



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### *Becoming a Model Borrower | Part 1*

Module 8 explores post-issuance administrative characteristics of a model borrower including transparency best practices and on-going risk mitigation, and managing internal controls, compliance, and cost saving opportunities. Other topics include disclosure responsibilities and communication with the market, as well as risks and consequences of improper or inadequate communication.

*Editor's Note: This transcript has been prepared by the California Debt and Investment Advisory Commission (CDIAC) and it believes it to be a fair and accurate reproduction of the comments of the speakers. Any errors are those of CDIAC and not the speakers.*

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**Narrator:** Being a model borrower is an important goal for any agency. A model borrower is an agency that honors its repayment commitments while consistently demonstrating its willingness and ability to provide complete, accurate, and consistent information to the market in a transparent and timely manner. Such an agency engenders trust with its constituents through adept administration that ensures the intended use of bond proceeds, seeks out opportunities to reduce costs and diligently adhere to regulatory requirements.

Model borrowers employ policies and practices that improve credit ratings, lower borrowing costs, and protect the public interest. Your ability to build and preserve the administrative culture required to be a model borrower is strengthened through your knowledge of fundamental administrative elements. This module will provide a high level survey of your agency's post issuance responsibilities with a focus on the disclosure, communication, and internal control practices that support a strong borrower reputation and enable your agency to deliver on your community's financing goals.

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**Narrator:** Federal securities disclosure laws are designed to facilitate transparency, efficiency, and fairness in the municipal market by ensuring that current or potential investors are provided timely and accurate information that is reasonably relevant to an investment decision. This information must be provided at the time of issuance, but also over the life of the bonds. Federal laws strictly prohibit making untrue statements or omissions of material facts that are in effect any time an agency is speaking to the market through offering documents like an official statement, annual reports, material, event notices, and voluntary disclosures of financial condition. Written and spoken words matter. Even information released on websites and public statements by elected officials are covered by these laws.

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**Narrator:** The initial disclosure in offering or issuance documents provides perspective investors or lenders all necessary and critical information prior to debt issuance. In the case of publicly offered debt, securities laws



obligate the issuer to disclose in the official statement all information that a reasonable investor would consider important in their investment decision.

A comprehensive due diligence examination conducted by members of the internal and external financing team are designed to ensure the accuracy and completeness of the initial disclosure before it is presented to the governing board for approval. However, your agency's commitment to high quality disclosure is only the beginning.

Disclosure laws are also intended to support efficiency and fairness in the secondary market, where municipal debt is frequently traded among a variety of investors after the primary offering. The continuing disclosure agreement required by law and approved by the governing body defines your agency's post issuance disclosure responsibilities. Your agency will commit to annually file information about the financial health or operating condition of the agency, as well as immediately report the occurrence of specific events that can affect the market's investment decisions relative to your bonds throughout their life. Submitting the issuers audited annual comprehensive financial report on time to the Municipal Securities Rulemaking Board's electronic Municipal Market access website is chief among these filing responsibilities.

Since each issue of debt may have unique continuing disclosure obligations, the agency must take steps to recognize and meet all disclosure responsibilities with as much diligence and attention to accuracy and truth as it applied to the initial disclosure.

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**Narrator:** Transparently communicating timely, audited and complete financial information to the market in an easily accessible format can provide benefits beyond adherence to legal obligations. A well-executed investor relations program can boost your agency's reputation for strong governance with rating agencies and investment analysts, which can positively affect the demand for your bonds.

One element of a commitment to investor relations is a dedicated website. The quality of your website signals to the market how important communication and transparency are to your agency. It should be taken seriously. Information provided on the website must be timely and continuously monitored for consistency with legally required disclosure. Posted information should always be accompanied with an "as of" date and never promote the purchase of your agency's bonds. Investor relations websites can be particularly useful tools, but agency procedures must be in place to fully mitigate the risk of distributing information that is outdated, inaccurate, inconsistent, or unintentionally published.

Another important element of investor relations is designating assigned staff to communicate with investors and analysts that may reach out directly to the agency with questions regarding the availability of certain financial and operating information. Fielding inquiries from investors is common and not prohibited, but providing material information to some market participants and not others, known as selective disclosure, can create unfair and exploitable advantages in the market. Any information deemed material must also be disseminated to the market at large. Assigning specific staff to the investor relations role maintains information, consistency, and safeguards against inappropriate and potentially illegal disclosure.

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**Narrator:** Agency officials and officers must be careful not to make public statements that may provide only a partial story or distort investors' perception of the issuer's financial condition, either positively or negatively. Statements, even those not made in the course of a bond financing, can also be considered disclosure or speaking to the market. These include statements made in press releases, interviews, public meetings and events, and governing board proceedings. Such statements should be assumed to be public and monitored by rating agencies, investment analysts, and other market participants. Public statements may need to be accompanied by other material information to avoid being misleading.

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**Narrator:** The liability for violation of disclosure laws such as making false, misleading, incomplete, or fraudulent statements lies with the public agency's directors, governing board members, officers and staff, and extends to all instances of speaking to the market. The ramifications of disclosure law violations can be severe in addition to the monetary penalties imposed by a settled SEC case, the agency and potentially some of its officials will face significant legal costs even if they are successful in avoiding an SEC enforcement action or settling on favorable terms. Elected officials can face civil and criminal judgements, including jail time for the most egregious violations and be disqualified from future participation in the municipal securities market.

SEC settlements frequently require the agency to retain an independent consultant to review its continuing disclosure policies and procedures and implement corrective measures to minimize the potential of future violations. In addition, the agency may need to engage in comprehensive remedial disclosure education and training supervised by bond counsel and designate a responsible individual to ensure compliance. Some agencies have been ordered to disclose any settlement in all official statements for a period of five years. This disclosure stains an agency's reputation for years and could lead to higher borrowing costs.

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**Narrator:** Model borrowers are vigilant in their prevention of disclosure law violations in primary offering documents, post issuance, reporting and communications in the course of maintaining good investor relations. A standard element of this vigilance is a well-developed disclosure policy that is integrated with the agency's comprehensive debt management policy. It sets out the agency's disclosure responsibilities, including the type, form, and timing of information to be disclosed. The personnel involved, the procedures to vet and monitor information for disclosure, and the process to assure that timely, complete, and accurate information is available to the entire market. This process will frequently include involvement of a disclosure working group or committee composed of senior staff, disclosure counsel, and the agency's municipal advisor. The group is responsible to review and evaluate the agency's disclosure controls and procedures and to scrutinize information for material misstatements or omissions before it is made public.

Well-developed disclosure policies also include periodic training for professional staff and elected officials who may speak to the market. A model borrower demonstrates its commitment to the market by adhering to well-developed disclosure policies.

The next section will explore the post issuance administrative elements that are essential to fulfilling your commitments to your constituents.



## DEBT ISSUANCE AND ADMINISTRATION SERIES FOR ELECTED OFFICIALS' TRANSCRIPT

### *Being a Model Borrower | Part 2*

Module 8 explores post-issuance administrative characteristics of a model borrower including transparency best practices and on-going risk mitigation, and managing internal controls, compliance, and cost saving opportunities. Other topics include disclosure responsibilities and communication with the market, as well as risks and consequences of improper or inadequate communication.

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**Narrator:** The commitments made when issuing debt extend well beyond high quality disclosure to the market. The market, and most notably, your constituents expect a model borrower to have the administrative policy and structure in place to ensure that debt proceeds are used as intended, cost savings as a priority, and the opportunities offered through the use of debt are preserved. An administrative structure that formalizes lines of reporting and appropriately assigns authority and responsibility to a trained and knowledgeable staff, allows a model borrower to successfully manage post issuance commitments. Ultimately, however, the responsibility for establishing and maintaining an administrative system and the culture that supports it belongs to the agency's governing body.

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**Narrator:** Perhaps the most important commitment an agency makes when it issues debt is that proceeds will be used as constituents expect. A well-developed internal control process is required to ensure that bond proceeds are used only for legal and intended purposes. They must be properly accounted for, managed and safeguarded in a manner consistent with applicable legal requirements. The internal control practices of model borrowers include bond closing procedures; open and direct communication with the trustee for custody and control of funds; use of specific compliance staff to monitor disbursement activity; established target dates and deadlines for the bond program; procedures to determine disposition of remaining bond funds; and a process to conduct and document final inspection and close out of the bond funded projects.

Most importantly, the approving officer will always confirm that the agency has complied with its internal control system. Before authorizing a disbursement of bond funds, bond proceeds should be subject to the same strong administrative policy and financial management safeguards applied to all funds entrusted to your agency's control.

Incorporation of a compliance test into the agency's audit program will provide governing bodies the ability to independently assess the efficiency and validity of the agency's internal control system, as well as other post issuance compliance procedures. Debt issued under Proposition 39 by school and community college districts requires an additional layer of independent oversight that can bolster administrative systems. A citizens' oversight



committee required to oversee the bond program can help improve investor and constituent transparency, promote prudent internal controls, discover potential problems, and position the district to communicate the accomplishments of a well run bond program to taxpayers. Adhering to strong internal control policies, which are integrated into an agency's debt management policy safeguards bond proceeds ensures that financing objectives are achieved and preserves the reputation of a model borrower.

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**Narrator:** A model borrower prioritizes cost savings through a debt management policy that includes regular review of the debt portfolio in the context of market conditions to identify opportunities to lower financing costs.

An established and legal method to reduce financing costs is to issue new debt to refinance or refund existing debt at a new lower interest rate. Refunding may also provide the added benefit of removing or alleviating certain restrictive covenants in prior agreements that may generate other financing and cost saving opportunities. The value of an opportunity to save financing costs through refunding is largely a function of the agency's rights to repay bond holders or lenders prior to maturity, laws governing the tax exemption of new refunding debt, the transaction costs associated with the new issuance, and the prevailing market interest rates. Given the variety and complexity of the elements that require thorough evaluation, the agency's municipal advisor is frequently engaged to identify and quantify the benefit of a refunding opportunity. The debt management policy will establish cost savings provisions or minimum thresholds required to execute the refunding transaction.

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**Narrator:** Model borrowers regard the investment of bond proceeds as an important component of minimizing borrowing costs, but any investment strategy must facilitate efficient project funding and preserve the bonds tax exempt status.

The time to start thinking about investment management is well before the sale of the bonds. An accurate funding plan is crucial when determining how much to borrow, but also which permitted investments will be included in the bond documents. Permitted investment provisions in the bond documents generally point back to state law that prescribes the investments allowed for surplus funds. These are generally characterized as conservative fixed income investments of very high credit quality that can be easily turned into cash to match the project draw schedule with very low risk of any principal loss.

Investments must be structured to prioritize the liquidity necessary to meet the periodic funding of the project. The greater the certainty in the draw schedule, the less liquidity needed in the portfolio and the more proceeds that can be invested.

A good investment plan requires strong communication between project managers and officials charged with investment responsibilities to effectively match liquidity with project funding requirements. Generally, issuers cannot earn arbitrage that is a return on their invested tax-exempt bond proceeds greater than the average borrowing rate on the debt. Issuers are required to monitor and report on the investment of their tax exempt bond proceeds to the internal revenue service for the life of the bond. Failure to comply can lead to substantial penalties and the potential retroactive loss of tax-exempt status for the bonds. Policies for post issuance tax compliance are integrated with the debt management policy and include the designation of staff to monitor and



report on compliance and procedures for tracking bond proceeds, investment income, and arbitrage compliance. Frequently internal administration is augmented by external tax specialists.

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**Narrator:** The path to becoming a model borrower requires a very intentional process and starts well before a decision to issue debt. The path begins with a comprehensive debt management policy that includes or is integrated with policies covering disclosure, internal controls, cost savings, and regulatory compliance. The debt management policy provides the strategic guidance essential to the decision to borrow and the fulfillment of critical post issuance commitments. Your leadership and engagement are essential to successfully travel the path to model borrower status.

As an elected official, you are able to promote an administrative culture that highly values the qualities of a model borrower. You also have the authority to engage in the required policy development and maintenance that will prepare and position your agency for success. A reputation as a model borrower is attainable and should be the goal of every agency that borrows money in the public or private markets.

When an agency borrows money, it is making a variety of very substantial commitments to lenders or bond holders, regulators, and constituents. A model borrower honors these commitments willingly and consistently, and in doing so, achieves the financing objectives of the agency, and most importantly, the goals of the constituency it serves.