State of Tennessee
Justin Wilson, Comptroller

For Immediate Release:
COMPTROLLER WILSONSUGGESTS MAJOR REFORMS FOR MUNICIPAL BOND FINANCING

May 1, 2009

Citing fundamental changes in the way many Tennessee local governments have been financing their debt, Comptroller Justin P. Wilson today recommended a series of reforms intended to protect taxpayers from the risks some of the more exotic types of financing carry.

Wilson outlined his proposed changes, including provisions that would effectively prevent most small cities and counties from engaging in some high-risk transactions, during a meeting of the Tennessee State Funding Board.

Wilson also told the State Funding Board, which oversees the guidelines regulating municipal financing deals, that he wants to consider other sweeping changes, possibly including limitations on the use of variable rate debt for municipal financing.

As cities and counties have turned to increasingly sophisticated types of financing, the potential risks for their constituents has gone up, Wilson said.

"We have to respond to a fundamental shift in the way in which local governments have been paying for parks, schools and other public works projects over the last few years," Wilson said. "Some local governments have been relying exclusively on variable rate debt, which can be as dangerous as a homeowner financing a mansion with an adjustable rate mortgage and no down payment up front."

Wilson recommended that so-called "interest rate swaps" only be allowed on financing deals valued at $50 million or more and "forward purchase agreements" only be allowed on deals valued at $25 million or more. Swaps and forward purchase agreements are contracts meant to reduce the borrower's interest rate risk related to debt. Under certain market conditions, payments on those types of transactions are subject to increase sharply.

The practical effect of establishing a minimum size limit on those types of transactions would be to keep smaller cities and counties with limited resources and expertise from taking those risks.

Also, Wilson recommended that cities and counties engaging in those types of transactions be required to have full-time staff members who could demonstrate they have sufficient education and training to understand the deals they are entering into on behalf of local taxpayers.

And Wilson recommended guideline changes intended to eliminate conflicts of interest between the various parties involved in the transactions and add new reporting and monitoring requirements for cities and counties. The proposals would increase the state's oversight role.

Wilson stressed that his proposals are just a starting point for a discussion about necessary reforms. He said he plans to seek public comment for at least 30 days on all of the ideas before any changes are made.

Wilson said he's begun to work with the Tennessee Commissioner of Commerce and Insurance to determine any regulatory changes that might be necessary and to examine disclosure requirements for variable rate securities. He notes there is limited federal regulation in this important area.

"This is only the first phase of a complex process," Wilson said. "It's not possible to wave a wand and fix every conceivable problem that might arise in the complicated universe of local government finance. But we can and will do more to make sure that ordinary Tennesseans are adequately protected from the uncertainties that are always present in the financial marketplace."

To review the draft guidelines, please visit http://www.tn.gov/comptroller/lf/lfsfundbd.htm

Comments on the guidelines can be sent to comptroller.web@tn.gov

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