
HARRIS COUNTY, TEXAS FINANCIAL MANAGEMENT PRODUCTS POLICY

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PREPARED BY:
OFFICE OF MANAGEMENT AND BUDGET - FINANCIAL MANAGEMENT DIVISION

FINANCIAL MANAGEMENT PRODUCTS POLICY

1. General Considerations. Harris County, Texas (the “County”) may consider the use of financial management products such as interest rate swaps, caps, floors and other similar transactions in connection with certain outstanding or authorized debt. The County shall enter into financial management products in a prudent and professional manner, and the County will take into account relevant risk factors and market conditions when evaluating its asset and liability management objectives. The term of a financial management product shall not extend beyond the final maturity date of the underlying debt or the maturity date of the referenced investments. The County may evaluate the use of financial management products by comparison to traditional financing structures, and the County may use financial management products only if they produce significant quantifiable value or reduce the risk exposure associated with management of the debt or investment portfolio. Financial Management, the County’s financial advisor, and the County’s swap advisor (the “Financial Management Products Committee”) shall periodically review current market conditions for financial management products, and the Financial Management Products Committee shall evaluate how current market conditions affect existing and/or proposed financial management products.
2. Guidelines for Financial Management Products
 - A. Financial management products may be used by the County: (i) to lower interest expense; (ii) to manage financial risk; or (iii) to create a risk profile not otherwise achievable through traditional debt or investment instruments.
 - B. Risk factors to evaluate when considering financial management products may include:
 - i. Interest rate risk
 - ii. Termination risk
 - iii. Counterparty risk
 - a. Credit Quality
 - b. Concentration
 - iv. Basis risk
 - v. Liquidity risk and/or market access risk
 - vi. Tax risk
 - vii. Accounting risk
 - viii. Collateral posting risk



C. Counterparty selection criteria:

- i. Counterparty shall be rated at least AA-/Aa3/AA- by at least one of Standard & Poor's Ratings Services ("S&P"), Moody's Investors Service ("Moody's"), and Fitch Ratings ("Fitch"), respectively; or
- ii. If rated below AA-/Aa3/AA- by at least one of S&P, Moody's, and Fitch, respectively, or if not rated, then the counterparty shall obtain credit enhancement with respect to its obligations under the financial management transaction from a provider that is rated at least AA-/Aa3/AA- by at least one of S&P, Moody's, and Fitch, respectively; or
- iii. If rated below AA-/Aa3/AA- by at least one of S&P, Moody's, and Fitch, respectively, or if not rated, then the counterparty shall provide credit support that requires the counterparty to deliver collateral for the benefit of the County (a) that is of a kind and in such amounts as specified therein and which relate to various rating threshold levels of the counterparty or its guarantor, beginning at AA-/Aa3/AA- (S&P/Moody's/Fitch) and (b) that, in the judgment of the County, is reasonable and customary for similar transactions, taking into account all aspects of the financial management product including, without limitation, the economic terms of the financial management product and the credit worthiness of the counterparty or its guarantor.

D. As required by Texas Government Code §1371.056, all financial management product counterparties to the County shall be required to disclose any payments made to third parties in connection with the procurement of the financial management product.

E. Limitation on financial management products may include:

The total outstanding notional amount of financial management products, net of any offsetting transactions, shall not exceed 35% of total outstanding par amount of County debt at the time a transaction is executed.

F. Reporting of counterparty mark-to-market exposure:

1. The net mark-to-market value for each outstanding financial management product, taking into consideration any exposure ceilings or offsetting transactions, is presented on the Annual Comprehensive Financial Report (ACFR) prepared by the County Auditor's Office under interest rates swap section in the notes to the financial statements.
2. If the aggregate net mark-to-market exposure for any counterparty is calculated to be a liability to the County in excess of \$75 million, then the designee shall



report this finding to the Harris County Commissioners Court (the "Commissioners Court").

3. Reporting Requirements. This Financial Management Products Policy must be reviewed and approved by the Commissioner Court annually.
 - A. As required by Texas Government Code §1371.057, prior to the execution of any financial management products the County shall submit a record of the proceedings of the County authorizing the execution of the financial management products, and other contract providing revenue or security to pay the financial management product, to the Attorney General for review and approval.
 - B. As required by Texas Government Code §1371.056, the Commissioners Court or an authorized officer of the County shall make a determination that each financial management product executed by the County conforms to this Financial Management Products Policy that identifies with respect to each financial management product:
 - i. Its purpose;
 - ii. The anticipated economic benefit and the method used to determine the anticipated benefit;
 - iii. The use of the receipts of the financial management product;
 - iv. The notional amount, amortization, and average life compared to the related obligation;
 - v. Any floating indices;
 - vi. Its effective date and duration;
 - vii. The identity and credit rating of the counterparties or credit support entities;
 - viii. The cost and anticipated benefit of transaction insurance, if any;
 - ix. The financial advisors, legal advisors and swap advisor and their fees;
 - x. Any security for scheduled and early termination payments;
 - xi. Any associated risks and risk mitigation features; and
 - xii. Early termination provisions



- C. As required by Texas Government Code §1371.061(a), on at least an annual basis an authorized designee of the County, in consultation with the Financial Management Products Committee, shall report in writing the status of all outstanding financial management products to the Commissioners Court. Any such report shall include, but not be limited to, the following information:
- i. A description of the terms of each transaction;
 - ii. A statement of the fair value of each transaction;
 - iii. A statement of the value of any collateral posted to or by the County for each transaction;
 - iv. A review of each transaction's cash flows;
 - v. Identification of the counterparty and any guarantor of the counterparty's obligation to the County for each transaction, and the credit ratings of the counterparty and the guarantor;
 - vi. A statement whether the continuation of the transactions under the agreements would comply with the County's financial management product policy;
 - vii. Disclosure of all changes to existing financial management products or new financial management products entered into by the County since the last report to the Commissioner's Court;
4. Regulatory Compliance Guidelines. Pursuant to the authority of Section 731 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), which includes amendments to the Commodity and Exchange Act (the "CEA") regarding over-the-counter derivative instruments including financial management products, regulations were published by the Commodity Futures Trading Commission (the "CFTC") that define business conduct between swap dealers and their counterparties such as the County (referred to in the regulations as "Special Entities"). Following is a list of regulatory requirements imposed under the authority of Dodd-Frank with which the County shall make every reasonable effort to comply.
- A. As required by CFTC Regulation 23.450, which includes language added to 7 U.S. Code Section 6s(h)(5) of the CEA, it is the County's policy to procure a qualified independent representative (the "QIR") as its swap advisor. In order to qualify as a QIR, the swap advisor must meet the following criteria:
- i. Has sufficient knowledge to evaluate the transaction and associated risks;
 - ii. Is not subject to a statutory disqualifications;



- iii. Is independent of the swap dealer (counterparty);
 - iv. Undertakes a duty to act in the best interest of the County;
 - v. Makes appropriate and timely disclosures to the County;
 - vi. Evaluates consistent with any guidelines provided by the County, fair pricing and the appropriateness of the financial management products; and
 - vii. Is subject to restrictions on certain political contributions imposed by the CFTC, the Securities and Exchange Commission (the "SEC"), or a self-regulatory organization subject to the jurisdiction of the CFTC or the SEC.
- B. At least annually, the County shall conduct a review of its QIR to ensure that it still meets the criteria listed in Part A above. If it is determined that the QIR no longer meets the criteria listed in Part A above, then the County shall, in a timely manner, select a replacement QIR that meets the criteria listed in Part A above.
- C. In order to ensure that the County is in compliance with all regulatory reform imposed by Dodd-Frank, the County may be required to execute one or more Dodd-Frank protocol agreements (each a "Protocol Agreement") with each counterparty and/or the QIR prior to executing any financial management product.
- D. Section 2(h)(1) of the CEA requires that certain financial management products, including those commonly entered into by state and local government entities such as the County, must be cleared through a derivatives clearing organization unless otherwise exempt from clearing under the "End User Exception" in Section 2(h)(7) of the CEA. In order to qualify for the End User Exception, the County must report to the CFTC on either an annual or a transaction-by-transaction basis that it (i) is not a financial entity; (ii) is using financial management products to hedge or mitigate commercial risk; and (iii) will notify the CFTC, in a manner set forth by the CFTC, how it generally meets its financial obligations associated with entering into non-cleared financial management products. The County, in consultation with the QIR, shall make its best efforts to comply with Section 2(b)(1) and 2(b)(7) of the CEA, as applicable.