

## **BILL ANALYSIS**

C.S.S.B. 968  
By: West, Royce  
County Affairs  
Committee Report (Substituted)

### **BACKGROUND AND PURPOSE**

Chapter 1371, Government Code, is a public finance statute that authorizes certain Texas state agencies and local governments to issue variable rate debt obligations and to enter into credit agreements, including interest rate swap agreements, to manage interest rate risks and support payment of the obligations. With these tools, issuers are able to raise funds for needed infrastructure improvements on more efficient terms than those authorized by other laws.

C.S.S.B. 968 updates Chapter 1371, Government Code, (a) to authorize state agency and other local government issuers of debt obligations to employ modern interest rate management products in order to reduce borrowing costs, manage interest rate risks, or both and (b) to require that they observe prudent financial practices in authorizing and monitoring interest rate management agreements.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

### **ANALYSIS**

SECTION 1. Amends Section 1371.001, Definitions, Government Code, including changes to Subsection (1), (2), (4), (5), (7), (8) and adding new Subsection 3-a.

Subsection (1) adds to the definition of "credit agreement" that such an agreement may include authorization by a governing body in anticipation of, or related to, some or all of the issuer's obligations or interest on obligations.

Subsection (2) (D) is amended to include in the definition "eligible project" those approved by a majority of the voters but for which no debt obligation has been issued or for which there is other indebtedness payable from ad valorem taxes.

Subsection (3-a) Defines "Interest rate management agreement" as including a swap, basis, forward, option, cap, collar, floor, lock, and/or hedge transactions. Includes a master agreement that provides standard terms for transactions, an agreement to transfer collateral as security for transactions; or a confirmation of transactions.

Subsection (4) includes in the definition of "issuer" by adding that a issuer as defined by Section 1201.002, Government Code, is one that has a principal amount of at least \$100 million in past and present long-term indebtedness or a combination of both and such indebtedness is rated in one of the four highest rating categories for long-term debt instruments by a nationally recognized rating agency for municipal securities. Such rating has no effect on the current credit agreement or credit enhancement related to the obligation.

Subsection (5) includes in the definition of "obligation" future but not yet authorized ratings. It does not include an obligation payable wholly or partly from ad valorem taxes unless:

(A) there is voter approval in an election held for the purpose of authorizing the obligation, or

(B) the issuer is legally authorized to issue public securities payable wholly or partly by ad valorem taxes for the purpose for which the obligation is to be issued; and

has complied with any legal conditions before it pledges ad valorem taxes to pay the principal of, or interest on, the obligation.

Subsection (7) is amended to include in the definition of "project cost" interest on the financing of obligations and payments on credit agreements during and after construction.

Subsection (8) (E) is amended to include in the definition of "public works" property or a facility for a transit authority system, as defined by Section 451.001, Transportation Code.

SECTION 2. Amends Section 1371.003 Relationship to Other Law, Subsection (a), Government Code, by adding that this Chapter is wholly sufficient authority within itself for the execution of a credit agreement. Provides that any restrictions or limitations contained in other laws do not apply to the procedures prescribed by this chapter or to the issuance of obligations, the execution of credit agreements, or the performance other acts authorized by this Chapter.

SECTION 3. Amends Section 1371.051 Authority to Issue Obligation, Subsection (3)(A) and (B) to substitute the term "credit agreement" for the words "an interest rate lock, interest rate hedging agreement, or other" as part of the financing of a payment. Revises existing text for appropriate use of defined term "interest rate management agreement," as provided in Section 1.

SECTION 4. Amends Section 1371.056 Authority to Enter Into and Execute Credit Agreements, Subsection (a), Government Code, to allow the issuer to execute and deliver any number of credit agreements in anticipation of, related to or in connection with some or all of the issuer's obligations or interest on obligation, or both, at any time, without regard to whether the obligations have been authorized or issued. Deletes existing text authorizing a governing body (rather than issuer) to authorize such actions and conforms text to definitions, as provided in Section 1.

Subsection (b) adds that except as provided by this section, a credit agreement must substantially contain the terms and provide that the governing body approves the period. A credit agreement may provide that it may be terminated with or without cause, or becomes effective at the option of another party to the credit agreement, if the governing body first finds that the option best serves the interests of the issuer.

Subsection (c) adds that the governing authority may delegate to any number officers or employees of the issuer the authority to approve specific terms of, to execute and delivery, or to terminate and amend in accordance with its terms, a credit agreement on behalf of the issuer, subject to any conditions placed by the governing body. The delegation, however, must include specification of the principal amount or the notional amount, the term, the rate, the source of payment, the security, the identity or credit rating of an authorized counterparty, and the duration of the authorization. For an interest rate management agreement, the fixed or floating rates, economic consequences, early termination provisions, type, provider; and costs of credit enhancement must be included.

Subsection (d) adds that the cost to the issuer of payments under a credit agreement may be paid and secured by any source, including any revenue and money of the issuer available to pay the obligation, or (4) ad valorem taxes if the credit agreement is authorized in anticipation of, in relation to, or in connection with an obligation that is wholly or partly payable from ad valorem taxes.

Subsection (e) is amended by adding to the provision that a credit agreement is an agreement for professional services, but is not a contract subject to Subchapter I, Chapter 271, Local Government Code.

Subsection (f) is added to provide that if a credit agreement is authorized and is executed in anticipation of the issuance of an obligation described by Section 1371.001(5)(B) because the issuer is authorized by Subchapter C, Chapter 271, Local Government Code, to issue certificates of obligation:

(1) notice is required in Section 271.049, Local Government Code, and  
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(2) the issuer may enter into a credit agreement and issue the certificates of obligation only if:

(A) a petition is not signed by at least 5% of the registered voters of the issuer protesting the execution of the credit agreement;

(B) the issuance and execution are approved at a bond election under Chapter 1251; or

(C) notice is not required before the certificates of obligation are authorized.

Subsection (g) payments received by an issuer under a credit agreement or on termination of all or part of a credit agreement may be used to:

(1) pay the obligations, or costs to be financed, with which the credit agreement was entered into;

(2) pay other liabilities secured on parity with or senior to the obligations with which the credit agreement was entered into; or

(3) after (1) and (2) above are satisfied, make payments for any other purpose obligated or financed and liabilities and expenses under this Chapter, unless the credit agreement is paid primarily from ad valorem taxes.

Subsection (h) provides that an issuer may agree to pay or receive a payment on early termination of an interest rate management agreement due to a breach or for another reason and determining the payment by a specific amount, formula or by a process or algorithm.

Subsection (i) Authorizes a credit agreement which is secured in accordance with Subsection (d)(4) to be executed without an election or the imposition of an ad valorem tax unless required by the Texas Constitution. Requires an election to be held substantially in the manner provided for an election under Chapter 1251 (Bond Elections) if the Texas Constitution requires an election for the credit agreement.

Subsection (j) An issuer may enter into an interest rate management agreement transaction only:

(1) If the issuer has either entered into at least three interest rate management transactions before November 1, 2006, or has entered into one or more interest rate management transactions with notional amounts totaling at least \$400 million before that date; or

(2) as provided by Subsection (k)

Subsection (k) An issuer may enter into an interest rate management transaction if:

(1) the governing body has a risk management policy adopted, amended, or ratified within the preceding two years, which governs entering into and managing interest rate management agreements and transactions that address:

(A) conditions under which the issuer may enter into such agreement without independent advice from a financial or swap advisor who has experience in interest rate management transactions; and

(B) authorized purposes, types and credit of counterparties, credit risks and other risks, liquidity, methods of counterparty selection and limits for awarding a transaction, monitoring, and exposure;

(2) the issuer has received from the counterparty:

(A) if the transaction was not awarded through a competitive bidding process:

(i) a statement of the counterparts judgment that the difference in basis points between the rate of the transaction and the mid-market rate for a comparable transaction falls within the commonly occurring range for comparable transactions;

(ii) a statement of the amount of the difference as determined by the counterparty; or

(iii) if the counterparty does not know of a comparable transaction or mid-market rate, a statement of another suitable measure of pricing acceptable to the counterparty; and

(B) the counterparty's disclosure of any payments the counterparty made to another person to procure the transactions; and

(3) the governing body of the issuer or their authorized representative has determined that the transaction will conform to the issuer's interest rate management agreement policy after reviewing a report of the CFO of the issuer that identifies:

(A) its purpose;

(B) the anticipated economic benefit and the method of determination of same;

(C) the use of the receipts of the transaction;

(D) the notional amount, amortization, and average life compared to the related obligation;

(E) any floating devices;

(F) its effective date and duration;

(G) the identity and credit rating of the counterparties;

(H) the cost and anticipated benefit of transaction insurance;

(I) the financial and legal advisors and their fees;

(J) any security for scheduled and early termination payments;

(K) any associated risks and risk mitigation features; and

(L) early termination provisions.

Subsection (I) While an interest rate management agreement transaction is outstanding, the governing body of the issuer shall review and ratify or modify its related risk management policy at least biennially. Deletes existing text authorizing the governing body to delegate to an officer or employee the authority, under the terms and for the period approved by the governing body, to enter into a credit agreement and transactions under a credit agreement, and execute any instruments in connection with those transactions, notwithstanding Subsection (b).

SECTION 5. Amends Section 1371.057 Review and Approval of Obligation, Credit Agreement, and Contract by Attorney General, Subsections (b) and (c), Government Code, by establishing consistency in terminology within the section.

SECTION 6. Amends Section 1371.059 Validity and Incontestability, Subsection (a), Government Code, is clarified grammatically. Subsection (b) provides that an issuer in proceedings to authorize an obligation or credit agreement must be approved by the attorney general and registered with the comptroller unless exempted by Chapter 12202.007 or the obligation or credit agreement matures within one year. Subsection (c) The issuer may agree to waive sovereign immunity from suit or liability for the purpose of adjudicating a claim to enforce the credit agreement or obligation or for damages for breach of the credit agreement or obligation. This section does not apply to a state agency, a state institution of higher education or a county with a population of 900,000 or more.

SECTION 7. Amends Subchapter B, Chapter 1371, Government Code by adding Section 1371.061, Management Reports, as follows:

(a) An officer of the issuer of an interest rate management agreement transaction shall monitor and report on the transaction. A written report shall be presented to the governing body at least annually on all outstanding transactions. The report must:

- (1) describe the terms of the transactions;
- (2) contain a statement:
  - (A) of the fair value of each transaction;
  - (B) of the value of any collateral posted to or by the issuer under the transactions with each counterparty at the year's end; and
  - (C) reviewing the transactions' cash flows;
- (3) identify each counterparty, any guarantor of the counterparty's obligations and the credit ratings of the counterparty and guarantor; and
- (4) state whether the continuation of the transactions would comply with the issuer's interest rate management agreement policy.

(b) This section does not apply to an issuer that has entered into at least three interest rate management agreement transactions before November 1, 2006; or one or more such transactions with notional amounts totaling at least \$400 million before the same date.

SECTION 8. Adds to Section 65.461, Subchapter C, Chapter 65, Education Code, as follows:

Section 65.461. Bond Enhancement Agreements Subsection (a)(1) defines "bond" or "note" to mean a bond or note authorized by the board of regents of The University of Texas System for issuance according to Section 18, Chapter 55 or 66, Article VII, Texas Constitution, or any applicable law.

(2) "Bond enhancement agreement" means an interest rate swap agreement, a currency swap agreement, a forward payment conversion agreement, an agreement providing for payments based on levels of or changes in interest rates or currency exchange rates, an agreement to exchange cash flows or a series of payments, or other agreement.

Subsection (b) allows the board to enter into bond enhancement agreements placing an obligation on the board. A bond enhancement agreement is for professional services and shall contain the terms and conditions for the period of time the board authorizes. Fees and expenses for the bond enhancement agreement may be paid from and secured by a lien on and pledge of revenue funds of the board and its institutions, proceeds of the sale of bonds or notes, or from any other source legally available for that purpose. Such payments are deemed to be for the support and maintenance of The University of Texas System administration and may be paid from any source.

Subsection (c) allows the board to authorize one or more officers or employees to act on behalf of the board in entering into, delivering, determining the counterparty and terms of the bond enhancement agreement as specified by a board resolution.

Subsection (d) allows the resolution to authorize a financing program pursuant to more than one bond enhancement agreement.

Subsection (e) Unless specified otherwise by the board or its designee, the bond enhancement agreement is not a credit agreement for the purposes of Chapter 1371, Government Code or Section 65.46 of this Chapter, or any successor to such laws, even if issued in part under either such law.

Subsection (f) requires that this section be construed liberally to effect the legislative intent and purposes of this section, and all powers granted by this section shall be broadly interpreted to effect that intent and those purposes and not as a limitation of powers.

SECTION 9. The changes in the law made by this Act apply only to proceedings related to obligations or credit agreements or interest rate management agreements adopted on or after the effective date of this Act. Proceedings related to these transactions before the effective date of this Act are governed by the law in effect on the date the proceedings were initiated and the former law is continued in effect for that purpose.

SECTION 10. An agreement described by this section is ratified in all respects, without regard to whether the agreement to waive sovereign immunity is limited to the extent permitted by law, if the agreement:

(1) is entered into before the effective date of this Act by an issuer as defined by Section 1371.001(4), Government Code, that has authority by statute or under its charter to sue and be sued or to plead and be impleaded; and

(2) waives sovereign immunity from suit or liability for breach of an obligation or of a credit agreement authorized by Chapter 1371, Government Code.

SECTION 11. Upon passage, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.

### **EFFECTIVE DATE**

Upon passage, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.

### **COMPARISON OF ORIGINAL TO SUBSTITUTE**

1. In proposed Section 1 of the bill, Subsection 9 is moved to new Subsection 3-a as follows:

(3-a) "Interest rate management agreement: means an agreement that provides for an interest rate transaction, including a swap, basis, forward, option, cap, collar, floor, lock, or hedge transaction, a similar transaction, or any combination of those types of transactions. The term includes:

- (A) a master agreement that provides standard terms from transactions;
- (B) an agreement to transfer collateral as security for transactions; or
- (C) a confirmation of transaction.

2. In proposed Section 6, in Section 1371.059. Validity and Incontestability. add to Subsection (c) This subsection does not apply to an issuer that is:

- (1) a state agency, including a state institution of higher education; or
- (2) a county with a population of 900,000 or more.

3. Move proposed content in Section 8 to Section 9 and add proposed Section 8, as follows: Subchapter C, Chapter 65, Education Code is amended by adding Section 65.461 to read as follows:

Bond Enhancement Agreements. (a) In this section :

(1) "Bond" or "note" means a bond or note that the board is authorized to issue according to law, including Section 18, Article VII, Texas Constitution, Chapter 55 or 66 of this code, or other applicable law.

(2) "Bond enhancement agreement" means an interest rate swap agreement, a currency swap agreement, a forward payment conversion agreement, an agreement providing for payments based on levels of or changes in interest rates or currency exchange rates, an agreement to exchange cash flows or a series of payments, or other agreement, including an option, put, or call, to hedge or modify payment, currency, rate, spread, or other exposure.

(b) The board may at any time and from time to time enter into one or more bond enhancement agreements that the board determines to be necessary or appropriate to place the obligation of the board, as represented by the bonds or notes issued or to be issued, in whole or in part, on the interest rate, currency, cash flow, or other basis desired by the board. A bond enhancement agreement is an agreement for professional services and shall contain the terms and conditions and be for the period that the board authorizes. The fees and expenses of the board in connection with a bond enhancement agreement, including any payments due from the board under a bond enhancement agreement, may be paid from and secured by a lien on and pledge of all or any part of any of the revenue funds of the board and its institutions, proceeds of the sale of bonds or notes to which the bond enhancement agreement relates, or from any other source that is legally available for the purpose of paying the bonds or notes and the interest on the bonds or notes or that may otherwise be legally available to make those payments. Payments due from the board under a bond enhancement agreement relating to bonds or notes issued pursuant to Section 18, Article VII, Texas Constitution, are deemed to be for the support and maintenance of The University of Texas System administration and may be paid from the available university fund.

(c) The resolution of the board authorizing a bond enhancement agreement may authorize one or more designated officers or employees of the board to act on behalf of the board in entering into and delivering the board enhancement agreement and in determining or setting the counterparty and terms of the board enhancement agreement specified in the resolution.

(d) The resolution of the board authorizing a financing program pursuant to Section 65.46 may include authorization of one or more bond enhancement agreements.

(e) Unless the board or its designee elects otherwise in its authorization or approval of a bond enhancement agreement, the bond enhancement agreement is not a credit agreement for purposes of Chapter 1371, Government Code, or Section 65.46 of this Chapter, or any successor to such laws, regardless of whether the bonds or notes relating to the bond enhancement agreement were issued in part under either such law.

(f) This section shall be construed liberally to effect the legislative intent and purposes of this section, and all powers granted by this section shall be broadly interpreted to effect that intent and those purposes and not as a limitation of powers.

**4.** Changed effective date from September 1st, 2007 to upon passage, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.