

## CHAPTER 2257. COLLATERAL FOR PUBLIC FUNDS

### SUBCHAPTER A. GENERAL PROVISIONS

*Effective as of September 1, 2003*

#### **§ 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, 78<sup>th</sup> 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; or
  - (E) a floating-rate collateralized mortgage obligation that does not constitute a high-risk mortgage security.
- (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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1995, 74th Leg., ch. 76, § 5.48(a), eff. Sept. 1, 1995; Acts 1995, 74th Leg., ch. 914, § 5, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 254, § 1, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 891, § 3.22(4), eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1423, § 8.70, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 62, § 7.63, eff. Sept. 1, 1999.

#### **§ 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.

Added by Acts 1997, 75th Leg, ch. 254, § 2, eff. Sept. 1, 1997.

**§ 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).

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

**§ 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.

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

**§ 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.

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

#### **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.

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

#### **§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993, Acts of 78<sup>th</sup> Leg eff. Sept. 1, 2003.

#### **§ 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.

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

#### **§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1999, 76th Leg., ch. 344, § 5.006, eff. Sept. 1, 1999.

#### **§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.16, eff. Sept. 1, 1997.

**§ 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.

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

#### **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.

(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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1995, 74th Leg., ch. 1010, § 1, eff. June 17, 1995; Acts 1997, 75th Leg., ch. 891, § 3.17, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 344, § 5.007, eff. Sept. 1, 1999.

##### **§ 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.

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

##### **§ 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.

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

##### **§ 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.

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

**§ 2257.045. Receipt of Security by Custodian** On receipt of an investment security, a custodian shall:

(1) immediately identify on its books and records, by book entry or another method, the pledge of the security to the public entity; and

(2) promptly issue and deliver to the appropriate public entity officer a trust receipt for the pledged security.

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

##### **§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.18, eff. Sept. 1, 1997.

**§ 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.

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

**§ 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.

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

**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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.19, eff. Sept. 1, 1997.

**§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.19, eff. Sept. 1, 1997.

**§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.19, eff. Sept. 1, 1997.

**§ 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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 891, § 3.19, eff. Sept. 1, 1997.

**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.

Added by Acts 1993, 73rd Leg, ch. 268, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 165, § 6.31, eff. Sept. 1, 1997.

**§ 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.

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

**§ 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.

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