

Tennessee State Funding Board Model Finance Transaction Policies: Statement on Debt Management

Debt Management Policy

Beginning January 1, 2012, all Public Entities¹ should have an adopted Debt² Management Policy in effect prior to issuing debt. The Policy should be tailored to the Entity's financing needs and should represent the use of debt as a part of over-all financial management. *Most Entities*, particularly those who intend to borrow only through a federal or state agency loan program or from a community financial institution, *may need only a simple policy.*

Whether considering a simple or a detailed policy, Entities should be guided by the following four principles for strong financial management in the public sector:

- Understand the transaction
- Explain to citizens what is being considered
- Avoid conflicts of interest
- Disclose costs and risks

Before considering and adopting a policy, members of the Governing Body of an Entity need to have a basic understanding of public finance. While most Entities should seek professional outside assistance, the Entities remain responsible for the development of the policy.³

All debt management policies must provide for public accountability and transparency in⁴:

- the debt financing decision, the structure and sale of the debt instruments, and the status of all on-going debt obligations;
- the selection of and payment for professional services related to debt issuance;
- the avoidance of conflicts of interest;
- the full and timely disclosure of all proposed and actual costs to citizens, the Governing Body, investors, and regulators; and
- the periodic review and amendment process for the policy.

All debt management policies must include the following provisions, changed only to reflect the identity of the Entity and to conform to the language of the policy:

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- **Transparency**
 - The Entity shall comply with legal requirements for notice and for public meetings related to debt issuance. In the interest of transparency, all costs (whether interest, issuance, continuing, or one-time) shall be disclosed to the citizens/members, Governing Body, and other stakeholders in a timely manner.

The method for disclosure of cost and other information, including documentation of compliance with this Policy, shall be developed by (*office or individual*) and maintained in (*specify location*).

○ **Professionals**

- Counsel⁵: The Entity will enter into an engagement letter agreement with each lawyer or law firm representing the Entity in a debt transaction. (*No engagement letter is required for any lawyer who is an employee of the Entity or lawyer or law firm which is under a general appointment or contract to serve as counsel to the Entity.*)
- Financial Advisor: The Entity will enter into a written agreement with each person or firm serving as Financial Advisor (*if any*) in debt management and transactions. In a competitive sale the Financial Advisor (*either*):
 - shall not be permitted to bid on an issue for which they are or have been providing advisory services; **or**
 - may bid on an issue for which they are providing advisory services only if (i) the Governing Body grants in writing specific authority on a transaction by transaction basis, (ii) such sale is properly carried out through a widely and publicly advertised sale, during normal bond sale hours, and through an industry standard, electronic bidding platform, and (iii) the Financial Advisor fee is separately billed from the underwriting fee.
- In a publicly offered, negotiated sale the Financial Advisor (*either*):
 - shall not be permitted to resign as Financial Advisor in order to underwrite an issue for which they are or have been providing advisory services; **or**
 - may resign as Financial Advisor in order to underwrite an issue for which they are or have been providing advisory services if another Financial Advisor is retained for the issue.
- Underwriter: The Underwriter in a publicly offered, negotiated sale (*if there is no Financial Advisor*) must provide pricing information to the Governing Body (or its designated official) prior to the award of the debt.

○ **Conflicts**

- Professionals involved in a debt transaction hired or compensated by the Entity must disclose to the Entity existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Bond Counsel, Swap

Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall include that information reasonably sufficient to allow the Entity to appreciate the significance of the relationships. No disclosure is required that would violate any rule or regulation of professional conduct.

Best Practices

Attached is an outline of topics and language to be considered for inclusion in a debt management policy, annotated with explanation and examples. Of course, a debt policy must be compliant with Federal, State, and Local laws, rules, and regulations. The policy should be reflective of the size and nature of the Entity and its financing needs, with consideration given to any specific comments made by the rating agencies in their most recent credit reports (if any) on the Entity or made by the Entity's auditor in its Management Letter.

This guidance is not all-inclusive, but addresses the basic elements to be included in a debt policy (both required provisions as well as best practices) and the process for adoption. This is designed to be considered along with the Government Finance Officers Association's (GFOA) recommended best practices, published credit rating criteria from the three nationally recognized rating agencies, and recommendations of the Entity's legal and financial advisors. The attached bibliography and links are provided to assist an Entity with writing its own policy.

The Tennessee State Funding Board recommends, in addition to a Debt Management Policy, formal adoption of Budget, Capital Planning, Cash and Investment Management Policies.⁶ Adoption of financial policies does not prevent unforeseen or negative events from occurring, but it does provide the executive and legislative leadership of the Entity guidance for decision-making. Adoption of financial policies does not prevent an Entity from making bad decisions, but it does:

- enhance the quality of decisions,
- rationalize the decision-making process,
- identify objectives for staff to implement, and
- demonstrate to the Credit Rating Agencies evidence of strong financial management practices.

Further, it separates the policy discussion from the immediacy of having to get a transaction done.

Authority

The Funding Board has developed this guidance regarding Debt Management Policies pursuant to the authority in Tenn. Code Ann. Section 9-21-151(b)(1) to develop finance transaction policies to provide guidance to Entities in preparing their own policies.

¹ This includes the State, State agencies, local governments and local government instrumentalities, including other authorities, boards, districts, instrumentalities or entities created by such Entities or any combination of such Entities. Although a conduit issuer, such as an industrial development corporation, is included in the definition of “Entity”, a private enterprise borrowing through it is not.

² The term “debt” refers to bonds, notes, capital leases, loan agreements, obligations and any other evidence of indebtedness lawfully issued, executed or assumed by an Entity.

³ An Entity may not abdicate responsibility for development of a policy to another Entity other than to the Entity that created it. For example, an Entity borrowing from or participating in a pool or conduit program may not adopt the policy of the issuer lender (such as a public building authority); a created entity (such as an airport authority) may adopt the policy developed by its creating authority (such as the city or county).

⁴ Debt policies should be consistent with the Ethics Policies; refer to Tenn. Code Ann. Section 8-17-101: “citizens of Tennessee are entitled to an ethical, accountable and incorruptible government.”

⁵ The requirement for an engagement letter does not apply to any lawyer who is an employee of the Entity or any lawyer or law firm under a general appointment as counsel to the Entity and not serving as bond counsel for the transaction.

If bond counsel for a debt transaction does not represent the Entity in that transaction, the Entity will enter into a fee payment letter agreement with such lawyer or law firm specifying:

- a. the party represented in the debt transaction; and
- b. the Entity’s obligation with respect to the payment of such lawyer or law firm's fees and expenses.

⁶ The Funding Board’s Guidelines for entering into an Interest Rate or Forward Purchase Agreement (“Agreement”), require a Debt Management Policy and Derivatives Management Policy be adopted that comply with the Funding Board’s requirements. The term “derivative” refers to an interest rate agreement as defined in Tenn. Code Ann. Section 9-22-103 and other transactions related to debt obligations as identified by the State Funding Board.