

# **“Adopt Resolution Authorizing Second Amendment of Metropolitan’s Master Swap Policy”**

**Business and Finance Committee**

**Item 8-9**

**May 10, 2010**

# Overview

- **Changes in Capital Markets**
- **Current Swap Program**
  - **Established in 2001**
  - **First Amendment 2009**
- **Proposed Changes to Master Swap Policy**
- **Potential Transactions**
- **Recommendation**

# Changes in Capital Markets Mean Changes in MWD Swap Policy

- Metropolitan's last swap executed in 2006
- Market participants have changed:
  - Firms no longer exist (e.g., Bear Stearns)
  - Firms no longer participate in municipal swap market (e.g., UBS and JPMorgan)
  - Firms downgraded (e.g., Morgan Stanley, Citi)
- Potential new financial regulations may lead to additional changes

# Metropolitan's Swap Program is Based on Board Policy

- **Master Swap Resolution (2001)**
  - Section 5922 California Government Code - finding required
  - Defines authority to execute swaps
  - Approval for authorized swaps and supporting agreements
  - Security and payment provisions
- **Master Swap Policy (2001, amended 2009)**
  - Purpose
  - Parameters and guidelines
  - Counterparty qualifications and limitations

# Metropolitan's Swap Program

- **Notional Balance: \$1.41 billion**
- **Seventeen swaps**
  - \$6 million to \$166 million
- **Four counterparties**
  - Credit Ratings range from "A" to "AA-"
  - Qualified swap counterparty credit rating: "Aa3" or "AA-"
- **Mark-to-Market Value April 30, 2010**
  - (\$112.8) million
- **Current Board Authority: \$500 million**

# Proposed Changes to Master Swap Policy

- **Allow Additional Counterparties**
  - Current policy limits available firms
  - Expands universe of higher rated credits
  - Reduces risk of counterparty failure through diversification
- **Counterparty Exposure Limits**
  - Maximum net exposure of \$50M, and
  - Maximum net exposure up to 50% of total exposure for all swap transactions

# Proposed Changes to Master Swap Policy

- **Authority to Assign (“Novate”) Swaps**
  - **Must be qualified swap counterparty**
  - **Enables Metropolitan to react quickly to credit events in market**
  - **Avoid potential termination payment**
- **Other changes to update and improve language and terminology in response to current market conditions**

# Potential Transactions:

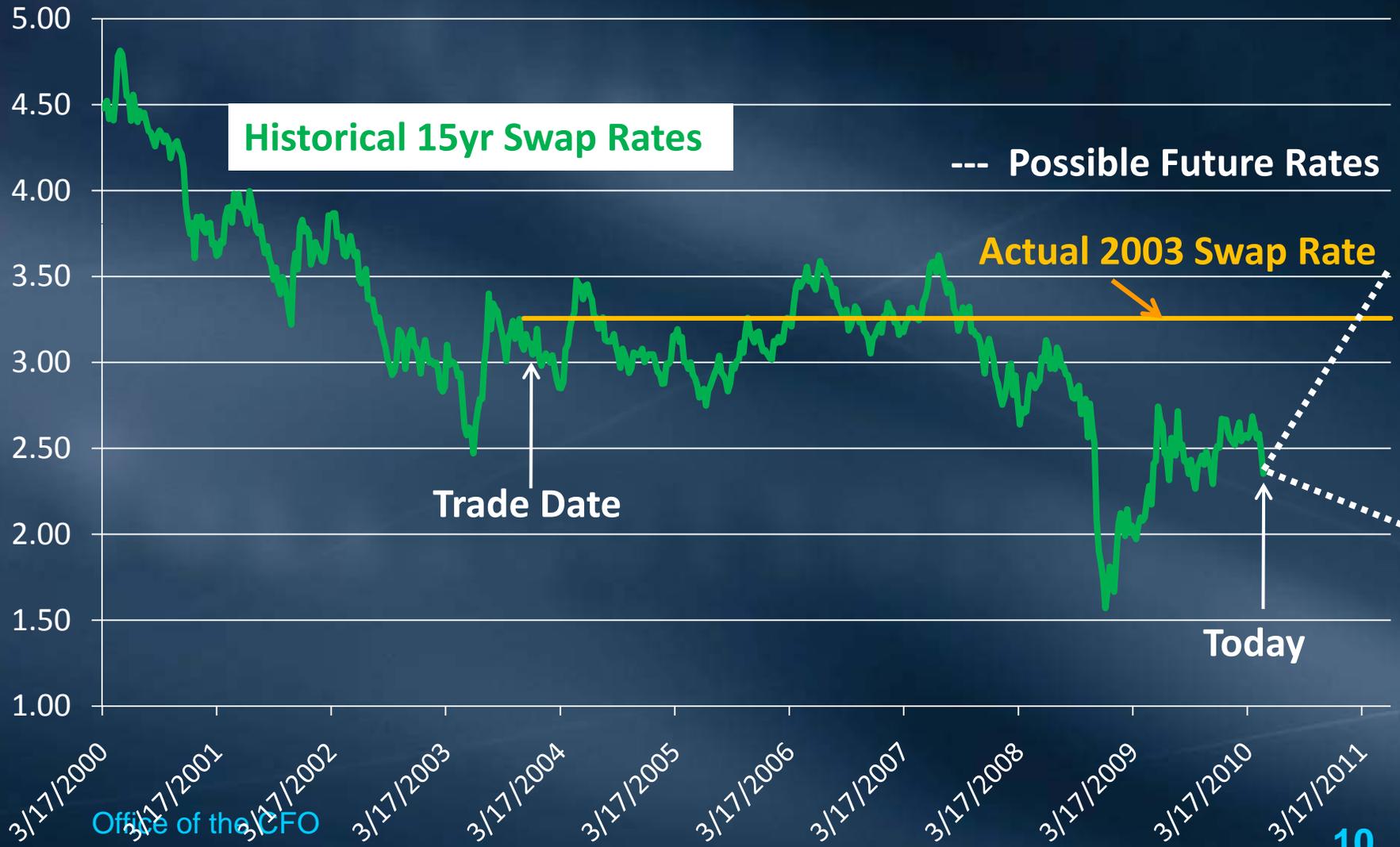
## Novate UBS AG Swaps

- **Novation (transfer) of UBS AG swaps to other qualified swap counterparties**
- **UBS AG no longer active in swap market**
- **New swap counterparties would have higher credit ratings**
- **Current market terms and conditions are more favorable to Metropolitan**

# Potential Transactions: Cancellation Option

- Metropolitan sells an option to terminate a swap to a swap counterparty in return for an upfront payment
  - Counterparty has the right to terminate the swap on a specific date in the future at par
  - Current market opportunity due to level of interest rates, steepness of yield curve, and volatility of interest rates

# Why Would a Counterparty Pay for the Option?



# How Does Metropolitan Benefit?

- Metropolitan receives payment upfront
- If option is not exercised – Metropolitan retains payment
- If option is exercised – Metropolitan is left with unhedged variable rate debt
  - Within asset/liability guidelines
  - Metropolitan retains payment

# Summary

- **Adopt Resolution to Amend Master Swap Policy**
  - Reflecting changes in market
  - Reduce risk to Metropolitan
  - Opportunities to reduce costs
- **Consider novation of UBS AG swaps**
- **Consider cancellation option**

# Recommendation

## Option #1:

- **Adopt CEQA determination, and adopt resolution authorizing second amendment to the Master Swap Policy**
- **Authorize novation of UBS AG swaps to other qualified swap counterparties**
- **Authorize the General Manager/CFO to amend existing swap agreements to provide for cancellation options**