker's bank, as defined by Section 34.105, Finance Code; and
- (3) a federal home loan bank.

§ 2257.105. Monitoring Collateral

(a) Each participating institution shall file the following reports with the comptroller electronically and as prescribed by rules of the comptroller:

- (1) a daily report of the aggregate ledger balance of deposits of public agencies participating in the pooled collateral program that are held by the institution, with each public entity's funds held itemized;
- (2) a weekly summary report of the total market value of securities held by a custodian trustee on behalf of the participating institution;
- (3) a monthly report listing the collateral securities held by a custodian trustee on behalf of the participating institution, together with the value of the securities;
- (4) as applicable, a participating institution's annual report that includes the participating institution's financial statements.

(b) The comptroller shall provide the participating institution an acknowledgment of each report received.

(c) The comptroller shall provide a daily report of the market value of the securities held in each pool.

(d) The comptroller shall post each report on the comptroller's Internet website.

§ 2257.106. Annual Assessment

(a) Once each state fiscal year, the comptroller shall impose against each participating institution an assessment in an amount sufficient to pay the costs of administering this subchapter. The amount of an assessment must be based on factors that include the number of public entity accounts a participating institution maintains, the number of transactions a participating institution conducts, and the aggregate average weekly deposit amounts during that state fiscal year of each participating institution's deposits of public funds collateralized under this subchapter. The comptroller by rule shall establish the formula for determining the amount of the assessments imposed under this subsection.

(b) The comptroller shall provide to each participating institution a notice of the amount of the assessment against the institution.

(c) A participating institution shall remit to the comptroller the amount assessed against it under this section not later than the 45th day after the date the institution receives the notice under Subsection (b).

(d) Money remitted to the comptroller under this section may be appropriated only for the purposes of administering this subchapter.

§ 2257.107. Penalty for Reporting Violation The comptroller may impose an administrative penalty against a participating institution that does not timely file a report required by Section 2257.105.

§ 2257.108. Notice of Collateral Violation; Administrative Penalty

(a) The comptroller may issue a notice to a participating institution that the institution appears to be in violation of collateral requirements under Section 2257.104 and rules of the comptroller.

(b) The comptroller may impose an administrative penalty against a participating institution that does not maintain collateral in an amount and in the manner required by Section 2257.104 and rules of the comptroller if the participating institution has not remedied the violation before the third business day after the date a notice is issued under Subsection (a).

§ 2257.109. Penalty for Failure to Pay Assessment The comptroller may impose an administrative penalty against a participating institution that does not pay an assessment against it in the time provided by Section 2257.106(c).

§ 2257.110. Penalty Amount; Penalties Not Exclusive

(a) The comptroller by rule shall adopt a formula for determining the amount of a penalty under this subchapter. For each violation and for each day of a continuing violation, a penalty must be at least \$100 per day and not more than \$1,000 per day. The penalty must be based on the factors that include:

- (1) the aggregate average weekly deposit amounts during the state fiscal year of the institution's deposits of public funds;
- (2) the number of violations by the institution during the state fiscal year;
- (3) the number of days of a continuing violation; and
- (4) the average asset base of the institution as reported on the institution's year-end report of condition.

(b) The penalties provided by Sections 2257.107-2257.109 are in addition to those provided by Subchapter D or other law.

§ 2257.111. Penalty Proceeding Contested Case A proceeding to impose a penalty under Section 2257.107, 2257.108, or 2257.109 is a contested case under Chapter 2001.

§ 2257.112. Suit to Collect Penalty The attorney general may sue to collect a penalty imposed under Section 2257.107, 2257.108, or 2257.109.

§ 2257.113. Enforcement Stayed Pending Review Enforcement of a penalty imposed under Section 2257.107, 2257.108, or 2257.109 may be stayed during the time the order is under judicial review if the participating institution pays the penalty to the clerk of the court or files a supersedeas bond with the court in the amount of the penalty. A participating institution that cannot afford to pay the penalty or file the bond must stay the enforcement by filing an affidavit in the manner required by the Texas Rules of Civil

Procedure for a party who cannot afford to file security for costs, subject to the right of the comptroller to contest the affidavit as provided by those rules.

§ 2257.114. Use of Collected Penalties Money collected as penalties under this subchapter may be appropriated only for the purposes of administering this subchapter.