TCNJ
THE COLLEGE OF NEW JERSEY

Section:	XII.1.1	
Title:	Interest Rate Swap	
Effective Date:	February 18, 2020	
Approved By:	Board of Trustees	
Responsible Unit:	Office of the Treasurer (609) 771-2186	
Related Documents:	N/A	
History:		
Version	Date	Notes
1.0	February 18, 2020	Reviewed; no changes made
1.0	December 4, 2007	New Policy; Initial Release

I. INTRODUCTION

This policy will govern the use by The College of New Jersey (TCNJ) of interest rate swap transactions for the purpose of either reducing the cost of existing or planned tax exempt debt, or to hedge the interest rate of existing or planned tax exempt debt. By using swaps in a prudent manner, TCNJ can take advantage of market opportunities to reduce costs and reduce interest rate risk. The use of swaps must be tied directly to TCNJ debt instruments. TCNJ shall not enter into swap transactions for speculative purposes.

II. DEFINITIONS

N/A

III. POLICY

A. GENERAL

1. Legality/ Approval

Prior to entering into any swap agreement, the College must receive:

- An opinion acceptable to the market from a nationally recognized law firm that the agreement is a legal, valid and binding obligation of the counterparty and that entering into the transaction complies with applicable law.

- An opinion from its Swap Advisor in connection with the agreement to the effect that the terms and conditions of such agreement represent fair market value for such transaction as of its date.

- Approval from the Board of Trustees evidenced by a board resolution authorizing the swap.

B. FEATURES OF THE AGREEMENTS

1. Form of Agreements

Generally, each new Swap Agreement shall contain terms and conditions as set forth in the International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement. Each agreement shall also include terms specifying the amount and timing of payments, maturity, security, collateral, defaults, remedies, termination and such other terms, conditions, provisions and safeguards as the College, in consultation with the New Jersey Educational Facilities Authority (NJEFA), legal counsel and Swap Advisor, deems necessary or desirable.

2. Terms of Agreements Relating to Interest Rate Swaps

The terms of any Swap should refer to the following guidelines:

- *Downgrade provisions* triggering terminations shall in no event be worse for the College than those affecting the counterparty.

- *Governing law* will be the laws of the State of New Jersey.

- *The specified indebtedness related to credit events* in any agreement should be narrowly defined and should refer only to indebtedness of the College that could have a materially adverse effect on the College's ability to perform under the swap.

- *Collateral thresholds* for the swap provider should be set on a sliding scale reflective of credit ratings, size and directional market risk of the transaction. Collateral requirements should be established and based upon the credit ratings of the counterparty or guarantor.

- *Eligible collateral* should generally be limited to U.S. Treasury securities and obligations of Federal Agencies.

- The College (but not counterparty) should generally have the right to *optional termination* of an agreement at "market", at any time over the term of such agreement.

- *Termination value* should be set by utilizing Market Quotation, Second Method, unless the College in consultation with NJEFA deems an alternate method is appropriate.

3. Qualified Counterparties

The College shall not enter into an agreement with a counterparty that does not have (1) (a) a general credit rating of at least “A1” or “A+” from one of the nationally recognized statistical rating organizations, as recognized by the Securities and Exchange Commission, or (b) a subsidiary rated “AAA” by at least one nationally recognized statistical rating organization, (2) a minimum capitalization of at least $100 million and (3) a demonstrated record of successfully executing municipal swap transactions. For each swap agreement, NJEFA shall determine whether to require a higher credit standing from qualified counterparties, after consultation with the College and its swap advisor.

In addition to the rating criteria specified above, the College, where appropriate, will seek additional credit enhancement and safeguards in the form of:

- Contingent credit support or enhancement;
- Collateral consistent with the policies enumerated above;
- Ratings downgrade triggers; or
- Guaranty of parent, if any.

4. Methods of Procuring Swaps

Swaps can be procured via competitive bids or on a negotiated basis.

Competitive - The competitive bids should include a minimum of three firms with counterparty credit ratings determined as set forth herein.

Negotiated – On behalf of the College, NJEFA may procure swaps by negotiated methods if a determination is made by the College in consultation with its swap advisor that due to the complexity of a particular transaction, speed of execution or to recognize a good idea, a negotiated bid would result in the most favorable pricing to the College.

5. Counterparty Exposure

The College shall endeavor to diversify its exposure to counterparties. To that end, before entering into a swap agreement, it will obtain an evaluation of its exposure to the relevant counterparty or counterparties and how the proposed transaction would affect the exposure. The exposure should be measured in terms of notional amount, mark to market valuation and volatility.

6. Term and Notional Amount

In most cases, the appropriate term for a swap agreement shall be the same as for the bonds it is being used to hedge. Similarly, the notional amount of an agreement should amortize at least as quickly as do the bonds it is being used to hedge.

7. Pledging of Collateral

As part of any swap agreement, the College may, based on credit ratings of the counterparty, require collateralization or other forms of credit enhancements to secure any or all payment obligations under the agreement. As appropriate, the College, in consultation with NJEFA, legal counsel and its Swap Advisor, may require collateral or other credit enhancement to be posted by the counterparty subject to the collateral threshold amounts specified for such agreement. Additional collateral for decreases in credit ratings of each counterparty and/or increases in threshold mark to market exposure shall be posted by each counterparty in accordance with the provisions contained in the swap agreement. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the College, NJEFA and the counterparty. The market value of the collateral shall be determined on not less than a weekly basis, or more frequently if the NJEFA determines it is in the College's best interest given the specific collateral.

8. Prohibited Agreements

The College will not use swap agreements that:

(i) Are purely speculative in nature or create extraordinary leverage or risk;

(ii) Lack adequate liquidity to terminate without incurring a significant bid/asked spread; or

(iii) Provide insufficient price transparency to allow reasonable valuation.

C. EVALUATION AND MANAGEMENT OF THE AGREEMENTS

1. Evaluation

The College, along with NJEFA and Swap Advisor, will review the following areas of potential risk. The College will work with NJEFA to have in place procedures to evaluate and understand the risks and to overcome or mitigate them, in the event that unfavorable situations occur:

Interest Rate Risk:

Interest rate risk is the risk that interest costs on a bond or an agreement will increase and cost more than the rates associated with a fixed-rate obligation. The College, in conjunction with NJEFA will develop procedures to monitor rates on all variable rate bonds and fixedto-floating Swaps.

Basis Risk:

Basis risk is the risk of a mismatch between the actual variable interest rate on the College's debt and the variable interest rate on the Index from which any payments under a swap agreement are received.

Prior to entering into any swap agreement, the College and its swap advisor will review the historical relationships and trading differentials between the variable rates on similar bonds and the Index. After entering into any agreement with basis risk, the College will require that NJEFA monitor any such mismatch and evaluate opportunities to reduce or eliminate basis risk at attractive prices.

Termination Risk:

Termination risk occurs when there is a need to terminate a swap agreement in an interest rate environment that dictates a termination payment by the College or the counterparty.

Each swap agreement will be structured such that the counterparty's right to early termination is limited and such that the counterparty has no optional termination rights. Further, the College will require that a termination payment will be based on an agreement's market value, giving the College the best chance to recover such market value from a replacement counterparty.

Counterparty Risk:

Counterparty risk occurs when there is the failure of a counterparty to make required payments under a swap agreement. The Swap Monitor retained by NJEFA will monitor exposure levels, ratings thresholds and collateralization requirements and recommend actions that should be taken to enforce remedies when appropriate. The College will consider termination of any counterparty when the ratings fall below the minimum required for entering into the swap agreement.

Credit Risk:

Credit risk occurs when an event modifies the credit rating of a counterparty. The Swap Monitor retained by NJEFA will monitor the ratings of the counterparties and their credit enhancers, and in the event of a downgrade will immediately review available remedies, such as collateralization and additional credit enhancement, and recommend the appropriate enforcement action.

Liquidity Risk:

Liquidity risk occurs when there is an inability to renew a liquidity facility on a floating rate bond issue. The College will require that NJEFA evaluate the expected availability of liquidity support for variable rate debt.

Tax Risk:

Tax risk is created by potential changes in the tax laws that could affect payment under a swap agreement. The College in consultation with NJEFA, our Swap Advisor and legal counsel will review the tax events in any proposed agreements, including a discussion of the impact of potential changes in tax law on payments under each swap agreement based on taxable indices.

2. Monitoring

The Swap Monitor retained by NJEFA will monitor the terms, market value, accruals, collateralization, ratings and other critical terms of all swap agreements. For each agreement, the Swap Monitor will report regularly, and as requested, to the College and NJEFA. Such reports will also include various sensitivity analyses.

3. Updates to the Policy

The College staff in consultation with the Swap Advisor and NJEFA shall review this Policy at least annually, and the Treasurer shall submit any suggested updates to the Board of Trustees for approval.

4. Terminating Agreements

Optional Termination:
The College, in consultation with its Swap Advisor, NJEFA and legal counsel, and with advance the approval of the Board of Trustees, may terminate an agreement if it is determined that it is financially advantageous or otherwise appropriate under the circumstances to do so.
Mandatory Termination:
In the event that a swap agreement is terminated as a result of a termination event, such as a default or a decrease in credit rating of either the College or the counterparty, the College along with its Swap Advisor and NJEFA will evaluate whether it is financially advantageous or otherwise appropriate to obtain a replacement swap agreement, or, depending on market value, make or receive a termination payment.

D. DISCLOSURE AND FINANCIAL REPORTING

1. Reporting to Finance & Investment Committee of the Board of Trustees

The Swap Monitoring Report will be presented to the Finance and Investment Committee of the Board of Trustees on a quarterly basis for discussion. At a minimum, the report shall include a list of all swaps with notional value and interest rates, a list of counterparties and their respective credit ratings, mark-to-market values, swap cash flow summary, and other key terms or material events/actions of the counterparty.

2. Continuing Disclosure

The College will take steps to ensure that there is full and complete disclosure of all swap agreements to rating agencies, and in continuing disclosure documents. With respect to its financial statements, the College will adhere to the disclosure guidelines for financial reporting of swaps, as set forth by the Government Accounting Standards Board or other applicable accounting standards.