



Office of the Attorney General
State of Texas

DAN MORALES
ATTORNEY GENERAL

July 11, 1996

To All Bond Counsel:

Re: Use of a Surety Bond or Bond Insurance for a Reserve Fund

As stated in the All Bond Counsel letter of September 5, 1995, the use of a surety bond for a reserve fund with a separate obligation to repay amounts drawn under the surety bond is authorized only for those issuers qualified to use article 717q, Tex. Rev. Civ. Stat. Ann. Left open at that time was the possibility of the use of a surety bond or insurance policy for a reserve fund by a "non-q" issuer, where there was no separate obligation to repay.

We have now been presented with several issues which provide for the use of a bond insurance policy for the reserve fund for a non-q issuer. Resolving all of the questions raised by the use of insurance has been more difficult than we originally anticipated. Therefore, before finalizing the structure of a financing for a non-q issuer which is considering a surety bond or bond insurance policy for the reserve fund, please contact one of the division attorneys and submit preliminary drafts of the ordinance, order or resolution and the insurance policy. (Sometimes the operative document is referred to as a surety bond, but it appears to become a bond insurance policy for a limited dollar amount by the time the necessary changes have been made.)

While there may be further refinements of our position, it is our view that bond insurance can be used as or in lieu of a reserve fund of a non-q issuer, subject to the following:

1. It is our view that a financing may be structured to put into place an insurance policy - or a supplemental or "satellite" policy - for a specified reserve fund amount, where the insurer is subrogated to the rights of bondholders in the same manner as it is for standard bond insurance policies, and this is the sole obligation for repayment to the insurer. Questions remain as to whether an alternative structure calling for the repayment of the insurer through the replenishment of the reserve fund on a periodic basis is authorized for a non-q issuer.

2. If a policy is used in conjunction with cash in the reserve fund, the authorizing document must specify the methodology for replenishment of the fund and repayment of the insurer. Note that providing for replenishment of the cash portion first may not be compatible with the requisite subrogation structure.
3. It appears to us that it may be necessary for a reserve fund insurance policy to cover all parity bonds on a pro rata basis, though this may depend on the structure of the reserve fund or funds, and we have not reached a final conclusion as to this aspect. (This would seem to apply to entities qualifying as issuers under article 717q as well.)

We would appreciate your comments as to the above. Additionally, there may well be issues or aspects of this use of bond insurance that we have not considered, and your comments or suggestions as to these are solicited as well.

Regarding personnel matters, as most of you know, Sheela Rai has departed Public Finance for the Opinion Committee. I have appointed Lynn Stuck as the new assistant chief of the division, but no one has as yet been hired to fill the open position. Most of you have probably had some interaction by this time with Lisa Adelman, who was hired last fall to replace the departing Monty Watson. In addition to these changes, Marsha Strongin recently announced her intention to return to her former employer, the City of Austin. Thus, we now have two open positions.

Very truly yours,



Jim Thomassen
Assistant Attorney General
Chief, Public Finance Division