

Comments to Little Hoover Commission
Public Hearing on Bond Oversight
Thursday, September 22, 2016
State Capitol, Room 437
Thursday, September 22, 2016, 9:30 a.m.

INTRODUCTION

Good morning to members of the Commission and staff. Thank you for inviting Treasurer Chiang to offer his comments on this subject. As Treasurer Chiang is unable to be with you in person this morning, he has asked me to present these views to you for your consideration.

Governmental financial information can appear complicated. Financing capital projects in government is even more complicated. It involves borrowing money for large, expensive, and long-lived capital projects, such as water facilities, universities and highways. Although states can pay for such capital assets from current revenues or monies set aside for specific purposes, borrowing the funds allows them to spread the costs across multiple generations of taxpayers and users. This promotes fairness across generations. But, it can also promote opacity—not the transparency needed to foster a more accountable government.

THE MARKET FOR GOVERNMENTAL DEBT

Presently, there are about \$3.7 trillion of outstanding state and local bonds in the United States. Most state and local government debt is issued for terms longer than one year and terms of thirty years are common. Investors buy these bonds and often hold them to maturity. Unlike other securities' markets where the investor expects to move in and out of the investment, government bonds are characterized by a generally low level of turnover over the life of the bond. This gives rise to the principle that the investor has a vested, long-term interest in how the governmental borrower actually uses the funds that the investor has loaned it because both parties are in the transaction for the long term.

Because decisions to issue bonds occur sporadically in many governmental agencies, there is a tendency toward incrementalism in policy making about such decisions. This incrementalism encourages a pattern of mutual adaptation among a multiplicity of actors advocating different values, representing different interests, and possessing different information. The result is a reduced or devalued incentive to “look at the bigger picture.” Debt is a finite resource and decisions to take on debt are among the most important decisions that any government official makes—regardless of the level of government.

THE DOLLARS ARE LARGE – OVERSIGHT IS ESSENTIAL

California and her public agencies would benefit greatly from adopting a system to improve transparency and oversight of borrowed money. Such a system would link proceeds of these borrowed monies to results the public can readily see—producing greater accountability to the public that pays the bills. A plan for the sensible replacement of California's crumbling infrastructure is a policy priority for the Treasurer. He has already called for development of measurement tools, institution of a decision-influencing and collaborative body of experts to vet projects to be financed, and a mechanism for using found money to pay down the cost of California's accumulated infrastructure deficit.

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Building on this, if you assume that you cannot manage what you cannot measure, then it is logical that California—and her local agencies—also need to get better at producing greater clarity and accountability to the public on how borrowed money is spent. This accountability standard needs to be embedded into the individual plans of each agency that uses bonds obligating the public to long-term repayment of these large sums. A more effective, responsive and accountable system of tracking is one of the hallmarks of a government that is responsive to its citizens and stakeholders.

ACCOUNTABILITY NEEDS THE RIGHT TOOLS

If the state and its local agencies are to be downwardly accountable to citizens, then a precondition for such accountability is to produce tools designed to encourage the public to exercise its oversight rights. In 2016, this often means that technology must be employed to create that empowerment. To that end, since becoming your treasurer in 2015, Treasurer Chiang has taken concrete steps to use modern technology to improve this accountability. These efforts built on his efforts over eight years as your Controller, where he created web sites to enable the public to view information on public employees' pay, local government expenditures, and the use of temporary taxes approved by the voters in November 2012 as Proposition 30¹.

Recall that Proposition 30 temporarily raised certain tax rates to provide additional financial support for public schools. Since its inception, Proposition 30 has generated more than \$30 billion in revenues to the state. Those temporary revenues must be spent on classroom expenses and may not be used for administrative costs.

EMULATE THE GOOD MODELS WE HAVE

To accomplish the mission of holding public officials accountable to the taxpayers, then-Controller Chiang created the "TrackProp30" website. By visiting this site, which remains operational today, anyone can easily track every tax dollar raised by Proposition 30. This transparency tool was built to help taxpayers monitor every dollar raised, where it was allocated, how it was spent, and whether it was used in accordance with the law. In approving temporary tax increases by approving Proposition 30, voters entrusted their elected officials to use those extra funds to stave off more than \$5 billion in cuts to schools and help restore their fiscal stability during the most severe recession since the 1930s. Promises of appropriate and prudent spending were made to the public and the TrackProp30 tool enables the public to hold the state and its local education officials accountable for keeping those promises.

Visiting the site, users can see how much each school district, charter school, and community college receives annually from Proposition 30; view all revenues received by each local education agency,

¹ Proposition 30, officially known as The Schools and Local Public Safety Protection Act of 2012, raises personal income taxes for seven years on taxpayers with incomes of \$250,000 or more. It also increases sales taxes by a quarter-cent for four years.

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including not only Proposition 30 funds, but all federal and state funds and local property taxes; and, see a detailed breakdown of all expenditures made by local education agencies, including the amount spent on books and supplies, salary and benefits, and services and operations.

DEBTWATCH CHANGES THE GAME

Shortly after he was inaugurated as your Treasurer, Chiang unveiled another open data website, providing important details about debt issued by California and its local government entities. Like TrackProp30, this site, called DebtWatch, is designed to promote transparency in government. The site makes it easy for taxpayers to track proposed and issued debt, cost of issuance, and bond and tax election results across all units of government in California.

California and its local governments have borrowed more than \$1.5 trillion from Wall Street over the past three decades to build roads, schools, and other critical public works. DebtWatch aspires to empower Californians to hold government accountable for these borrowing decisions which can often require the repayment of two dollars for every dollar borrowed. The site's debt-related information covers more than 30 years, from 1984 to the present. Included are more than 2.8 million fields of data, which are updated monthly.

The data in DebtWatch is required by state law, which requires government entities to submit debt issuance data to the Treasurer's California Debt and Investment Advisory Commission (CDIAC) in a timely manner. While CDIAC has offered some of this debt data for years, DebtWatch now features intuitive, visual tools that make it easier for the general public to look up data about their community, download raw numbers, create charts and make comparisons among issuers.

DEBTWATCH WILL ADOPT TO THE FUTURE

However, the data that has accumulated over the past thirty years is static in its nature—it represents a point in time measurement. California needed more and an opportunity was handed to us in early 2015, when it was discovered that millions of dollars were missing from bond funds during a routine audit by the Association of Bay Area Governments (ABAG), an issuer of bonds for local governments, nonprofit organizations, and private entities in the San Francisco region. The San Francisco Chronicle reported that this bond money, which was earmarked for public parks and street improvements in downtown San Francisco, was allegedly embezzled by ABAG's director of financial services.

The ease in which one of ABAG's leaders allegedly fleeced millions of dollars in bond funds raised concerns regarding whether there were sufficient safeguards at the thousands of state and local agencies which are responsible for protecting borrowed funds pending disbursements on projects approved by the public and for which the public has a long-term obligation to repay these funds. Seizing that opportunity, Treasurer Chiang formed a special task force charged with developing best practices

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guidelines on the fiduciary care of bond proceeds that will be issued to all state and local government issuers of debt.

THE TASK FORCE ON BOND ACCOUNTABILITY

The task force, known as the Task Force on Bond Accountability, was chaired by former Santa Cruz County Treasurer and Assembly Speaker *Pro Tempore* Fred Keeley. The Task Force was co-chaired by Jay Goldstone, who served as chairman of the Municipal Securities Rulemaking Board (MSRB)². You will hear directly from the co-chairs of that task force later this morning.

This multidisciplinary group was comprised of current and former securities regulators, local treasurers, an elected mayor, public agency fiduciaries, academicians, and finance industry experts. In addition to its mission to develop best practices guidelines for how bond proceeds should be managed to reduce the risk of fraud, waste, and abuse, the Task Force considered strategies to increase transparency and oversight of the use of bond funds.

NEW LAW WILL PROMOTE GREATER ACCOUNTABILITY

As this task force was being formed, the State Senate also conducted legislative oversight hearings to examine how state and local public agencies manage bond proceeds. Senator Bob Hertzberg, chairman of the Senate Committee on Governance and Finance, was designated to lead the hearings focused on identifying problems and finding solutions to avoid abuse and waste. A critical piece of legislation, SB 1029, arose from those hearings, the work produced by the task force, and the Treasurer's strong, long-held desire to bring sunlight on this dark corner of the financial world. SB 1029 was passed by the Legislature and was signed into law by the Governor last week.

Existing law had already established CDIAC within the State Treasurer's Office to support and improve public finance practices by providing public officials with information, analysis, and training. CDIAC has collected, maintained, and provided comprehensive information on all state and local debt authorization and issuance for about thirty years. This data has served as a statistical clearinghouse for all state and local debt issues. Existing law requires CDIAC to make this information readily available upon request by any public official or any member of the public. But, the data was hardly easy to access and understand by the taxpayer.

² The MSRB is a national self-regulatory organization whose mission is to protect investors, municipal entities and the public interest by promoting a fair and efficient municipal market, regulating firms that engage in municipal securities and advisory activities, and promoting market transparency.

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CDIAC IS PREPARED TO RESPOND

SB 1029 will add to the data. Now, CDIAC will be required to track and report on all state and local debt authorization and issuance until fully repaid or redeemed. SB 1029 requires state and local agencies to submit an annual report for any issue of debt that is outstanding at any time during the fiscal year reporting period. The report must include the following information: (1) debt authorized during the reporting period, including amounts authorized at the beginning, amounts issued during, amounts authorized but unissued at the end, and debt authority that has expired during the reporting period; (2) debt outstanding during the reporting period, including the principal balance at the beginning, principal paid during, and principal outstanding at the end of the reporting period; and, (3) the use of proceeds of issued debt during the reporting period, including proceeds available at the beginning, proceeds spent and purposes for which they were spent during, and proceeds remaining at the end of the reporting period.

One of the important findings of the task force was the need for debt policies governing the protection and use of proceeds. SB 1029 now requires local agencies to adopt debt policies prior to the issuance of debt. Academic and industry experts advocate for debt policies that present the purposes for which debt proceeds may be used, the types of debt that may be issued, the relationship between the debt and an issuer's capital improvement program or budget, the policy goals related to the issuer's planning objectives, and internal control procedures that the issuer has implemented to ensure that debt proceeds will be used for intended purposes.

SB 1029 authorizes CDIAC to develop a reporting method other than a cumbersome paper-based filing, if technology permits and the alternate method furthers the bill's data collection requirements. That effort is already underway. The DebtWatch of the future will promote the transparency and create a more fertile environment for the accountability to the taxpayer that Treasurer Chiang has long sought.

ONGOING EFFORTS WILL BE NEEDED TO IMPLEMENT

Treasurer Chiang would caution the Commission that debt issues and programs come in many sizes and forms. There is a considerable difference between a single-facility project in a rural community and some of the large multi-asset programs financed by the state and large agencies. This diversity will make tracking and reporting of bond expenditures more challenging. Regardless, we must begin now to create the ecosystem that will enable organic growth in such transparency initiatives because the public needs and expects it of us.

CONCLUSION

Following this testimony and that of the co-chairs of the Task Force on Bond Accountability, you will also hear from several witnesses who are active in the bond oversight community. Theirs is an especially difficult mission as the complex world of bond finance can overwhelm those unfamiliar with its lexicon

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and habits. Nevertheless, please know that Treasurer Chiang is supportive of the concept of the bond oversight committee and seeks to promote professional growth in those individuals who choose to serve in that role. It is vital that all of our public servants encourage and cooperate with processes designed to provide greater clarity in this area. It is the Treasurer's goal to be part of a broad solution that will change the dynamics of the reporting of bond expenditures and that a better, more transparent culture in our governments will flourish

On behalf of Treasurer Chiang, I thank you for your attentive listening to these comments. I will be happy to take any questions you may have.