Derivative Management Policy

ROWAN UNIVERSITY POLICY

Title: *Derivative Management Policy*
Subject: Financial Management: *Guidance for the Use and Management of Derivative Instruments*
Policy No: *Fin: 2018:02*
Applies: *University-Wide*
Issuing Authority: *President*
Responsible Officer: *Senior Vice President for Finance and CFO*
Adopted: *09/26/2018*
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Last Reviewed: *12/01/2022*

I. PURPOSE

This Derivative Management Policy ("Policy") is a subsidiary component of and should be read in conjunction with the Debt Management Policy. The purpose of this Policy is to establish responsibilities, objectives, and guidelines for the use of interest rate swaps and similar products to manage the University's bond profile. As used in this document, University debt includes debt or other obligations issued by the Camden County Improvement Authority, Gloucester County Improvement Authority and New Jersey Economic Development Authority on behalf of the University.

II. ACCOUNTABILITY

Under the direction of the President, the Senior VP for Finance and CFO shall ensure compliance and implementation of this policy.

III. APPLICABILITY

This policy applies to all that are involved with the derivative Issuance and Management process.

IV. POLICY OBJECTIVES AND PHILOSOPHY

1. This Policy describes guidelines within which each interest rate swap and other similar transaction, including termination of an interest rate swap or other similar transactions are to be used to manage the University's debt portfolio by 1) balancing risk exposures related to fluctuating interest rates and other economic variables, 2) minimizing debt service cost, 3) balancing or rebalancing the ratio of fixed and variable rate debt, 4) responding to market conditions or interest rate cycles that offer value to the University and 5) hedging future interest rate conditions. Transactions will not be employed as investment instruments or for the purpose of speculation.
2. This Policy shall govern the use and management of all transactions. While the University will require adherence to this Policy in applicable circumstances, it recognizes that changes in the law, capital markets, University and or State programs and other unforeseen circumstances may from time to time

produce situations that are not covered by this Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility may be granted through specific authorization from the University's Board of Trustees.

3. It is the University's intention to enter into these transactions in a prudent and professional manner that will take into account the University's objectives in managing its debt portfolio, relevant risk factors, and market conditions. All transactions shall comply with applicable federal and State laws and University policies governing such transactions.

V. RESPONSIBILITIES

1. Management responsibility for the Derivative Management Policy is hereby delegated to the Senior Vice President and Chief Financial Officer ("CFO").
2. The CFO will have the following responsibilities:
    a. making recommendations to the Budget and Finance Committee of the Board of Trustees after consultation with the University's Financial Advisor prior to the execution of any transaction;
    b. monitoring each outstanding transaction on at least a quarterly basis by reviewing mark-to-market values, current cash flows, or other metrics;
    c. making recommendations to the Budget and Finance Committee of the Board of Trustees after consultation with the University's Financial Advisor when early indicators signal action may be required or necessary;
    d. provide an update to the Budget and Finance Committee of the University's Board of Trustees, detailing the status and other matters relating to each outstanding transaction, if any.

VI. GUIDELINES

The Board of Trustees, on the recommendation of the CFO after consulting with the University's Financial Advisor, may enter into any of the following transactions on a cash settle or physical settle basis: interest rate swaps, basis swaps, interest rate caps, interest rate floors, interest rate collars, options on interest rate swaps, forward-starting interest rate swaps or other similar transactions, and may from time to time shorten, terminate, extend, or otherwise modify transactions in order to manage its risk exposure, balance assets and liabilities, or reduce debt cost.

1. **Approved Purposes for Transactions**
    a. To achieve savings as compared to a product available in the cash/bond market. Savings shall be calculated after adjusting for
        i. applicable fees, including takedown, remarketing fees, credit enhancement, advisory and legal fees, and
        ii. the value of call options that may be foregone on the related debt obligations.
    b. To prudently hedge risk in the context of a particular financing or the overall asset/liability management. Examples include, but are not limited to, interest rate caps, rate locks and forward starting swaps.
    c. To incur variable rate exposure within prudent guidelines, such as selling interest rate caps or entering into a swap in which the University's payment obligation is based on a floating rate.
    d. To achieve more flexibility in meeting overall financial objectives than can be achieved in conventional markets. A basis swap would be an example of this type of transaction.
    e. To achieve diversification of the University's debt portfolio.
    f. To achieve diversification of counterparty exposure.
    g. To achieve any other University objective not listed above as described in a specific authorization by the Board of Trustees.
2. **General Guidelines**
    a. Each transaction recommended by the CFO must comply with the following guidelines, except as otherwise provided herein or in unusual market conditions, and all applicable legal documents, insurance covenants, and state and federal law.
    b. The CFO will consider in his/her recommendations, published rating agency guidelines in connection with each transaction.

c. All transaction documents must be completed using the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, Schedules to the Master Agreement, Credit Support Annex and confirmation, as appropriate and with such terms and conditions, and changes thereto, as are consistent with industry standards and this Policy.
d. Early termination provisions must be addressed in each transaction. Generally such provisions will provide for a termination at the sole option of the University.

3. **Aspects of Risk Exposure Associated with Such Transactions**
   a. Before entering into a transaction, the CFO and the University's Financial Advisor shall evaluate all the risks and requirements inherent in the transaction and provide such information to the Board of Trustees. The University recognizes that there are certain risks associated with interest rate swap transactions and similar transactions that it will consider prior to entering into any such transaction, including those risks described on Exhibit I hereto.
4. **Counterparty Exposure Limitation**
   a. The University shall consider exposure to counterparties. To that end, before entering into a transaction, the CFO and the University's Financial Advisor should determine the University's exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect such exposure.
   b. The CFO will evaluate counterparty exposure based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing and proposed transaction prior to any proposed transaction. Projected exposure shall be calculated quarterly based on the transaction's potential termination value taking into account possible adverse changes in interest rates.
   c. If exposure to any counterparty for any reason is determined by the CFO to be excessive, the CFO, in consultation with its legal counsel and financial advisor, shall explore remedial strategies to mitigate such exposure. The CFO will provide the results of this endeavor to the Budget and Finance Committee of the Board of Trustees in order to formulate a remedial plan, including any recommendations from the CFO to the Board of Trustees.
5. **Long-Term Implications**
   a. In evaluating a particular transaction, the CFO and the University's Financial Advisor shall review the long-term implications associated with each transaction, such as costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations, counterparty exposure and other similar considerations.
6. **Reflecting Such Contracts in Rowan University's Financial Statements**
   a. The University will require its counterparties to provide mark-to-market valuations of Swaps upon request, and if applicable, the University shall periodically evaluate the effectiveness of the hedge. In addition, the University will obtain periodic mark-to-market valuations from an independent third-party advisor or valuation firm.

VII. APPROVAL OF TRANSACTIONS

The University desires to establish an approval structure that provides adequate oversight of transactions while maintaining flexibility to execute such transactions in a timely manner.

1. The following structure and transaction approval procedures are established.
   a. The CFO shall review specific parameters for transactions within any general parameters authorized by the Board of Trustees. Any specific parameters that the CFO deems significant will be detailed in a Term Sheet.
   b. The CFO shall structure specific parameters for the termination of any existing transaction upon determination that such action is in the best interests of the University. Such recommendations will be reviewed and approved by the Board of Trustees.

VIII. REGULATORY COMPLIANCE

Following is a list of regulatory requirements imposed at the Federal level with which the University shall make every reasonable effort to comply:

1. **Dodd-Frank Compliance.** Pursuant to the authority of Section 731 of Title VII of Dodd-Frank Act, which includes amendments to the Commodity Exchange Act ("CEA") regarding over-the-counter derivative instruments, regulations were published by the Commodities Futures Trading Commission ("CFTC") that define business conduct between Swap Dealers or Major Swap Participants and their counterparties, including Swap Dealers or Major Swap Participants engaged in transactions with state and local governmental counterparties such as the University (referred to in the regulations as "Special Entities"). The new business conduct rules are far ranging and they can impact the University on several fronts as the University enters into or modifies transactions. The following sections are included in this Swap Management Plan in order to assist the University in complying with the CEA as amended by Dodd-Frank:
    a. Qualified Independent Representative
    In accordance with the CEA and as amended by Dodd-Frank, the University shall select a QIR that meets the following enumerated criteria:
        i. has sufficient knowledge to evaluate the transaction and risks;
        ii. is not subject to a statutory disqualification;
        iii. is independent of the interest rate swap provider or major interest rate swap participant. To be independent the QIR must currently not, and was not with a one-year look back, an associated person of the swap dealer; has no principal relationship with the swap dealer, provides timely disclosures of all potential conflicts of interest, complies with procedures designed to manage and mitigate conflicts of interest, is not controlled by, in control of, or under common control with the swap dealer, and was not recommended to the issuer by the swap dealer within one year of the transaction date;
        iv. undertakes a duty to act in the best interests of the University;
        v. makes appropriate and timely disclosures to the University;
        vi. evaluates, consistent with any guidelines provided by the University, fair pricing and the appropriateness of the transaction; and
        vii. is subject to restrictions on certain political contributions imposed by the CFTC, the SEC, or a self-regulatory organization subject to the jurisdiction of the CFTC or the SEC.
    b. At least annually, or as required by the Board of Trustees, the University shall conduct a review of its QIR to ensure that the QIR still meets the above enumerated criteria. In the event that it is determined that the QIR no longer meets the enumerated criteria, then prior to the execution of any transaction the University shall select a replacement QIR that meets the enumerated criteria.
2. Written Representations. In order to ensure that the University is in compliance with the regulations imposed by Dodd-Frank, the University may, but is not required to, execute a ISDA August 2012 DF Protocol Agreement with its QIR and each Counterparty prior to executing any transactions. If the University elects not to execute an ISDA August 2012 DF Protocol Agreement with a counterparty, then the University shall provide an alternate form of written representation to such Counterparty that meets all applicable disclosure requirements as required by Dodd-Frank.
3. Derivative Clearing Requirement.
    a. The CEA, as amended by Dodd-Frank, requires that certain derivative transactions, including those commonly entered into by state and local governmental entities, must be cleared through a derivatives clearing organization unless otherwise exempt from clearing under the "End User Exception" as specified in Section 2(h)(7) of the CEA. In order to qualify for the End User Exception to the clearing requirements of the CEA, the Special Entity 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 swaps to hedge or mitigate commercial risk; and
        iii. will notify the CFTC, in a manner set forth by the CFTC, how it generally meets it financial obligations associated with entering into non-cleared swaps.
    b. The University, in consultation with its QIR, shall make its best efforts to comply with the applicable derivative clearing requirements of the CEA as amended by Dodd-Frank.

IX. COUNTERPARTY REQUIREMENTS

It is University’s policy that the following conditions should apply to each transaction:

1. The CFO shall request that the counterparty fully disclose all costs including associated fees and costs. All fees and expenses paid by the counterparty to designated third parties will be fully disclosed in writing to the University in the confirmation for each transaction.
2. Provisions for protection in the event of a counterparty downgrade, including collateral or credit support shall be incorporated.
3. The counterparty shall disclose relationships with other third parties which may affect the transaction, such as broker-dealers, insurance companies, other swap providers and the University's financial advisor.
4. The counterparty shall provide its most recent financial audit and credit ratings.
5. At the time of entering into a transaction, the counterparty shall be rated at least A+/A1 by at least one nationally-recognized rating agency and not on rating/credit watch where a rating downgrade to below A+/A1 may be imminent, or have, as support for its obligations, a "A+/A1" subsidiary or other entity as rated by at least one nationally-recognized rating agency that can also meet all other counterparty requirements.

X. RESTRICTIONS

The following are University policies relating to restrictions on transactions:

1. The University will not enter into transactions for speculation.
2. The University will not execute any transactions with a term greater than the final maturity of its related outstanding long-term indebtedness.
3. The University will not enter into a transaction for an investment-related purpose.
4. The total "net notional amount" of all swaps related to bonds or other indebtedness is not to exceed the amount of related outstanding bonds or indebtedness. For purposes of calculating the net notional amount, credit shall be given in situations where there are off-setting swaps.

XI. EARLY WARNING MONITORING AND REPORTING FOR EXISTING TRANSACTIONS

The CFO will monitor existing transaction cash flows, market values and early warning indicators on an ongoing basis (no less than quarterly). The CFO will provide, after consultation with the University's Financial Advisor, a recommended course of action when early warning indicators dictate action is required. The list of "early warning indicators" can be expanded as needed but will include the following at a minimum:

1. A market movement that requires a collateral deposit or is within 10% of such requirement.
2. Any rating action with respect to a counterparty that may result in a rating downgrade to a level lower than the requirements specified in Section VII of this Policy.
3. A rating action on any financing program that could result in a collateral deposit as may be required under an ISDA agreement.
4. A change in tax law or a likely permanent market shift that produces or is likely to produce negative cash flows where the University must make payments to a counterparty.
5. Any unforeseen event that significantly, negatively impacts the expected results of the transaction and that is likely to continue.

While derivative transactions are outstanding, at least annually, the CFO or his designee shall report to the Budget and Finance Committee of the University's Board of Trustees, on all outstanding transactions as of the end of the fiscal year. The report shall include the following:

1. A list of all Swaps with notional value and interest rates, a list of counterparties and their respective credit ratings, and other key terms.
2. Information concerning any material event involving outstanding Agreements, including any default by a counterparty, a counterparty downgrade, or termination.
3. Actual collateral postings by counterparty, if any, per Agreement and in total by swap counterparty.

The CFO, in consultation with the University's Financial Advisor, may provide any recommendations to the Budget and Finance Committee of the Board of Trustees regarding the transactions and recommend any changes to the Derivative Management Policy.

XII. EXIT STRATEGIES

In the event of termination, whether voluntary or involuntary, the University's Financial Advisor in conjunction with the CFO, will evaluate the best possible strategy given the market, tax, legal and economic environment at the time of termination. The following are general guidelines for voluntary and involuntary termination strategies:

1. Voluntary Termination: The CFO will monitor market rates, termination values, tax changes, counterparty credit ratings, and any other relevant factors to determine if Voluntary Termination is warranted. Generally, an early termination will be warranted if it is economically advantageous for the University to do so, a more beneficial underlying debt structure can be attained or it will alleviate a current or anticipated risk inherent to the transaction. Based upon expected market conditions at the proposed termination date, the CFO, in consultation with the University's Financial Advisor, will establish a strategy prior to termination to hedge any exposure that is created by the termination.
2. Involuntary Termination: If certain events occur, such as a substantial ratings downgrade of any of the University's Financing Programs, involuntary termination may occur. Depending on market conditions, this may result in an obligation of the University to make a significant termination payment to the counterparty. In the event of a termination payment, the source of payment will be from legally and currently available sources for each Financing Program, including any collateral posted, insurance and /or reserves set up for this purpose. As soon as early warning monitoring indicators show that an involuntary termination may occur in the near term, the CFO, in consultation with the University's Financial Advisor, will establish a strategy to hedge any exposure based on then-prevailing market conditions. This strategy shall be monitored by the CFO and updated regularly in order to ensure that the strategy appropriately reflects changing market conditions.

XIII ATTACHMENTS

1. Attachment 1 - Risks Associated with Derivatives

Attachment 1
Risks Associated with Derivatives

1. **Basis Risk** - Risk that the payment on the variable rate debt obligations will exceed the swap receipt (the Securities Industry and Financial Markets Association or "SIFMA" Index or a percentage of the London Interbank Offered Rate or "LIBOR") due to an issuer-specific credit event or tax code change.
    a. Tax Event Risk - A form of basis risk - risk of higher tax-exempt interest rates (an increase in SIFMA Index) if tax law revisions lower the tax rate on interest income. In the extreme scenario, if a change in tax law eliminated tax-exempt interest income, the market would adjust "tax-exempt" security pricing so that there would be no material difference between the SIFMA Index and LIBOR.
    b. Credit Risk - Credit deterioration of the underlying debt obligations or any bond insurer, letter of credit provider, or liquidity provider insuring or enhancing the related debt obligations would result in basis risk discussed above.
2. **Counterparty Risk** - Risk that the counterparty cannot make future payments or cannot make a termination payment due to the University.

3. **Credit Risk**: Credit deterioration of the underlying debt would result in basis risk discussed above when underlying debt is in a variable rate mode or if the interest rate swap is used as a hedge of a future fixed rate debt issue.
4. **Disclosure Risk** - Accounting standards may require balance sheet and income statement entries for swap agreement interim values.
5. **LIBOR Index Discontinuance Risk**: The discontinuation of LIBOR may impact the effectiveness of the transaction as a hedge to underlying variable rate debt or other variable rate exposure and also may impact the mark to market value of this transaction. As a result, certain transactions may have to be amended during its term to address the potential discontinuation of LIBOR rate setting.
6. **Market Access Risk**: Risk that certain market conditions or disruptions could hinder or preclude the Issuer from accessing the capital markets and/or securing attractive financing terms when necessary to restructure, refund or finance potential obligations (i.e. LIBOR and MMD rates disconnect).
7. **Rollover Risk** – Potential rollover risk exists if the swap maturity does not match the maturity of the hedged debt.
8. **Tax Risk**: A form of basis risk – risk of higher taxexempt interest rates (an increase in SIFMA Index) if tax law changes lower the taxation rate on interest income. In the extreme scenario, if a change in tax law eliminated taxexempt status, the market would adjust “taxexempt” security pricing so that there would be no material difference between the SIFMA Index and LIBOR.
9. **Termination Risk** - Termination risk exists if (i) the University opts or is compelled to terminate the swap prior to maturity; (ii) credit ratings for any Financing Program are lowered to below specified downgrade thresholds and the University is unable or is not required to post collateral, as may be required by the swap agreements, to protect the counterparty against the risk resulting from the lowered rating; (iii) the counterparty is downgraded and the counterparty is unable to post collateral; or (iv) the counterparty is downgraded to a level that causes an involuntary termination. Early termination would be solely at the option of the University (except in certain credit events described in (ii), (iii) and (iv) above). It is University policy that the counterparty will not have the option to terminate at any time without cause.
10. **Yield Curve Risk**: On transactions where an Issuer’s payment is based on a shortterm index and its receipt is based on a longterm index, an Issuer faces potentially negative cash flows and market value implication in market environments when the yield curve is flat or inverted.