

WORK SESSION

DEBT

FINANCE

BY

MUNICIPAL

LIABILITY





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AML - Debt Financing

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# Alaska MUNICIPAL League

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① AML - Debt Fin.

February 12, 1988

FEB 25 1988

## MEMORANDUM

TO: The Honorable Steve Cowper, Governor  
The Honorable Stephen McAlpine, Lt. Governor  
David Hoffman, Commissioner  
Department of Community and Regional Affairs  
Hugh Malone, Commissioner  
Department of Revenue  
Tony Smith, Commissioner  
Department of Commerce & Economic Development  
John George, Director  
Division of Insurance  
Perry T. Davis, Executive Director  
Alaska Municipal Bond Bank Authority

FROM: Scott A. Burgess, AML Executive Director and Treasurer,  
Interim Board of Trustees, AML Joint Insurance Association

SUBJECT: DEBT FINANCING FOR MUNICIPAL LIABILITY EXPOSURES

Attached is a draft bill approved for submittal by the AML Board of Directors and our Joint Insurance Association Interim Board of Directors intended to enable municipalities and joint insurance associations of municipalities organized under AS 21.76 to use debt financing to establish reserves and self insure liability exposures. A previous draft was circulated last year.

Although this legislation is not absolutely necessary for the Alaska Municipal League Joint Insurance Association (AML/JIA) to begin its operations on July 1, 1988, we would like to have a bill of this sort introduced and approved during the current legislative session. We need it for a contingency in case excess insurance and reinsurance are not available at reasonable cost in the future. It would also give us more "clout" in current negotiations for coverage from commercial insurance companies.

The JIA intends to purchase excess insurance and reinsurance this year to limit our exposures. But this insurance coverage is subject to the same cyclical market conditions which can cause costs to escalate dramatically. We need enabling legislation to use debt financing as another "tool" to establish reserves or to insure exposures when the cost of excess insurance or reinsurance may become too expensive.

Elsewhere in the United States, municipalities are finding that the cost of debt financing for building a self insurance reserve can be substantially lower than the cost of premiums from commercial insurance companies. At the same time, the coverage can be much broader.

#### Summary of the Legislative Proposal

This bill would give a JIA explicit authority to incur debt. It would also enable the Alaska Municipal Bond Bank to underwrite this debt through the sale of revenue bonds, notes or certificates of participation either directly or through an entity it may create for the purpose of providing a self insurance program for municipalities.

The bill would enable a JIA to incur debt independent of the Bond Bank on contingency that the Bond Bank may not want to underwrite this type of risk. It would also give municipalities and the Bond Bank authority to make a deal independent of a JIA. This provision may be particularly attractive for those municipalities which do not desire to become a member of a JIA.

We desire to provide enabling authority for the Bond Bank to underwrite this type of debt because it could lower the interest rates. The Bond Bank has a better credit rating than most of our member municipalities could achieve acting independent of each other.

As added security, the bill would give the Bond Bank Authority powers to "intercept" state shared revenues destined for a municipality, if the municipality defaulted on its payment obligations for the debt. We consider this provision essential to making sure this debt will not adversely affect the credit rating of the Bond Bank. This provision is also essential to assuring that each municipality will pay its "fair share."

#### Negative Aspects of the Legislative Proposal

As with any new idea, this proposal is likely to attract some opposition. We have attempted to identify likely arguments which will surface if this bill is introduced.

##### 1. Commercial Insurance Companies, Insurance Brokers, and Agents

The commercial insurance industry is likely to oppose this proposal. Industry representatives have attempted to "deep six" joint insurance pooling arrangements in Alaska from the onset of our endeavors. They regard self insurance and pooling as a threat to the "free enterprise" system of commercial insurance.

The commercial insurance industry will argue that joint insurance arrangements should be covered by the same regulations which apply to conventional commercial insurance companies. The industry representatives will assert that our pool will end up as another device for more affluent municipalities to subsidize those which are less affluent or poorly managed. If there was a need for a pool in the past, the need is no longer as apparent because the market is relatively "soft" at present.

For the most part, we perceive insurance industry opposition as "enlightened self interest." We are breaking into a "good old boy" network. Our joint purchase and cost containment management systems will not enrich the property and liability insurance industry in the manner to which it has become accustomed. Industry arguments that JIAs will not be sufficiently capitalized have merit, however, and this proposal to enable debt financing for building reserves is intended to address that concern.

## 2. Department of Revenue

Representatives from the Department of Revenue have concern about the State's bond rating. This proposal represents another way for payment obligations to be incurred by political subdivisions of the State. Although debt of the Bond Bank is not a general obligation of the State, the State has given its "moral obligation" pledge as added security for Bond Bank debt.

If a municipality or association of municipalities defaulted on payment obligations to the Bond Bank or other lender, it could have a negative implication on the State's bond rating to the extent that the State's "moral obligation" means anything.

However, we think the use of debt financing for self insurance serves a legitimate public purpose, if the cost for the debt service is less than the cost of conventional insurance. If a judgement is rendered against a municipality which is not covered by insurance and the municipality does not have sufficient reserves to pay the judgement, debt would have to be incurred anyway.

The legislative proposal does not mandate underwriting by the Bond Bank. To the contrary, it reserves a right for the Bond Bank to deny a financing if the deal does not meet credit standards of the Bond Bank. The authority for the Bond Bank to "intercept" State shared revenues of a municipality should provide added comfort for the security of the debt.

3. Department of Community and Regional Affairs

Although we perceive that Commissioner Hoffman should be a natural proponent of this proposal, there is a technical feature which may give representatives of the Department some concern in relation to another proposal. The Governor's bill, HB 419, would "advance" State shared revenues to municipalities which are experiencing severe financial problems. The "advance," as we understand it, would require repayment over a term as an offset against future shared revenues.

If it became necessary for the Bond Bank to "intercept" shared revenues due to a default of a municipality over debt incurred for self insurance, a question is likely to arise as to who should have first claim to the money. We would suggest that Community and Regional Affairs should subordinate its interest to that of the Bond Bank.

4. Department of Law

A question is likely to arise as to whether payment obligations assumed by municipalities to the JIA and/or the Bond Bank for debt are constitutional in terms of compliance with Section 9, Article IX which reads as follows:

"No debt shall be contracted by any political subdivision of the State, unless authorized for capital improvements by its governing body and ratified by a majority vote of those qualified to vote and voting on the question."

We are relying upon the exception provided in Section 11, Article IX of the Constitution for the authority for municipalities to assume payment obligations to the JIA and/or the Bond Bank to incur debt for self insurance purposes. This section reads:

"The restrictions on contracting debt do not apply to debt incurred through the issuance of revenue bonds by a public enterprise or public corporation of the State or a political subdivision, when the only security is the revenues of the enterprise or corporation. The restrictions do not apply to indebtedness to be paid from special assessments on the benefited property, nor do they apply to refunding indebtedness of the State or its political subdivisions."

We regard the payment obligations of the municipalities as "revenues" of the JIA and/or the Bond Bank. They are, in a sense, member "assessments" payable from operating revenues of the municipalities and subject to annual appropriation.

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Further, we have included explicit language in the proposed legislation to prevent anyone from inferring that this is general obligation debt. [See our proposed language for Section 21.76.120, subsections (b) through (d).]

Conclusions

We would sincerely appreciate your timely consideration and support for this bill. The best and most appropriate mechanism is for the legislation to be introduced in the Senate and House Rules Committees by "Request of the Governor."

If you have further questions or suggestions for revision, please contact me. Thank you.

SAB:phl

Enclosure

(DRAFT//RU/1-31-88)

Introduced:  
Referred:

BY THE RULES COMMITTEE  
BY REQUEST OF THE GOVERNOR

IN THE \_\_\_\_\_

\_\_\_\_\_ BILL NO. \_\_\_\_\_

IN THE LEGISLATURE OF THE STATE OF ALASKA  
FIFTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act Relating to Financing of Municipal Insurance, and Providing for an Effective Date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

\*Section 1. AS 21.76.020 is amended to read as follows:

Sec. 21.76.020. Regulation by Division of Insurance. (a) A joint insurance arrangement may not be considered insurance for the purpose of any other law of the state and is not subject to regulations of the director except as expressly provided in (b) - (d) of this section and other provisions of this chapter. A cooperative agreement made by a joint insurance arrangement which pledges money to payment of bonds of the Alaska Municipal Bond Bank Authority is not subject to regulations of the director.

(b) A joint insurance arrangement is subject to examination by the division under AS 21.06.140 - 21.06.230.

(c) A joint insurance arrangement is subject to approval by the director. As a condition of approval by the director, a joint insurance arrangement shall have and maintain, as to the coverage provided,

(1) a certificate of excess insurance or reinsurance

(A) for property insurance, to the value of the single most valuable property covered;

(B) for liability insurance, to the highest policy limit provided by the arrangement;

(C) for workers' compensation, to the extent of all benefits allowed above retention;

(2) a certificate of insurance limiting the arrangement's total exposure for liability and workers' compensation to the arrangement's aggregate retention;

(3) evidence of assets allowable under AS 21.21.020 - 21.21.140, 21.21.225, or 21.21.230 in an amount no less than the arrangement's aggregate retention plus an amount considered adequate by the Director to cover administrative and adjustment expenses may be used in lieu of or to supplement the certificates of insurance required under (1) and (2) of this subsection if member contributions or debt financing is used to as means to establish reserves or to self insure exposures not covered by excess insurance or reinsurance.

(d) The value of assets and liabilities under (c) of this section shall be determined in accordance with AS 21.18.

\*Section 2. AS 21.76.030 is redesignated subsection (a) and AS 21.76.030 is amended by adding a new subsection to read:

(b) A cooperative agreement pledged to bonds of the Alaska Municipal Bond Bank Authority or other lender may contain other or different provisions from those enumerated in (a) as necessary to secure the bonds.

\*Section 3. AS 21.76.080(b) is amended to read as follows:

(b) An expenditure may be made from a joint insurance fund only

(1) to pay claims, losses, or benefits, including interest on them, and the administrative and adjustment expense incurred in connection with them, involving the types of protection for which the fund provides coverage as specified in the joint insurance agreement;

(2) to provide for the payment of the contractual obligations of the joint insurance fund to the Alaska Municipal Bond Bank Authority or other lender; and

(3) to purchase insurance coverage for the participants on a group basis.

**\*Section 4.** AS 21.76 is amended by the addition of the following section.

Sec. 21.76.120. Debt Financing. (a) A joint insurance arrangement may authorize the issuance of negotiable or nonnegotiable notes or certificates of participation to establish reserves and to self insure exposures not covered by excess insurance or reinsurance.

(b) Debt issued under this section shall be secured and payable from members of the joint insurance arrangement as provided in the cooperative agreement.

(c) Debt incurred by a joint insurance arrangement under this section is payable solely from the amounts pledged by members as apportioned in the cooperative agreement, except the pledge of a municipality shall not include revenues derived from taxes. Debt incurred under this section shall not constitute a general obligation of a municipality.

(d) All debts, liabilities and payment obligations assumed by municipalities in the cooperative agreement shall be several and not joint, except to the extent of contractually obligated payments pledged for purposes of risk pooling.

(e) The prohibitions of AS 37.10.085 do not apply to the issuance of debt or the use of proceeds from debt by a joint insurance arrangement.

(f) A joint insurance arrangement may enter into covenants and agreements concerning debt issued under this section and provide for any matter that affects the security of the debt.

(g) Notes and certificates of participation issued under this section may be sold at either public or private sale by the governing body of the joint insurance arrangement in the manner and at the price it determines.

**\*Section 5.** AS 44.85.005 is amended by addition the following subsections:

(5) Dramatic increases in the cost of liability and other insurance coverages for municipalities have adversely impacted municipal budgets; and,

(6) Even at increased premiums, insurance coverage is often not available for important municipal liability exposures.

\*Section 6. AS 44.85.010 is amended by adding the following new subdivision:

(c) It is the policy of the state to assist municipalities to provide for adequate insurance coverage by authorizing the bond bank authority to issue negotiable or nonnegotiable revenue bonds, notes or certificates of participation either directly or through an entity it may create for the purpose of providing a self insurance program for municipalities or joint insurance associations of municipalities organized under AS 21.76.

\*Section 7. AS 44.85.020 is redesignated subsection (a), and AS 44.85.020 is amended by adding a new subsection to read:

(b) If the Board of Directors of the bond bank authority determines it to be advisable, it may by resolution create a new entity for the purpose of issuing negotiable or nonnegotiable revenue bonds, notes or certificates of participation to provide a self insurance program for municipalities or joint insurance associations of municipalities organized under AS 21.76. The new entity has the rights and powers of the authority as stated in the resolution of the Board of Directors. The resolution creating the new entity shall state its name. The new entity is a public corporation and instrumentality of the state with legal existence and continuing succession the same as if it is the bond bank authority.

\*Section 8. AS 44.85.170 is amended to read as follows:

Sec. 44.85.170. Loans to Political Subdivisions or Joint Associations of Political Subdivisions. (a) The bond bank authority, to carry out the purposes and policies of this chapter,

(1) may lend money to municipalities through the purchase by the bond bank authority of municipal bonds of municipalities, and

(2) may make loans to municipalities or joint insurance associations of municipalities organized under AS 21.76 which meet credit standards of the bond bank authority secured by agreements between parties for the purpose of providing funding for a municipal self insurance program.

(3) Notwithstanding a home rule charter provision requiring public sale by a municipality of its municipal bonds, a municipality may sale its municipal bonds to the bond bank authority at a negotiated, private sale. The bond bank authority, for this purpose, may issue its bonds and notes payable solely from the revenues or funds available to the bond bank authority for such payment and may otherwise assist municipalities as provided in this chapter.

(b) Notwithstanding any provision of law, to the extent that any department or agency of the state is the custodian of money payable to a municipality, at any time after written notice to the department or agency head from the bond bank authority that the municipality is in default on the payment of principal or interest on municipal general obligation bonds of the municipality then held or owned by the bond bank authority or in default on the payment of amounts owed pursuant to an agreement between the bond bank authority and a municipality or a joint insurance association of municipalities organized under AS 21.76, the department or agency shall withhold the payment of that money from that municipality and pay over the money to the bond bank authority for the purpose of paying principal of and interest on bonds of the the bond bank authority or the amounts due under the agreement.

\*Section 9. AS 44.85.180(2) is amended to read as follows:

(2) the making of loans through the purchase of municipal bonds, notes or certificates of participation secured by agreements among the bond bank authority and municipalities or joint insurance associations of municipalities organized under AS 21.76 for the purpose of providing funding for a municipal self insurance program.

\* Section 10. This Act takes effect immediately in accordance with AS 01.10.070(c).