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Indiana Finance Authority
Master Swap Policy

I. AUTHORITY

The Indiana Finance Authority (the "IFA") is authorized to enter into interest rate swap transactions from time to time to better manage assets and liabilities and take advantage of market conditions to lower overall costs and reduce interest rate risk pursuant to state law.

This Swap Policy sets forth the manner of execution of swaps and related agreements, provides for security and payment provisions, and sets forth certain other provisions related to swap agreements between the IFA and qualified swap counterparties.

II. PURPOSE

The incurring of obligations by the IFA involves a variety of interest rate payments and other risks that a variety of financial instruments are available to offset, hedge, or reduce. It is the policy of the IFA to utilize swaps and other derivative financial instruments to better manage its assets and liabilities. The IFA may execute interest rate swaps if the transaction can be expected to result in one of, but not limited to, the following:

- Reduce exposure to changes in interest rates on a particular financial transaction or in the context of the management of interest rate risk derived from the IFA's overall asset/liability balance.
- Result in a lower expected net cost of borrowing with respect to the IFA's debt or achieve a higher expected net rate of return on investments made in connection with, or incidental to the issuance, incurring, or carrying of the IFA's obligations or other IFA investments.
- Manage variable interest rate exposure consistent with prudent debt practices.
- Manage exposure to changing market conditions in advance of anticipated bond issues (through the use of anticipatory hedging instruments)
- Achieve more flexibility in meeting overall financial objectives than can be achieved in conventional markets; for example, entering into a swaption with an upfront payment.

III. NON SPECULATION

Each Agreement and Transaction will be entered into not for purpose of speculation but solely in connection with the financing or investment activities of the IFA, including without limitation, converting interest on all or a portion of certain of the IFA's debt from a fixed rate to a floating rate, or from a floating rate to a fixed rate or from one floating rate to a different floating rate, reducing the cost of borrowing on its outstanding debt by optimizing the relative amounts of fixed and floating rate obligations or the risk of variations in its variations in its debt service costs, and by increasing the predictability of

cash flow from earnings on invested funds and thereby improving the IFA's ability to manage its funds and revenues.

IV. Senior Management Oversight

The Public Finance Director shall review this policy periodically (at least annually) to take into account business and market changes and shall be responsible for insuring the implementation of this policy and requiring that proposals to undertake derivatives activities include, as applicable:

- The resources required to establish sound and effective risk management systems and to attract and retain professionals with specific expertise in derivatives transactions;
- An analysis of the reasonableness of the proposed activities in relation to the organization's overall financial condition and capital levels;
- An analysis of the risks that may arise from the activities;
- The relevant accounting guidelines;
- The relevant tax treatment; and
- An analysis of any legal restrictions and whether the activities are permissible.

Consistent with this policy, the Public Finance Director shall take into account risk management, control and senior management functions to ensure that management is sufficiently independent of the performance of trading activities, thereby avoiding a potential incentive for excessive risk-taking, *e.g.*, when salaries are tied too closely to performance or profitability.

V. RISK MANAGEMENT: EXPOSURE ASSOCIATED WITH SWAPS

Before entering into a swap, the IFA shall evaluate all the risks inherent in the transaction. These risks to be evaluated should include basis risk, tax risk, counterparty risk, termination risk, rollover risk, and liquidity risk.

Type of Risk	**Description**	**Evaluation Methodology**
Basis risk	The mismatch between actual variable debt services and variable rate indices used to determine Swap payments.	The IFA will review historical trading differentials between the variable rate bonds and the index.
Tax risk	The risk created by potential tax changes that could affect Swap payments.	The IFA will review consequences of tax changes in proposed Agreements. The IFA will evaluate the impact of adverse tax consequences, the implantation of withholding taxes, or potential changes in tax law on LIBOR indexed Swaps.
Counterparty risk	The failure of the counterparty to make required payments.	The IFA will monitor exposure levels, creditworthiness, ratings thresholds, and collateralization requirements.
Termination risk	Premature termination of a hedge position requiring one of the parties to the Agreement to make termination payment and the ability to enter into an equivalent substitute transaction.	The IFA will compute its termination exposure for all existing proposed Swaps at market value and under worst-case scenario.
Rollover risk	The mismatch of the maturity of the underlying IFA-Backed Bonds.	The IFA will determine its capacity to issue variable rate bonds that may be outstanding after the maturity of the Swap.
Liquidity risk	The inability to access or renew a liquidity facility when required, e.g., upon premature termination of a swap.	The IFA will evaluate the expected availability of liquidity support for swapped and unhedged variable rate debt.
Credit risk	The occurrence of an event modifying the credit rating of a counterpart or otherwise lowering its creditworthiness.	The IFA will monitor the ratings of its counterparties and guarantors.

The IFA shall endeavor to diversify its exposure to counterparties. To that end, before entering into a transaction, it should determine its exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but rather how changes in interest rates would affect the IFA's exposure ("Maximum Net Termination Exposure"). For purposes of these limits, the Maximum Net Termination Exposure shall equal the aggregate termination payment for all existing and projected swap transactions that would be paid by an individual counterparty. For purposes of this calculation, the aggregate termination payment is equal to: [(i)] the termination payment based on the market value of all existing swaps as of the first day of the month prior to the execution of any proposed transaction, plus (ii) the reasonably expected worst-case termination payment of all proposed transactions.

The IFA should base the Maximum Net Termination Exposure on the net value of all outstanding derivative transactions. The IFA may also elect to take into account the Exposure to all related entities to a particular counterparty. Limits will be established for each counterparty, as well as the relative level of risk associated with each existing and projected swap transaction.

The guidelines below provide general exposure guidelines with respect to whether the IFA should enter into an additional transaction with an existing counterparty. The IFA may make exceptions to the guidelines at any time to the extent that the execution of a swap transaction provides benefits to the IFA. These limits shall only apply as of the time a swap or related transaction is entered into, and thus may be exceeded during the term of a swap or swaps with the same counterparty. A summary table is provided below:

Credit Rating	**Maximum Uncollateralized Exposure**
AAA	4.00% (a)
AA	5.00% (a)
Below AA- or Aa3	None

(a) Percentage of outstanding debt backed by the direct obligation of the IFA as shown on Exhibit A-4, Summary of Bonded Debt Outstanding in the Annual Report of Bonded Indebtedness.

The Public Finance Director shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. The slope of the swap curve, the marginal change in swap rates from year to year along the swap curve, and the impact that the term of the swap has on the overall exposure of the IFA shall be considered in determining the appropriate term of any swap agreement. In connection with the issuance or carrying of bonds, the term of a swap agreement between the IFA and qualified swap counterparty shall not extend beyond the final maturity date of existing debt of the IFA, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds.

The total "notional amount" of all swaps related to a bond issue should not exceed the amount of outstanding bonds. For purposes of calculating the net notional amount, credit shall be given to any swaps that offset for a specific bond transaction

VI. LONG-TERM IMPLICATIONS

In evaluating a particular transaction involving the use of derivatives, the IFA shall review long-term implications associated with entering into derivatives, including costs of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations and other similar considerations.

VII. FORM OF SWAP AGREEMENTS

Each interest rate swap executed by the IFA shall contain terms and conditions as set forth in an International Swaps and Derivatives Association, Inc. ("ISDA") Master Agreement, including any Schedules to the Master Agreement, Confirmations and Credit Support Annexes, or other comparable agreement widely used by recognized derivatives dealers. The swap agreements between the IFA and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Public Finance Director deems necessary or desirable.

The IFA may use law firms and financial advisory firm(s) with recognized experience in derivatives transactions to assist in preparation of the swap documents.

VIII. QUALIFIED SWAP COUNTERPARTIES

The IFA shall be authorized to enter into interest rate swap transactions with qualified swap counterparties rated at least "Aa2" or "AA" or equivalent by any two of the nationally recognized rating agencies (e.g., Moody's Investor Services, Inc. ("Moody's"), Standard and Poor's Ratings Services, A Division of the McGraw-Hill Companies, Inc. ("S&P"); or a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency. In addition, the counterparty must be a recognized derivatives dealer and have minimum capitalization of at least $150 million.

The IFA shall be authorized to enter into interest rate swap transactions with qualified swap counterparties rated below "Aa2" or "AA" should the swap counterparty provide:

1. Contingent credit support or enhancement in the form of a guarantee by a guarantor rated at least "Aa2" or "AA" or equivalent by any two of the nationally recognized rating agencies;
2. A letter of credit issued by a bank (i) rated at least "Aa2" or "AA" or equivalent by any two of the nationally recognized rating agencies, and (ii) having at least $[10] billion in assets; or
3. Collateral consistent with the policies contained herein.

IX. Termination Events and Events of Default

Optional Termination by the IFA.

The IFA shall, to the extent possible, include in all swap transactions provisions granting the IFA the right to optionally terminate a swap agreement at any time over the term of the agreement. The Public Finance Director shall determine if it is financially advantageous for the IFA to terminate a swap agreement.

An optional termination event is deemed to occur should the counterparty (or its credit support provider) fail to maintain either:

1. A Credit Rating of at least A3 from Moody's;
2. A Credit Rating of at least A- from S&P; or
3. An equivalent rating determined by a nationally recognized ratings service acceptable to both parties; and
4. The counterparty has not delivered collateral as required under the Credit Support Annex with the IFA.

Other Termination Events Affecting Either Party

Other termination events (allowing termination of the swap agreement at the option of the party not affected by the event) shall include, but are not limited to the following:

1. Illegality due to a change in law;
2. Credit Event Upon Merger (credit downgrade or similar result from a party’s merger); and
3. Ratings Downgrade. Should the IFA or counterparty (or its credit support providers) have one or more outstanding issues of rated unsecured, unenhanced senior debt and none of such issues has a rating of at least (i) Baa3 or higher as determined by Moody’s, or (ii) BBB- or higher as determined by S&P, or (iii) an equivalent investment grade rating determined by a nationally-recognized rating service acceptable to both parties.

Events of Default.

Events of Default of a Party allowing the non-defaulting party to terminate the swap agreement shall include, but are not limited to the following:

1. Failure to pay or deliver;
2. Breach of Agreement;
3. Credit Support Default;
4. Misrepresentation;
5. Failure to comply with required collateral provisions;
6. Failure to comply with any other provisions of the agreement after a specified notice period; and
7. Merger without Assumption.

Payments on Termination.

A termination payment to or from the IFA may be required in the event of termination of a swap agreement due to a termination event or an event of default. For payments on early termination, Market Quotation and the Second Method will apply, allowing for two-way mark-to-market breakage (assuming the swaps are documented under the 1992 form of the ISDA master agreement).

Notwithstanding the foregoing, it is the intent of the IFA not to make a termination payment to a counterparty that has defaulted under the agreement. Prior to making any such termination payment, the Public Finance Director shall evaluate whether it is financially advantageous for the IFA to obtain a replacement counterparty to avoid making such termination payment, to finance the termination payment through a long-term financing product or not to make the payment.

X. COLLATERAL REQUIREMENTS

As part of any swap agreement, the IFA may require its counterparty, or itself be required, to post collateral or other credit enhancement to secure any or all swap payment obligations. As appropriate, the Public Finance Director may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:

- Either the IFA or the counterparty may be required to post collateral if the credit rating of the IFA or the counterparty, or its credit support provider, falls below the "Aa3 or AA-" category. Additional collateral for further decreases in credit ratings of the IFA or the counterparty shall be posted in accordance with the provisions contained in the collateral support agreement to each swap agreement between the IFA and the counterparty.
- Collateral shall consist of cash, U.S. Treasury securities and U.S. Agency Securities.
- Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the IFA and each counterparty.
- A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty.
- The market value of the collateral shall be determined on at least a monthly basis.
- The IFA will determine reasonable threshold limits for increments of collateral posting thereafter consistent with the requirements for Maximum Uncollateralized Exposure noted above.
- The Public Finance Director shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to the IFA.

XI. SECURITY AND SOURCE OF REPAYMENT

The IFA may use the same security and source of repayment (pledged revenues) for Swaps as is used for the IFA bonds that are hedged or carried by the Swap, if any, but shall consider the economic costs and benefits of subordinating the IFA's regular payments and/or termination payments under the Swap. The IFA shall consult with Bond Counsel regarding the legal requirements associated with making the payments under the Swap on a parity or non-parity basis with the applicable outstanding IFA Bonds.

XII. SPECIFIED INDEBTEDNESS

The specified indebtedness related to credit events in any Swap agreement should be narrowly defined and refers only to indebtedness of the IFA that could have a materially adverse effect on the IFA's ability to perform its obligations under the Swap. Debt should typically only include obligations within the same lien as the Swap obligation.

XIII. OTHER CRITERIA

The IFA shall negotiate or competitively bid the price and terms of an interest rate swap transaction at the Public Finance Director's discretion.

For a competitive bid the number of firms solicited shall be no fewer than three.

For a negotiated transaction the IFA may use a financial advisory firm(s) to assist in the price negotiation. Additionally, the IFA may obtain an opinion from an independent party with recognized experience in the valuation of derivative transactions that the terms and conditions of any derivative entered into reflect a fair market value of such derivatives as of the execution date.

XIV. ONGOING REPORTING REQUIREMENTS

Written records noting the status of all interest rate swap agreements will be maintained by the Public Finance Director, and reported to the IFA board on a semiannual basis. These records shall include the following information:

- Highlights of all material changes to swap agreements or new swap agreements entered into by the IFA since the last report.
- Market values of each of the IFA's swap agreements.
- For each counterparty, the IFA shall provide the total notional amount position, Maximum Net Exposure and the Exposure to or from the counterparty, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
- The credit rating of each swap counterparty and credit enhancer insuring swap payments.
- Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.

- A summary of each swap agreement, including but not limited to the type of swap, the rates paid by the IFA and received by the IFA, indices, and other key terms.
- Information concerning any default by a swap counterparty to the IFA, and the results of the default, including but not limited to the financial impact to the IFA, if any.
- A summary of any swap agreements that were terminated.
- A summary of the net variable rate exposure.

The IFA may hire a financial firm to monitor its swaps on a daily basis and to look for ways to reduce the cost of a swap(s) or the Exposure that a swap brings.

The IFA shall reflect the use of derivatives on its financial statements in accordance with GASB Technical Bulletin No. 2003-1. The disclosure requirements include:

1. Objective of the Derivative
2. Significant Terms
3. Fair Value
4. Associated Debt
5. Risks

GLOSSARY OF TERMS

BASIS RISK – Basis risk refers to a mismatch between the interest rate received from the swap contract and the interest actually owed on the IFA's bonds. The risk, for example, in a floating to fixed rate swap is that the variable rate interest payments will be less than the variable interest payments actually owed on the hedged bonds.

CREDIT SUPPORT ANNEX – Covers the mutual posting of collateral, if required under the ISDA, to cover exposures of the counterparties to one another based on the net mark-to-market values of all swaps under the agreement.

THE CONFIRMATION – is executed for a specific derivative transaction and details the specific terms and conditions applicable to that transaction (fixed rate, floating rate index, payment dates, calculation methodology, amortization, maturity date, etc.).

COUNTERPARTY – A principal to a swap or other derivative instrument, as opposed to an agent such as a broker.

COUNTERPARTY RISK – The risk that the swap counterparty will not fulfill its obligations as specified by the terms of the contract. Under a fixed payer swap, for example, if the counterparty defaults, the IFA would be exposed to an unhedged variable rate bond position. The creditworthiness of the counterparty is indicated by its credit rating. The IFA has established minimum rating criteria for swap counterparties.

HEDGE – A position taken in order to offset the risk associated with some other position. Most often, the initial position is a cash position and the hedge position involves a risk-management instrument such as a swap.

INTEREST RATE CAP – An instrument that pays off on each settlement date based on the market value of a reference rate (i.e. BMA or LIBOR) and a specified contract rate; effectively establishes a maximum on a variable rate.

INTEREST RATE FLOOR - An instrument that pays off on each settlement date based on the market value of a reference rate (i.e. BMA or LIBOR) and a specified contract rate; effectively establishes a minimum on a variable rate.

INTEREST RATE RISK – The risk that a change in interest rates will cause an increase in relative or absolute debt service costs and negatively impact cash flow margins.

INTEREST RATE SWAP – An interest rate swap is a contract between two parties to exchange cash flows over a predetermined length of time. Cash flows are typically calculated periodically based on a fixed or variable interest rate against a set "notional" amount (amount used only for calculation of interest payments). Principal is not exchanged.

ISDA – The International Swaps and Derivatives Association. The global trade association whose members are dealers in the derivatives industry. Most swap transactions are traded under standard documentation created by ISDA.

ISDA MASTER AGREEMENT – The primary document for the terms and conditions governing the swaps market. The ISDA Master Agreement contains the terms for events of default, termination events, representations and covenants, early termination provisions and payment calculations.

LIBOR – The London InterBank Offered Rate. The interest rate that the banks charge each other for loans (usually in Eurodollars). This rate is applicable to the short-term international interbank market, and applies to very large loans borrowed for anywhere from one day to five years. The LIBOR is officially fixed once a day by a small group of large London banks, but the rate changes throughout the day.

NOTIONAL AMOUNT – The stipulated principal amount for a swap transaction. There is no transfer of ownership in the principal for a swap; but there is an exchange in the cash flows for the designated coupons.

ROLLOVER RISK – The risk that the term of the swap contract does not match the term of the related bonds being hedged. Upon the maturity of the swap, the risk may need to be re-hedged, causing the IFA to incur re-hedging costs.

TAX RISK – Risks associated with changes in tax laws. All issuers who issue tax-exempt variable rate debt inherently accept risk stemming from changes in marginal income tax rates. This is a result of the tax code's impact on the trading value of tax-exempt bonds. As marginal tax rates decline, the after tax value of tax-exempt income declines, forcing the tax-exempt rates to increase. This risk is also known as "tax event" risk, a form of basis risk under swap contracts. Percentage of LIBOR swaps and certain BMA swaps with tax event triggers, which can change the basis under the swap to a LIBOR basis from BMA, can expose issuers to tax event risk. Also changes in law that result in the payment of withholding taxes and a gross-up of a payment to take into account such tax.

TERMINATION RISK – The risk that the swap could be terminated as a result of any of several events, which may include a ratings downgrade for the IFA or the swap counterparty, misrepresentation, covenant violation by either party, bankruptcy of either party, swap payment default by either party, illegality, and default events under a bond indenture. The IFA could owe a termination payment to the counterparty or receive a termination payment from the counterparty, depending on how interest rates at the time of termination compare with the fixed rate on the swap. The IFA will make reasonable efforts to ensure that remedies available to a swap counterparty resulting from the IFA defaulting on its swap obligation should not infringe on bondholders' rights. These remedies should not be written into the bond indenture. Termination payments shall always be subordinate to debt service on IFA bonds.

SCHEDULE TO THE ISDA MASTER AGREEMENT – specifies what options for the various terms in the Master Agreement have been selected to govern the derivative transactions executed under the agreement.

SWAPTION – A swaption is an option on a swap. The swaption purchaser has the right to enter a specific swap for a defined period of time. This option can be exercised on a specific exercise date or series of exercise dates. It usually requires a payment by the party receiving the option.

SWAP CURVE – The name given to the swap's equivalent of a yield curve. The swap curve identifies the relationship between swap rates at varying maturities. Used in similar manner as a bond yield curve, the swap curve helps to identify different characteristics of the swap rate versus time.