

Commonwealth of Massachusetts State Finance and Governance Board

Annual Report
Fiscal Year 2017

Board Chair

Lourdes German
*Director, Lincoln
Institute of Land
Policy & Director,
The Civic Innovation
Project*

Board Members

Brent J. Anderson
*President, Pilgrim Bay
Insurance Agency*

Katherine Holahan
*Vice President,
Government Affairs,
Associated Industries
of Massachusetts*

Supreo Ghosh
*Office of the State
Treasurer,
Commonwealth of
Massachusetts*

Susan Perez
*Deputy Treasurer
Office of the State
Treasurer,
Commonwealth of
Massachusetts*

Board Secretary

Mark Attia
*Director of Debt
Management &
Special Finance
Programs
Executive Office for
Administration and
Finance,
Commonwealth of
Massachusetts*

Honorable Madams and Messrs.;

We are pleased to deliver the Annual Report of the Commonwealth of Massachusetts (the “Commonwealth”) State Finance and Governance Board (the “Board”).

The Board was created pursuant to Massachusetts General Laws Chapter 6, Section 97. Our legislative mandate is to promote transparency, public accountability and adherence to best practices by all state entities with respect to proper governance of state entities and investments, borrowing or other financial transactions by state entities involving public funds, including tax supported debt.

This report provides a summary of our operations as of the end of Fiscal Year 2017, and is submitted pursuant to Massachusetts General Laws Chapter 6, Section 98. To that end, this report covers:

- A summary of the current statutory and regulatory framework that governs the Board, following changes enacted to the Board’s regulations pursuant to Executive Order Number 562.
- A synopsis of the Board’s findings regarding investments, borrowing and other financial transactions carried out by state entities; and
- A synopsis of the Board’s activities to promote proper governance, transparency, public accountability and best practices.

The Board continues to make significant progress in furtherance of its legislative mandate. We look forward to discussing any aspect of our operations with you, should you like additional information or have questions.

Sincerely,

The Massachusetts State Finance and Governance Board

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BOARD MEMBERS

Brent J. Anderson

President

Pilgrim Bay Insurance Agency

Brent J. Andersen is the founder and president of Pilgrim Bay Insurance Agency, a Massachusetts based commercial insurance brokerage with a focus on Surety, Commercial Construction and Public-Sector risks. He served for ten years on the Board of Trustees of Quinsigamond Community College, including six years as the Board Chair. In addition, Brent is a past Trustee of the Pension, Health and Welfare and Annuity funds for the Heat and Frost Insulators Union Local 6 of Boston. Currently, he continues to serve on a variety of community boards in Central Massachusetts. He holds a Bachelor's Degree in Finance from Nichols College, is a graduate of Saint John's High School and has been the Treasurer of the Massachusetts Republican Party since 2003.

Katherine Holahan

Vice President, Government Affairs

Associated Industries of Massachusetts

Katie's policy focus at Associated Industries of Massachusetts is workforce development and education, as well as healthcare. Before joining AIM, Katie spent seven years in the office of the Massachusetts House Minority Leader and three years in the office of the House Ways and Means Committee, gaining particular experience in workforce and economic development issues. She holds a bachelor's degree from Fairfield University and a master's degree from Boston College.

Lourdes German

Director, Lincoln Institute of Land Policy

Director, The Civic Innovation Project

Faculty, Boston University

Lourdes Germán is Director of International & Institute-Wide Initiatives at the Lincoln Institute of Land Policy where she is helping to advance the Institute's global municipal fiscal health campaign. An expert in municipal finance, Lourdes began her career as a public finance attorney representing government entities. Following that work, Lourdes co-created the national municipal finance business division at Fidelity Investments, the largest global mutual fund company, as a Vice President of Municipal Finance, and opened and managed Fidelity's first New York office for public finance. Following Fidelity, Lourdes' professional experiences included serving as General Counsel and Vice President of a national municipal investment management company, creating and teaching a graduate government finance course at Northeastern University, and advising non-profits focused on urban economic growth. Lourdes is also the founder and director of the Civic Innovation Project, an online thought leadership platform that was awarded the 2015 State of Boston Innovation Award for its impact using technology to advance city-to-city learning with respect to the most challenging issues facing governments. Outside of work, Lourdes serves as Governor Baker's appointed Chair of the

Massachusetts State Finance and Governance Board, is a government appointee of the Mayor of Boston to the committee focused on the City's audit and finance matters, serves on the board of Boston Women in Public Finance, and serves on the board of United Way.

Supreo Ghosh

Office of the State Treasurer, Commonwealth of Massachusetts

Supreo works on debt and liability management for State Treasurer's Office, with a focus on issuance and risk management of the State's general obligation and special obligation debt, private placements, bank facilities and off-balance sheet liabilities. As a subject matter expert at the FDIC following the financial crisis, he worked closely with regulators at the FDIC, Federal Reserve, SEC and the US Treasury Department on risk monitoring of financial institutions, with a focus on regulatory policy and rule-making relating to the implementation of Dodd-Frank. He has also worked in the economic research and analysis department at the Federal Reserve. Supreo brings over 20 years of experience in Investment Banking, Capital Markets and Financial Advisory, having worked at Morgan Stanley, Credit Suisse, Bank of America and Deutsche Bank. He has an MBA in Finance from Sloan School of Business at MIT and a Bachelor's from MIT.

Susan Perez

Deputy Treasurer

Office of the State Treasurer, Commonwealth of Massachusetts

Sue Perez is a Deputy Treasurer in the Massachusetts State Treasurer's Office with a focus on the Commonwealth's debt management operations. Sue is responsible for all of the Commonwealth's short-term and long-term borrowing needs for its \$22 billion debt portfolio consisting of issues within the General Obligation credit as well as various Special Obligation credits. Sue also serves as Executive Director of the Massachusetts Clean Water Trust ("MCWT"), a position she has held since March of 2012. Since that time she has guided the MCWT through multiple new money and refunding issues, through a structural change in the way its bonds are issued, and through multiple successful issuances of MCWT Green Bonds. Sue has over 25 years of experience in accounting, audit and financial management. She has been the Senior Finance Director for a \$3.4 billion service company, and at the other end of the spectrum was one of the initial members of a start-up company with the responsibility of establishing the finance and human resources departments. Sue was an auditor at PriceWaterhouse Coopers, during which time she received her CPA. She is a graduate of the Boston University School of Management, with a B.S. in Business Administration. She resides in Foxboro.

STATUTES AND REGULATIONS GOVERNING THE BOARD

The Board serves under the Governor and is subject to the Governor's supervision pursuant to Massachusetts General Laws Chapter 6, Section 17. The enabling authority, powers, and function of the Board are governed by: Massachusetts General Laws Chapter 6, Section 97; Massachusetts General Laws Chapter 6, Section 98; and Title 976 of the Code of Massachusetts Regulations, Section 2.00. In addition, the Board also has statutory authority pursuant to Massachusetts General Laws Chapter 29, Section 53 to grant certain waivers related to the issuance of bonds or notes by the Commonwealth of Massachusetts.

A non-exhaustive summary of the key provisions of Title 976 of the Code of Massachusetts Regulations, Section 2.00 that are in effect at present, is as follows:

- A requirement that all state entities that adopt a substantive revision to their investment policy file the revised investment policy with the Board. (*Title 976 of the Code of Massachusetts Regulations, Section 2.03*)
- A requirement that all state entities that adopt a substantive revision to their debt management policy file the revised debt management policy with the Board. (*Title 976 of the Code of Massachusetts Regulations, Section 2.04*)
- A review process for financial transactions involving derivative financial products. The regulation requires the submission of an analysis by an independent financial advisor, a certified copy of the governing board's vote, and (if not previously submitted) the governing board's "derivatives policy," with copy of that board's vote to establish such a policy. The Board's review function consists of reviewing the materials submitted to the Board to conclude whether the materials required to be submitted, pursuant to 976 CMR 2.00, have been submitted, evidencing compliance with the level of due diligence required to be undertaken by the entity with respect to the proposed financial transaction involving a derivative financial product. This regulation also requires that an entity (which has received a Board conclusion that the required items were in fact submitted), must report to the Board following the execution of the derivative financial product transaction. (*Title 976 of the Code of Massachusetts Regulations, Section 2.05*)
- A procedure relating to qualified conduit debt transactions involving derivative financial products. The regulations enable qualified conduit debt transactions that involve a derivative financial product not to be reviewed under Title 976 of the Code of Massachusetts Regulations, Section 2.00. The Board's review of such transaction is limited to confirming that the transaction constitutes a Qualified Conduit Debt Transaction. The regulations do, however, require a review of any such transactions that involve a guarantee if the guarantee exceeds one million dollars, or if the Board has delegated the authority to enter into such a guarantee to staff. The regulations also require any entity that enters into such guarantees to submit a "Guarantee Program Report" at least quarterly. The Board received

satisfactory Guarantee Program Reports covering the Fiscal Year 2017 for the Massachusetts Development Finance Agency, the State Entity authorized to issue Qualified Conduit Debt Transactions, and administers a Guarantee Program in support of such transactions. This requirement applies regardless of whether the guarantee transaction was reviewed by the Board. (*Title 976 of the Code of Massachusetts Regulations, Section 2.06*)

- A review of requests for a waiver from the presumption of a competitively bid financing. This regulation implements Massachusetts General Laws Chapter 29, Section 53. That statute requires competitive sales whenever the Commonwealth is selling bonds that mature later than three years from the date of issuance. It also allows the Board to waive this requirement, i.e., allow to the Commonwealth to undertake a negotiated sale for maturities greater than three years. Although the statute does not say so explicitly, the regulation also assumes that this requirement for a waiver applies whenever an entity that is selling bonds with Commonwealth support is selling those bonds on a negotiated basis. This regulation prescribes the requirements for the Commonwealth and a governing board of a state entity to request such a waiver. (*Title 976 of the Code of Massachusetts Regulations, Section 2.07*)

A full copy of Title 976 of the Code of Massachusetts Regulations, Section 2.00 is included as Appendix B to this report.

BOARD FINDINGS & ACTIVITIES

In Fiscal Year 2017, the Board took many steps to fulfill its legislative mandate, including the review of its regulations and numerous transactions by state entities. In this section, the report presents a brief synopsis of the result of a regulatory review process initiated by the Board during Fiscal Year 2017. It also presents select notable determinations and findings by the Board regarding investments, borrowing and other financial transactions carried out by state entities that can be instructive to other state entities.

It is important to note that all of the decisions below applied prospectively, and were not intended to affect any determinations already made by the Board. To access to the entire record of the Board's findings, and all filings submitted to the Board by state entities, including Debt Management Policies pursuant to the statutes and regulations that govern the Board, please see the Board's website.

- ***Regulatory Review Pursuant to Executive Order Number 562***

On March 31, 2015, Governor Baker issued Executive Order Number 562 commissioning a complete and comprehensive review of all existing Executive Branch regulations. Executive Order Number 562 directed each secretariat, agency, department, board, commission, authority or other body within the Executive Department to promptly undertake a review of every regulation currently published in the Code of Massachusetts Regulations under its jurisdiction. Pursuant to this directive, the Board with the assistance of the General Counsel of the Executive Office of Administration and Finance of the Commonwealth ("EOAF"), undertook a comprehensive review of the regulations that govern the board, specifically, Title 976 of the Code of Massachusetts Regulations, Section 2.00.¹ Changes that were proposed by the Board with respect to the noted regulations were evaluated by the following guiding principles: 1. The standard of review under Executive Order Number 562; 2. the statutory framework for the regulations was considered; and 3. the content of the regulations was considered, with a principal goal that the regulations should promote proper governance, transparency, public accountability and best practices.

The standard of review pursuant to Executive Order Number 562 broadly limited regulations to those mandated by law or which were "essential to the health, safety, environment or welfare of the Commonwealth's residents." To satisfy the noted standard or review, a promulgating agency was required to make certain showings, including: 1. that there was a clearly identified need for governmental intervention, and 2. that the costs of the regulation did not exceed the benefits that would result. It was also relevant to the analysis under Executive Order Number 562 that the regulations that govern the Board are primarily government-facing. For regulatory frameworks like those of the Board that exert authority over other state entities

¹ The regulations in effect for the Board at the time that the regulatory review process commenced under Executive Order 562 were the regulations adopted July 19, 2010, and accordingly, the noted regulations served as the starting point for the Board's review.

(rather than private businesses) an evaluation of the regulation's burdens and inefficiencies on other governmental entities was also part of the analysis.²

The statutory framework for the regulations was important, in particular, an assessment of the degree to which regulations were coherent and aligned to the statutory framework governing the Board. This required an evaluation of Massachusetts General Laws Chapter 6, Section 98. The noted statute requires the Board to “promote transparency, public accountability and adherence to best practices by all state entities with respect to proper governance of state entities and investments, borrowing or other financial transactions made or entered into by state entities and involving public funds, including tax supported debt.” In addition, Massachusetts General Laws Chapter 6, Section 98, Subsection (b), further requires that the Board review any transaction involving a “derivative financial product” that a state entity of the Commonwealth proposes to enter.³ Subsection (c) of Massachusetts General Laws Chapter 6, Section 98, also authorizes the Board to promulgate regulations for the purposes of “requiring state entities to report, adopt appropriate policies and adhere to best practices with respect to governance, investments, borrowing and other financial transactions.”

Finally, when analyzing the regulations pursuant to Executive Order Number 562, the content of the regulations was examined in view of several important considerations. This included an assessment of factors like the degree to which the regulations expanded on the statutory role of the Board, the degree to which the regulations were overly prescriptive, the degree to which the regulations were overly burdensome in the required submissions by state entities, a cost-benefit analysis, and other factors were considered.

When the review process pursuant to the Executive Order Number 562 concluded, the Board identified several areas for potential revision to the regulations. Most notably, changes were identified to sections of Title 976 of the Code of Massachusetts Regulations, Section 2.00 where sections of the regulations were considered to go beyond the statutory requirements.

² The term “state entity” is defined in Title 976 of The Code of Massachusetts Regulations, Section 2.02, as follows: “The Commonwealth, any state authority as defined in M.G.L. c. 29, § 1, or other state entities of the Commonwealth with responsibility for managing and overseeing Public Funds.” The term is also defined in Massachusetts General Laws Chapter 6, Section 97, as follows: “the commonwealth, a state authority or another state entity with responsibility for managing and overseeing public funds.”

³ The term “derivative financial product” is defined as in Massachusetts General Laws Chapter 6, Section 97 as follows: “financial instruments with values derived from or based upon the value of other assets or on the level of an interest rate index including, but not limited to, detached call options, interest rate swaps or swaptions, caps, floors and collars, but not including bond insurance or other credit or liquidity enhancement of bonds or notes or agreements related to the lending or investment of the proceeds of bonds or notes.” It is also defined in the Title 976 of the Code of Massachusetts Regulations, Section 2.02 as follows: “Any financial instrument which is a bond or note issue of a State Entity Authorized to Issue Debt or which is related to a bond or note issue of a State Entity Authorized to Issue Debt the value of which is derived from or based upon the value of other assets or on the level of an interest rate index including, but not limited to, a call option on a bond, interest rate swap agreements, interest rate swaptions, caps, floors, collars, inverse floaters and auction rate securities; provided, however, that any bonds or notes issued by State Entities Authorized to Issue Debt with fixed rates of interest shall not constitute Derivative Financial Products, regardless of whether such fixed rate bonds or notes are issued with a call option, regardless of whether such fixed rate bonds or notes are insured by bond insurance or other form of credit enhancement, and regardless of investment or lending of such fixed rate bond or note proceeds.”

Revisions were also considered that would preserve the public purpose while increasing efficiency and clarity.

Draft revisions to the regulations were presented for the Board's deliberation at the September 2016 open meeting of the Board. Amendments to the regulations were then finalized in a process that included a hearing and public comment period, and filing of the amended regulations with the Secretary of the Regulations Division of the Commonwealth of Massachusetts.

A final regulatory framework was adopted under Title 976 of the Code of Massachusetts Regulations, Section 2.00 in March of 2017, and appear as Appendix B to this report.

- ***Determination with respect to the Board's Review of Derivative Financial Transactions of Charter Schools***

A question was raised regarding whether the Board's review should continue to extend to certain transactions involving charter schools. As brief background, the Board's historical practice had been to review derivative financial transactions involving charter schools because charter schools were considered state entities and, thus, subject to the sections of Massachusetts General Laws Chapter 6, Section 97; Massachusetts General Laws Chapter 6, Section 98; and Title 976 of the Code of Massachusetts Regulations, Section 2.00. Taken together, the noted statutes and regulations were considered to require the Board to conduct a review of any transaction relating to derivative financial products proposed to be entered into by a state entity.

The analysis of this issue began with a review of Massachusetts General Laws Chapter 6, Section 97, which defines the term, "state entity," as "the commonwealth, a state authority or another state entity with responsibility for managing and overseeing public funds." The Board had historically treated any transactions in which a charter school guarantees the debt as a transaction involving a "derivative financial product" involving a "state entity," thus requiring review by the Board. This historical interpretation had been adopted informally and did not expressly appear in the Board's regulations or in any other guidance promulgated by the Board, as best as could be determined.

The Board, and EOAF counsel, further considered the statutes that govern the formation of charter schools, specifically, Massachusetts General Laws Chapter 71, Section 89. The noted statute provides that the board of a "commonwealth charter school" shall "be deemed to be public agents authorized by the commonwealth to supervise and control the charter school." Applying the definition of a "state entity" to this definition, the Board and EOAF counsel determined that a charter school board is not "the Commonwealth", and that such an entity is also not a "state authority."

The Board and EOAF counsel reached the determination that a charter school board is not a "state entity with responsibility for managing and overseeing public funds." This conclusion was supported by the reasoning that charter school boards in effect have a license from the Commonwealth, but such license does not render them a "state entity." This aligns with practice across other areas of state government in the Commonwealth where licenses are issued,

for example, to operate a hospital, health insurer, nursing homes, among other entities. Those organizations also receive substantial “public funds” but the attributes of the noted organizations, without more, do not make those entities a “state entity.”

Taken together, the factors above supported the conclusion reached by the Board and EOAF counsel that it need not review “derivative financial transactions” involving charter schools in the future, absent additional facts or factors which would bring a derivative transaction by a charter school within the purview of the regulations and statutes that govern the Board.

- ***Determination with respect to Massachusetts Housing Partnership Derivative Program***

The Board was asked to review a time-limited swap program developed by the Massachusetts Housing Partnership. In the course of its review, the Board had to examine whether the Massachusetts Housing Partnership’s request that the Board approve a swap “program” was a request within the scope of the statutes and regulations that govern the Board, specifically, Title 976 of the Code of Massachusetts Regulations, Section 2.05.

As brief background, the Massachusetts Housing Partnership is a public non-profit that supports and finances affordable housing. As part of its work, the Massachusetts Housing Partnership decided to utilize the Department of Housing and Urban Development/United States Treasury Federal Financing Bank Risk-Sharing Program (“Risk-Sharing Program”) as a source of funding for the loans that it makes to its borrowers. According to information the Massachusetts Housing Partnership presented to the Board, the Risk-Sharing Program provided avenues for low interest rates on long-term fixed-rate multifamily housing loans, but lacked options for long-term forward rate commitments as part of the program.

In order to leverage the Risk-Sharing Program as a low-cost financing avenue, the Massachusetts Housing Partnership developed a swap program that would allow it to provide the required forward rate commitment during the construction period, and hedge interest rate risk. The swap transactions within the noted swap program were designed to have identical financial structures: a forward-starting, fixed-pay, cash settled interest rate swap, in an aggregate notional amount not to exceed \$50,000,000.

Materials presented to the Board indicated that the swap program was structured to allow the Massachusetts Housing Partnership to execute the swap transactions as needed through the period ending December 31, 2017. According to the Massachusetts Housing Partnership, this was intended to preserve its flexibility to execute the noted hedges in a contemporaneous way in view of the interest rate risk arising from its forward rate commitment. Without the noted timing flexibility, the Massachusetts Housing Partnership explained that it may be not be able to hedge its interest rate risk immediately, thereby reducing the potential effectiveness of the hedging program. The purpose of structuring the swap program as described was also to eliminate the potential administrative burdens that could have occurred if numerous identical swap transactions were presented individually for the Board’s approval, by the Massachusetts Housing Partnership.

Upon considering the language of Title 976 of the Code of Massachusetts Regulations, Section 2.00 and the materials presented by the Massachusetts Housing Partnership, the Board rendered its approval of the swap program. In reaching the determination, the Board considered materials presented by the Massachusetts Housing Partnership that included the following for each respective swap transaction in the program: (i) a written analysis and recommendation of its independent financial advisor; (ii) materials indicating that each transaction in the swap program is consistent with Massachusetts Housing Partnership's Policy on Forward-Starting Swaps; (iii) materials indicating that the benefits of the forward-starting swap outweigh the risks of the forward-starting swap; (iv) materials indicating that the Massachusetts Housing Partnership board of Directors or executive committee had approved the proposed transactions; among others.

CONCLUSION: THE YEAR AHEAD

As noted throughout this report, the Board's purpose is to promote transparency, public accountability, and adherence to best practices related to debt and derivative financial products. In Fiscal Year 2018, the Board will continue to discharge its statutory mandate by executing its review function with respect to derivative transactions in accordance with the statutes and regulations that govern the Board. In addition, the Board will also continue to receive the debt management and investment policies filed by the various state entities noted in the regulations that govern the Board, and will share such policies on the Board's website.

As the Board further considers the parameters and scope of its role, additional activities it may pursue in Fiscal Year 2018 include expanding the content on the Board's website to include additional resources for debt-issuing state entities in Massachusetts. The Board will specifically consider enhancing the degree to which the Board's website, and its annual report, can serve as a channel for promoting content that enables issuers to remain informed of the best practices and determinations related to debt and derivative financial products.



The Board also expects to begin exploring a substantive review of the statutes that govern the Board. Massachusetts General Laws Chapter 6, Section 98 (c)(2), allow the Board to propose legislative changes to improve governance practices or the management of public funds. The Board expects to specifically examine the definition of "derivative financial product" as it appears in various statutes and regulations that govern the Board and assess the degree to which changes should be introduced in the noted area.

APPENDIX A: STATE ENTITIES LIST

The following is a list of the state entities in the Commonwealth that have filed ***debt management policies*** with the Board, as of the date of this report, and links to their respective policies:

- Mass Development Restricted Funds Investment Policy and Guidelines 
- Massachusetts Department of Transportation Debt Issuance and Management Policy 
- Massachusetts Department of Transportation Interest Rate Swap Management Policy 
- Massachusetts Department of Transportation Board Vote 
- Massachusetts Educational Financing Authority Debt Management Policy 
- Massachusetts Housing Finance Agency Debt Management Policy 
- Massachusetts Housing Finance Agency Master Swap Policy 
- Massachusetts Port Authority Debt Issuance and Debt Management Policy 
- Massachusetts State College Building Authority Debt Management Policy
- Massachusetts Water Pollution Abatement Trust Debt Management Policy 
- Massachusetts Water Pollution Abatement Trust Debt Management Procedures 
- Massachusetts Water Resources Authority Capital Finance Management Policy 
- Massachusetts School Building Authority Debt Management Policy 

The following is a list of the state entities in the Commonwealth that have filed ***investment policies*** with the Board, as of the date of this report, and links to their respective policies:

- Massachusetts Educational Financing Authority Investment Policy 
- Massachusetts Housing Finance Agency Investment Policy 

All ***transactions*** considered by the Board for state entities is made public in the minutes and agendas of the meetings of the Board conducted pursuant to open meeting laws. Those materials are available on the Board's website, or by written request at the address below:

State Finance and Governance Board
c/o Director of Debt Management and Special Finance Programs
Executive Office for Administration and Finance
State House, Room 373
Boston, MA 02133
<http://www.mass.gov/anf/budget-taxes-and-procurement/cap-finance/fab/>

976 CMR: STATE FINANCE AND GOVERNANCE BOARD

976 CMR 2.00: STATE FINANCE AND GOVERNANCE BOARD REGULATIONS

Section

- 2.01: Purpose and Application
- 2.02: Definitions
- 2.03: Policies Relating to Investment of Public Funds
- 2.04: Debt Management Policies
- 2.05: Review of Financial Transactions Involving Derivative Financial Products
- 2.06: Review of Qualified Conduit Debt Transactions Involving Derivative Financial Products; with Guarantee
- 2.07: Review of Requests for Waiver from Presumption of a Competitively Bid Financing
- 2.08: Board Contact Information

2.01: Purpose and Application

The powers and responsibilities of the Board set forth in M.G.L. c. 6, § 98 are intended to promote transparency, accountability and best practices among State Entities with respect to investments, borrowing or other financial transactions involving public funds made or entered into by State Entities.

2.02: Definitions

For purposes of 976 CMR 2.00, the following definitions shall apply, in addition to the definitions appearing in M.G.L. c. 6, § 97:

Board. The State Finance and Governance Board, established under M.G.L. c. 6, § 97.

Commonwealth. The Commonwealth of Massachusetts.

Derivative Financial Product. Any financial instrument which is a bond or note issue of a State Entity Authorized to Issue Debt or which is related to a bond or note issue of a State Entity Authorized to Issue Debt the value of which is derived from or based upon the value of other assets or on the level of an interest rate index including, but not limited to, a call option on a bond, interest rate swap agreements, interest rate swaptions, caps, floors, collars, inverse floaters and auction rate securities; provided, however, that any bonds or notes issued by State Entities Authorized to Issue Debt with fixed rates of interest shall not constitute Derivative Financial Products, regardless of whether such fixed rate bonds or notes are issued with a call option, regardless of whether such fixed rate bonds or notes are insured by bond insurance or other form of credit enhancement, and regardless of investment or lending of such fixed rate bond or note proceeds.

Public Funds. Any funds that are received by a State Entity Authorized to Issue Debt from the Commonwealth or any other public or private source, and are under the control of and are expended at the discretion of the State Entity Authorized to Issue Debt.

Qualified Conduit Debt Transaction. Any issue of bonds or notes issued by a State Entity Authorized to Issue Debt acting in a conduit role for a non-governmental, for-profit or non-profit corporation or group of related or unrelated for profit or non-profit corporations (none of which is itself a State Entity Authorized to Issue Debt) (collectively, the borrower), and any derivative financial products related to such issue, which are secured by and payable by the borrower, a related guarantor, or any third party guarantee such as a letter of credit or bond insurance. Such bonds or notes, or related derivative financial products, shall not be payable under any circumstances from public funds of, and shall not be the liability of, the State Entity Authorized to Issue Debt that issued the bonds or notes, the Commonwealth or any other State Entity Authorized to Issue Debt.

Qualified Conduit Debt Transaction with Guarantee. Qualified Conduit Debt Transaction for which there is a related guarantee provided by the State Entity Authorized to Issue Debt acting in a conduit role.

State Entity. The Commonwealth, any state authority as defined in M.G.L. c. 29, § 1, or other state entities of the Commonwealth with responsibility for managing and overseeing Public Funds.

(MA REG. # 1334, Dated 3-10-17)

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2.02: continued

State Entity Authorized to Issue Debt. Any State Entity with authority to issue bonds or notes, including the following currently existing State Entities Authorized to Issue Debt while they continue to exist, and any future State Entities Authorized to Issue Debt that are created by statute and that meet the definition set forth in M.G.L. c. 6, § 97 and 976 CMR 2.00:

Commonwealth of Massachusetts	Massachusetts Clean Water Trust
Massachusetts Bay Transportation Authority	Massachusetts Water Resources Authority
Massachusetts Development Finance Agency	University of Massachusetts Building Authority
Massachusetts Educational Financing Authority	Woods Hole, Martha's Vineyard, Nantucket Steamship Authority
Massachusetts Housing Finance Agency	Regional Transit Authorities
Massachusetts Port Authority	
Massachusetts School Building Authority	
Massachusetts State College Building Authority	
Massachusetts Department of Transportation as successor to Massachusetts Turnpike Authority	

State Entity Authorized to Issue Debt Subject to Waiver Process (SESWP). The meaning set forth in 976 CMR 2.07.

2.03: Policies Relating to Investment of Public Funds

Upon adoption of a substantive revision, a State Entity Authorized to Issue Debt shall file its revised policy or policies related to the investment of Public Funds with the Board.

2.04: Debt Management Policies

Upon adoption of a substantive revision, a State Entity Authorized to Issue Debt shall file its revised policy or policies related to debt management with the Board. The Board shall make the policies filed with it available on its website and to any member of the public upon reasonable request to review.

2.05: Review of Financial Transactions Involving Derivative Financial Products

In furtherance of its statutory authority and mandate, the Board hereby establishes 976 CMR 2.05 to ensure that financial transactions involving a Derivative Financial Product are properly analyzed and managed to ensure consistency with State Entity Authorized to Issue Debt objectives, suitability of the transaction, and avoidance of unintended consequences.

In the event that a State Entity Authorized to Issue Debt is entering into a new financial transaction that involves a Derivative Financial Product, the State Entity Authorized to Issue Debt shall submit the following materials to the Board:

- (1) If not previously submitted, a copy of the State Entity Authorized to Issue Debt's derivative policy* with a certified copy of the vote of the governing board of the State Entity Authorized to Issue Debt or certificate of the authorized official of the State Entity Authorized to Issue Debt if such State Entity Authorized to Issue Debt does not have a governing board; and
- (2) A written analysis of the proposed Derivative Financial Product transaction by an independent financial advisor with relevant expertise, together with the advisor's recommendation as to whether or not the State Entity Authorized to Issue Debt should enter into the proposed transaction. Such analysis should include but not be limited to:
 - (a) a detailed description of the Derivative Financial Product;
 - (b) a description of risks, strategies for mitigating any such risks, and any benefits;

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2.05: continued

- (c) scenario analyses or stress tests demonstrating impact on the State Entity Authorized to Issue Debt under extreme financial market events or conditions as a result of entering into the subject Derivative Financial Product; and
- (d) in the case of a restructuring of an existing Derivative Financial Product, a comparison of the expected benefits resulting from the restructuring with the potential risks resulting from the restructuring.

(3) A certified copy of the minutes of the meeting of the governing board of the State Entity Authorized to Issue Debt (such meeting to be held on a date not greater than two years prior to the date of Board review), or a certificate of the authorized official of the State Entity Authorized to Issue Debt, demonstrating or confirming that:

- (a) the written analysis and recommendation of the independent financial advisor was presented to the board, or to the official and transmitted to the board;
- (b) that the structure of the Derivative Financial Product is consistent with the derivative policy adopted by the board or approved by the authorized official;
- (c) that the benefits of the Derivative Financial Product outweigh the risks of the use of a Derivative Financial Product; and
- (d) that the governing board or the official approved the proposed transaction.
 - * The following issues should be considered in connection with such a policy:
 1. How derivative products fit within the overall debt management program;
 2. Expected outcomes or goals of entering into a derivative product (*i.e.* synthetically fix a variable rate at lower rate than otherwise available in the market);
 3. Security and sources of payments for ongoing costs associated with the derivative product and for termination costs of the derivative product;
 4. A list of the types of derivative products that may be used and a list of the types of derivative products that are prohibited;
 5. The conditions under which these types of products can be utilized (*i.e.* bidding procedures, minimum benefit thresholds, terms of master agreements, *etc.*);
 6. The maximum amount of derivatives contracts, or a means of determining such amount;
 7. Guidelines and criteria for selecting counterparties;
 8. Methods for evaluating, measuring and managing derivative risk;
 9. Methods and process for procuring derivative products;
 10. Post issuance monitoring, reporting and ongoing risk mitigation procedures, including periodic valuation.

The Board's review pursuant to 976 CMR 2.00 shall consist of reviewing the items required to be submitted to the Board described in 976 CMR 2.05(3)(d)1. through 10. The Board shall either conclude that the items required to be submitted have in fact been submitted consistent with the purpose and intent of 976 CMR 2.00, or that said items have not been submitted in a manner consistent with the purpose and intent of 976 CMR 2.00. Any conclusion shall be established by vote of the Board, and confirmed in writing (which may be by e-mail) to the State Entity Authorized to Issue Debt. Such conclusion shall be valid unless the State Entity Authorized to Issue Debt informs the Board of any material change in any of the submittals pursuant to 976 CMR 2.05 or unless six months have lapsed from the date of Board conclusion.

A State Entity Authorized to Issue Debt which has received a Board conclusion that the items required to be submitted in connection with 976 CMR 2.00 were in fact submitted consistent with the purpose and intent of 976 CMR 2.00 must report to the Board at the Board meeting next following the execution of the Derivative Financial Product transaction. Such report should include, but not be limited to, the results or final terms of the Derivative Financial Product transaction.

2.06: Review of Qualified Conduit Debt Transactions Involving Derivative Financial Products; with Guarantee

- (1) With respect to any proposed Derivative Financial Products that are related to a Qualified Conduit Debt Transaction, the Board's review of such transaction shall be limited to confirming that the transaction constitutes a Qualified Conduit Debt Transaction.

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(2) In order to request a review of any Derivative Financial Products that are related to a Qualified Conduit Debt Transaction, a State Entity Authorized to Issue Debt must submit the following items to the Board prior to such Derivative Financial Product being executed:

- (a) A written description of the proposed Derivative Financial Product transaction(s), including: the parties involved; the schedule; the amount; the security (including any guarantor of payment obligations); and terms.
- (b) A certification of bond counsel to the proposed transaction confirming that the transaction constitutes a Qualified Conduit Debt Transaction pursuant to 976 CMR 2.06.

Not later than five business days following receipt of the material submitted in connection with any Derivative Financial Product related to a Qualified Conduit Debt Transaction, the Secretary of the Board will contact the State Entity Authorized to Issue Debt in writing (which may be by e-mail) to either:

- 1. confirm that, based on the materials provided under 976 CMR 2.00, the transaction constitutes a Qualified Conduit Debt Transaction and either no public funds are at risk in the transaction or the amount of guarantee, if any, is equal to or less than the threshold amount in 976 CMR 2.06(3); or
- 2. notify the State Entity Authorized to Issue Debt that the materials submitted were incomplete or that they fail to demonstrate that the transaction constitutes a Qualified Conduit Debt Transaction.

(3) With respect to any proposed Derivative Financial Products that are related to a Qualified Conduit Debt Transaction with Guarantee, the Board's review of such transaction shall be the same as the review of Qualified Conduit Debt Transactions Involving Derivative Financial Products as described in 976 CMR 2.06(2), provided that the governing board of the related State Entity Authorized to Issue Debt has delegated authority to its staff to extend such guarantee without further approval based on an established threshold dollar value and/or risk rating of such guarantee as may be determined by the governing board from time to time, or provided that the guarantee is not greater than \$1 million.

(a) With respect to any proposed Derivative Financial Products that are related to a Qualified Conduit Debt Transaction with Guarantee which does not meet the criteria in 976 CMR 2.06, the Board's review of such transaction shall be the same as review of financial transactions involving Derivative Financial Products as described in 976 CMR 2.05.

(b) A State Entity Authorized to Issue Debt that issues Qualified Conduit Debt Transactions With Guarantee must submit a periodic (but at least quarterly) report of its guarantee programs (Guarantee Program Report). The Guarantee Program Report shall include, but not be limited to: the number and dollar amount of outstanding guarantees by segregated guarantee program and the change in the number and dollar amount of such guarantees from the prior reporting period; the number and dollar amount of guarantees paid during the reporting period with an explanation of the circumstances surrounding such payments. The Board, in its sole discretion, may request further information about the guarantee program.

2.07: Review of Requests for Waiver from Presumption of a Competitively Bid Financing

Statutorily, the Commonwealth may not sell bonds or notes maturing at a time later than three years from their dates on a negotiated basis without receiving a waiver from the Board. In addition, any State Entity Authorized to Issue Debt for which the Secretary of Administration and Finance approves the sale of its bonds or which issues bonds that receive Commonwealth support to the extent that Commonwealth disclosure is used in the marketing of such bonds, may not sell bonds or notes on a negotiated basis without receiving a waiver from the Board, including but not limited to the University of Massachusetts Building Authority, the Massachusetts State College Building Authority, certain of the Massachusetts Department of Transportation bonds, the Massachusetts Clean Water Trust, the Massachusetts Development Finance Agency as issuer of bonds supported by Commonwealth contract assistance and the Woods Hole, Martha's Vineyard and Nantucket Steamship Authority (together with the Commonwealth, "State Entities Authorized to Issue Debt Subject to Waiver Process" or "SESWP"). In the event that a SESWP seeks to sell bonds or notes on a negotiated basis, the SESWP shall submit the following materials to the Board:

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- (1) If not previously submitted, a copy of the SESWP's Debt Management Policy with a certified copy of the board of the SESWP vote or certificate of the authorized official of the SESWP if such State Entity Authorized to Issue Debt does not have a governing board;
- (2) Certified copy of the minutes of a meeting of the governing board of the SESWP or certificate of the authorized official of the SESWP, evidencing awareness and approval that the SESWP will be selling bonds or notes on a negotiated basis; and
- (3) A letter from an authorized official of the SESWP to the Board and presented at a Board meeting requesting a waiver from the presumption of a competitively bid financing and demonstrating that:
 - (a) the process or criteria to determine the method of sale set forth in the SESWP's Debt Management Policy had been thoroughly followed;
 - (b) an explanation for why the SESWP believes negotiation is a better approach;
 - (c) the date beyond which such waiver, if granted, would expire;
 - (d) a "not-to-exceed" amount of bonds to be sold; and
 - (e) a description of the use of proceeds of the subject bonds or notes. Such letter shall be personally presented to the Board by an appropriate official of the SESWP.

Consistent with statute, the Board's presumption is that SESWP bond sales will be conducted on a competitive basis. There may be exceptions to this premise, however, where the anticipated benefit of a negotiated sale can be demonstrated. The Board's review pursuant to 976 CMR 2.00 shall consist of reviewing the items required to be submitted to the Board as described in 976 CMR 2.07(3)(a) through (e). The Board shall either conclude that the items required to be submitted have in fact been submitted in a manner consistent with the purpose and intent of 976 CMR 2.00 and grant a waiver, or that said items have not been submitted consistent with the purpose and intent of 976 CMR 2.00. Any conclusion shall be established by vote of the Board, and confirmed in writing (which may be by e-mail) to the SESWP. Any conclusion will expire six months from the date thereof.

A SESWP that received a waiver pursuant to 976 CMR 2.00 must present results of the sale, including comparative pricing information, to the Board at the next Board meeting following the execution of the negotiated sale.

2.08: Board Contact Information

Whenever a document is required to be submitted to the Board under 976 CMR 2.00, it shall be submitted to:

State Finance and Governance Board
c/o Director of Debt Management and Special Finance Programs
Executive Office for Administration and Finance
State House, Room 373
Boston, MA 02133

REGULATORY AUTHORITY

976 CMR 2.00: M.G.L. c. 6, § 98.

STATE FINANCE AND GOVERNANCE BOARD

Commonwealth of Massachusetts

Executive Office of Administration & Finance

State House, Room 373

Boston, Massachusetts 02133