



Negotiating a Swap Document

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Before the Negotiations...

- Establish a Swap Policy
- Understand the risks
- Receive appropriate approvals
- Develop procedures for monitoring the swap risk
- Identify disclosure requirements
- Manage counterparty risk
- Consider termination events



Before the Negotiations...cont'd

- If savings are expected, what savings should the swap generate over fixed-rate bonds?
- What credit rating is required of the counterparty?
- Why are we utilizing a swap?
- Do we (and our boards) understand all the risks?
- Have we considered the use of a swap advisor?



Risk Awareness in Negotiations

- Termination Risk – issuer is obligated to make termination payment before maturity
- Counterparty Risk – inability of counterparty of make scheduled or termination payments
- Basis Risk – payment on the variable rate bonds will exceed the swap receipt due to a credit event, compression or tax event
- Amortization Risk – mismatch of swap hedge and expiration of the underlying obligation
- Credit Risk – credit deterioration would cause basis risk



Ready to Negotiate – Now What?

- Understand that legal documentation is separately negotiated and can impact credit profile and bondholders of rated debt
- Understand use of:
 - ISDA Master Swap Agreement
 - Schedule to the Master
 - Credit Support Annex
 - Swap confirmation
 - Legal opinions



ISDA Master Swap Agreement

- Preprinted and standardized
- Can govern multiple derivative transactions
- Multi-currency vs. Local Currency
- Contains payment provisions
- Includes representations re: events of Default/Termination events and covenants
- Early termination provisions and payment calculation methodologies

Schedule to the Master – Let the Fun Begin!

- Section V
 - Events of Default and Termination Events
 - Cross Default provision
 - Credit Event upon Merger provision
 - Credit support default
 - Additional Termination Event
 - Downgrade provision
- Section XI
 - Defining Governing Law and Jurisdiction



More Fun – The Credit Support Annex –governs the posting of collateral for credit enhancement and is normally bilateral

- Most modifications are made to Paragraph 13 – “Election and Variables”
 - Eligible Collateral
 - Definition of collateral that can be posted
 - Thresholds
 - Impact of counterparty debt ratings
 - Set to avoid “nuisance” collateral transfers

More fun with the Credit Support Annex



- Valuation and Timing
 - How often should collateral be marked to market?
 - What is frequency of collateral transfers?
- Holding and Using Posted Collateral
 - Who acts as custodian? Required credit rating?

Additional Thoughts – just when you thought you had enough!!

- Terms of the swap – vanilla vs. imbedded options (while not part of negotiations, it impacts everything)
- Insured provisions – for termination payment only or for regularly scheduled payments
- Has the institution impacted bond covenants and/or bondholders?



Questions??

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