
Interest Rate Swaps for the General Bond Practitioner: Basic Structures, Documentary and State Law Issues

**Municipal Law Group
Committee on Derivatives - State Law Issues**

August 2009



**National Association
of Bond Lawyers**

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INTEREST RATE SWAPS FOR THE GENERAL BOND PRACTITIONER: BASIC STRUCTURES, DOCUMENTARY AND STATE LAW ISSUES

**Municipal Law Group
Committee on Derivatives - State Law Issues**

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National Association
of Bond Lawyers

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I.

Introduction and Scope

(A) Background.

The Municipal Law Group Committee on Derivatives – State Law Issues (the “Committee”) of the National Association of Bond Lawyers (“NABL”) provides this publication as a benefit to its members, in light of the substantial growth and arising of issues in the use of interest rate swaps and other derivatives as a part of public finance transactions in recent years. This publication provides an overview of the subject of interest rate swaps and other derivative transactions in the context of municipal finance, which should be of particular benefit to general bond practitioners and the NABL membership at large. With the cooperation of the International Swaps and Derivatives Association, Inc. (ISDA®), annotated copies of forms commonly used to document municipal swap transactions are included, along with annotations provided by the Committee authors of this publication identifying various documentary, state law and other issues that may arise in the implementation of such forms in the context of municipal finance transactions.

This publication is for instructional purposes and not for purposes of providing legal, economic or other advice. The National Association of Bond Lawyers (NABL) and its licensor(s) do not advise on the suitability of any swap or other derivative transaction, and this publication is not intended as a statement of any position of NABL or its licensor(s), formal or otherwise, as to the matters discussed. In addition, this publication is introductory in nature and therefore does not address all aspects surrounding the topic of interest rate swaps, derivatives or the issues summarized or examples given herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

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(B) Scope of Publication.

After a discussion of certain introductory matters in this Part I, Part II of this publication describes the basic structure and economics of derivative transactions, focusing primarily on the types of swap transactions most commonly employed in municipal finance. Topics covered include the basic terminology used in swap transactions and common transactional structures and purposes. With these fundamental elements at hand, Part III then follows with an overview of the various roles and tasks that may be allocated among a municipal issuer, various legal counsel and other professionals involved in the implementation of swap transactions. Although this publication does not attempt to summarize all applicable state and federal laws that may apply to municipal swap transactions, nor to establish or imply any particular “best practices” or other standard of care, Part III addresses certain issues of state law, and



other legal authority and related considerations, that will often apply to municipal issuers in the context of an interest rate swap.

Part IV then provides a general overview of the basic ISDA[®] Master Agreement documentation structure most commonly employed in connection with municipal swap transactions. Following this overview, Annexes A through D present, with the cooperation of ISDA[®], forms of the 1992 ISDA[®] Master Agreement (Local Currency – Single Jurisdiction) and accompanying Schedule and Credit Support Annex, along with a sample “short-form” swap confirmation, a general format often used for “confirming” the primary economic terms of a swap. As mentioned above, these forms are annotated by the Committee authors of this publication to identify certain documentary, state law and other issues that may arise in the implementation of such forms in the context of municipal finance transactions.

(C) Topics Not Covered.

Being introductory in nature, this publication does not address comprehensively all issues relating to interest rate swaps or other derivatives, whether in the municipal finance context or otherwise. For example, although this publication highlights certain legal, documentary and other issues relating to municipal swaps and other derivatives, it does not attempt to address all the state or local law, documentary or other issues that might be applicable to any particular transaction contemplated by an issuer in any particular jurisdiction. In addition, apart from some passing informational references, this publication does not address any of the following issues, notwithstanding that an understanding of each may be necessary for a complete understanding of municipal swaps and other derivatives:

(1) Tax issues.

The implications of interest rate swaps and other derivative products on the calculation of the arbitrage yield on related tax-exempt bonds (e.g., “yield integration” or “qualified hedge” treatment) or other tax issues presented by swaps and derivative transactions (e.g., terminations of swaps, offsetting hedges or “back to back” swap transactions).

(2) Disclosure / securities laws issues.

Disclosure of swaps or other derivatives as part of any official statement or other materials used in the marketing of bonds or other obligations, for purposes of applicable securities laws issues or otherwise.

(3) Accounting treatment.

The appropriate treatment of swaps or other derivative transactions for accounting purposes under existing or proposed standards or rules.

(4) Swap procurement.

Procedures or other considerations relating to the procurement and pricing of swaps or other derivatives and any laws that may be applicable in connection therewith.



(5) Bankruptcy issues.

Issues concerning the treatment of swaps and similar transactions under any federal or state bankruptcy, insolvency or similar laws.

(6) Laws specific to any particular jurisdiction.

Although this publication is expressly aimed at identifying general state law issues that should be considered in connection with municipal swap or other derivative transaction, such issues are identified in general form, are not intended as an exhaustive list of all such potentially applicable laws, and are not to be read as a statement of the laws that may actually apply in the case of any particular issuer under any applicable jurisdiction.

As mentioned above and as with prior NABL publications, this publication and its annexes and annotations are intended solely to educate and assist counsel comprising the NABL membership and others and not to establish or imply any particular “best practices” or other standard of care. The approaches undertaken by those involved in swap transactions, whether as counterparties or their legal, financial or other advisors, will vary as a result of differences in applicable state or other laws and regulations, factual differences, differences in the nature and approaches of the parties themselves and geographical variations in practice. The coverage of any topic in this publication is not intended to imply that any party or its advisors has a duty or requirement to address that matter in any particular transaction or situation. Conversely, the absence of mention or elaboration with respect to any matter in this publication does not imply that such matter is not of importance in connection with any particular transaction or situation or that its consideration in connection with a particular transaction or situation is improper.¹

(D) Traditional Governmental Versus “Conduit” Transaction Structures.

The nature of the issues surrounding swap transactions of the types described in this publication will depend in part upon whether the swap is entered into by a municipal or other governmental issuer (generally referred to herein as a “municipal issuer” or “issuer”) versus, on the other hand, by a non-governmental entity (e.g., a 501(c)(3) organization or other “conduit borrower”) which issues one or more series of obligations through a governmental “conduit issuer”. In the context of swap transactions relating to conduit bond issues, such swaps are regularly entered into directly between the conduit borrower and the swap provider, without the conduit issuer being a party to the swap.

Although this publication generally speaks in terms of transactions entered by municipal issuers, many of the issues described apply equally with respect to swaps entered by municipal issuers and those entered by conduit borrowers. For example, although the nature of the party entering the swap may be different, swaps entered by both municipal issuers and conduit borrowers present many common basic structuring issues and economic risks, as well as many common general issues of documentation. On the other hand, certain issues, such as whether sufficient governmental authority exists for entering a swap

¹ This position has been taken by NABL in connection with prior projects and publications. *See, e.g.,* MODEL OPINION REPORT OF THE NATIONAL ASSOCIATION OF BOND LAWYERS COMMITTEE ON OPINIONS AND DOCUMENTS (February 14, 2003) at page ii.



transaction, may depend materially upon whether the swap is entered by a municipal issuer as opposed to a conduit (non-governmental) borrower. Some of these distinctions are pointed out where applicable in this publication.

(E) Acknowledgements.

The Committee and the authors of this publication extend special gratitude to the International Swaps and Derivatives Association, Inc. (ISDA®) in enabling the use of certain ISDA® forms as a part of this publication. The Committee also thanks Kristin H.R. Franceschi of DLA Piper LLP (US) in Baltimore, Maryland, who serves on the NABL Board of Directors; Elizabeth Wagner, formerly Director of Governmental Affairs of NABL; and Fredric A. Weber of Fulbright & Jaworski LLP in Houston, Texas, each for their contributions in reviewing and providing helpful input on the various drafts of this publication. The Committee additionally recognizes the contributions of past chairs of the NABL Bond Attorneys' Workshop panels on interest rate swaps, including E. Tyler Smith of Haynsworth Sinkler Boyd, P.A. in Greenville, South Carolina; John Lutz, Esq. of McDermott Will & Emery in New York, New York; Stevie D. Conlon, Attorney at Law in Arlington Heights, Illinois; and others whose past efforts have provided a valuable resource for use in the preparation of this publication. Lastly, the Committee acknowledges the helpful review and comment provided by derivatives advisor Jeff S. Klein of Kensington Capital Advisors, LLC in Charlotte, North Carolina.

II.

Basic Structure and Economics of Derivative Transactions

(A) Derivatives and Notional Principal Contracts Generally.

An interest rate swap is a form of “derivative” transaction. Most simply, a “derivative” transaction is a contract that “derives” its value from the value, or changes in value, of another financial instrument or index. In the municipal markets, the most common forms of derivative transactions include the following, each typically entered between an issuer or conduit borrower and a financial institution serving as the “swap provider”:

- “interest rate swaps”
- “interest rate caps”
- “interest rate floors”
- “interest rate collars”

These types of transactions, which may be employed by an issuer or conduit borrower for purposes of reducing (i.e., “hedging”) or modifying in other ways its overall interest rate risk relative to certain outstanding bonds or other obligations, as well as for other purposes including some discussed in greater detail below, are generally included within the family of transactions referred to as “notional principal contracts”. A notional principal contract is a contract typically between two parties (or “counterparties”, such as the issuer and a financial institution), under which one such counterparty agrees to make payments to the other based on an interest rate or other index, in exchange for such other party likewise agreeing to make payments in turn based on an interest rate or index, all at such specified intervals and subject to such other terms and conditions as may be negotiated into the contract. Although the payments of each counterparty are calculated based on a “notional” principal amount, under these sorts of contracts no actual amount of “principal” is exchanged.

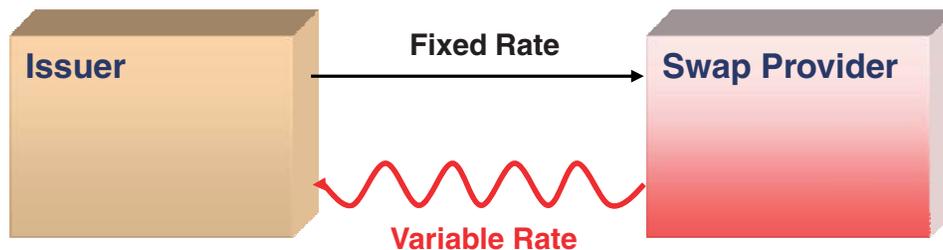


(B) Interest Rate Swaps.

(1) Introduction to the Basic Structure.

The most common form of interest rate swap (whether in municipal finance or otherwise) is the “floating-to-fixed” interest rate swap agreement, in which one party agrees to make fixed payments and the other party agrees to make payments based on a floating rate of interest (*e.g.*, SIFMA or a percentage of LIBOR, as discussed in greater detail in paragraph II(B)(2)(b) below). Such an arrangement may be depicted as follows:

Basic “Floating-to-Fixed” Interest Rate Swap Agreement



(2) Floating-to-fixed interest rate swaps (or “plain vanilla” swaps).

Under a floating-to-fixed interest rate swap, the issuer agrees to make payments based on a fixed rate and to receive payments from the swap provider based on a floating interest rate index. Under such an arrangement, the offsetting payments are usually netted (“payment netting”) rather than each party paying the full amount owed under its respective component (or “leg”) of the transaction. As discussed in greater detail in this paragraph II(B) below, an issuer will typically enter a floating-to-fixed rate swap if it has separately issued or intends to issue floating rate bonds and desires to hedge some or all of the variable interest rate risk on such bonds. By combining such a swap transaction with the issuer’s floating rate bonds, the issuer may hedge all or some portion of its variable rate exposure and create “synthetic fixed rate” debt. This type of structure is frequently referred to as a “plain vanilla” swap transaction.

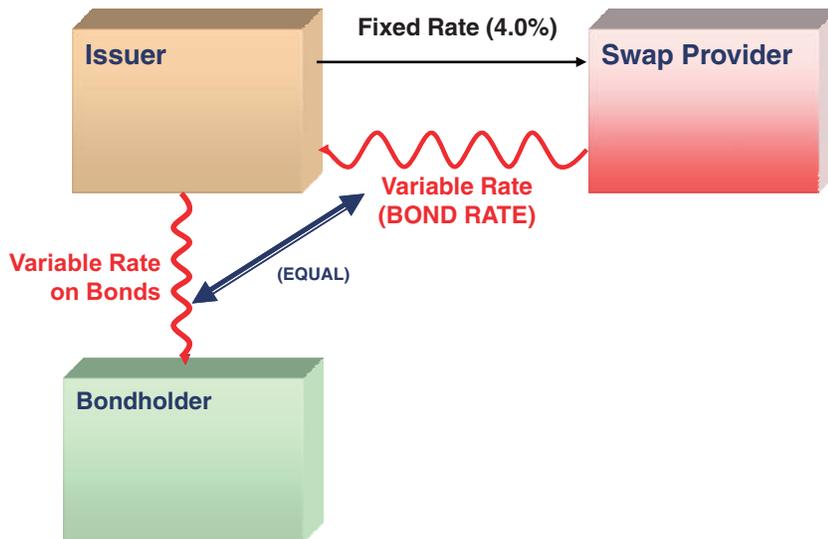
Even a simple “plain vanilla” swap transaction must include provisions particular to the parties’ needs. For example, the size of the swap (its “notional” principal amount) might be equal to the entire principal amount of the hedged bonds or, alternatively, might cover some lesser principal amount. In addition, the notional principal amount of the swap may amortize on the same basis as the bond principal amount amortizes or on some other basis. The issuer may be required to terminate a like portion of its swap upon the redemption of all or a portion of the hedged bonds (*i.e.*, so that the notional principal amount of the swap matches the principal outstanding under the hedged bonds). Further, the duration of a swap may extend to the maturity date of the hedged bonds or, on the other hand and subject to applicable legal requirements, may terminate in advance of the final maturity of the hedged bonds.



(a) **Plain vanilla swap tied to the “bond rate” or “cost of funds”.**

Suppose that an issuer issues tax-exempt bonds bearing interest at a floating rate and enters into a separate floating-to-fixed interest rate swap under which it agrees to pay 4.0%² to its swap provider (calculated on the “notional” principal amount equal to the principal amount of such bonds) and to receive, from the swap provider, an amount perfectly corresponding to the actual interest cost on such variable rate bonds. The issuer can then use the receipts under the swap to pay the equivalent amounts that it is required to pay on its bonds (i.e., its “cost of funds”). The overall result is that the issuer effectively “fixes” its effective borrowing cost at the 4.0% fixed rate component under the swap (during the term (or “tenor”) of the swap, so long as the swap provider continues to perform its obligations under the swap). Because the amounts received by the issuer under this type of swap cover the amount of interest owed under the hedged bonds (assuming the swap provider continues to perform its obligations under the swap), such a transaction is often referred to as a “bond rate” or “cost of funds” swap.

“Bond rate” swap used to create synthetic fixed rate debt



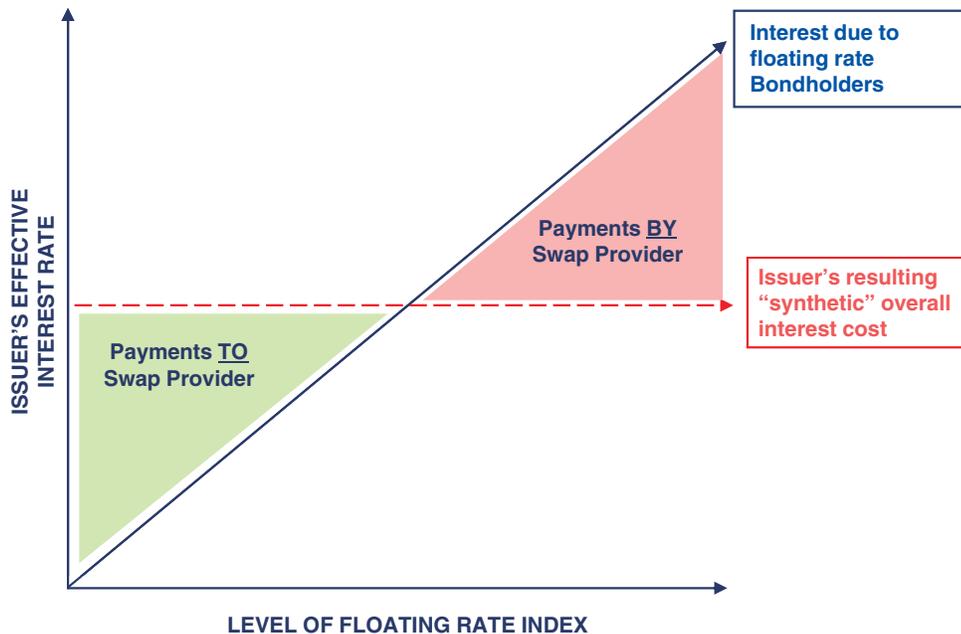
The following graph illustrates the payments that result from such a “bond rate” or “cost of funds” interest rate swap from the perspective of the issuer, depending on the interest rate applicable at any time to the variable rate bonds. If the floating rate received by the issuer under the interest rate swap (the horizontal axis reflecting the “Level of Floating Rate Index” below) matches the variable rate of interest on the issuer’s bonds (the vertical axis reflecting the “Issuer’s Effective Interest Rate” below), then the cash flows are identical as represented by the diagonal blue line pointed northeastwardly below. As a result, these cash flows in such circumstances cancel each other out from the issuer’s perspective and the resulting effective “synthetic” interest cost to the issuer will equal the fixed rate payable by the issuer under the swap, as reflected by the dashed red line below.

² Any swap or other rates included in this publication are solely for illustrative purposes and do not imply any particular swap or other rate, or spread between rates, that may be available to any party in connection with any particular transaction at any time.



Graph Showing Payments for Interest Rate Swap

(assuming no "basis")



If at any point in time the interest rate due to the bondholders is *greater* than the fixed interest rate paid by the issuer to the swap provider under the swap (i.e., where points on the diagonal blue line are *higher* than the issuer's "synthetic fixed rate" reflected as the dashed red line above), under such a bond rate swap the swap provider will make payments to the issuer sufficient to cause the issuer's overall net interest cost to remain at the synthetic fixed rate (the dashed red line). Conversely, if the interest rate due to the bondholders is *less than* the issuer's synthetic fixed interest rate (i.e., where points on the diagonal blue line are *lower* than the issuer's "synthetic fixed rate" reflected as the dashed red line above), under a bond rate swap the issuer will *make payments to* the swap provider in a manner causing the issuer's overall synthetic interest rate cost to remain at the synthetic fixed rate (the dashed red line).

Although bond rate or "cost of funds" swaps are relatively easy to understand (by issuers, their governing councils or boards and others) and were commonly used in the early years of the municipal swap market, such swaps have become relatively less common in the municipal markets in recent years. This decline is in part due to the fact that, under a bond rate swap, the swap provider assumes certain risks that will affect pricing to the issuer (i.e., the fixed rate leg of the swap), including the risk of a downgrade of the issuer, a credit enhancer or the issuer's bonds or other credit-related risks; a change in federal or state tax laws affecting the rate paid to bondholders; and the failure by the remarketing agent (or, to the extent that auction rate bonds continue to remain issued or outstanding following market events preceding the date of this publication, an issuer's auction agent) properly to set the interest rate on the hedged bonds. As a result, "cost of funds" swaps transfer risks to the swap provider in addition to interest rate risk and are thus likely to be materially more expensive than swaps in which the variable rate is set by a broader market-oriented index such as those described in greater detail in paragraph II(B)(2)(b) below.

In addition, to the extent that the marketplace, notwithstanding the above considerations, has been willing to provide swaps affording a "cost of funds" hedge to issuers, such transactions have often included (and often continue to include) language sometimes referred to as "market disruption" or



“alternative floating index” provisions for the benefit of the swap provider. Under these provisions, under certain conditions the agreement of the swap provider to pay the issuer the actual bond interest rate in exchange for the fixed rate leg payable by the issuer to the swap provider may change, such that the swap provider thereafter becomes obligated to pay the issuer, in lieu of such bond rate or other measure, an amount based upon a broader market oriented index such as those described in II(B)(2)(b) below.

“Market disruption” and related conditions are thus effectively trigger-like events, and may include circumstances such as downgrade events relative to the issuer or the hedged bonds or other obligations, the failure of the hedged bonds to maintain a floating interest rate that correlates with a market-oriented index over a period of time, as well as the expiration of credit enhancement and events of default and the like. Depending upon the formulation in the swap documents, these sorts of provisions may eliminate the “cost of funds” element of the swap *automatically* to the alternative index, whereas other variations may result in such an elimination following the election of the swap provider after the occurrence of one or more of the triggering conditions. Such provisions may, or may not, also provide that upon the discontinuation of the circumstances that originally triggered the shift to an alternative index, the calculation methodology applicable during the “market disruption” or other specified condition no longer applies and the swap reverts to its “cost of funds” character in effect prior to the occurrence of such circumstances.

(b) “Index-based” plain vanilla swap.

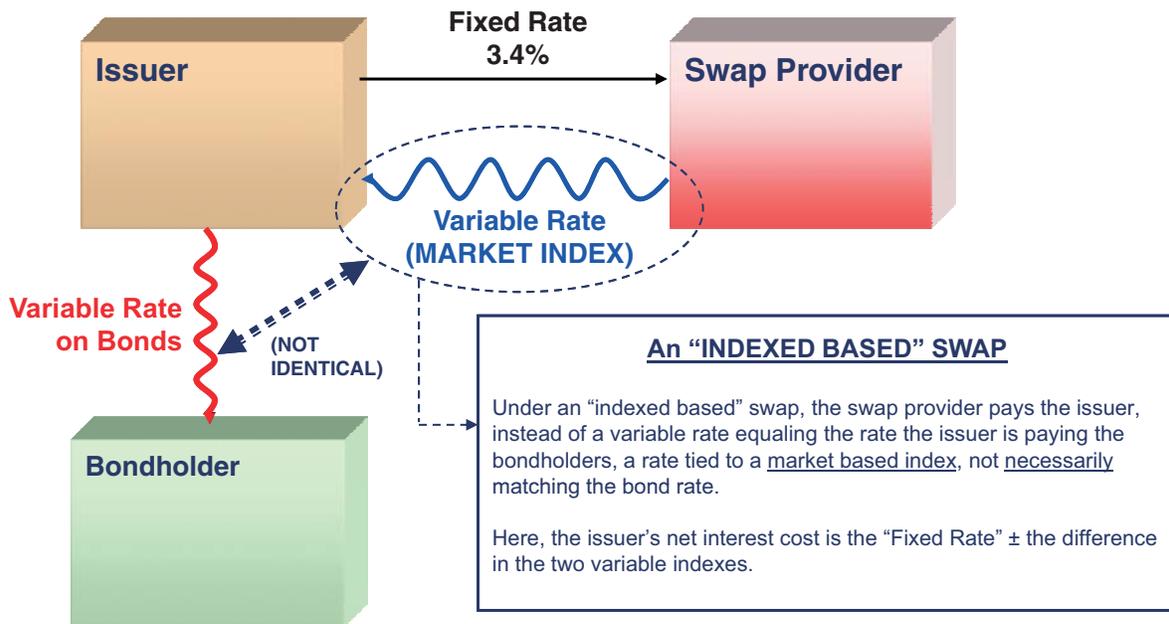
In lieu of entering into a “cost of funds” swap, suppose the same issuer and its swap provider were to enter into a transaction under which the issuer agrees to pay a fixed rate to its swap provider, in exchange for receiving from such swap provider payments based on an objective market-based index (typically selected with the intent of reasonably approximating the variable rate expected to borne by the bonds over the term of the swap – barring some extraneous event such as an issuer downgrade or a change in income tax rates³). Such a structure may be depicted as follows:

(Diagram appears on the following page)

³ See the discussion of tax rate “basis risk” in paragraph II(B)(2)(d)(ii) of this publication below.



“Index Based” Swap Used to Create Synthetic Fixed Rate Debt



As shown in the above diagram, this transaction presents a risk to the issuer in that the payments received by the issuer under the swap transaction over any particular period may not perfectly match the related variable interest payments on the bonds. This possibility that bond interest payments and variable receipts under the swap may not match is referred to as “basis risk”. Issuers may determine to accept basis risk in return for a lower fixed rate swap payment than would likely be available for a “cost of funds” swap. For purposes of illustration, in the diagrams shown above the same issuer is shown as paying a synthetic fixed rate of 3.4% for a bond rate swap as opposed to a rate of 4.0% when using an “index based” swap and retaining the “basis risk” inherent in the index based structure.⁴

The two indices that are most commonly used in structuring the variable rate leg for index-based swaps in municipal transactions are The Securities Industry and Financial Markets Association (“SIFMA”) Municipal Swap Index (the “SIFMA Index”) and the 30-day London Interbank Offered Rate (“LIBOR”). These two indexes are different from each other in ways that make the selection of which such index to use, or combination of which to use, important in the structuring of any synthetic fixed rate or other derivative-type financing.

⁴ See footnote 2 above. Additionally, while the payments received from the swap provider in any period may not exactly match the interest payments on the related bonds, irregularities in the market or bond remarketing, changes in federal or state tax law and other factors can cause wider disparities, as between the variable rates and indexes included within a synthetic fixed rate transaction, than the issuer contemplated at the time of entering into the swap.

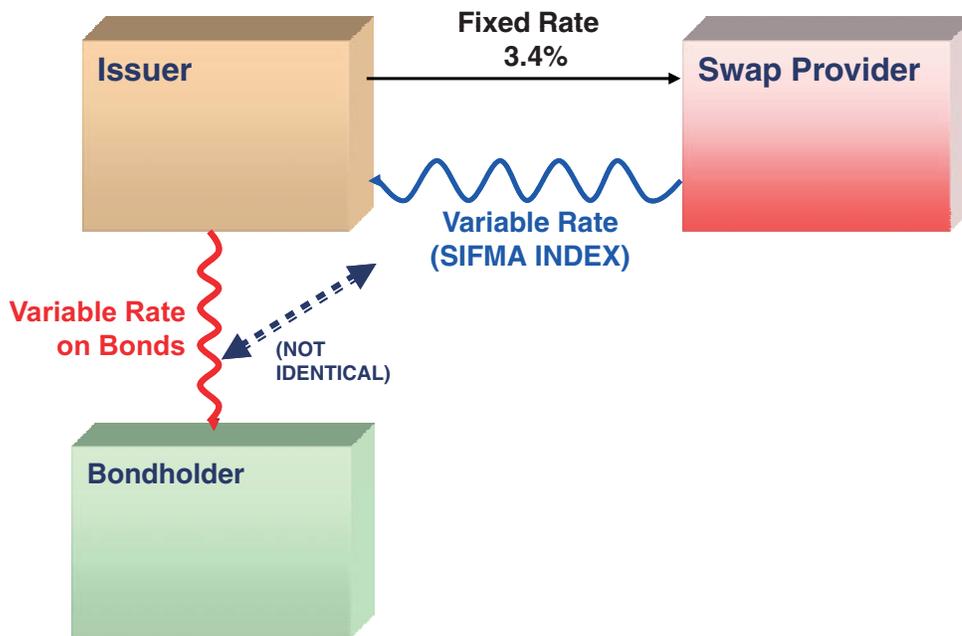


- (i) The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index.

The SIFMA Index, formerly known as The Bond Market Association / PSA Municipal Swap Index or “BMA”, is announced every Thursday by SIFMA as a composite index based upon hundreds of highly rated tax-exempt (non-AMT) variable rate demand obligations. As of the date of this publication, the number of tax-exempt obligations taken into account in establishing such index is approximately 650 every week, although such number may vary from time to time. Because the SIFMA Index was created to provide the financial markets with a reasonable measure of the weekly interest rates on highly-rated tax-exempt variable rate bonds, it is often used as a proxy rate for obligations having characteristics similar to those comprising the index. The SIFMA Index is thus widely used in swap transactions hedging tax-exempt debt.⁵

A swap employing the SIFMA Index as the basis for determining the variable rate leg payable by the swap provider to the issuer may thus be diagrammed as follows.

“SIFMA-Based” Swap Used to Create Synthetic Fixed Rate Debt



The only difference in the graph above and the comparable preceding graph used to depict an index-based swap in general, is the specification of the SIFMA Index as the market index employed in the swap transaction.

⁵ The SIFMA Index is available on a subscription basis and information on subscribing, along with an informative and detailed discussion of the index itself and its calculation, may be found at SIFMA’s website located at www.sifma.org.



(ii) The London Interbank Offered Rate (LIBOR).

Another index that is commonly used in determining the variable rate leg payable by the swap provider to an issuer under an index-based plain vanilla swap is the London Interbank Offered Rate for United States dollars (“USD-LIBOR” or, for purposes of this publication, “LIBOR”) published by the British Bankers Association (“BBA”). LIBOR rates constitute a composite measure of interest rates that highly-rated banks charge for borrowing United States dollars from each other on the London interbank market. LIBOR, which is compiled by the BBA in conjunction with Reuters and released to the public shortly after 11.00 a.m. London time each business day, is used locally and internationally as a reference rate for short-term interest rates for dollar borrowings. In municipal swap transactions, the most widely used LIBOR index is that applicable to interbank loans having a term of 30 days (“30-day LIBOR”).⁶

Because the interest on those loans comprising the LIBOR index are subject to federal income taxation, the LIBOR index is generally not expected to match interest rates on tax-exempt bonds in ordinary interest rate environments.⁷ For this reason, when the LIBOR index is used in determining the variable rate leg of an interest rate swap hedging tax-exempt bonds, the LIBOR index rate is typically multiplied by a percentage to reflect the lower rates typically paid to holders of tax-exempt variable rate debt, who should be generally willing to accept a lower interest rate on an issuer’s obligations if the bondholder is able to exclude its interest income from such obligations from federal income taxation. This mathematical relationship is demonstrated by the following chart depicting data from 1993 to August 2009, during which period the line that results from multiplying the 30-day LIBOR rates by 67% produces a reasonable “fit” with the rates reflected in the composite index of tax-exempt obligations comprising the SIFMA Index (with the notable exception of the large “spike” occurring in September 2009, in connection with the bankruptcy filing of Lehman Brothers Holdings Inc., the near bankruptcy of AIG and related significant financial events).

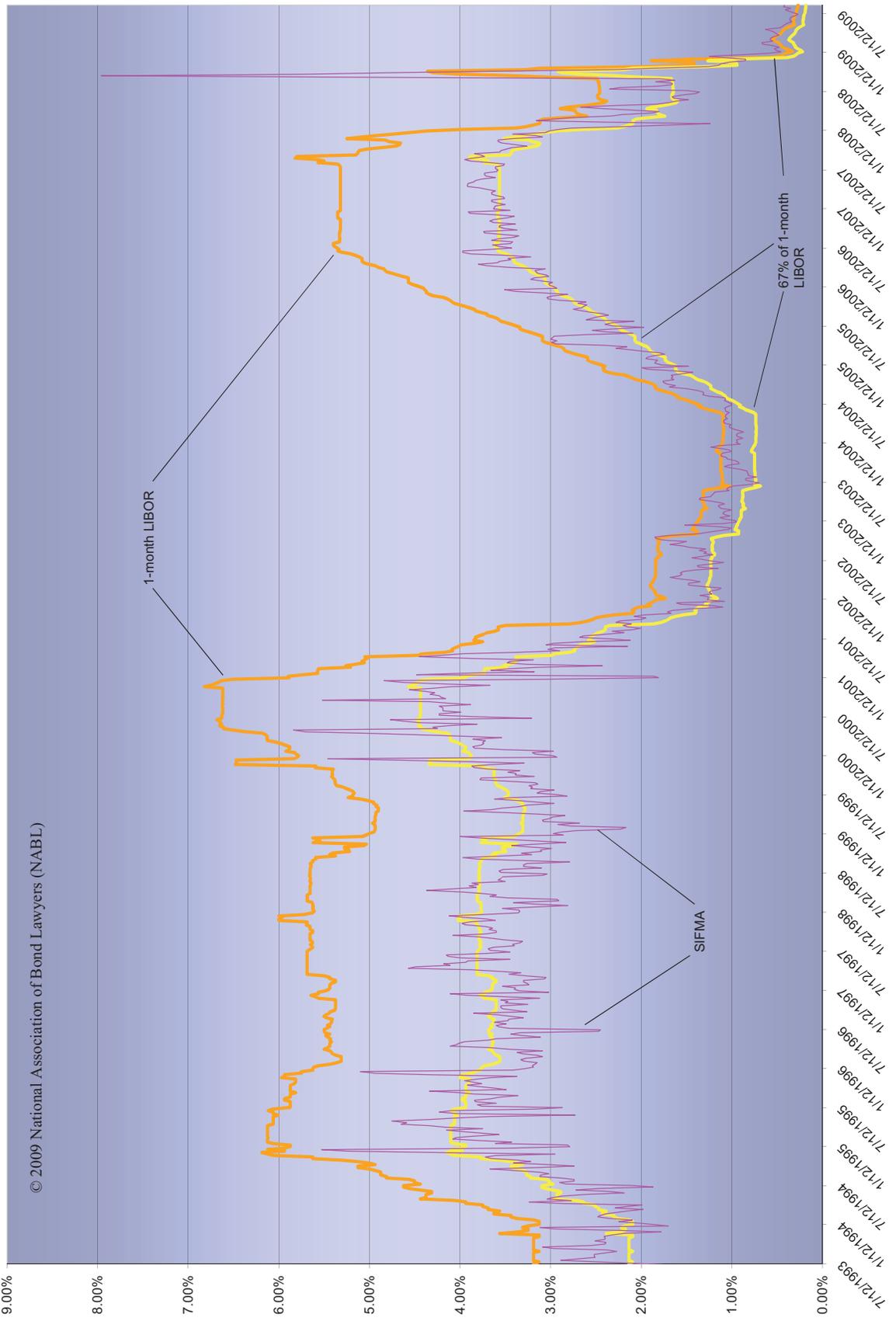
(Chart appears on the following page)

⁶ These rates, along with much additional rate and other related information, may be located at the British Bankers’ Association’s website at www.bba.org.

⁷ However, due in large part to the action of certain mathematical relationships of which a basic overview is provided in paragraph II(B)(2)(d)(ii) below, as well as issues concerning fees often charged by funds investing in tax-exempt obligations, during periods of relatively low short-term interest rates the 30-day LIBOR index and the SIFMA Index are often observed to “converge”, as reflected in the chart on the following page during lower short-term interest rate periods. This phenomenon commonly associated with such low-rate environments is often referred to as “yield compression”.



— 1-month LIBOR — 67% of 1-month LIBOR — SIFMA



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The above chart is illustrative with respect to the relationship between the SIFMA Index and 30-day LIBOR and the degree to which multiplying 30-day LIBOR by 67% constructs a variable rate index providing a generally good fit to the SIFMA Index on average over most of the depicted period (i.e., an index having generally good fit to any issue of variable rate bonds having characteristics which enabled them to trade at a weekly interest rate comparable to the SIFMA Index on average over such period). However, although it is informative to observe this fitness over the example period shown above, it is important to note that notwithstanding that an index calculated relative to 30-day LIBOR (or LIBOR of any other maturity) might ultimately fit well with the SIFMA Index (or variable rate bonds floating closely to SIFMA) *on average over a period of time*, at any particular point in time the spreads between such indexes (or between such a LIBOR-based index and such an issue of bonds) may be substantial.

It is also important to note that, although a substantial number of plain vanilla interest rate swaps have used 67% of 30-day LIBOR as their variable rate leg to create synthetic fixed rate debt, there exists no singularly accepted or “best” percentage to apply to 30-day LIBOR (or LIBOR of any other maturity) in structuring such transactions across the municipal marketplace. A logical goal, expressed by many market participants in designing the variable rate leg of a LIBOR-based swap, is to choose the percentage by which LIBOR will be multiplied in the manner that is most reasonably expected to approximate the floating interest rate on the bonds to be hedged. However, many variables, both known and unknown, can go into any such analysis and thus departures in approach are common.⁸

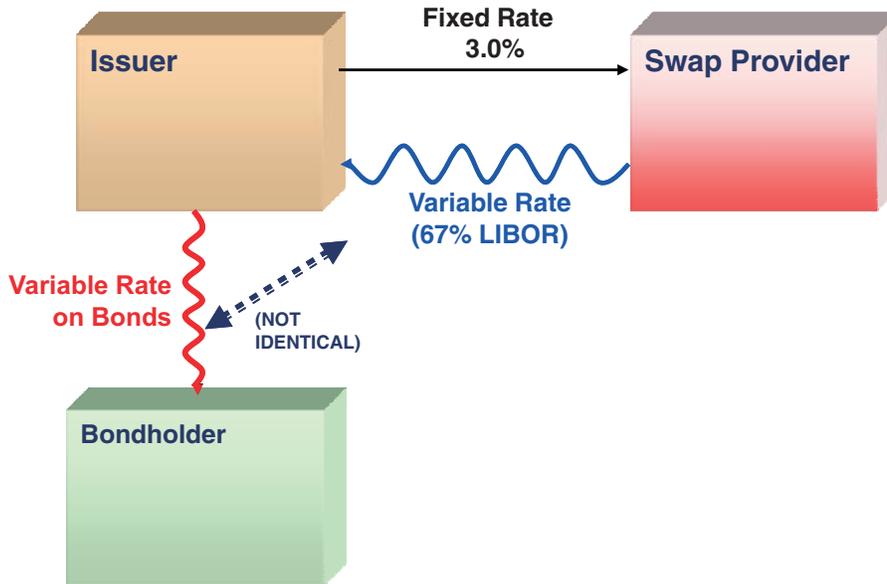
In addition, many plain vanilla swaps are structured such that, in exchange for paying a given fixed rate under the swap, the issuer will receive from the swap provider a specified percentage of LIBOR *plus* a fixed spread. For example, the variable rate component of such a swap might require the swap provider to pay the issuer a formula such as 62% of 30-day LIBOR + 0.35%. Again, there is no universally accepted “best” means to structure the variable rate component of a floating-to-fixed rate swap transaction, whereas the goal in such structuring is often an analysis of what might be expected to provide the best fitness, over time, of the variable rate received by the issuer under the applicable swap relative to the rate payable by the issuer on its related variable rate bonds.

⁸ A comparison of 30-day LIBOR versus the SIFMA Index for the period extending from July 6, 2005 through September 3, 2008, using weekly observations for each series, reveals a minimum ratio of SIFMA ÷ LIBOR of 39.7% for the period as a whole, a maximum ratio of 101.2% and an average of the ratios over all such weekly observations of 69.6%. On the other hand, the period from September 10, 2008 through August 19, 2009, portions of which included substantial degrees of economic dislocation, reflects a minimum ratio of 44.97%, a maximum ratio of 265.25%, and an average of the ratios over the weekly observations of 121.03%.



An “index based” swap employing a “% of LIBOR” (or “%LIBOR”) as the index for determining the variable rate leg payable by the swap provider to the issuer under the swap may thus be diagrammed as follows:

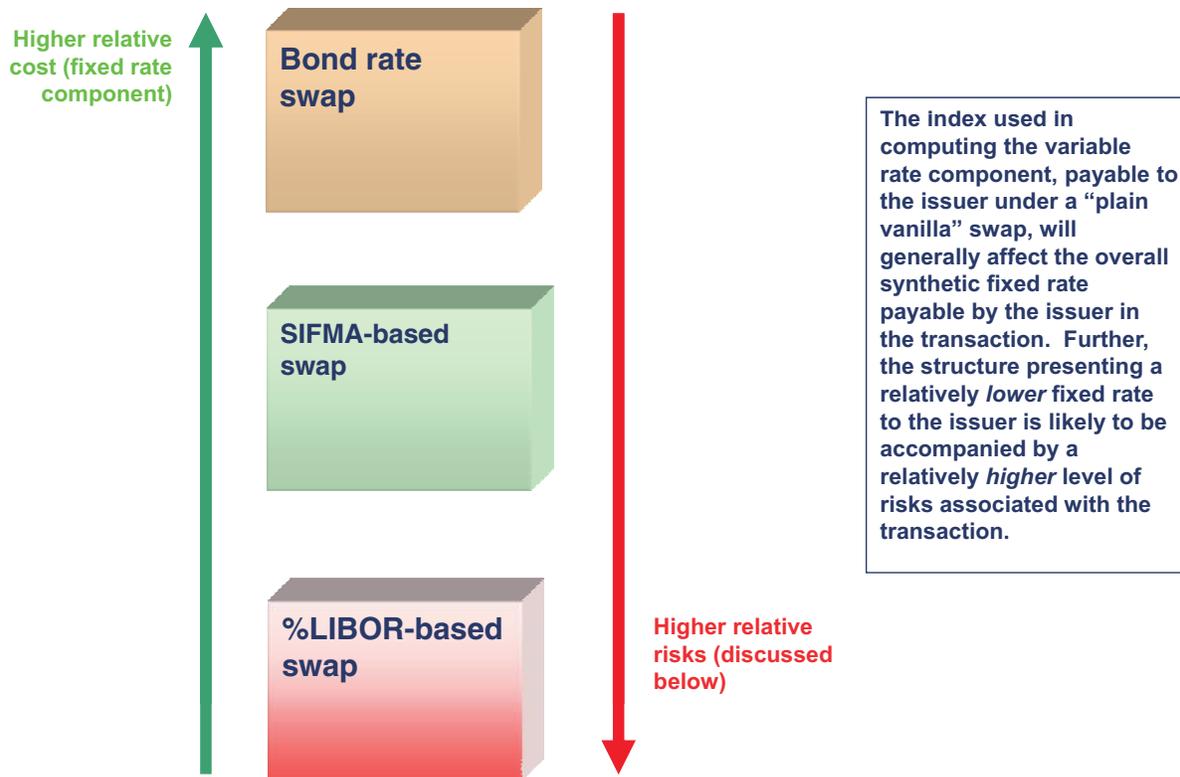
“%LIBOR-Based” Swap Used to Create Synthetic Fixed Rate Debt



The examples diagrammed above are intentionally designed to illustratively demonstrate the potential for relative savings, in terms of the fixed rate that the issuer is required to pay the swap provider, as the transaction structure proceeds from the bond rate swap (4.0%), to the SIFMA-based swap (3.4%), to the LIBOR-based swap (3.0%). The illustrations underscore how the fixed rate to be paid by an issuer under a plain vanilla swap will depend materially on the method used for determining the variable rate leg to be received by the issuer under such swap. Spreads actually available at any given time, however, will naturally depend upon the interest rate environment in effect at such time and other factors.

Under ordinary economic conditions, an issuer should expect to pay, on otherwise identical swap transactions, a higher fixed rate on a bond rate swap than on a SIFMA-based swap and, in turn, a higher fixed rate on a SIFMA-based swap than on a LIBOR-based swap. As might be expected, a relative *reduction* in rate is generally tied to a relative *increase* in risks, and some of the most commonly considered risks are discussed in greater detail in paragraph II(B)(2)(d) below.





(c) **Economic objectives.**

- (i) Hedging the issuer’s exposure to variable interest rates.

There are many circumstances in which issuers enter into interest rate swaps to achieve synthetic fixed rate indebtedness, as opposed to borrowing on a conventional fixed rate basis. A straightforward example is an issuer that enters a plain vanilla “floating-to-fixed” rate swap to hedge itself against the risk of interest rate changes, most notably increases in interest rates that might otherwise strain the issuer’s budget. In some instances and for credit-related and potential other reasons, an issuer may have limited to no access to the conventional fixed rate bond markets (e.g., the issuer may be capable of obtaining a relatively short-term letter of credit to enhance floating rate bonds yet be incapable of obtaining an investment grade rating or credit enhancement for a term sufficient to enable it to issue conventional fixed rate bonds), in which case the issuer may deem the use of an interest swap to create synthetic fixed rate its next best option. As another example, an issuer may enter into a plain vanilla swap hedging an *existing* issue of variable rate bonds in times of relatively low interest rates. The issuer may thereby be able to realize a measurable amount of the economic benefits of a refunding of the bonds without completing a traditional refunding with conventional fixed rate bonds.

- (ii) Potentially cheaper borrowing costs.

An issuer may also elect to borrow on a synthetic fixed rate basis with the goal of achieving an overall lower cost of borrowing (i.e., the fixed rate on the swap payable by the issuer together with other costs pertaining to the variable rate bonds such as those for credit enhancement, remarketing fees, trustee



fees and the like) than it might achieve through conventional fixed rate bonds. In some instances, even lower borrowing costs may be obtainable if the issuer assumes (or retains) additional risks in connection with the financing, most notably “basis risk” and “tax risk” as discussed in greater detail in paragraph II(B)(2)(d) below. In structuring a swap transaction, the issuer can choose to assume or retain certain risks that would otherwise be assumed by the bondholders in a conventional fixed rate financing. For example, as described above by selecting a SIFMA-based swap the issuer will generally assume basis risk and by selecting a LIBOR-based swap the issuer may additionally be assuming some of the risks of changes in marginal tax rates that are borne by the holders of fixed rate bonds.⁹

(iii) “Forward starting” swaps and synthetic advance refundings.

In many instances, an issuer may deem it advantageous to enter a swap transaction, and thus lock in the fixed rate payable by the issuer under the swap, even in advance of issuing the bonds or other obligations to which the swap will relate. This structure is generally referred to as a “forward starting” swap and is often employed in light of the fact that swap transactions may, in many instances, be entered into on a more expeditious timeframe than the related bonds may be issued. Such an issuer may simply desire to mitigate the potential effects that movements in interest rates may have on its borrowing costs in advance of the earliest time by which the related bonds may be issued.

In other instances, an issuer of project bonds may deem it appropriate to enter a forward starting swap to lessen the likelihood that the economic feasibility of the project will be jeopardized by upward movements in interest rates. Similarly, an issuer of refunding bonds may use a forward starting swap as a hedge against the prospect that upward movements in interest rates may erode the savings otherwise potentially obtainable from the refunding, when the refunding can not be accomplished as quickly as the swap can be entered. An issuer may also enter into a forward starting swap structured to become effective on the next available call date of an issue of fixed rate bonds, for the purpose of realizing refunding savings under circumstances when such bonds may be subject to tax law or other prohibitions on an advance refunding (i.e., a “synthetic advance refunding”).

(iv) Other structuring considerations.

In addition to timing considerations, swap transactions are also often structured by the counterparties in various other particular economic respects. For example, swap contracts need not necessarily cover the entire principal amount of an issue of bonds over their entire term, and thus are often entered to hedge only a portion of an issue of variable rate bonds over all or a portion of the term of such bonds. Some parties also deem it advantageous to embed “optionality” into swaps of various types, such as including provisions enabling the issuer to terminate the swap on one or more future dates “at par” (i.e., without the making of any termination or settlement payment, as discussed more particularly in

⁹ Certain of the risks that are most commonly be taken into account in contemplating or structuring any swap transaction are discussed in greater detail in paragraph II(B)(2)(d) below and elsewhere in this publication. This relationship between the relative costs (in terms of the fixed rate leg payable by the issuer under a swap) versus the risks presented to the issuer by the overall transaction (as presented based upon the index selected for the variable rate leg received by the issuer under such swap), as commonly observed in the municipal swap market, is reflected in the diagram included at the end of paragraph II(B)(2)(b) above. A greater discussion of the allocation of “tax risk” in structuring a synthetic fixed rate financing is set forth in paragraph II(B)(2)(d)(ii) below.



paragraph II(B)(2)(d)(iii) below). In some instances, this type of option may be used to mimic the 10-year call or similar call features of conventional fixed rate bonds.

Each of these types of swap transaction structures may present their own special risks to the parties that issuers engaged in such transactions should understand with, if applicable, the advice of outside advisors. An issuer should likewise understand the particular features of any interest rate swap along with their implications in terms of any applicable state law or other restrictions and the related costs, benefits and risks. For example, among the most notable of such risks particular to “forward starting” swap transactions is the risk that the swap is entered into but the debt or other transaction anticipated to be hedged is not ultimately consummated, or is ultimately consummated but on terms that depart from those that were anticipated at the time of entering the swap. Under such circumstances, the issuer may be faced with consequences such as the payment of a settlement or other amounts in connection with the termination or restructuring of the swap transaction as discussed in paragraph II(B)(2)(d)(iii) below.

(d) Risks in a synthetic fixed rate financing.

(i) Basis risks generally.

Interest rate swaps contain certain risks that are not inherent in traditional fixed rate financings. Among such risks, one of the most important to be understood is the extent to which a swap may not present a perfect interest rate hedge to the issuer due to “basis risk”. “Basis risk”, as introduced in paragraph II(B)(2)(b) above, will exist in any synthetic fixed rate financing to the extent that the payments received by the issuer under the variable rate leg of the swap do not correspond with the interest payments required of the issuer under the variable rate bonds intended to be hedged. To the extent that an interest rate swap has a “bond rate” or “cost of funds” element (and no “market disruption” or similar provisions are triggered) as described above, so long as the swap provider performs its obligations under the swap there should be generally no basis risk to the issuer. However, synthetic fixed rate structures under which the swap provider pays the issuer a rate based upon an independent index (such as SIFMA or %LIBOR) present the issuer with basis risk.

In the case of an “index based” swap, an issuer should expect that the rate of interest borne by its variable rate bonds will not exactly match the variable index-based rate component received by the issuer under the swap, due to factors as commonplace as general market “noise” between the swap index rates and the bond rates as well as more systematic factors. For example, a material reduction in the creditworthiness of the issuer or its credit enhancer (relative, e.g., to the creditworthiness of the issuers whose obligations comprise the SIFMA Index) may result in a sustained increase in the rates payable by the issuer under its variable rate bonds, which will not be covered by a corresponding increase in the amounts received by the issuer from its swap provider on an index-based swap. Another circumstance that may create a systematic element of basis risk is the risk that an issuer’s remarketing agent or auction agent may fail to efficiently price the issuer’s variable rate bonds on an ongoing basis, a risk that a swap provider would not correspondingly cover under a typical index-based swap.

(ii) Tax rate basis risk.

An additional “systematic” type of basis risk, which is frequently discussed in the structuring of a swap used to create synthetic fixed rate debt (particularly in selecting between a SIFMA-based swap versus a %LIBOR-based swap), is the potential effect on the overall financing of a change in the marginal income tax rates applicable to the holder of the tax-exempt bonds to be hedged.



Assuming the efficient pricing of debt instruments having otherwise comparable terms and creditworthiness, a bondholder should be willing to purchase and retain a tax-exempt bond only to the extent that the amount of interest that it receives on such bond is the same as the bondholder would receive under a taxable obligation *net of* the amount of income tax such bondholder would be required to pay on such obligation. On a simplified basis, this relationship is frequently illustrated by the following formula (where t represents the rate of income tax payable by the bondholder on its taxable interest income):

$$Interest_{tax-exempt} = (1 - t) \times Interest_{taxable}$$

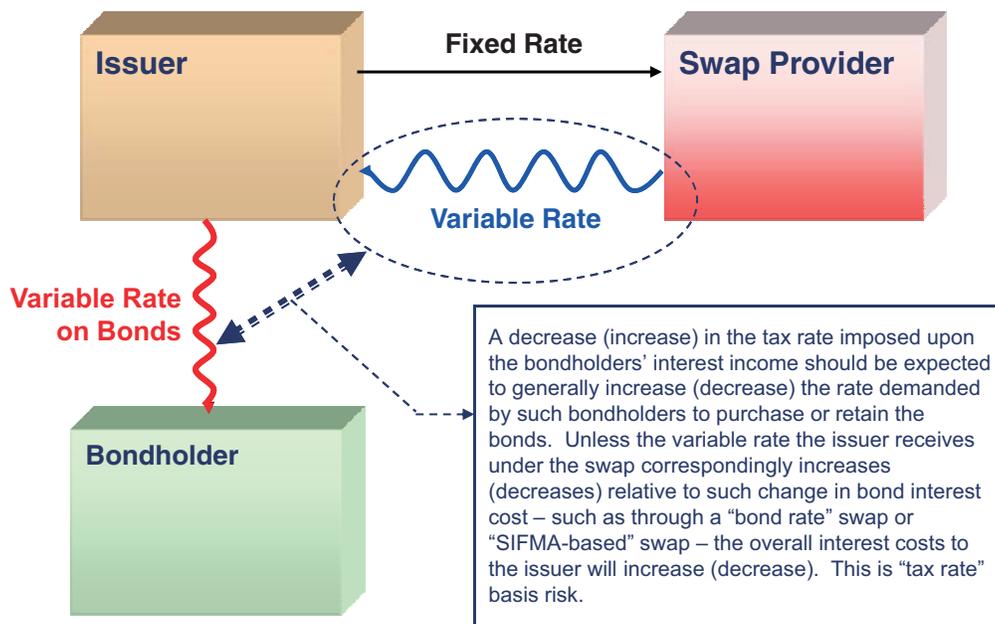
This type of relationship should be generally observed in light of market pressures that might otherwise be brought to bear. For example, because a decrease in tax rates [t] should result in the after-tax income received by holders of taxable bonds [$(1 - t) \times Interest_{taxable}$] being greater than that which would otherwise be applicable (in that the bondholder is not required to pay as large a share of its interest income to the government), such a decrease in tax rates should result in bondholders throughout the marketplace shifting their holdings from tax-exempt to taxable instruments until the laws of supply and demand result in the equation shown above being generally re-established. More directly stated, any decrease (increase) in the tax rates applicable to bondholders should result in a general increase (decrease) in the interest rates on tax-exempt bonds relative to taxable obligations. In the extreme case, in the event that the marginal tax rate applicable to the bondholders' interest income were to be cut to zero percent, there should be effectively no difference between the rate of interest applicable to tax-exempt and taxable bonds otherwise having the same credit, maturity and other features. (Mathematically stated, if $t = 0$ in the above equation, in such case $Interest_{tax-exempt} = Interest_{taxable}$.)

Given the foregoing, an issuer of tax-exempt bonds swapped to a synthetic fixed rate may be subject to "tax rate" basis risk as follows: If the tax rate applicable to the bondholders' interest income decreases, the issuer should be expected to pay a relatively higher borrowing cost on the overall financing *unless* the variable rate received by the issuer under the swap correspondingly increases to cover the additional interest cost on the bonds. Conversely, if the tax rate applicable to the bondholders' interest income *increases*, the issuer should be expected to pay a relatively *lower* borrowing cost on the overall financing *unless* the variable rate received by the issuer under the swap correspondingly *reduces* along with the reduction of interest cost on the bonds.

(Diagram appears on the following page)



“Tax Rate” Risks of Synthetic Fixed Rate Debt



Many market participants have suggested that the interest rate swap market, which has historically been based on taxable instruments, may be more efficient than the tax-exempt market for longer maturities. Potential sources of this phenomenon, when observed, may include the uncertainty of federal income tax rates: because bond purchasers are unsure of what their tax rates will be in later years, they are perceived to demand a premium for taking this tax law change risk in the form of a marginal increase in the fixed interest rate they would demand in the absence of this risk. It is argued by many that less such inefficiencies exist in the taxable swap market.¹⁰

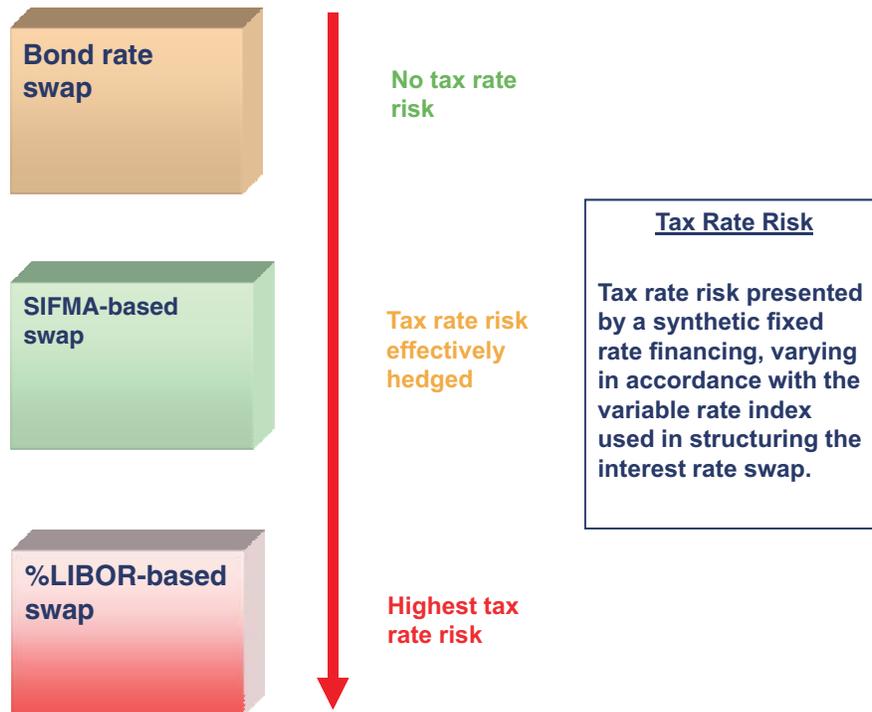
In light of the foregoing, a critical component of any issuer's analysis of *which* type of swap to use (e.g., bond rate, SIFMA or %LIBOR) is to take into account the relative amount of “tax rate” risk created by the applicable structure. More specifically, although such transactions have become relatively uncommon in tax-exempt finance, a bond rate swap presents essentially no tax risk to the issuer because in such a transaction the swap provider agrees to cover the actual interest cost under the bonds regardless of any effect of tax rate changes (provided that the swap does not contain “market disruption” or similar provisions such as discussed in paragraph II(B)(2)(a) above). A SIFMA-based swap, in turn, hedges the issuer against federal income tax risk to the extent that a change in tax rates modifying the interest payable by the issuer on its tax-exempt bonds is matched by a corresponding effect reflected in the tax-

¹⁰ NABL cannot confirm and does not take a position on the accuracy of this argument, which is being set out for educational purposes only. Any pricing advantages that may be achieved by structuring a municipal finance transaction using an interest rate swap should be balanced against the risks that an issuer will effectively retain or accept through a swap structure.



exempt bonds *that comprise the SIFMA Index itself*.¹¹ Lastly, a %LIBOR-based swap provides no protection against tax rate risk, because to the extent that a change in tax rates modifies the interest payable by the issuer on its tax-exempt bonds, the change will *not* have a corresponding effect in the *taxable* obligations that are observed in compiling the LIBOR index.

This general relationship may be diagrammed as follows:



(iii) Market rate / “termination” risk.

An issuer entering into an interest rate swap is well-served to assess, often with the advice of independent outside advisors, the extent to which the fixed rate component established by the parties when closing (i.e., “pricing”) the transaction corresponds generally within the range of rates being charged for similar swap transactions in the broader marketplace (i.e., the “on-market component” of the fixed rate) *plus* in most instances an additional charge (or “spread”) charged by the swap provider as compensation for its own profit, internal credit costs and the like.¹² To the extent that the fixed rate

¹¹ However, the SIFMA Index may not reflect changes in the bond rate resulting from any changes in state or local taxation on the interest on the bonds.

¹² In some instances a swap counterparty may be asked to pay certain amounts to or for the account of the issuer on an “up front” basis upon the closing of the swap, such as in connection with “embedded loans” as discussed in paragraph III(A)(4) below. Two common examples involve a fixed (or “off market”) payment by the swap provider to cover the costs of professionals who provided services to the issuer in connection with the swap, or to assist the issuer in funding costs associated with the termination of a prior derivative transaction being replaced with the swap. In exchange for such up front payments, the swap provider will generally include an additional spread within the fixed rate component payable by the issuer over the term of the swap. Although this publication does not comprehensively address these structures, they do present additional issues for consideration by an issuer,



payable by the issuer under the swap is priced at its inception on an “on-market” basis (together with the applicable spread) then, under common formulations for assessing payments required upon terminating a swap (discussed in greater detail in this paragraph II(B)(2)(d)(iii) below, and assuming no movements in the broader market pricing for similar swaps in such instant), were the swap to be terminated by the parties at the instant immediately succeeding such inception, theoretically the issuer should expect to pay a termination amount to the swap provider calculated solely with respect to the “spread” component of the fixed rate described above. This is due to the fact that, under this hypothetical scenario, the component relating to the “on market” aspect of the fixed rate leg of the swap has not changed.¹³ From another perspective, to the extent that an “on-market” interest rate swap represents an exchange of two current market interest rates at the time the swap is entered, it should be expected to have an approximately zero or “neutral” value at inception (except to the extent of the spread charged by the swap provider for its own profit, internal credit charges and the like). Such value, whether measured at the time the swap is entered or at any other time during its term, is generally referred to as the “marked-to-market” value of the swap.

As market rates move following the inception and pricing of a swap, this “marked-to-market” value of the swap will correspondingly change: if market rates *rise* such that the fixed rate component that the issuer would be required to pay in order to enter a replacement swap having terms identical to the original swap (over the remaining term of such original swap) likewise *rise*, then the marked-to-market value to the issuer of the original swap should be expected to *increase* in value with the issuer in such case preferring to pay its then cheaper “below-market” fixed swap payments. Under common termination pricing methodology discussed below, if this issuer were to terminate its swap during the increased interest rate environment, the issuer would be likely to *receive* a payment upon such termination of the swap as compensation for the swap having “*positive* marked-to-market value to the issuer”. In the terminology of the swap and related markets, in such instance the issuer is said to be “*in the money*” under the swap.

Conversely, if market rates *fall* such that the fixed rate component that the issuer would be required to pay in order to enter a replacement swap having terms identical to the original swap (over the remaining term of such original swap) likewise *fall*, then the marked-to-market value of the original swap to the issuer should be expected to *decrease* in value with the issuer in such case otherwise preferring to pay the lower “market” rate on a *replacement* transaction rather than its higher “above-market” fixed swap payments. Under the same common termination pricing methodology, if this issuer were to terminate its swap during the decreased interest rate environment, the issuer would be likely to *pay* an amount upon such termination of the swap as compensation for the swap having “*negative* marked-to-market value to the issuer”. In the terminology of the swap and related markets, in such instance the issuer is said to be “*out of the money*” under the swap.

In general, under provisions commonly included in swap documentation, upon the early termination of a swap the parties will “settle up” based largely on the marked-to-market value of the swap

such as their potential characterization as loans subject to applicable state law or other borrowing requirements, as well as tax-related implications concerning the extent to which all or a portion of such a swap may be treated as a “qualified hedge” for tax-exempt bond yield calculation and other purposes. See Treasury Regulations ¶ 1.148-4(h)(2)(i)(C).

¹³ For purposes of simplicity, this discussion ignores the “bid / ask” aspects, generally applicable to the financial markets accessed by swap dealers in relation to the offering and pricing of interest rate swaps and other derivatives and hedging strategies by such providers and dealers.



at the time of termination. Alternatively, in some instances swap counterparties may enter into an “offsetting” swap whereby each takes a paying position reverse to that respectively applicable under the first swap. To the extent these reverse positions result in the overall payments cancelling out (i.e., the variable rate the issuer receives under the first swap equals the variable rate it is obligated to pay on the “offsetting” swap), the issuer may reduce its overall payment obligations relative to those under the initial swap contract alone.¹⁴

In sum, depending on movements in interest rates subsequent to the entering of a swap transaction, one party to the swap is likely to be required to make a “settlement” or “termination” payment to the other upon any termination of a swap in advance of its scheduled expiration. This payment which may be required to be paid by either party (i.e., either the issuer or its swap provider depending on the movements in interest rates) to the other may be substantial in amount. Issuers entering into swap transactions often seek expert financial advice as to the projected magnitude of any swap termination payment under varying assumed future interest rate market scenarios, a type of analysis often referred to as a “termination sensitivity analysis”.

The likelihood that either party to a swap transaction may be subject to a termination of the transaction is dependent upon the particular “events of default” or “termination events” set forth in the swap documentation. For example and as more particularly described below, standard ISDA[®] documentation typically provides one or both parties to the transaction the ability to terminate the transaction upon the occurrence of certain standard “Events of Default”, such as a failure to pay or perform any obligation under the transaction itself as well as the occurrence of certain cross-default and bankruptcy related events. Standard ISDA[®] documentation also includes certain “Termination Events”, such as an adoption or change in law that renders a party’s obligations under the transaction unlawful, which *if continuing* may provide one or both parties to terminate the swap. In addition, parties to swap transactions frequently include customized “Additional Termination Events” in the swap documentation.

Additional Termination Events commonly encountered include the ability for one party to require the termination of a swap transaction following the occurrence of certain events such as a downgrade of the credit rating of the other party (or its guarantor or other credit enhancer) below a negotiated threshold, the redemption or other payment of the bonds hedged by the swap, or the breach by a party of any coverage ratios or other covenants set forth in the documents pertaining to the swap or related bonds. As mentioned above, under certain circumstances an issuer will negotiate a provision enabling it to terminate a transaction at any time at its option. An optional termination may be negotiated either with the issuer being subject to a potential termination payment or receipt (a “market termination” option) or, alternatively, to no such termination payment or receipt (a “par call” option).

¹⁴ Such a reduction in payment exposure may be subject to the issuer taking additional credit exposure with the swap provider in light of the additional swap transaction, raising issues as to the ability of the issuer and swap provider to net or set-off amounts owing to each other under the multiple transactions along with other potential issues. For example, “offsetting” swaps may generate various tax-related issues that, in addition to not being addressed by this publication, are not fully developed under federal income tax regulations presently in effect.



(iv) Issues relating to credit enhancement applicable to the *hedged obligations*.

When an issuer hedges a series of bonds or other obligations that are the subject of third-party credit enhancement such as bond insurance or a letter of credit, the issuer should be particularly mindful of any interplay between the rights and interests of the credit enhancer and those of the provider of the swap transaction. In many instances, the provider of such credit enhancement and the swap provider may be the same or related entities, and the approach taken in the applicable documents is often reflective of such a relationship.

The issues that may arise in this context are many. However, by way of examples:

- As discussed in paragraph II(B)(2)(d)(i) above, an issuer may be subject to “basis risk” under an index-based swap to the extent that the credit enhancer of the related variable rate bonds suffers a downgrade or other adverse credit event. This type of scenario has negatively affected many issuers nationwide, in some instances to a dramatic degree, as a result of the series of downgrades in the monoline bond insurance industry that began at the end of 2007.
- If the provisions of a swap transaction permit the swap provider to terminate the swap upon a ratings event relative to the credit enhancer for the hedged bonds, the issuer is exposed to such termination risk in the event of an adverse credit event on such credit enhancer or the inability of the issuer to obtain substitute credit enhancement in a manner sufficient to negate such termination event.
- A credit enhancer for the issuer’s bonds may require that some portion (or all) of the bonds be hedged under an interest rate swap, and such a requirement may be accompanied by a ratings requirement as to the applicable swap provider. In such cases the issuer is subject to the risk that an adverse credit event relative to the swap provider, or the expiration or termination (e.g., upon a default) under the swap, may trigger an event of default under the bond credit enhancement documents resulting in the potential for an event of default under, and possibly an acceleration of, the hedged bonds.
- Similarly, the documents applicable to the credit enhancement for the bonds may also include direct “cross default” provisions under which the obligations relative to such credit enhancement (or the bonds) may be deemed in default upon an event of default (or other termination events) arising under the swap transaction – and *vice versa*. In either case, the issuer becomes subject to the risk of termination of the swap and/or the credit enhancement and a possible event of default under, and possible acceleration of, the bonds.
- The documents governing a swap transaction may present other limitations on the ability of the issuer to substitute credit enhancement on the hedged bonds. Such rights may be expressly set forth in the swap documents, or may result from less direct means. For example, when the swap provider and bond credit enhancer are the same or related entities, it is common that any collateral pledged to secure the issuer’s obligations relative to the credit enhancement are cross-collateralized to secure the issuer’s obligations under the swap as well, which



may result in “collateral tie-up risk” discussed in greater detail in paragraph II(B)(2)(d)(vi) below.

- The documents governing credit enhancement for the bonds may also require that the consent of such credit enhancer be obtained in connection with amendments or other modifications or restructurings (or possible terminations) of related interest rate swaps.
- Special issues may also arise with respect to issuers having master ordinances, master indentures or the like in place which enable pledges of revenues or other collateral on an ongoing basis. As discussed in greater detail in paragraph III(D) below, such issues may include determining the relative priorities and other matters concerning the sources of payment and security relative to the issuer’s bonds, swaps, agreements for credit enhancement and other obligations, along with any applicable requirements for (or against) the entering of swaps and related restrictions and the effect of swaps on quantitative and other covenant tests.

(v) Issues relating to credit enhancement for the
swap transaction.

Prior to the series of monoline bond insurer downgrades which began at the end of 2007, it was commonplace for one or both parties to an interest rate swap to obtain credit enhancement covering its respective obligations under the swap in the form of a swap insurance policy. In some instances, the provider of swap insurance for one (or at times both) sides of the swap transaction is the same monoline insurance company insuring the payments on the related series of hedged bonds. While many of these types of insured swap transactions remain in place as of the date of this publication, the current status of the monoline insurance industry has resulted in many swap counterparties foregoing swap insurance on the one hand, and at times taking measures to minimize or eliminate certain negative effects of their outstanding swap insurance policies where possible on the other hand.

Because the issues presented by swap insurance are many and often complex, and in light of the rapid and continuing evolution of these issues and the options available in the monoline insurance industry, this publication does not provide any detailed discussion of current issues. However, certain of the issues historically involved with swap insurance are comparable in nature to those discussed with respect to the credit enhancement of hedged bonds in paragraph II(B)(2)(d)(iv) above, and the more general considerations include the following:

- If the provisions of the swap transaction permit the swap provider to terminate the swap upon a ratings event relative to the credit enhancer for the swap, the issuer may be exposed to such termination risk in the event of an adverse credit event on such credit enhancer or the inability of the issuer to obtain substitute credit enhancement for the swap in a manner sufficient to negate such termination event.
- Swap insurers have generally required the inclusion of specialized provisions into the documents governing insured swaps, including provisions under which the swap may or may not be terminated with or without such credit enhancer’s consent, and in some cases circumstances in which the transaction must be terminated at the swap insurer’s direction, as well as other types of control and



consent rights, such as consents to any changes to the swap documents and provisions granting the swap insurer control over default or termination remedies.

In light of the changes taking place in the bond and swap insurance industry mentioned above, however, market participants are presently evaluating and formulating alternative documentary provisions regarding the consent, control and similar specialized rights and remedies to be enjoyed by swap insurers and other parties under applicable transactions.

(vi) Other risks.

Interest rate swaps present certain additional risks that are not inherent in conventional fixed rate municipal financings. Included among those risks are the following:

- Amortization risk. If an issuer determines to pay off all or any portion of the variable rate bonds hedged by an interest rate swap on any amortization schedule other than the notional principal schedule on which the swap is based, such prepayment will typically *not* result in a corresponding reduction in the notional principal amount of the swap. Accordingly, the swap transaction may become “out of balance” from an economic standpoint with the hedged bonds. As referenced above, in such events the swap documentation may require a like termination of a portion of the swap; any such partial termination will ordinarily result in one party – either the issuer or the swap provider, depending on movements in market interest rates – having to pay a partial termination amount to the other.
- Rollover risk. To the extent that the term of a swap term is not coterminous with the maturity of the issuer’s hedged bonds, the ability of the issuer to “roll over” the terminating swap into a new hedge is subject to the economic conditions in effect at the time that the replacement swap is executed. Such conditions may result in (i) the issuer simply accepting the variable rate payable on the bonds on an “unhedged” basis following the termination of the swap; (ii) the issuer entering a new swap effective on the rollover date, which may be at a higher (or lower) fixed rate than would have been available had the issuer originally swapped for a longer period of time or issued fixed rate bonds; and/or (iii) for credit, market or other reasons, the issuer finding itself unable to obtain a swap transaction commencing (on a “forward starting” basis or otherwise) at or about the time of the termination of the original swap.
- Collateral tie-up risk. In many instances the issuer or the swap provider (or both) may be required to pledge collateral to secure its respective obligations under the documents governing a swap transaction, and there are varying forms that such collateral may take. For example, collateral may include property already pledged by the issuer to the swap provider acting in some other capacity, such as that of the letter of credit bank or liquidity facility provider if the swap provider is also serving in either such capacity. If an issuer later desires to obtain substitute credit or liquidity enhancement from an unrelated financial institution while the swap is still in effect, the existing pledge of collateral to the swap provider may limit its ability to secure such substitute liquidity or credit enhancement (e.g., if an issuer attempts to replace an existing 3-year letter of



credit securing its bonds with a substitute letter of credit from another financial institution, but has entered into a 7-year swap with the original letter of credit provider). In many instances, this may make third party financing impracticable or impossible without terminating the swap – and paying (or possibly receiving) any required settlement amount – or obtaining a release or subordination by the swap provider of its collateral. The result may be the assignment of the existing swap to the new credit provider or, in the absence of such alternative, the termination of the existing swap and replacement with a new swap transaction entered into with the incoming credit provider.

- Covenant tie-up risk. Similar to “collateral tie-up risk” discussed above, swap providers often require an issuer to agree to various affirmative and negative covenants during the term of a swap. In instances where the swap provider is a financial institution having other credit relationships with the issuer, this is sometimes accomplished by provisions in the swap documents to the effect that the issuer will continue to comply with all agreements set forth in the other credit documents with the financial institution (or some other master ordinance or trust indenture binding the issuer) regardless of any payoff of the obligations that are the subject of the original credit agreement or master document. Thus, the swap agreement may effectively commit the issuer to the various covenants in master credit documents or ordinances beyond the term originally required in such documents, even if the bonds or other obligations bound by those restrictions are paid or are refunded under other security documents.
- Counterparty risk. The issuer is exposed to the credit risk of its swap counterparties, in that it is always possible that any swap provider (or its guarantor or other credit enhancer) may suffer an event of bankruptcy or other financial hardship inhibiting its ability to make payments under the swap or to post collateral securing its obligations.¹⁵
- Additional Termination Event risk. Parties to swap transactions frequently include “Additional Termination Events” in the swap documentation which may include, as discussed in paragraph II(B)(2)(d)(iii) above, the ability for one party to require the termination of a swap following the occurrence of certain events such as a downgrade of the credit rating of the other party (or its guarantor or other credit enhancer) below a negotiated threshold, the redemption or other payment of the bonds hedged by the swap, and the breach of certain coverage ratios or covenants set out in any related bond documents. In addition, and particularly when the financial institution acting as the swap provider is the same entity providing credit enhancement for a related series of the issuer’s bonds, the financial institution will often require that an “Additional Termination Event” be triggered upon the termination or replacement of its credit enhancement on the bonds.

¹⁵ Although not explored in this publication, the issue of counterparty risk has become particularly acute in light of the general financial crises leading up to the date of this publication and, in particular, the bankruptcies of Lehman Brothers Holdings Inc. and affiliated entities which have highlighted several issues that may arise in this context. For example, pronouncements from these proceedings strongly suggest, in the view of the bankruptcy court, a limited period of time within which a bankruptcy default must be asserted without waiving such default. Further information on this important topic may be found, as of the date of this publication, at www.Lehman-Docket.com.



- Legal authority risk. As discussed in greater detail in paragraph III(A) below, there may be instances in which it is unclear whether or not a particular swap or other derivative transaction is legally authorized or permitted with respect to a particular governmental entity under applicable state law.
- Other potential risks. There may be other potential risks involved in entering into a swap, depending on the circumstances of the parties and the specifics of the particular transaction, and this publication does not attempt to address all such risks and related issues.

(3) Fixed-to-floating interest rate swaps.

(a) **Structure.**

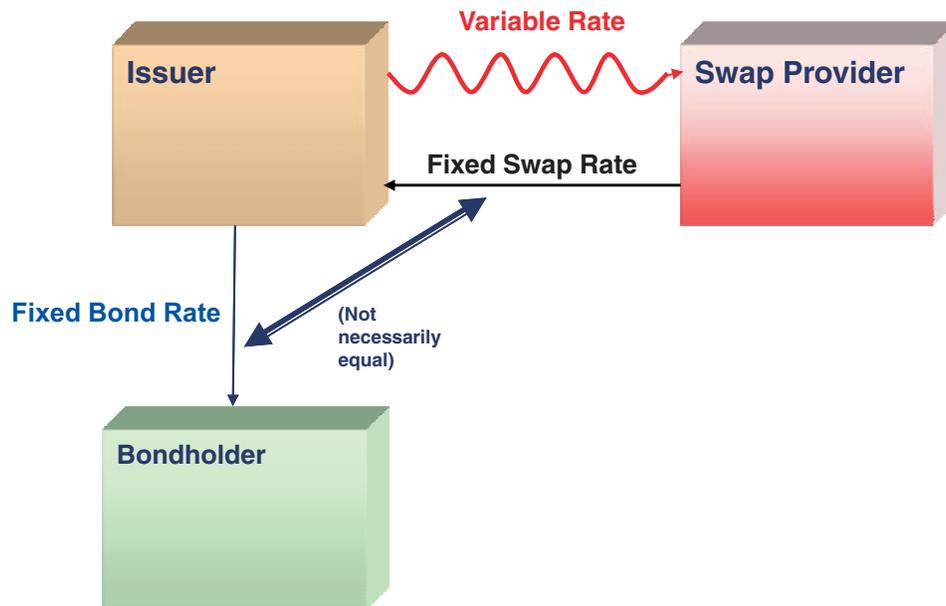
As its name would suggest, a “fixed-to-floating” interest rate swap is essentially the reverse of the “floating-to-fixed” interest rate swap more commonly entered by municipal issuers and described above. Thus, under a fixed-to-floating interest rate swap the issuer agrees to make swap payments based on a *floating* interest rate index and to receive swap payments from the counterparty based on a *fixed* rate. As is the case with a floating-to-fixed rate swap, the swap payments are typically calculated based upon a notional principal amount with no actual principal being exchanged and the offsetting swap payments are typically netted.

An issuer might enter a fixed-to-floating rate swap if it has separately issued fixed rate bonds and would prefer to have floating borrowing costs on all or some portion of those bonds. For example, suppose the issuer has fixed rate bonds outstanding bearing interest at the rate of 6.0%, and then enters a fixed-to-floating rate swap under which the issuer agrees to pay the SIFMA Index and to *receive* 6.0%. The issuer can then use the 6.0% fixed rate that it receives under the swap to pay the fixed rate owed under its bonds. The overall goal in this context would be to convert the issuer’s overall effective borrowing cost from a fixed rate into that comprising the variable SIFMA Index.

(Diagram appears on the following page)



“Fixed-to-floating” Swap Used to Create Synthetic Variable Rate Debt



An issuer might also use a fixed-to-floating rate swap during the construction period of a long-term capital project. In these types of transactions, bond proceeds are often invested in floating rate instruments creating a mismatch between what the interest paid by the issuer under its fixed rate debt versus what it receives on these short-term investments. A short-term fixed-to-floating swap may thereby enable the issuer to mitigate the effects of negative arbitrage during the investment period for the bond proceeds in the context of a long-term fixed rate financing.

Similar to floating-to-fixed interest rate swaps, the floating rate that the issuer pays on the swap can be based upon the actual rate received on some related floating rate asset or liability, or can be based upon a similar, but not identical, measurement such as the SIFMA Index or %LIBOR. The size of the swap or its notional principal amount can be equal to the entire principal amount of the bonds or some lesser or greater amount. If a swap agreement covers all of the bonds in an issue, the notional principal amount may amortize as the bond principal amount amortizes. Further, the swap may be for a time period equal to the maturity of the bonds or, subject to applicable legal requirements, some other period of time.

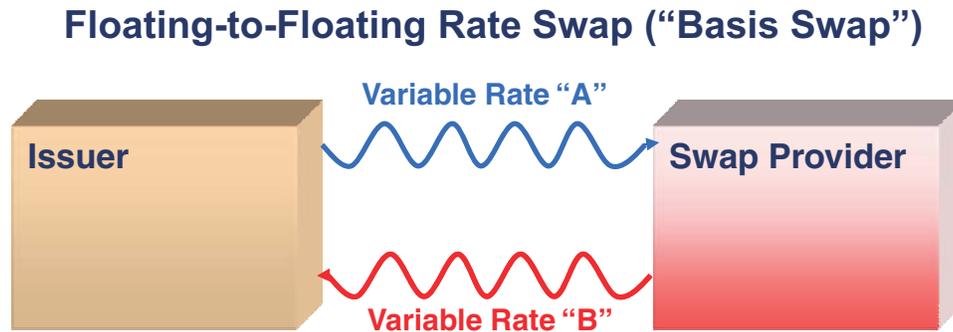
(b) Economic Objectives and Risks.

One economic objective for an issuer to use a fixed-to-floating swap, in addition to those mentioned above, is to achieve a cheaper borrowing cost to the extent that an issuer can achieve a lower all-in floating swap rate than it would pay if it directly issued floating rate tax-exempt bonds, taking into account the risks associated with the synthetic structure. Because a fixed-to-floating interest rate swap eliminates the need for a liquidity facility and remarketing agent (or auction agent where applicable) that are often required for floating rate bonds, many of the additional costs of variable rate debt are obviated by the use of synthetic floating rate debt. A synthetic fixed-to-floating rate structure may also permit an issuer to hedge rates earned on its liabilities and assets, particularly in circumstances in which the issuer has floating rate assets (e.g., a floating rate mortgage loan or a student loan portfolio). For example, if an issuer has floating rate assets and short-term interest rates decline, the decrease in the floating rate swap obligation may offset the reduction in earnings on the issuer's floating rate assets, and *vice versa*.



(4) Floating-to-floating interest rate swaps (“basis swaps”).

Under a floating-to-floating interest rate swap, an issuer agrees to make swap payments to the swap provider based on one floating interest rate index and to receive floating swap payments from the swap provider based on a different floating index. As with the other types of swap transactions discussed above, the swap payments are typically calculated based on a notional principal amount with no actual principal being exchanged and the offsetting swap payments are typically netted. This is commonly referred to as a “basis swap” and may be diagrammed as follows:



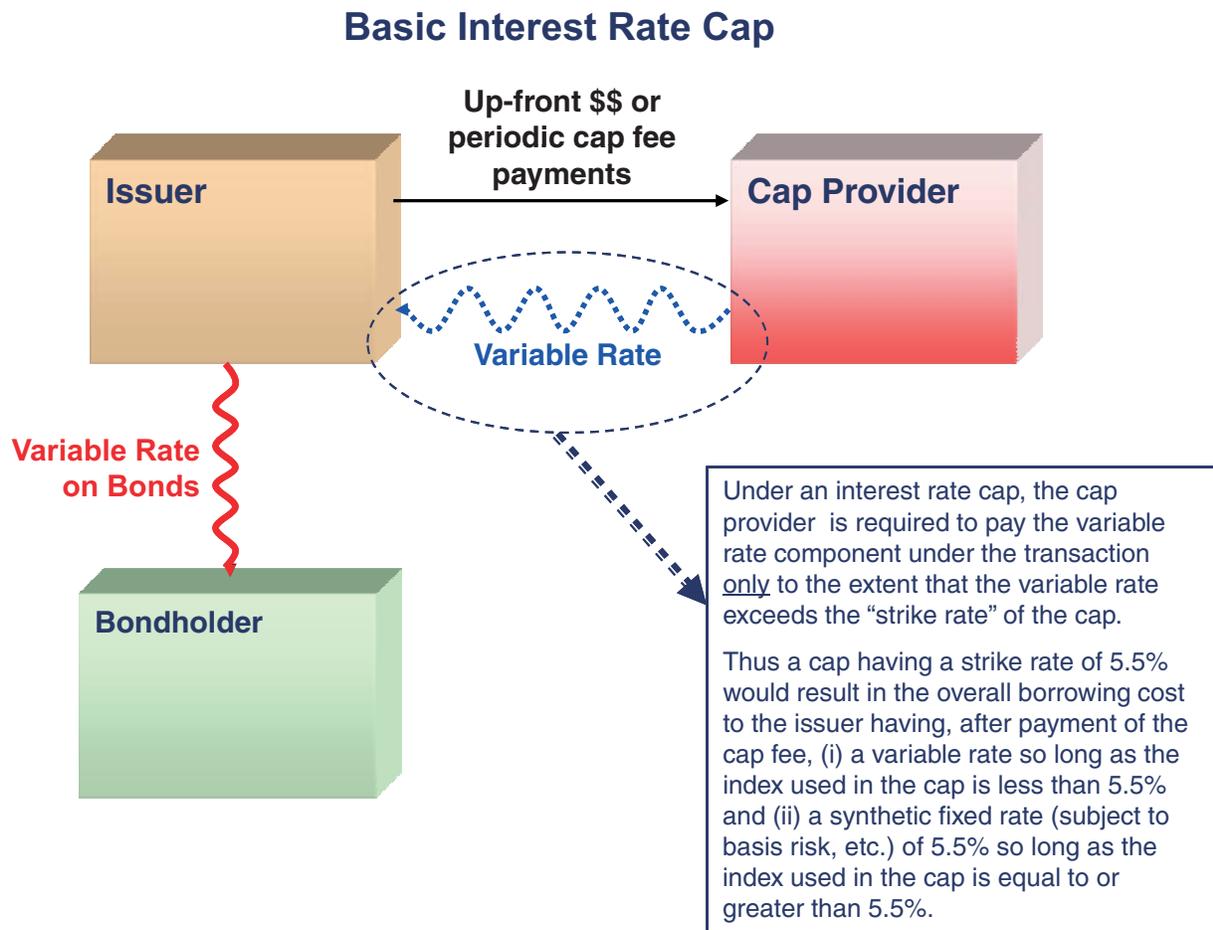
For example, a housing or student loan bond issuer may originate floating rate loans based on the 1-year Treasury bill index. In that case, such an issuer might issue floating rate tax-exempt bonds and enter into a floating-to-floating swap in which it pays a floating rate tied to the 1-year Treasury bill index and receives a floating rate equal to the SIFMA Index. As another example, suppose an issuer of variable rate bonds, swapped to a synthetic fixed rate employing a %LIBOR-based swap, desires to reduce the amount of basis risk presented to the issuer by reason of potential tax rate changes along the lines described above. Such an issuer may consider entering a basis swap to hedge against this risk by agreeing to pay the swap provider an amount based upon a %LIBOR in exchange for receiving from the swap provider an amount calculated with respect to the SIFMA Index.



(C) Interest Rate Caps, Floors and Collars.

(1) Interest rate caps.

An interest rate cap is a notional principal contract under which an issuer pays a cap premium (either up-front or in periodic installments) to purchase the cap in exchange for receiving payments from the cap provider if and when a specified interest rate or index exceeds a predetermined rate. This predetermined rate is often referred to as the “strike rate”. As reflected in the following diagram, an issuer of floating rate tax-exempt-bonds could use an interest rate cap to protect against increases in the specified floating rate above the strike rate. An issuer who purchases a cap has counterparty risk to the extent that the provider of the cap is unable to perform its obligations under the agreement. The issuer may also have basis risk if the interest rate on the issuer’s floating rate bonds is based on a different index than the index used to determine the cap provider’s payment obligations under the cap.

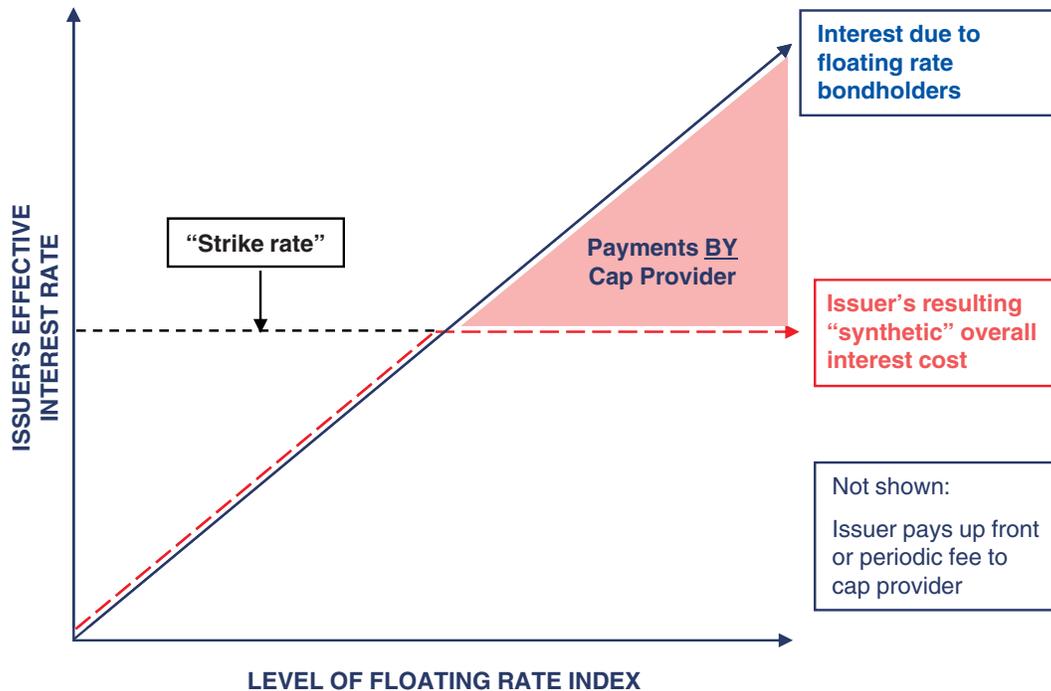


The following graph illustrates the payments that result from such an interest rate cap (assuming no basis risk) from the perspective of the issuer, using the same methodology as discussed in greater detail in the comparable diagram for an interest rate swap in paragraph II(B)(2)(a) above:



Graph Showing Payments for Interest Rate Cap

(assuming no "basis")



To the extent that the interest rate due to the issuer's bondholders is lower than the "strike rate" of the cap and under the assumptions mentioned above, the issuer's overall interest cost is unaffected by the cap and remains variable below such strike rate (the diagonal portion of dashed red line). However, to the extent that the interest rate due to the bondholders exceeds such strike rate, the cap provider will be obligated to make payments to the issuer sufficient (assuming no basis risk) to cause the issuer's synthetic rate to remain capped at the strike rate of the transaction (the horizontal portion of dashed red line).

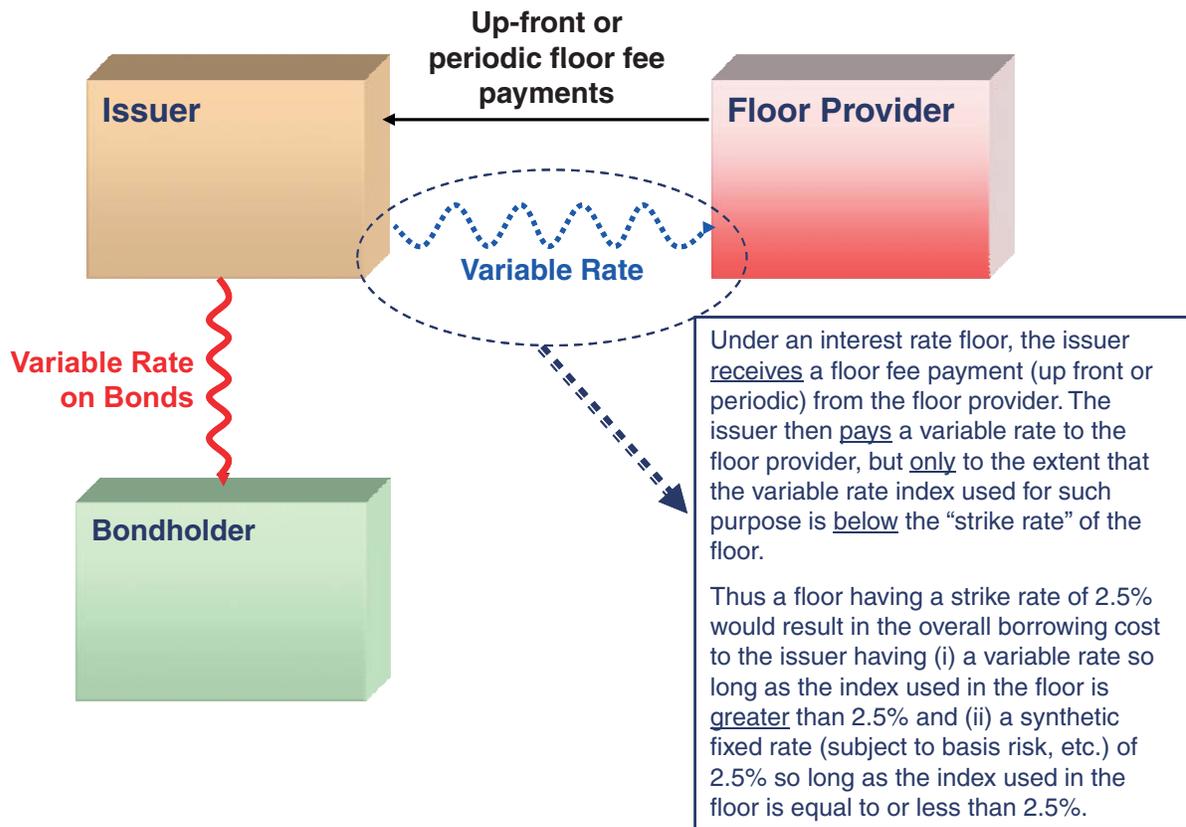
(2) Interest rate floors.

An interest rate floor is conceptually the opposite of an interest rate cap. Instead of "purchasing" a cap, an issuer of floating rate tax-exempt bonds may "sell" a floor at a specified interest rate or "strike rate". Under a floor, the issuer *receives* a specified payment (either up-front or periodically over time) from the counterparty for selling the floor, in exchange for paying to the purchaser of the floor an amount equal to the excess of the floor rate over specified interest rate or index. From the issuer's standpoint, the principal reason to enter into a floor may be to obtain funds in return for the possibility of having to make a payment pursuant to the floor in the future.



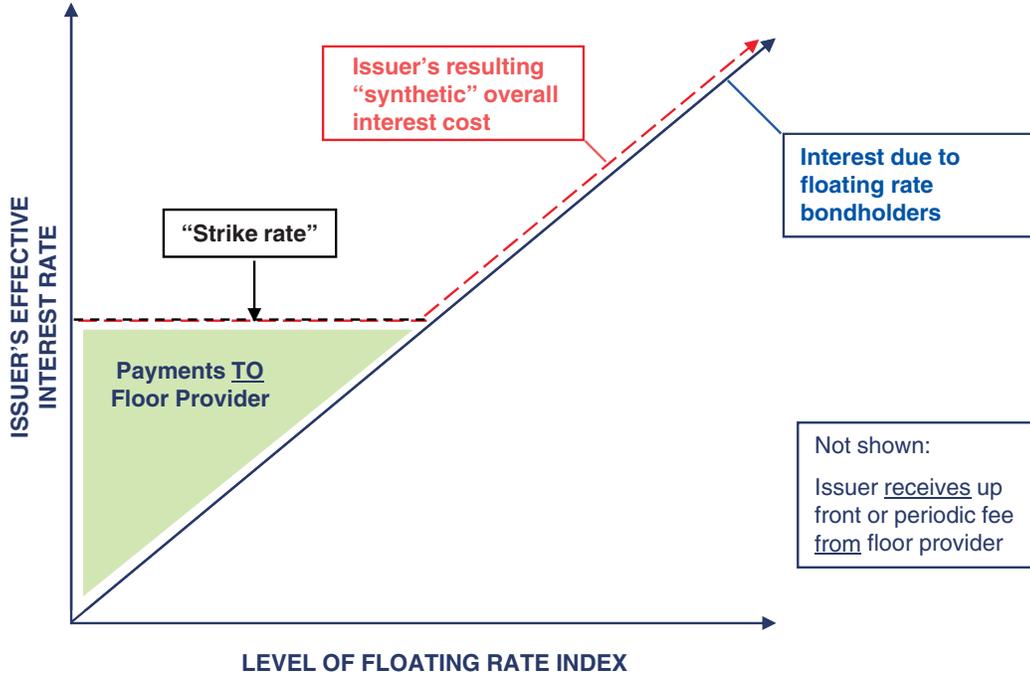
Selling a floor in connection with an issue of variable rate bonds is in essence the selling of all or a portion of the downside benefit of floating rate debt: the issuer of the floating rate debt receives a fixed amount (either up-front or periodically over time) from the counterparty or “floor provider” and then makes payments to the floor provider if the interest rate on the specified floating rate index falls below the strike rate. Any payments made by the issuer to the floor provider will, in the typical transaction, represent the difference between the strike or “floor” rate and the interest rate or index used in structuring the floor transaction. The issuer does not have counterparty risk or basis risk because it is the issuer who must perform in the future rather than the counterparty (except to the extent that the amount payable by the counterparty for the floor is payable by the floor provider over time rather than up front). Basis risk, however, may be present to the extent that the index used for setting the floor is different from the index used to determine the interest rate on any of the issuer’s bonds or other bonds to which the floor relates.

Basic Interest Rate Floor



The following graph illustrates the payments that result from such an interest rate floor (assuming no basis risk) from the perspective of the issuer:

Graph Showing Payments for Interest Rate Floor (assuming no "basis")



Note in the above diagram that, to the extent that the interest rate due to the issuer’s bondholders (assuming no basis risk) is greater than the “strike rate” of the floor (*i.e.*, the bend in the dashed red line), the issuer’s overall interest cost is unaffected by the floor and remains variable above such strike rate. However, to the extent that the interest rate due to the bondholders is below such strike rate, the issuer will make payments to the floor provider sufficient (assuming no basis risk) to cause the issuer’s synthetic rate to remain elevated at the strike rate of the transaction (the horizontal portion of dashed red line).

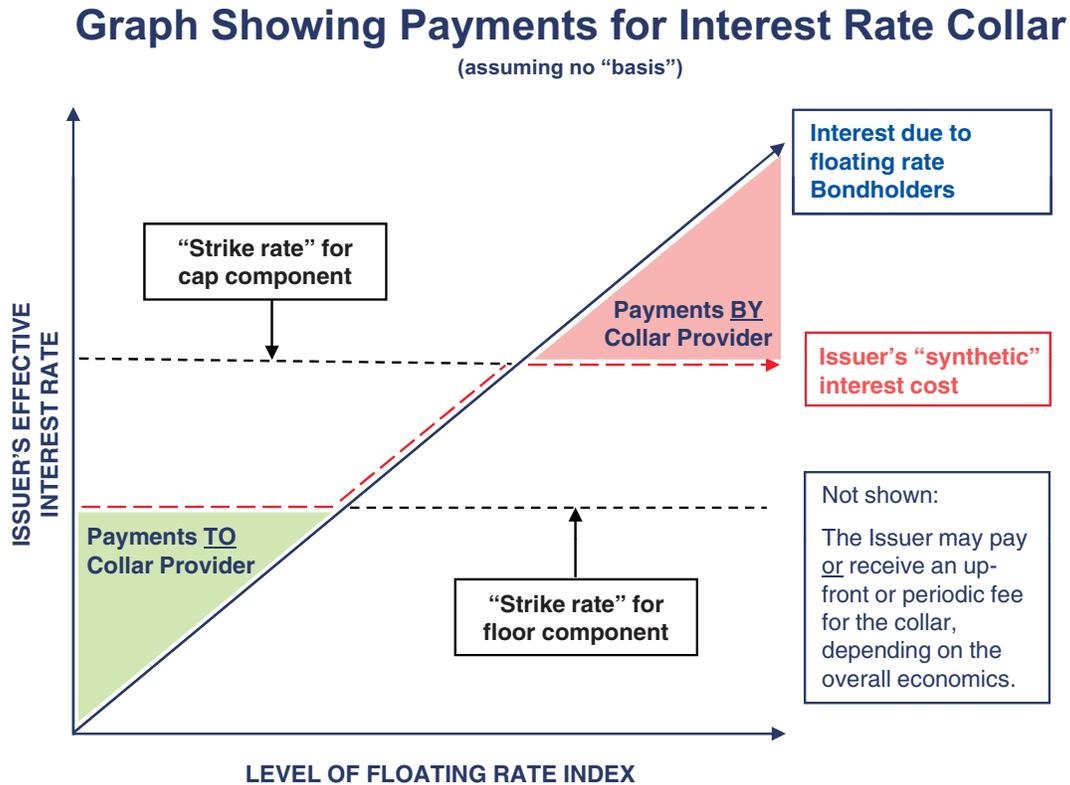
(3) Interest Rate Collars.

An interest rate collar is essentially a combination of a cap and a floor, with the issuer of floating rate bonds giving up the potential benefit from lower interest rates by executing a floor in exchange for the purchase of protection from higher interest rates by the purchase of a cap. The result is that, while interest rates on the bonds (or the applicable index used, as the case may be) are above the cap or below the floor, the issuer has a synthetic fixed rate instrument, but while those interest rates are within the “band” existing between the strike rates for the cap and floor components, the interest rate payable by the issuer is still at a floating rate. The levels of the cap and floor strike rates that together comprise a collar are often determined in part in a manner that, together, result in there being no net upfront cost to the issuer or its counterparty, *i.e.* the issuer’s cost of purchasing the cap is offset by the sale price received by the issuer from the sale of the floor (a “costless collar”). However, it is not necessary that the two exactly offset. Interest rate collars entail counterparty risk to the extent that the collar provider is unable to meet its obligations under the contract and involve basis risk to the issuer to the extent that the payments from the counterparty to the issuer under the collar (under relatively high interest rate environments) do not



match the amount that would otherwise cause the issuer's overall interest cost to be capped at the strike rate for the cap component of the collar.

The following diagram illustrates the payments that result from such an interest rate collar (assuming no basis risk) from the perspective of the issuer:



Note in the above diagram that to the extent that the interest rate due to the issuer's bondholders (assuming no basis risk) is between the floor and cap "strike" rates (*i.e.*, the two bends in the dashed red line), the issuer's overall interest cost is unaffected by the collar and remains variable between such rates. However, to the extent that an issuer employs a collar with respect to an issue of variable rate bonds and the variable interest rate due to the bondholders exceeds the cap rate, the collar provider will make payments to the issuer sufficient (assuming no basis risk) to cause the issuer's overall synthetic rate for the financing to remain capped at the strike rate of the transaction (the rightmost horizontal portion of dashed red line). Conversely, to the extent that the interest rate due to the bondholders is below the floor rate, the issuer will make payments to the collar provider sufficient (assuming no basis risk) to cause the issuer's synthetic rate to remain at the floor rate of the transaction (the leftmost horizontal portion of dashed red line).



(D) Forwards and Options.

(1) Forwards.

In general, a “forward” contract is an agreement to purchase something at a stated time in the future at a stated price to be paid in the future (a “futures” contract is merely an exchange-listed forward contract). A pure “at the money” forward contract would have no payment associated with it at the outset. A forward contract may be combined directly or indirectly with a bond or other financing transaction. For example, an issuer may structure a swap agreement as a forward contract to lock in interest rates in a rising interest rate environment.

As another example, an existing bond issue may be ineligible for an advance refunding today under Internal Revenue Code Section 149(d) in the event it would exceed the limitation on the permitted number of advance refundings. In that case, an issuer might agree, subject to applicable state law considerations, on a forward basis to issue fixed rate refunding bonds for delivery on or shortly prior to the first call date for the refunded bonds. Alternatively, the issuer may agree to issue variable rate bonds on the call date for the outstanding bonds and enter into a “forward starting swap” under which the exchange of payments does not begin until the call date of the refunded debt as discussed above. Through this structure, the swap provider would pay the interest on the floating rate bonds beginning on their date of issue and the issuer would pay a fixed rate beginning at the same time. However, the laws applicable in certain states may have implications on the ability of an issuer to enter into a forward starting swap, and such implications should be taken into account in structuring and documentation such a transaction where applicable.

(2) Options.

(a) **In general.**

An option contract is an agreement under which one party pays an option premium in return for the right, but not the obligation, to purchase something or exercise some other right in the future at a specified price. For example, an issuer might wish to sell an option to a purchaser to buy specified fixed rate bonds to be issued in the future in return for an up-front option premium. Subject to state law and any other applicable considerations, options may be used with respect to bonds, swaps or other derivatives giving the purchaser the right to have the seller enter into the transaction at a later date. Options can be settled with either physical delivery or in cash, depending on their terms. They may be exercisable throughout their term (“American Style”) or only on a specified date (“European Style”) or on multiple specified dates (“Bermudan Style”).

(b) **Put options.**

The purchaser or holder of a “put option” pays a fee in return for the right to “put” or sell a specified property owned by the purchaser to the writer of the option. The seller or writer of the option typically receives a fee and agrees to buy the specified property covered by the put option at certain times. Put options are often used to enhance liquidity or preserve value with respect to property. For example, short-term floating rate tax-exempt bonds often have put options that grant the bondholder (as the option holder) the right to tender the bonds back to the issuer (as the option provider), usually at par. In another example, an issuer (as the option holder) might buy a put option with respect to Treasury investments held in a bond reserve fund to enhance the liquidity and preserve the value of the reserve fund so as to enable it to buy longer term investments otherwise subject to principal valuation risk.



(c) **Call options.**

A call option is an option in which the purchaser or holder of the call has the right, but not the obligation, to “call” or require the owner of a specified property to sell the property to the holder of the call at a specified price. Call options may be structured to be exercisable at any time before expiration or at one or more specified times. A common illustration of call options in municipal finance is the optional redemption call feature that is standard on many bonds.

(d) **Swaptions.**

Under more complex scenarios, issuers and counterparties may include varying degrees of optionality into swap transactions, known as “swaptions”, which include transactions under which one party may purchase (or sell) the option to enter into a swap or other derivative contract in the future.

III.

Legal and Other Considerations

An important aim of this publication is to apprise bond practitioners and the general NABL membership of, in addition to the basic structure of municipal interest rate swaps, various state law and other legal considerations often pertaining to such transactions. Depending on the nature of a given transaction and the applicable parties and legal jurisdiction, such considerations may include ascertaining and confirming the source of the issuer’s legal authority for entering the transaction along with any statutory or other limitations on such authority. Another important consideration is the manner in which an issuer can be educated and advised, in each case as appropriate, as to issues such as the structuring, mechanics, documentation, costs, benefits and risks of any proposed transaction.

An issuer contemplating any swap transaction will often seek and obtain outside assistance in the preparation and adoption of any requisite resolutions, ordinances or similar approvals for the transaction; in establishing an interest rate swap policy if desired or required; in assessing that the swap transaction conforms with any applicable statutory or other legal or contractual requirements; in negotiating the swaps documents themselves and in the preparation of any offering document disclosures relating to the swap. An issuer may also be asked or required to obtain certain opinions from legal counsel in connection with any particular swap or related transaction. In light of the breadth and varied nature of these issues, an overarching consideration for the issuer facing a swap transaction is to determine the means by which it will become educated and advised on these issues, including particularly whether such education may be provided by one or more financial advisors (which may specialize in swaps and related transactions), legal counsel (which may include the issuer’s own counsel, bond counsel or special “swaps” counsel), the issuer’s internal resources, others or, in many instances, some combination of the foregoing.



(A) Analysis of Legal Authority.

(1) Introduction.

An issuer contemplating an interest rate swap or other derivative transaction should assess and understand the source and extent of its authority to enter the transaction as well as any limitations and restrictions on such authority. In the case of a municipal issuer, the potential sources for such authority may include express statutory grants of authority from the state legislature or constitution, as well as implied authority potentially derived (to the extent applicable) from “home rule” powers or other general grants of authority to governmental entities as discussed in greater detail in this paragraph III(A) below. On the other hand, while private conduit borrowers such as corporations or other non-governmental entities are not likely to be subject to the same statutory or other restrictions that apply to governmental entities (insofar as the actual authority to enter a swaps transaction is concerned), conduit borrowers should similarly assess the extent of their legal authority to enter swaps (such as under state statutes governing corporations or limited liability companies generally) as well as any applicable approvals required to be obtained from a board of directors or trustees or the like and any requirements or limitations set forth in governing documents or resolutions of the conduit borrower or under the terms of any borrowing or other agreements by which it may be bound.

(2) Express statutory authority.

As of the date of this publication, a substantial number of states have enacted some form of legislation providing express statutory authority for specified types of governmental entities to enter into interest rate swap agreements and other types of derivative transactions. However, among those states that have enacted legislation, the legislation is far from uniform and the statutory approaches vary considerably and, within a state, often likewise vary across types of governmental entities. For example, certain ways in which swaps statutes may vary include the following among others:

- restrictions on which types of governmental entities are authorized to enter into swaps or other derivative transactions;
- limitations on the types of swap agreements that may be entered into, such as restrictions on the term over which a swap agreement may be effective or the nature of the indebtedness that may be swapped;
- restrictions on the fixed rate component payable by the issuer under the derivative transaction;
- the types of findings, resolutions, ordinances, educational requirements or other actions that must be taken prior to entering a swap;
- whether an independent financial or swap advisor (or other professionals) must be retained to assist the issuer in connection with the swap and the extent to which such advisors must provide written assurances regarding the transaction at, before or after closing;
- whether issuers of different types are subject to a competitive bid process with respect to particular types of transactions;



- whether the approval of certain state or other boards or officials must be obtained prior to the entering of a swap; and
- whether the issuer must provide initial and/or periodic reporting to a state or other entity, and other particulars that must be satisfied before (or in some instances after) a swap or other derivative agreement may be executed.

(3) Implied authority.

In the absence of express statutory authority for a swap or other derivative transaction, issuers of various types may possess sufficient *implied* authority to enter into a swap or similar transaction by virtue of general “home rule” or comparable powers of the issuer, or under generally worded statutory authority (e.g., statutes authorizing issuers to enter into contracts or arrangements incidental to the issuance or carrying of indebtedness).

(a) **“Dillon’s Rule” and the evolution to “Home Rule”.**

In an 1886 ruling of the Iowa Supreme Court, Judge John F. Dillon penned what is commonly known as “Dillon’s Rule” or the “Rule in Dillon’s Case”:

“It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: first, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation—not simply convenient, but indispensable. *Any fair, reasonable, substantial doubt concerning the existence of power is resolved by the courts against the corporation, and the power is denied.*”¹⁶

Following this ruling, Judge Dillon’s relatively restrained approach to finding municipal authority became legal doctrine in a substantial majority of the states although, as among such states, the courts’ applications of the approach have varied greatly in the relative degrees to which they afford latitude to local governments. As a result of a multitude of difficulties that Dillon’s Rule created in the realm of state and local relations, and starting with the State of California in 1913, most states have moved away from the approach of Dillon’s Rule to the relatively broader grants, in varying forms, of “home rule” authority through constitutional amendments or other legislative actions. As an example of one formulation of “home rule” authority, in the 1970s the State of South Carolina amended its Constitution in a manner that enabled that state’s adoption of its Home Rule Act. Under this formulation:

“Each municipality of the State, in addition to the powers conferred to its specific form of government, may enact regulations, resolutions, and ordinances, not inconsistent with the Constitution and general law of this State, including the exercise of powers in relation to roads, streets, markets, law enforcement, health, and order in the municipality or respecting any subject which appears to it necessary and proper for the security, general

¹⁶ See generally *Clark v. City of Des Moines*, 19 Iowa 199, 212 (1865) (emphasis supplied).



welfare, and convenience of the municipality or for preserving health, peace, order, and good government in it”¹⁷

Therefore, in the absence of express statutory authority concerning a proposed swap or other derivative transaction, consideration can be given as to the extent to which the general authority of the issuer to take certain actions is substantially restricted under a narrow “Dillon’s Rule” approach under applicable state law or is, rather, subject to a more liberal interpretation afforded under a “home rule” approach. Any such an analysis should take into account the specific applications of such doctrines in the relevant jurisdiction, to the extent necessary, as well as the facts and circumstances surrounding the issuer and the proposed transaction.

(b) “Home Rule” type powers under specific statutes.

In some instances given the particular facts and circumstances, an issuer may seek authority to enter into a derivative transaction under statutes that may grant “home rule” type powers to certain entities in connection with certain types of transactions. For example, a state statute permitting an issuer to incur indebtedness may include provisions granting the issuer the authority to take such actions as may be generally in furtherance of, or incidental to, the issuance of such indebtedness. In such case and upon gaining sufficient comfort with all related principles of statutory construction in the applicable jurisdiction, an issuer and its counsel may be in a position to determine whether such a grant of authority is sufficient to enable the issuer legally to enter into the transaction.

(c) The *Hammersmith* Case.

Given the relative lack of case law in the United States involving the implied authority for governmental entities to enter into derivative transactions, a case decided by the House of Lords in England in 1991 is frequently cited as an example of what can happen if the “legal authority” issue is not properly addressed. *Hammersmith and Fulham London Borough Council* is a London borough that, from 1983 to 1988, entered into a substantial volume of speculative interest rate swaps. Its activity in the swap markets was so extensive that, on March 31, 1989, the borough had amassed 297 outstanding swap transactions covering an aggregate of £2.966 billion (approximately US\$5 billion) in notional amount, an amount that exceeded the amount of indebtedness that the borough had outstanding by a multiple of approximately *fifteen*. Given the substantial losses that the borough began to incur following a detrimental movement in interest rates, an auditor appointed by the Audit Commission of Local Authorities in England and Wales filed a lawsuit asking the courts to determine whether the swap agreements were valid.

After a period of litigation, the House of Lords ruled in *Hazel v. Hammersmith & Fulham London Borough Council*¹⁸ that the swaps were *ultra vires* and thus unenforceable. The House of Lords reached its decision following the analysis of the Divisional Court in which the lawsuit was originally filed. Under this analysis, the court first found that no express statutory authority existed for the borough to

¹⁷ SOUTH CAROLINA CODE OF LAWS (1976) § 5-7-30. Correspondingly, the South Carolina statutes provide a rule of construction that “the powers of a municipality shall be liberally construed in favor of the municipality.” *Id.* § 5-7-10.

¹⁸ *Hazel v. Hammersmith & Fulham London Borough Council*, [1991] 2. W.L.R. 372 (Eng. H.L.). See Alexander E. Kolar, *Note: Hammersmith Meets Orange County: “Wishing Upon a Star” With Taxpayer Money in the Municipal Bond Derivative Market*, 49 Wash. U.J. Urb. & Contemp, L. 315 (Summer 1996).



have entered into the swap agreements. In the absence of such express statutory authority, the reasoning followed, such swaps could only be held valid if there existed implied authority under Section 111 of the Local Government Act of 1972, which codified the common law rule that local authorities possessed implied power “to do any thing (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions.”¹⁹ Concluding that the swap agreements were entered into for speculative purposes, the House of Lords deemed them outside of such implied authority and thus illegal, resulting in significant losses to the financial institutions that had provided the swaps and, in the eyes of many, resulting in a tangible “tarnishing” of London’s reputation as a major financial center.²⁰

(4) State laws having potential negative implications on swaps authority.

In addition to analyzing the source and extent of any express authority available to an issuer to enter swaps or other derivative transactions, consideration should also be given to state laws that may effectively prohibit or restrict certain actions (whether such laws apply solely to governmental entities or otherwise) in a manner having negative implications upon the issuer’s ability to enter into a particular form of swap or derivative. By way of examples:

- State constitutional or statutory debt limitations. The laws in effect in some states may affect the extent to which a swap or other derivative transaction, or any of the various obligations of the issuer thereunder, may implicate state constitutional or statutory debt limitations. In addition, some interest rate swaps are structured to include what economically constitutes and is referred to as an “embedded loan”. In one scenario, an issuer may terminate an existing interest rate swap and replace it with a second swap and, in order to finance a termination payment owed by the issuer to the swap provider under the first swap, agree to pay the swap provider under the second or replacement swap an “above market” fixed rate component in exchange for that swap provider’s making a single up-front payment, for the benefit of the issuer, to finance the termination payment on the first swap. In other scenarios, an issuer may similarly negotiate an embedded loan and related above-market fixed rate on a swap transaction to finance certain fees related to a swap (e.g., a financial advisor’s fee). In these instances, it may be particularly important to assess the potential characterization of these “embedded loans” as indebtedness for state law purposes.²¹

¹⁹ Local Government Act, 1972, ch. 70, 111(1) (Eng.).

²⁰ See Michael Quint, *British Court Invalidates Some Financial Swaps*, N.Y. TIMES, November 6, 1989 (emphasis supplied) (citations omitted).

²¹ “Embedded loans” may also present federal income tax and additional issues that are generally beyond the scope of this publication. See, however, the discussion in paragraph II(B)(2)(d)(iii) of this publication and footnote 24 below.



- State law prohibitions on gambling or related activities. To the extent that a state may have constitutional or statutory prohibitions or restrictions on activities that may constitute “gambling” or similar activities, such laws may have potential implications as to certain forms of swaps or other derivatives transactions entered by particular types of entities.
- State (and federal) laws concerning commodities futures. It is common practice for a swap provider to require that its counterparty represent that it is an “eligible contract participant” or that it or the transaction is otherwise exempt from certain federal provisions concerning the regulation of commodities futures. Correspondingly, any state laws regulating items such as commodities or commodities futures may have implications on a swap or derivative transaction.
- State laws concerning permitted investments. State constitutional or statutory provisions that limit the scope of permissible investments for an issuer should be considered, in connection with any proposed swap or other derivative transaction, to confirm that no aspect of the transaction is prohibited under such laws. Such laws are typically enacted to protect public funds from exposure to undue investment risks and may have implications for certain swap and other derivative transactions. In many instances a swap provider an issuer will enter into a “Credit Support Annex” or other arrangement by which one or both parties may be required, often subject to certain contingencies and thresholds, to post collateral securities to secure such party’s the parties’ respective obligations under one or more swap or other derivative transactions.²² In such events, attention must be given as to the extent to which the securities required (either actually or contingently) to be posted are permitted investments for the issuer under applicable state laws or the issuer’s investment policy, in either of the cases where the securities under consideration are to be posted *by* or *to* the issuer governmental entity.
- Other state law prohibitions. The above list is not intended to be all-inclusive and the constitutional or statutory provisions that may be applicable in connection with the entering of any given transaction by any particular issuer (particularly as to municipal issuers) will vary from state to state and from transaction to transaction.

(5) Laws Concerning the Validity of Long-Term Contracts.

Because the duration of a swap agreement will commonly extend beyond the terms of the members of an issuer’s governing body or the current fiscal period, the validity of certain provisions that might be included as part of a swap agreement might depend on the legal ability, under applicable state laws, for governmental entities to be bound by such provisions on a long-term basis. Such laws often exist to ensure that a given municipal board or council might not unduly restrict the degree of discretion

²² See the annotated form of ISDA® Credit Support Annex accompanying this publication as Annex C.



intended to be afforded to future boards or councils. A common formulation of such laws has been summarized in one treatise as follows:

“Unless authorized by statute a municipal council may enter into contracts during their term of governance however, if the term of the contract extends beyond the term for which the members of the council were elected the ability of the current council to bind subsequent councils is limited. In the exercise of the *business powers* of a municipal corporation, the municipality and its officers are controlled by no such rule and they may lawfully exercise their powers in the same way as a private individual or a business corporation under like circumstances. For example, a municipal council may contract for a water supply, street lighting, and gas supply and bind subsequent boards because such contracts are within the exercise of the city's *business or proprietary powers*; however, this will not be the case if the contract is one for professional services or with respect to *policy making functions* because current officeholders must be able to govern free of restrictions imposed by predecessors.”²³

Thus under this type of formulation, the authority for a municipal issuer to agree to certain provisions contained within a swap or other derivative transaction may depend upon the extent to which such provisions may be deemed in furtherance of the issuer's “business or proprietary” powers. On the other hand, to the extent that any such provisions of a swap agreement or other derivative contract may impede upon the ability of a municipal council or officials to exercise their policy making functions, then such provisions may be called into question. Instances in which courts have determined that long-term contracts improperly impeded the policy making functions of a governmental body have included, by way of examples, contracts relative to the engagement of professionals and agreements restricting the abilities of a municipality as to the naming and removal of officers.²⁴

(B) Education of the Issuer.

In light of the numerous issues involved in the structuring and implementation of a swap or other derivative transaction, an issuer considering any such transaction is faced with determining the means by which it can become educated and advised on such issues. The applicable considerations can include, among others, those pertinent to the structuring, mechanics, documentation, costs, benefits and risks of the proposed transaction; the establishment and following of a swaps policy where applicable; and any other procedures required of the issuer or otherwise deemed appropriate.

(1) Understanding the roles and tasks of the parties and professionals.

Issuers often engage various professionals and other advisors to provide educational, advisory and other services to the issuer in connection with swap and other derivative transactions given their complexity (along with complexities often presented by the bond or other transactions to which such transactions may relate). As mentioned above, candidates frequently providing these services may

²³ AM JUR 2D MUNICIPAL CORPORATIONS, COUNTIES, OTHER POLITICAL SUBDIVISIONS § 135 at 204-06 (“Acts as binding successors”) (footnotes omitted; emphasis supplied).

²⁴ See *id.* (citing, *inter alia*, *Harrison Central School District v. Nyquist*, 59 A.D.2d 434, 400 N.Y.S.2d 218 (3d Dep’t 1977), *appeal denied*, 44 N.Y.2d 645, 406 N.Y.S.2d 1026, 378 N.E.2d 126 (1978) and *Newman v. McCullough*, 212 S.C. 17, 46 S.E.2d 252 (1948)).



include one or more financial advisors, legal counsel (which may include the issuer's own internal or outside counsel, bond counsel or special "swaps" counsel), the issuer's own internal resources and, in many instances, some combination of the foregoing. To the extent that issuers do obtain the services of outside professionals or other advisors, they may often obtain written engagement letters or other materials outlining the tasks respectively to be performed by these professionals or advisors. As to any attorneys engaged by the issuer to assist in the legal aspects of a swap transaction, such attorneys are likely to be subject to state laws or other rules concerning the engagement of attorneys and attorney-client relationships.²⁵

In addition, although issuers commonly also receive a material amount of education and information from existing and prospective swap providers themselves, in such instances an issuer does well to keep in mind that the business interests of the swap provider and the issuer are, by necessity, adverse to each other in fundamental ways. It is largely for this reason that swap documentation routinely includes provisions by which the issuer disclaims having relied, upon any such materials or other information provided by the swap provider, in making any determination to enter the applicable transaction.

(2) Tasks potentially undertaken for the benefit of an issuer by legal counsel (or other advisors).

Legal counsel are frequently requested to perform various tasks for or on behalf of an issuer entering a swap transaction, whether such counsel consists of the issuer's own in-house or outside counsel, bond counsel, special swap counsel or other counsel. Although, as pointed out in paragraph I(C) above, this publication is not intended to establish or imply any particular "best practices" or other standard of care,²⁶ issues and considerations with respect to which an issuer may retain legal counsel

²⁵ Rule 1.5(b) of the MODEL RULES OF PROFESSIONAL CONDUCT (American Bar Association © 2008) provides that "The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, *preferably in writing*, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client" (emphasis supplied).

However, under the version of Rule 1.5(b) as adopted in some states the requirement for a written engagement letter is (or may under certain circumstances be) mandatory. See, e.g., Wisconsin SCR 20 : 1.5(b)(1) ("The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate as in the past. If it is reasonably foreseeable that the total cost of representation to the client, including attorney's fees, will be \$1000 or less, the communication may be oral or in writing. Any changes in the basis or rate of the fee or expenses shall also be communicated in writing to the client.").

²⁶ Counsel providing legal services to an issuer may (and, under rules applicable in some states, may be required) specify the scope of its services in a written engagement or similar letter. See paragraphs I(C) and III(B)(1) and footnote 25 of this publication above. Approaches by attorneys and others involved in swap transactions may vary as a result of factual differences, differences in the attorneys' practice styles and local practices. Mention of any topic in this paragraph III(B)(2) or elsewhere in this publication is not intended to imply that counsel has a duty or requirement to address that matter in any particular transaction or situation. Conversely, the absence of mention or elaboration with respect to any matter in this paragraph III(B)(2) or elsewhere in this publication does not imply that such matter is not of importance in connection with any particular transaction or situation or that its consideration in connection with a particular transaction or situation is improper.



might include the following, among others, certain of which are discussed in greater detail elsewhere in this publication:

- ascertaining the legal authority applicable to the issuer in connection with the swap, along with any limitations or restrictions on such authority (see paragraph III(A) above);
- assisting in preparing any interest rate swaps policy deemed appropriate by the issuer (or required by state law, if applicable) (see paragraph III(B)(3) below);
- preparing any ordinances or resolutions that may be required as part of the approval of the swap and related transactions (see paragraph III(C) below);
- educating the issuer as to the risks imposed by the swap transaction. As discussed in greater detail in paragraph II(B)(2)(d) above, such risks may include, among others, tax risk, other basis risk, market rate / termination risk, amortization risk, rollover risk, collateral tie-up risk, covenant tie-up risk, counterparty risk and legal authority risk;
- assisting the issuer in presenting approval documents to, and discussing the swap transaction in general with, the governing body of the issuer or any applicable finance or other committees (see paragraph III(C) below);
- helping the issuer in conforming the swap transaction to any applicable state laws (see this Part III generally);
- negotiating the swap transaction documents, together with any modifications or amendments that may be required of any related documents such as master bond ordinances, indentures and other collateral documents (see Part IV and the Annexes to this publication below);
- preparing materials summarizing or otherwise relating to the swap transaction in any official statement or other marketing materials of the issuer (see paragraph III(H) below);
- assisting in coordinating the proper execution and closing of the swap transaction;
- rendering any legal opinions required in connection with the transaction (see paragraph III(G) below); and
- advising, if applicable, on potential “qualified hedge” treatment or other federal or state tax issues involved in the proposed swap transaction.

Although certain of the potential tasks and roles enumerated above are of an inherently legal nature, chiefly the ascertaining of legal authority, advising on state law provisions and the rendering of legal opinions, certain aspects of the above tasks may be performed by financial or other non-lawyer advisors retained by the issuer. Given the technical aspects surrounding the structuring and economics of swap transactions, counsel may suggest the hiring of a financial or swap advisor to advise the issuer as to various business and economic risks in any given transaction. Such financial advisors are often available



to assist in educating the issuer and in analyzing various risks quantitatively through numerical analyses and other information.

(3) Preparation and adoption of a swaps and derivatives policy.

Prior to entering a swap transaction, and in some instances as a requirement of state law, many issuers adopt written policies concerning the entering, maintaining, replacing and terminating of interest rate swaps. In addition to providing a means for presenting a governing board's or council's current position or policy as to swaps and other derivatives, these policies frequently serve as a helpful educational tool for the issuer and its staff. Matters addressed in such a policy may include, among other things, a presentation of the circumstances under which the issuer may consider entering into swaps, target ratios for matters such as the total (or maximum) notional amount of swaps authorized relative to the total amount of outstanding indebtedness of the issuer, the types of professionals (and written opinions and advice) the issuer might obtain in connection with any swap transaction, the means by which the issuer may select its swaps counterparties, any minimum credit rating or other standards that may apply in such determinations, and the personnel designated to monitor and manage swaps and to ensure compliance with any applicable state laws and accounting requirements.

Some swap policies include provisions to the effect that the policy is solely a policy in nature and not intended to create any legal or other commitment binding the issuer either as to itself or as to third parties. Correspondingly, some policies provide that a certificate of any designated official of the issuer may be considered conclusive and binding, as to any matters set forth therein, concerning the compliance of any action by the entity with the terms of the policy. Forms and potential guidelines concerning such policies may be obtained from experienced financial advisors as well as from numerous other potential sources.²⁷

(4) Establishment of accounting and monitoring procedures.

Issuers often deem it appropriate (and under certain state laws may be required) to designate one or more officers or staff, acting with or without outside professional advice, to monitor the ongoing performance of its swap and other derivative transactions and assess the extent to which its existing swap transactions are performing in accordance with their intended goals. Such monitoring may involve preparing or obtaining statistical analyses on a periodic basis, for example, as to the extent that the variable rate receipts by the issuer under a plain vanilla swap match the variable rate of interest on the related hedged indebtedness. The information compiled and monitored by such personnel may also include the existing notional amount of swaps as allocated among applicable swap providers, the current credit ratings of such swap providers, the termination or settlement values of all outstanding swap transactions, the remaining terms of such swap transactions and the possibilities for addressing rollover risk²⁸ in the event of swaps scheduled to terminate in advance of the final maturity of any related indebtedness, an analysis of the overall portfolio of financial assets, liabilities and swaps in light of any applicable parameters in the issuer's swap policy or other policies to the extent applicable, and any information required for the issuer to be in compliance with applicable state law, accounting and other requirements.

²⁷ See, e.g., Government Finance Officers Association, *Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy* (October 11, 2005).

²⁸ See the discussion of "rollover risk" in paragraph II(B)(2)(d) above.



(C) Approvals of the Governing Body.

In connection with entering an interest rate swap or other derivative transaction, it is likely that the issuer will be required to or will otherwise take various actions, such as the adoption of one or more ordinances or resolutions and the making of findings (whether required by state law or otherwise) in the consideration and approval of the transaction as well as the forms of any documents to be executed by the issuer. Bond counsel, counsel to the issuer and other professionals involved in the transaction may participate in the associated preparation of approving documents and the presentation of documents to the governmental board or council of the issuer. Issues frequently associated with an issuer's proper authorization of a swap or other derivative transaction include:

- that all notice, public hearing and other formalities that generally need to be followed by the issuer in taking official action have been properly met;
- a recitation of findings or the inclusion of any other matters that may be required or helpful, to the extent applicable, under any state laws concerning the entering of swaps or other derivatives. For example, approvals of municipal swap transactions may include findings such as the following:
 - that the transaction is entered into for purposes of managing the financial assets or liabilities of the issuer and not for purposes of speculation;
 - an identification of the related assets or obligations to which the swap transaction relates;
 - that in entering the transaction, the governmental board or council, and/or its proper financial officials, have received sufficient education and analyses to enable them to understand the structure, benefits and risks of the transaction, including an identification of any independent professionals retained to provide such education and advice to the extent applicable;
 - findings as to the specific goals of the transaction and the means by which the transaction is designed to accomplish such goals;
 - a finding that, after review by the governing board or council and/or the proper governmental officials, the proposed transaction satisfies all applicable requirements of any swaps or other policy that may be applicable to the issuer (or that, to the extent of any departure from such policy, that such departure is noted and duly waived, or that the policy is amended to the extent appropriate to accommodate such departure); and
 - any other appropriate findings, whether required by state law or for other potentially applicable reasons;



- approvals of the forms of the documents that will govern the swap transaction, including any collateral or other ancillary documents or any amendments that may be required to any existing agreements of the issuer (such as any master borrowing ordinance or similar document or instrument) in connection with the transaction;
- a designation of the official or officials charged with negotiating the final structure of the transaction and final forms of the related documents and whether any such officials may act individually or must act in concert with one or more other officials;
- any parameters that the governmental board or council may deem appropriate in delegating authority for the final form of such swap or derivative transaction, which may include, for example:
 - any minimum or maximum notional amounts applicable for the transaction;
 - any minimum or maximum duration (or “tenor”) of the transaction;
 - any maximum fixed rate component of the swap transaction; and
 - a specification of the types of the variable rate indexes that may be employed as part of the transaction (e.g., the SIFMA Index or %LIBOR).

(D) Conforming the Transaction to Existing Ordinances and Documents.

A swap or other derivative transaction under consideration by an issuer may, depending on the particular facts and circumstances, have various implications as to certain related ordinances, agreements or other documents or actions of the issuer. Typical among these issues are a determination of the source of payment (and any related pledge if applicable) from the issuer to the swap provider; the extent to which any pledge of revenues or other assets by the issuer may rank on a parity basis (or some other basis) with competing pledges; provisions of existing ordinances, indentures and agreements that may restrict or prohibit swaps or other derivatives; and the extent to which the transaction may be taken into account for purposes of any quantitative or similar tests that may be applicable to the issuer, such as any applicable rate covenants or additional indebtedness tests.

(1) Source of repayment for the swap transaction.

In making any determination of whether to enter into a swap transaction with an issuer, a swap provider will typically require an understanding of the sources of funds that will be available to the issuer to satisfy its payment obligations under the transaction. For example, a revenue bond issuer such as a utility or parking system may desire, or be legally required, to limit the swap provider’s recourse for swap payments to revenues obtained from the operation of the applicable utility or other system. Moreover, to the extent that any such issuer incurs indebtedness or other obligations under a master ordinance or indenture, such documents may include “waterfall” provisions to the effect that such revenues must be applied to pay all debt service due and owing under the obligations issued thereunder, and to maintain any required balances in any operating funds, debt service reserve funds or maintenance funds or the like, in advance of applying any system revenues toward the payment of swap obligations.



(2) Pledges and parity status of swaps relative to other obligations.

If an issuer is required to pledge revenues or other assets to the payment of swap obligations (or, where sufficient state law authority exists, to pledge its taxing power on a general obligation basis), then there will often be a need for the preparation and approval of such resolutions, ordinances and instruments as may be required to effect such a pledge. In effecting any such pledge, the swap documentation will often make clear the extent to which the pledge will rank on parity with (or subordinate or on some other basis with respect to) the other financial obligations of the issuer. For example, swaps are often structured so that regularly scheduled payments owing under the swap are secured by a pledge on parity with interest owing under the related series of bonds. Termination or settlement payments are at times likewise secured on a parity basis, whereas at other times they are secured on a basis subordinate to interest and principal on such bonds. In other instances, master ordinances or similar instruments may materially restrict (or may not include language workably enabling) the ability of the swap provider to enjoy a lien on certain assets of the issuer to secure the issuer's obligations under the swap.

A swap provider may also propose that a revenue bond issuer agree not to apply any surplus revenues of the revenue generating system (following any required "waterfall" applications) to the payment of any other amounts until all obligations due to such swap provider are first satisfied in full. This effectively provides the swap provider an unperfected foothold on surplus revenues prior to any other parties that may seek similar treatment, potentially including credit enhancers and liquidity providers along with other potential swap providers as well. In some instances, an issuer may provide a swap provider with a "most favored nation" status, to the extent that the issuer is willing to agree that it will afford no *other* swap provider or other creditor with superior treatment, in terms of having access to the surplus revenues of the system for the payment of amounts owing to such swap provider, than the treatment enjoyed by such swap provider.

(3) Potential prohibitions of swaps under covenants or other restrictions.

It is always possible that provisions included in an issuer's master bond ordinances or resolutions, trust agreements, or bond insurer or other credit or liquidity enhancement agreements or other agreements, may limit or restrict the ability of the issuer to enter into a particular swap or derivative transaction, or to pledge collateral or take other actions ancillary to the transaction. In light of the tremendous growth of the municipal derivatives markets in recent years, more currently negotiated agreements are likely to include express restrictions or other provisions concerning swaps and other derivatives. But even if no express restrictions or provisions are present, such agreements or instruments may include broad prohibitions on the incurrence of "obligations" which may potentially be interpreted to restrict the ability of the issuer to enter into swap transactions except in conformity with such documents.

(4) Effect of swaps on quantitative and other tests.

Another documentary issue that may be applicable in the structuring and implementation of a swap or other derivative transaction is the manner in which the existence of such transactions is to be taken into account with respect to an issuer's additional indebtedness tests, debt service coverage or similar ratios, debt service reserve requirements and rate setting and other covenants. For example, a master bond ordinance may require that the issuer maintain a minimum ratio of net revenues to debt service, or other form of debt service coverage or similar ratio, or may require that such a ratio be satisfied as a condition to the issuer incurring any additional indebtedness or entering swaps. If an issuer subject to such tests has a substantial portion of its indebtedness in variable rate bonds that are hedged to a synthetic fixed rate, then a sharp increase in market interest rates could cause the issuer to remain in compliance with such ratios *only if* the hedge were taken into account in calculating such compliance.



However, in the absence of express guidance in the applicable ordinance, indenture or other instrument, the bond trustee or other party entrusted with the monitoring of such matters may be required to disregard the swap and deem the issuer in noncompliance. Without comparable clarifying language, it may likewise be difficult to ascertain the appropriate treatment of interest rate swaps in measuring compliance under rate and other quantitative covenants applicable to the issuer. In addition, depending upon the accounting treatment accorded to an issuer's swap transactions and the general rules (if any) stated as to the applicability of prescribed accounting standards in the issuer's master bond ordinance, resolution or other applicable documents, absent clarifying language as to the proper treatment of swaps, an issuer may be required to include the potential termination value of the swap at any given time as "indebtedness" of the issuer for purposes of applicable covenants.²⁹

Although relatively modern master ordinances and indentures are likely to address how *variable rate debt* is to be taken into account for purposes of various quantitative tests where applicable, master documents presently binding upon a substantial number of issuers provide little to no guidance as to how swaps are to be taken into account in calculating debt service on hedged bonds for purposes such as rate covenants and additional indebtedness tests. To the extent that such documents or instruments do contain language as to the treatment of swaps for quantitative purposes, there are wide disparities in approach. For example, while some master bond ordinances or indentures may treat variable rate indebtedness hedged with a plain vanilla swap as if such indebtedness bore interest at the fixed rate leg payable under the swap or at some specified "certified rate" as provided in accordance with such an ordinance or indenture, such formulation ignores the effect that basis risk may have on the issuer in the event that, for reasons such as those discussed in paragraph II(B)(2)(d) above, the variable rate component of the swap transaction ceases to match the variable rate of interest under the bonds. As another example, some master bond documents permit or require interest rate swaps to be taken into account in various ways for quantitative tests, but only to the extent that the swap provider satisfies certain credit rating or other criteria.

(5) "Cross covenants" and "cross defaults".

Another issue that commonly arises in connection with the documentation of an interest rate swap or other derivative transaction is the extent to which the documents governing the transaction are "cross covenanted" or "cross defaulted" to other obligations or agreements of the issuer. In municipal finance transactions, a swap provider will frequently propose "cross covenant" and "cross default" language. "Cross covenant" provisions constitute a means by which the issuer agrees in the applicable swap documents – typically the Schedule to ISDA® Master Agreement – to perform its obligations and agreements set forth in any applicable master ordinance or indenture (commonly defined on a collective basis in the swap documents as the "Covered Indenture" or "Security Documents") for the benefit of the swap provider for so long as the swap agreement remains in place.

²⁹ See the discussion of termination payments in paragraph II(B)(2)(d)(iii) above.



“Cross default” provisions, on the other hand, may provide that an event of default by the issuer under such “Covered Indenture” or “Security Documents”, or an event of default on other obligations for borrowed money, will likewise trigger an event of default under all swap transactions between the issuer and such swap provider. The result, upon the triggering of any such cross default, is commonly for the swap provider to have the option to terminate all swap transactions in effect between the parties, with the issuer being required to pay (or receive, depending on market conditions) a termination or settlement amount in connection with the termination.

Language often included in swap documentation obligates the issuer to continue to comply with its obligations and agreements under the Covered Indenture or Security Documents, and that the events of default set forth in such agreements or instruments will continue to apply for the benefit of the swap provider, even if the Covered Indenture or Security Documents cease to otherwise be binding and in effect (*e.g.*, because of the payment or defeasance of the obligations issued under such documents). In addition, language commonly requested by swap providers provides, for purposes of such “cross covenants” and “cross defaults”, that no modification or amendment to the Covered Indenture or Security Documents will be taken into account for purposes of the swap documentation unless expressly agreed by the swap provider.

Different versions of these sorts of provisions are likely to afford different degrees of flexibility to an issuer. For example, an issuer will typically prefer to avoid a situation in which, following a material modification (or restatement or replacement) of its master bond related documents, any cross covenant and cross default provisions would result in the issuer being effectively subject to two different sets of covenants and defaults: those contained in its bond documents as amended or replaced, on the one hand, and those being deemed to remain in effect, for the benefit of a swap provider, under the issuer’s bond related documents as they existed when the interest rate swap was executed. Under some variations of these provisions, the swap provider agrees not to unreasonably withhold its consent to modifications or amendments of the issuer’s bond documents (for purposes of the swap documentation) under certain circumstances, *e.g.*, as long as they do not materially adversely affect the rights and interests of the swap provider or the ability of the issuer to perform its obligations to the swap provider.

(6) Covenants not to amend other documents or instruments.

As discussed more particularly above in the context of “cross covenants” and “cross defaults”, a swap provider may request that an issuer agree that modifications or amendments of provisions of its master bond documents or other specified agreements or instruments will not be taken into account, *for purposes of any applicable “cross covenant” or “cross default” language* that may be included for the benefit of the swap provider in the swap documents themselves, without the prior consent of such swap provider. In addition, swap documents may include more direct prohibitions on amendments to master bond documents and other agreements or instruments without the consent of the swap provider. Such prohibitions on modifications and amendments are often negotiated between the parties and some formulations likewise include provisions that certain types of amendments (*e.g.*, supplements to master bond documents creating the issuance of additional obligations) do not require the consent of the swap provider, or that certain types of consents will not be unreasonably withheld.



(7) Voting and consent requirements of swap providers under master documents.

Under some interest rate swap and other derivative arrangements, an issuer will secure its obligations under a swap transaction with, among other potential collateral, a “note” or “obligation” issued under a master bond ordinance or indenture. In these instances, the terms of the applicable master ordinance or indenture may affect the extent to which the provision of such a note or obligation is possible and, if so, the manner in which this special form of “hedge note” or “hedge obligation”, which secures a swap obligation rather than conventional indebtedness, will be taken into account for various purposes under such ordinance or indenture. As a primary example, not all such master indentures or ordinance are, in the absence of an amendment to provide clarifying language, definitive as to the extent to which such a “hedge note” may be deemed outstanding in any principal amount for purposes of voting or other issues applicable generally to holders of obligations under the master ordinance or indenture and, if so, what that “principal” amount (or amortizing amount) should be.

(8) Modernization of master bond documents.

Depending on the facts and circumstances, as well as applicable state law restrictions or other issues, some issuers may be well-served by examining their existing master bond documents or similar instruments and considering the extent to which amendments or modifications to such documents, when possible, may be helpful in clarifying the extent to which swaps and other derivative transactions are permitted and taken into account for the various purposes under such documents. Even if an issuer is not a party to any swaps or derivatives and does not presently anticipate entering any in the future, it might nonetheless consider adopting amendatory or restatement language, whenever the opportunity arises, to specify how swaps and other derivatives are to be addressed in the event that a swap or other derivative transaction may be entered in the future.

(E) Review and Negotiation of Documentation.

Issuers commonly engage such advisors as they deem appropriate to assist in the review and negotiation of swap documentation, particularly with respect to matters involving the legal, financial and credit implications of the transaction. Depending upon the circumstances, this might include counsel to the issuer, bond counsel or some other designated counsel such as “special swaps counsel”. To the extent that the issuer has an independent financial or swap advisor involved in the transaction, such advisor might be well positioned to assist in such review and negotiation.

Much of the documentary process involved in the negotiation of interest rate swaps and derivative transactions has been standardized through the ongoing efforts and resulting publications of the International Swaps and Derivatives Association, Inc. (ISDA®). In particular, the majority of municipal interest rate swap transactions between swap providers and issuers in the United States are documented using either the 1992 or 2002 version of the International Swaps and Derivatives Association, Inc. (ISDA®) Master Agreement, together with a Schedule and, in some instances, Credit Support Annex thereto. Each of such documents are discussed in greater detail below and, with the cooperation of ISDA®, annotated forms of these documents are included as Annexes A-C to this publication.

The ISDA® documentation included with this publication is annotated by the authoring NABL Committee with the intent of highlighting provisions that are often the subject of particular review and negotiation. However, the particular points that may be the proper subject of negotiation in any given transaction, for any given issuer, will naturally vary from case to case. This publication does not purport



to identify all provisions that may be the subject of negotiations, nor does this publication intend to advance or set forth any “best practices” or “correct” or other official position or language.

(F) “Pricing” and the “Confirmation”.

In most instances, the ISDA[®] Master Agreement and Schedule and any accompanying annexes (commonly referred to as the “ISDA[®] documents”) form a written contract between a swap provider and an issuer to set forth the general framework and provisions that would apply *in the event* that a swap transaction is entered into between these two counterparties. Notably, however, absent the entering of an actual swap transaction, executed ISDA[®] documents standing alone typically create no rights or responsibilities binding the parties. Because a party’s decision to enter into a swap or other derivative transaction may be market sensitive, participants in the swap market sometimes deem it appropriate to have the general legal framework pre-negotiated and “on the shelf” in anticipation of being able to move quickly in the event that market circumstances motivate the parties to enter into a specific transaction at any given time.

Once the ISDA[®] documents have been finalized and executed, the actual swap transaction is typically entered into between the parties by telephone on what is often referred to as the “pricing” or “closing” call. On this call the economic terms of the particular swap transaction are finalized and confirmed, such as starting and ending dates of the swap, the notional principal amount (or schedule) of the swap or any variable rate index and fixed rate measures payable by the parties thereunder. Shortly following the pricing call, these items are “confirmed” by a written “confirmation letter” (or “Confirmation”) typically prepared by the swap provider and delivered to the issuer for execution. Either by their own customary practices or upon request, swap providers will often circulate a draft Confirmation in advance of the pricing call (leaving the few remaining unknown items marked with blanks or “TBD”), so that the Confirmation may be completed immediately following the pricing call, leaving relatively little room for confusion or error.

As an alternative to the above sequence for documenting an interest rate swap, occasions may arise in which swap counterparties will execute a transaction and a written Confirmation in *advance* of agreeing to the terms of the ISDA[®] Master Agreement and Schedule as well as potential ancillary documents such as those required for credit enhancement or collateral. In these instances, the swap Confirmation may include a provision that states that one or both parties may have the optional right to terminate the swap in the event that the required ISDA[®] and other documentation is not finalized and executed within a specified period following the entering of the transaction. However, such an approach presents the issuer with the risk that, in the event that an agreement can not be reached concerning all follow-up documentation, the swap may be subject to termination (leaving the issuer unhedged) and the issuer may correspondingly be required to pay (if not receive) a settlement or termination payment in the manner described in paragraph II(B)(2)(d)(iii) above.

(G) Legal Opinion.

In connection with the entering by an issuer into a swap or derivative transaction, the swap provider will often request delivery of a legal opinion letter with respect to matters concerning the issuer and the transaction. Under laws or practices applicable in some states, certain municipal issuers may be required to obtain such a legal opinion even if not requested or required by the swap provider. Counsel rendering these types of opinions may be the issuer’s own counsel, bond counsel or in some instances special swap counsel to the issuer or others. Matters covered in legal opinions rendered on behalf of an issuer in connection with a swap or other derivative transaction may include the following:



- the legal existence of the issuer;
- the authority of the issuer to enter into the transaction;
- the due authorization, execution and delivery of the transaction and related documents (which may include any related bond documents, such as documents subject to any “cross covenant” or “cross default” provisions under the terms of the swap documents);
- the enforceability of the transaction against the issuer, including any choice of law provisions or provisions by which the issuer consents to the jurisdiction of any tribunals;
- that all governmental consents required in connection with the swap transaction have been obtained;
- that the source of payment legally committed to the payment of amounts owing by the issuer under the transaction swap (e.g., any revenues subject to the terms of a master bond ordinance or similar document) is validly as set forth in the applicable documents;
- the effectiveness and validity (and perfection if applicable) of any pledges securing the transaction;
- other possible opinions, such as absence of litigation, no conflicts with applicable laws or agreements and the like;
- particularly with respect to swaps entered by municipal issuers, opinions such as whether the issuer is subject to suit in connection with the swap transaction; that the issuer either has no, or has validly waived, any defense on the grounds of sovereign immunity; and that any specific provisions in the swap documents concerning the choice of governing law and consents to the specified jurisdiction(s) of courts are enforceable.

The ability to provide opinions such as those enumerated above will depend significantly upon the laws of the applicable jurisdiction(s). Moreover, as pointed out in paragraph I(C) and elsewhere in this publication above, this publication is not intended to establish or imply any particular “best practices” or other standard of care.³⁰

(H) Offering Document Disclosure Considerations.

Disclosures concerning existing or potential swap transactions are often made by issuers in their official statements or other documentation used in the offering or remarketing of the issuer’s bonds or other obligations. Although this publication does not attempt to address comprehensively these disclosure issues and any corresponding obligations, and although styles and extents of swap disclosure language

³⁰ See paragraph I(C) of this publication along with footnotes 1 and 26 above.



vary considerably in practice, disclosures made concerning swaps in connection with the transaction in an offering document may include:

- an identification of the various swap or other derivative transactions along with a general description of their basic purposes, which disclosures sometimes include disclosures as to the durations, marked-to-market valuations and economic terms and any sources of payment or pledged security applicable to the transactions;
- the general risks presented by the swap or derivative transactions, which may include some of the nature discussed above in this publication (see paragraph II(B)(2)(d) above);
- the extent to which the transactions are taken into account for purposes of any financial information included in the offering document, such as debt service tables or debt service coverage or similar quantitative ratios as applicable, which disclosures are often made by way of footnotes to the applicable financial information;
- the treatment of interest rate swaps for purposes of various quantitative or other tests under the applicable bond documents (e.g., additional bonds tests and debt service coverage ratios – see paragraph III(D)(4) above); and
- any other disclosures that may be appropriate in light of the particular circumstances.

IV.

Documentation of Interest Rate Swaps

(A) International Swaps and Derivatives Association, Inc.

The majority of municipal interest rate swap and other derivative transactions undertaken in the United States are documented using the standardized documentation architecture developed by the International Swaps and Derivatives Association, Inc. (ISDA®). ISDA was chartered in 1985, and today boasts over 800 member institutions from 57 countries on six continents. These members include most of the world's major institutions that deal in privately negotiated derivatives, as well as many of the businesses, that use over-the-counter derivatives. Among the most notable accomplishments of ISDA® is its development of the ISDA® documentation to promote uniformity among participants in the derivatives market. Given such common usage of these ISDA® forms, counsel and others involved in municipal finance transactions benefit in becoming familiar with the basic ISDA® documentation structure and the ISDA® forms that are frequently employed in documenting municipal swap and other derivative transactions.



(B) General ISDA® Documentation Structure

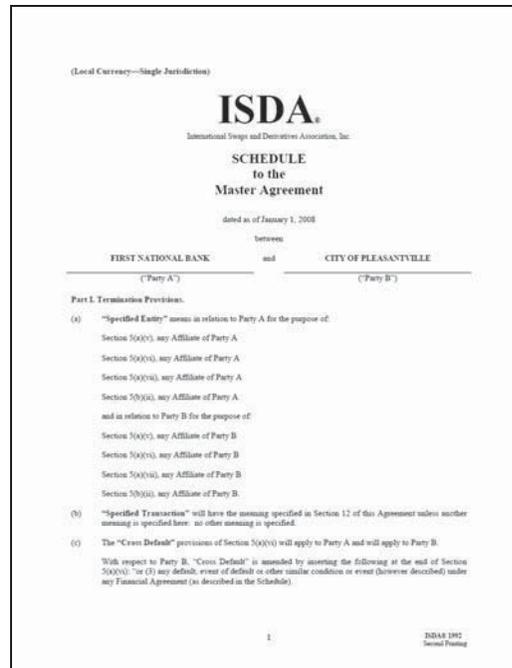


As discussed above, the majority of swap transactions between swap providers and governmental entities in the United States are documented using by either the 1992 or 2002 version of the International Swaps and Derivatives Association, Inc. (ISDA®) Master Agreement, together with a Schedule and, in some instances, Credit Support Annex thereto. The Master Agreement sets forth the fundamental provisions of derivatives contracts entered or to be entered between the parties to the agreement.

To promote uniformity among transactions, the Master Agreement as a form is generally never modified with the exception of the date and the names of the parties to the agreement. When a Master Agreement is entered into between a swap provider and an issuer, it is common practice for the swap provider to be designated as “Party A” in the document with the issuer being named as “Party B”, and such naming convention typically flows through any schedules and annexes accompanying or forming a part of the Master Agreement. On the other hand, some swap counterparties choose to customize the naming convention, replacing “Party A” or “Party B” with more descriptive terms.

Although the Master Agreement is generally not modified directly on its form, the parties to the Master Agreement generally make certain elections and refinements to its terms through the custom negotiation of a Schedule to the Master Agreement (or the “ISDA® Schedule”). The ISDA® Schedule will typically set forth (a) certain “elections” made by the parties and similar provisions that are contemplated by the Master Agreement, (b) any amendments or changes, agreed to by the parties, to the language that would otherwise apply under the language of the Master Agreement standing alone, and (c) certain other matters pertinent to derivative transactions to be entered into between the parties.





One or both parties to a Master Agreement may be required to post collateral to the other, often by reference to formulae that provide for the posting of collateral to the secured party to the extent that movements in interest rates have resulted in such secured party being subject to the credit risk of the pledging party (i.e., the risk that the pledging party would be unable to make the payment of any termination or settlement payment in the event that some or all of the derivative transactions between the parties were to terminate).³¹ To accommodate this structure, ISDA® has published its form of “Credit Support Annex”, an annotated form of which accompanies this publication as Annex C.

ISDA® has published many forms and other resources in addition to those described above, such as forms of written confirmations for swaps and other derivatives of various types, standardized definitions of terms that may be incorporated by reference into documents governing swap transactions, and other resources. More information on ISDA® and such additional forms and other resources may be found at ISDA’s website at www.isda.org.

Forms of the ISDA® Master Agreement, Schedule to Master Agreement and Credit Support Annex accompany this publication as Annexes A-C, respectively, and Annex D provides a sample “short-form” interest rate swap confirmation based on forms published by ISDA® and commonly used as a template for potential reference in a “plain vanilla” swap transaction. Each of these forms is presented with accompanying annotations, provided by the NABL Committee authors of this publication with the intent of highlighting provisions that implicate state law issues for issuers as well as provisions that are often the subject of particular review and negotiation. However, the particular points that may be the proper subject of review, analysis and negotiation in any particular transaction, for any particular issuer, will vary from case to case and as mentioned above. This publication, while highlighting certain commonly negotiated provisions, does not purport to identify all provisions that may be the subject of

³¹ See the discussion of termination and settlement risk and payments in paragraph II(B)(2)(d)(iii) of this publication above.



such review, analysis and negotiations, nor does this publication intend to advance or set forth any “best practices” or other “correct” position or language.

(C) ISDA[®] Master Agreement

(1) 1992 ISDA[®] Master Agreement (Local Currency – Single Jurisdiction)

A basic outline of the ISDA[®] Master Agreement begins on the following page. The authors of this publication have chosen to outline and annotate the *1992 ISDA[®] Master Agreement (Local Currency – Single Jurisdiction)* given its widespread application in municipal swap and other derivative transactions. ISDA has published other forms of Master Agreements that are used in state and municipal derivatives transactions, the most recent being the 2002 ISDA[®] Master Agreement (Multicurrency-Cross Border). For a brief discussion of notable differences between the 1992 and 2002 forms, see paragraph IV(C)(3) of this publication below.

The following outline of the ISDA[®] Master Agreement is a summary only and is not intended to describe comprehensively the applicable document. Capitalized terms and section references are, except as otherwise expressly noted, to the applicable terms and sections contained in the ISDA[®] Master Agreement. In addition, certain portions of the following outline are re-summarized, for purposes of convenience, in the form of ISDA[®] Master Agreement attached hereto as Appendix A.



Basic Outline of ISDA® Master Agreement (1992)
(Local Currency – Single Jurisdiction)

(This outline is a summary only and is not intended to describe comprehensively the applicable document. Capitalized terms and section references are, except as otherwise expressly noted, to the applicable terms and sections contained in the ISDA® Master Agreement)

Preamble

Summarizes the role of the Master Agreement and accompanying “Schedule” as enabling the parties to enter into “Transactions” pursuant to “Confirmations”.

Section 1 – Interpretation

Incorporates definitions from Section 12 and provides certain rules of interpretation, including that the terms of the Master Agreement are subject to modification by the Schedule thereto and any applicable Confirmation.

Section 2 – Obligations

Sets forth the general obligations of the parties to perform their obligations under each Transaction as set forth in the applicable Confirmation, methods for settlement of obligations, certain conditions to performance such as the absence of defaults, the ability for changes in account information and provisions concerning the netting of payments and interest to accrue at the Default Rate upon failure for obligations to be paid when due.

Section 3 – Basic Representations

Sets forth certain basic representations involving each party’s status, powers, absence of conflicts with laws and contracts, the obtaining of required governmental and other consents, the binding nature of the parties’ respective obligations, the absence of default-type events and litigation, and the accuracy of certain factual information provided by the parties.

Section 4 – Agreements

Sets forth certain basic covenants involving the furnishing of information, maintaining of governmental and other authorizations and compliance with laws.



Section 5 – Events of Default and Termination Events

Includes the following standard “Events of Default”:

- Failure to pay amounts or deliver items when required under the agreement.
- Failure to perform other obligations when required under the agreement.
- “Credit Support Default” (default under any credit support document, such credit support terminating prematurely, or repudiation of such credit support).
- Misrepresentation of facts.
- Default under “Specified Transactions” (typically, derivatives-type transactions between the parties).
- “Cross Default”, which, if elected by the parties in the Schedule to the Master Agreement, provide the non-defaulting party with a termination right in the event of certain defaults above a specified threshold under obligations for borrowed money.
- Bankruptcy-type events.
- “Merger Without Assumption” (reorganization of a party in a manner in which the surviving entity is no longer bound by the agreement).

Includes the following standard “Termination Events” enabling one or either party to a Transaction to terminate the Transaction *if* the circumstances are then continuing:

- “Illegality” (changes in law that render a party’s obligations unlawful).
- “Credit Event Upon Merger” (if elected by the parties as being applicable in the Schedule to the Master Agreement, a reorganization of a party into a surviving entity with reduced creditworthiness).
- “Additional Termination Events” (any other events set forth in the Schedule or any Confirmation as constituting “Termination Events” for purposes of the Master Agreement).



Section 6 – Early Termination

Sets forth in detail the consequences of an Event of Default or Termination Event described in Section 5. In general, if an Event of Default occurs with respect to a party, then the non-defaulting party has the right to cause the Transactions governed by the agreement to be terminated. If “Automatic Early Termination” is elected with respect to the defaulting party in the Schedule to the Master Agreement, then certain bankruptcy-type events may result in the *automatic* termination of the transactions, subject to applicable bankruptcy and insolvency laws.

On the other hand, the consequences of a Termination Event generally depend upon whether it relates to an “Illegality” described above. If an Illegality occurs with respect to *both* parties, then the parties must use reasonable efforts to reach agreement (within 30 days of notice thereof) on action to avoid the Termination Event. If the parties can not reach such an agreement, or any other type of Termination Event occurs, then, except as modified by the Schedule or a Confirmation, one or both of the parties may have the right to terminate the Transactions entered into under the Master Agreement as more particularly set forth and annotated in Annex A.

Section 6 also sets forth the procedure for calculating the amounts that are owed between the parties upon the termination of the transactions subject to the Master Agreement, including the ability for the counterparties to make certain elections in the Schedule between “Market Quotation” or “Loss”, as the means for determining the termination amount, and between “First Method” or “Second Method” (which addresses the issue of whether a defaulting party may be entitled to *receive* any settlement amount otherwise owed upon swap termination). These elections are discussed in greater detail in Annex A.

A special rule applies for Termination Event with two “Affected Parties”, under which both parties make their independent calculations of Market Quotation or Loss, whichever applies, and then the ultimate payment amounts are determined as described in Section 6(e)(ii)(2).

Section 7 – Transfer

Imposes a limitation on the transfer of the parties’ rights and obligations under the agreement and Transactions thereunder.

Section 8 – Miscellaneous

Sets forth “boilerplate” type provisions applicable to swap transactions.

Section 9 – Expenses

Requires a defaulting party to pay and indemnify a non-defaulting party for its expenses in connection with the enforcement of the agreement.



Section 10 – Notices

Sets for the procedure for delivery and effectiveness of notices and changes of address.

Section 11 – Governing Law and Jurisdiction

Recites that the law to govern the agreement is as specified in the Schedule. Notes that if the Schedule provides that New York law governs, then the parties are *deemed* to consent to the non-exclusive jurisdiction of courts of the State of New York and to the United States District Court located in the Borough of Manhattan. In addition, provides for a waiver by the parties of any rights to sovereign immunity. Section 11 also provides for a waiver of immunities.

Section 12 – Definitions

Defines various terms used throughout the agreement.

Signatures



(2) Annotated form of 1992 ISDA® Master Agreement (Local Currency – Single Jurisdiction)

Attached to this publication as Annex A is the form of *1992 ISDA® Master Agreement (Local Currency – Single Jurisdiction)*, which as mentioned above is widely incorporated for use in municipal derivatives transactions. ISDA has published other forms of Master Agreement, including a multi-currency, multi-jurisdiction version of the 1992 ISDA® Master Agreement, and a more recent 2002 ISDA® Master Agreement (Multicurrency-Cross Border).

(3) The 2002 ISDA® Master Agreement

As mentioned above, the most recent ISDA Master Agreement is the 2002 ISDA® Master Agreement (Multicurrency-Cross Border). A key difference between the 1992 Master Agreement and the 2002 Master Agreement forms is that the 2002 Master Agreement includes a single methodology for determining the amounts payable by the parties upon the termination of a transaction, referred to as the “Close-out Amount,” rather than alternative options as provided in the 1992 Master Agreement. In response to concerns that meaningful quotations were often difficult to obtain in connection with any determination based upon the “Market Quotation” language in the 1992 Master Agreement, the “Close-out amount” involves, in essence, a party calculating its losses or costs (or gains, as applicable) that would be required to make itself whole for the economic equivalent of the terminated transaction. In making such a determination, the 2002 Master Agreement requires the applicable party to act in good faith and use commercially reasonable procedures.

In addition, the 2002 Master Agreement adds a “Force Majeure Event” as a Termination Event and makes various changes in the Events of Default and other provisions to the Master Agreement. The reader may wish to obtain and review a copy of the 2002 Master Agreement to compare its provisions and include those modified provisions that may be appropriate in light of applicable state laws, including the definition of “Close out Amount”, the *force majeure* provisions, fraud exclusion and certain abbreviated cure periods. ISDA made various other changes in constructing the 2002 Master Agreement form in addition to those mentioned above, and for this reason the reader may wish to obtain and review a copy of the 2002 Master Agreement to compare its provisions and assess the impact of those modified provisions that may be appropriate in light of applicable state laws.

(D) ISDA® Schedule

(1) General purpose and structure

As discussed above, parties entering an ISDA Master Agreement generally refine their business terms through the custom negotiation of a Schedule to the Master Agreement (or the “ISDA® Schedule”). The ISDA® Schedule will typically set forth (a) certain “elections” made by the parties and similar provisions that are contemplated by the Master Agreement, (b) any amendments or changes, agreed to by the parties, to the language that would otherwise apply under the language of the Master Agreement standing alone, and (c) certain other matters pertinent to derivative transactions to be entered into between the parties.



(2) Annotated form of ISDA[®] Municipal Counterparty Schedule
(Local Currency – Single Jurisdiction)

Attached as Annex B to this publication is an annotated form of U.S. Municipal Counterparty Schedule to the ISDA[®] Master Agreement. The annotations included in separate “text boxes” to the attached form of ISDA[®] Schedule are provided by the NABL Committee authors to highlight various issues for consideration with regard to the documentation of typical municipal swap transactions and certain particular considerations bearing on state laws. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects surrounding the topic of interest rate swaps, derivatives or their documentation or the issues summarized or annotations set forth herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

(E) ISDA[®] Credit Support Annex

In many instances a swap provider an issuer will enter into a “Credit Support Annex” (or “CSA”) to the ISDA[®] Master Agreement or other arrangement by which one or both parties may be required, often subject to certain contingencies and thresholds, to post collateral securities to secure the parties’ respective obligations under one or more swap or other derivative transactions. Attached as Annex C to this publication is an annotated form of an ISDA[®] Credit Support Annex commonly used for this purpose. Under the standard framework as reflected in this form, one party (in a “unilateral” CSA) or both parties (in a “bilateral” CSA) are required to post cash or securities to the other depending upon factors most commonly driven by the extent to which the party acting as “Pledgor” is “out of the money” under the transactions in effect under the Master Agreement.³² Such factors may also include the credit ratings applicable to the parties at any applicable time or comparable factors.

Under the standard form of CSA attached as Annex C, paragraphs 1 through 12 set forth the general framework in which the posting of collateral by the parties may be established. Although Paragraphs 1 through 12 are generally not modified directly themselves, Paragraph 13 of the CSA is generally intended to set forth the specific agreements and elections of the parties with respect to the economic parameters for posting collateral, as well as any modifications the parties may desire to make to the standardized provisions of Paragraphs 1 through 12. The annotations included in separate “text boxes” to the attached form of CSA are provided by the NABL Committee authors to highlight various issues for consideration with regard to the CSA-type collateralization arrangements commonly employed in municipal swap transactions. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects that may be applicable. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

(F) Swap Confirmation

As discussed in paragraph III(F) above, common practice provides that once the ISDA[®] Master Agreement and Schedule, along with any other applicable documents, have been finalized and executed,

³² See the discussion in paragraph II(B)(2)(d)(iii) above.



the actual swap transaction is typically entered into between the parties by telephone on what is often referred to as the “pricing” or “closing” call. On this call the economic terms of the particular swap transaction are finalized and confirmed, such as starting and ending dates of the swap, the notional principal amount (or schedule) of the swap or any variable rate index and fixed rate measures payable by the parties thereunder. Shortly following the pricing call, these items are “confirmed” by a written “confirmation letter” (or “Confirmation”) typically prepared by the swap provider and delivered to the issuer for execution. Either by their own customary practices or upon request, swap providers will often circulate a draft Confirmation in advance of the pricing call (leaving the few remaining unknown items marked with blanks or “TBD”), so that the Confirmation may be completed immediately following the pricing call, leaving relatively little room for confusion or error.³³

Attached as Annex D to this publication is an annotated form of a “short-form” interest rate swap confirmation which, although not constituting a verbatim ISDA[®] form *per se*, is comprised primarily of components published by ISDA[®] that are commonly used in a “plain vanilla” swap transaction. In lieu of entering into a Master Agreement and Schedule, in some instances parties may execute and deliver a “long-form confirmation”, which is a single self-contained agreement setting forth all the provisions to govern a specific swap or other derivative transaction. Long-form Confirmations have historically been employed, for example, for transactions having such a degree of complexity that they are more appropriately handled outside of the standardized Master Agreement / Schedule document architecture. However, long-form confirmations are less commonly employed in municipal finance transactions.

³³ As also discussed in paragraph III(F) above, an alternative to the above sequence may sometimes occur in which the counterparties execute a transaction and a written Confirmation in *advance* of agreeing to the terms of the ISDA[®] Master Agreement and Schedule as well as potential ancillary documents. In these instances, the Confirmation may include a provision that states that one or both parties may have the optional right to terminate the swap in the event that the required ISDA[®] and other documentation is not finalized and executed within a specified period following the entering of the transaction. However, such an approach presents the issuer with the risk that, in the event that an agreement can not be reached concerning all follow-up documentation, the swap may be subject to termination (leaving the issuer unhedged) and the issuer may correspondingly be required to pay (if not receive) a settlement or termination payment in the manner described in paragraph II(B)(2)(d)(iii) above.



Annex A

ANNOTATED FORM OF ISDA® MASTER AGREEMENT

Attached is an annotated form of the 1992 ISDA® Master Agreement (Local Currency – Single Jurisdiction). The annotations included in separate “text boxes” are provided by the NABL Committee authors to highlight various issues for consideration with regard to the documentation of typical municipal swap transactions and certain particular considerations bearing on state laws. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects surrounding the topic of interest rate swaps, derivatives or their documentation or the issues summarized or annotations set forth herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

The attached form of Master Agreement (other than the annotations referred to above) is the property of ISDA®. This Annex A and all other International Swaps and Derivatives Association, Inc. (ISDA®) form documentation included within this publication (other than such annotations) is provided by special permission under a non-exclusive license from ISDA® and is subject to the following copyright notice and any other proprietary legends set forth thereon.

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Notwithstanding the foregoing and any copyright notice set forth within this Annex A, all annotations to such ISDA® forms included in this publication are the intellectual property of the National Association of Bond Lawyers and are subject to the following copyright notice. Such NABL Committee annotations are denoted by shaded text boxes included within this Annex A.

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NO PART OF THE PUBLICATION TO WHICH THIS ANNEX A IS ATTACHED NOR ANY OF THE ANNOTATIONS INCLUDED WITHIN THIS ANNEX A MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN CONSENT OF THE NATIONAL ASSOCIATION OF BOND LAWYERS IN EACH INSTANCE. MOREOVER, NO PART OF THIS ANNEX A (OTHER THAN SUCH ANNOTATIONS) MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN PERMISSION OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC. IN EACH INSTANCE.



Annotation:

As introduced in this publication, the ISDA[®] Master Agreement sets forth the basic provisions to govern swaps or other derivative transactions entered or to be entered between the parties to the Master Agreement. Any modifications to the Master Agreement are accomplished through elections and amendatory language set forth in the "Schedule" to the Master Agreement, rather than within the Master Agreement itself. Modifications may also be accomplished through a Confirmation entered into between the parties, although when included in a Confirmation such modifications typically will relate only to the transaction evidenced by that particular Confirmation. Parties to a single Master Agreement may enter into multiple transactions under a single Master Agreement and Schedule.

An annotated version of a commonly used Schedule to the ISDA[®] Master Agreement is attached as Annex B and a sample form of simple Confirmation for an interest rate swap is attached as Annex D.

In lieu of entering into a Master Agreement and Schedule, in some instances parties may execute and deliver a "long-form confirmation", which is a single self-contained agreement setting forth all the provisions to govern a specific swap or other derivative transaction. Long-form Confirmations have historically been employed, for example, for transactions having such a degree of complexity that they are more appropriately handled outside of the standardized Master Agreement / Schedule document architecture. However, as discussed in this publication above, long-form confirmations are less commonly employed in municipal finance transactions.

(Local Currency - Single Jurisdiction)

ISDA[®]

International Swap Dealers Association, Inc.

MASTER AGREEMENT

dated as of _____,

Annotation:

The date of the Master Agreement is essentially for reference purposes, except to the extent that a Master Agreement entered into between the same counterparties but dated a later date may be more easily identified as restating or replacing, to the extent applicable, a previously dated Master Agreement. In the event of such a replacement, the parties can include express language clarifying, for the avoidance of confusion, that the later agreement supersedes the earlier agreement.

On the other hand, in some circumstances, swap counterparties may intend to be parties to more than one Master Agreement in effect simultaneously (in which case different dates may be helpful for purposes of reference). For example, such parties may implement swap transactions of a particular municipal enterprise, or backed by specific revenue pledges, that are evidenced by separate Master Agreements and Schedules, even when such transactions are with the same swap provider. Transactions insured by different swap insurers may also be addressed through separate Master Agreements.

[PARTY A]

and

[PARTY B]

Annotation:

Except to the extent modified in the Schedule to the Master Agreement, “Party A” and “Party B” are afforded identical treatment throughout the Master Agreement. However, as a matter of market custom for municipal transactions, “Party A” is typically used to designate the financial institution or other swap provider whereas “Party B” is used to denote the issuer. Depending on the preferences of the parties, the designations of “Party A” and “Party B” may be replaced globally with the actual names of the parties or with more descriptive defined terms throughout the document (e.g. the “Bank” and the “City” or “Borrower”).

have entered and/or anticipate entering into one or more transactions (each a “Transaction”) that are or will be governed by this Master Agreement, which includes the schedule (the “Schedule”), and the documents and other confirming evidence (each a “Confirmation”) exchanged between the parties confirming those Transactions.

Annotation:

Although the Master Agreement and accompanying Schedule set forth the contractual *framework* within which any swap or other derivative transactions may be entered into between the parties, the Master Agreement does not, in and of itself, establish any legal duties between the parties *until* such a transaction is entered or “executed”. This intent is consistent with use of the expression “anticipate entering into one or more transactions” above. In addition, the Master Agreement does not, by its terms, have any termination date and thus any party that desires to avoid confusion as to whether future swap transactions might be deemed subject to a particular Master Agreement may consider including express language to such effect in the documents governing such future swap transactions.

Accordingly, the parties agree as follows: -

1. Interpretation

(a) **Definitions.** The terms defined in Section 12 and in the Schedule will have the meanings therein specified for the purpose of this Master Agreement.

(b) **Inconsistency.** In the event of any inconsistency between the provisions of the Schedule and the other provisions of this Master Agreement, the Schedule will prevail. In the event of any inconsistency between the provisions of any Confirmation and this Master Agreement (including the Schedule), such Confirmation will prevail for the purpose of the relevant Transaction.

Annotation:

Under the above standard rule of interpretation the swap documents will, absent any modification in the Schedule or an applicable Confirmation, control in the following order of priority for any particular transaction: (1) the Confirmation, (2) the Schedule and (3) the Master Agreement. In other words, the terms of the Master Agreement and Schedule can be trumped by the terms of a Confirmation. For this reason swap counterparties are well-served to carefully review the terms of any Confirmation, notwithstanding that in many instances a Confirmation may be generated with relatively little time for review prior to signature.

(c) **Single Agreement.** All Transactions are entered into in reliance on the fact that this Master Agreement and all Confirmations form a single agreement between the parties (collectively referred to as this “Agreement”), and the parties would not otherwise enter into any Transactions.

Annotation:

The ISDA® “Master Agreement” structure is intended to enable netting among multiple transactions governed under the same Master Agreement, including termination netting and, if elected in the Schedule as provided in Section 2(c) below, payment netting. Treating all swap or other derivative transactions as constituting a single agreement should assist counterparties to a single Master Agreement in avoiding any “cherry-picking” relative to the termination of transactions in a default or bankruptcy scenario.

2. Obligations

Annotation:

Section 2 sets forth the general obligations and conditions of the parties to perform under each transaction entered under the Master Agreement as detailed in each respective Confirmation, methods for the settlement of obligations, certain conditions to performance such as the absence of defaults, the ability for changes in account information, provisions concerning the netting of payments and the accrual of interest at a Default Rate upon the failure of obligations to be paid when due.

(a) **General Conditions.**

(i) Each party will make each payment or delivery specified in each Confirmation to be made by it, subject to the other provisions of this Agreement.

(ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in freely transferable funds and in the manner customary for payments in the required currency. Where settlement is by delivery (that is, other than by payment), such delivery will be made for receipt on the due date in the manner customary for the relevant obligation unless otherwise specified in the relevant Confirmation or elsewhere in this Agreement.

(iii) Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant Transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.

(b) **Change of Account.** Either party may change its account for receiving a payment or delivery by giving notice to the other party at least five Local Business Days prior to the scheduled date for the payment or delivery to which such change applies unless such other party gives timely notice of a reasonable objection to such change.

(c) **Netting.** If on any date amounts would otherwise be payable:

- (i) in the same currency; and
- (ii) in respect of the same Transaction,

by each party to the other, then, on such date, each party's obligation to make payment of any such amount will be automatically satisfied and discharged and, if the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, replaced by an obligation upon the party by whom the larger aggregate amount would have been payable to pay to the other party the excess of the larger aggregate amount over the smaller aggregate amount.

The parties may elect in respect of two or more Transactions that a net amount will be determined in respect of all amounts payable on the same date in the same currency in respect of such Transactions, regardless of whether such amounts are payable in respect of the same Transaction. The election may be made in the Schedule or a Confirmation by specifying that subparagraph (ii) above will not apply to the Transactions identified as being subject to the election, together with the starting date (in which case subparagraph (ii) above will not, or will cease to, apply to such Transactions from such date). This election may be made separately for different groups of Transactions and will apply separately to each pairing of branches or offices through which the parties make and receive payments or deliveries.

Annotation:

Amounts payable on the same date, in the same currency and with respect to the same transaction under the Master Agreement are typically netted. In addition, the parties may elect to have payments on the same date, in the same currency and with respect to *different* transactions under the Master Agreement netted. When made, this election is typically indicated in the Schedule to the Master Agreement. See Part 3(e) of the form of Schedule to ISDA[®] Master Agreement attached as Annex B.

(d) ***Default Interest; Other Amounts.*** Prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party that defaults in the performance of any payment obligation will, to the extent permitted by law and subject to Section 6(c), be required to pay interest (before as well as after judgment) on the overdue amount to the other party on demand in the same currency as such overdue amount, for the period from (and including) the original due date for payment to (but excluding) the date of actual payment, at the Default Rate. Such interest will be calculated on the basis of daily compounding and the actual number of days elapsed. If, prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party defaults in the performance of any obligation required to be settled by delivery, it will compensate the other party on demand if and to the extent provided for in the relevant Confirmation or elsewhere in this Agreement.

Annotation:

Under the laws applicable in some states, provisions obligating a swap counterparty to pay interest at a Default Rate may implicate limitations on interest rates or liquidated damages. For example, many states have usury laws with potential implications on such provisions. As to liquidated damages, many states have statutory or common laws comparable to the notion, as expressed in The Restatement (Second of Contracts), that “Damages for breach by either party [to a contract] may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.” RESTATEMENT (SECOND) OF CONTRACTS § 356 (1981).

3. Representations

Annotation:

Section 3 of the Master Agreement sets forth basic representations involving each party’s status, powers, absence of conflicts with laws and contracts, the obtaining of required governmental and other consents, the binding nature of the parties’ respective obligations, the absence of default-type events and litigation, and the accuracy of certain factual information provided by the parties. Note that the representations of Section 3 are deemed to be *remade* at the time a transaction is entered into between the parties to the Master Agreement. It is common practice, particularly in municipal swap transactions, for the Schedule to the Master Agreement to include representations in addition to those included below in this Section 3.

Each party represents to the other party (which representations will be deemed to be repeated by each party on each date on which a Transaction is entered into) that:

(a) ***Basic Representations.***

- (i) ***Status.*** It is duly organised and validly existing under the laws of the jurisdiction of its organisation or incorporation and, if relevant under such laws, in good standing;
- (ii) ***Powers.*** It has the power to execute this Agreement and any other documentation relating to this Agreement to which it is a party, to deliver this Agreement and any other documentation relating to this Agreement that it is required by this Agreement to deliver and to perform its obligations under this Agreement and any obligations it has under any Credit Support Document to which it is a party and has taken all necessary action to authorise such execution, delivery and performance;

Annotation:

Particularly with respect to municipal swap transactions, parties are well-served to evaluate the source of their legal power and authority to enter a swap or other derivative transaction under applicable state or other law. A detailed discussion of the “legal authority” issue is set forth in paragraph III(A) of this publication above.

(iii) **No Violation or Conflict.** Such execution, delivery and performance do not violate or conflict with any law applicable to it, any provision of its constitutional documents, any order or judgment of any court or other agency of government applicable to it or any of its assets or any contractual restriction binding on or affecting it or any of its assets;

Annotation:

An accurate making of this representation may necessitate an issuer and/or its counsel determining the extent to which the entering of a swap or other transaction under the Master Agreement, including any related pledges of collateral or other undertakings, is permitted or requires any applicable consent or other action under state laws, existing ordinances, resolutions, indentures or credit enhancement agreements and/or satisfies any restrictions on additional obligations thereunder. See the discussion in paragraph III(D) of this publication above.

(iv) **Consents.** All governmental and other consents that are required to have been obtained by it with respect to this Agreement or any Credit Support Document to which it is a party have been obtained and are in full force and effect and all conditions of any such consents have been complied with; and

Annotation:

Swap counterparties, particularly in the context of municipal swap or other derivative transactions, are well-served to ensure that any state laws requiring the consent of a state office or other agency prior to execution of an interest rate swap or other derivative transaction have been satisfied. In many instances the consent of a bond insurer or other credit enhancer, as well as potential other third parties, may also be required.

(v) **Obligations Binding.** Its obligations under this Agreement and any Credit Support Document to which it is a party constitute its legal, valid and binding obligations, enforceable in accordance with their respective terms (subject to applicable bankruptcy, reorganisation, insolvency, moratorium or similar laws affecting creditors' rights generally and subject, as to enforceability, to equitable principles of general application (regardless of whether enforcement is sought in a proceeding in equity or at law)).

Annotation:

As mentioned above, swap counterparties often have cause to consider the legal power and authority for an issuer to enter into a derivative transaction under applicable state law. A detailed discussion of the "legal authority" issue is set forth in paragraph III(A) of this publication. If a municipal issuer entering a swap enjoys sovereign immunity from suit to enforce the Master Agreement, an accurate making of the above representation may entail the inclusion of qualifying or other language in such regard the Schedule to the Master Agreement. See Part 4(b)(v) of the annotated Schedule.

(b) ***Absence of Certain Events.*** No Event of Default or Potential Event of Default or, to its knowledge, Termination Event with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or performing its obligations under this Agreement or any Credit Support Document to which it is a party.

(c) ***Absence of Litigation.*** There is not pending or, to its knowledge, threatened against it or any of its Affiliates any action, suit or proceeding at law or in equity or before any court, tribunal, governmental body, agency or official or any arbitrator that is likely to affect the legality, validity or enforceability against it of this Agreement or any Credit Support Document to which it is a party or its ability to perform its obligations under this Agreement or such Credit Support Document.

Annotation:

The “Absence of Litigation” provision is the only representation in Section 3 that takes “Affiliates” of the parties into account. The term “Affiliate” is defined broadly in Section 12 of the Master Agreement by employing the concept of “control”. Unless modified in the Schedule to the Master Agreement, this “no litigation” representation is limited to matters bearing upon the Agreement or any Credit Support Document.

(d) ***Accuracy of Specified Information.*** All applicable information that is furnished in writing by or on behalf of it to the other party and is identified for the purpose of this Section 3(d) in the Schedule is, as of the date of the information, true, accurate and complete in every material respect.

Annotation:

The above “Accuracy of Specified Information” paragraph provides a convenient means of identifying with specificity the documents that the parties represent as to truth and accuracy. When any such information or other item is designated as being “identified” for purposes of the above Section 3(d), it is commonly referred to as “Specified Information” and such identification is ordinarily made expressly in the Schedule to the Master Agreement.

4. *Agreements*

Each party agrees with the other that, so long as either party has or may have any obligation under this Agreement or under any Credit Support Document to which it is a party:

Annotation:

Section 4 of the Master Agreement sets forth certain basic covenants involving the furnishing of information, the maintaining of governmental and other authorizations and compliance with laws. In addition to the standard covenants set forth below, parties to municipal swap transactions may add additional covenants in the Schedule to the Master Agreement, such as the “Compliance with Covered Indenture” and “Incipient Illegality” covenants included in the form of Schedule to the Master Agreement attached to this publication as Annex B.

- (a) ***Furnish Specified Information.*** It will deliver to the other party any forms, documents or certificates specified in the Schedule or any Confirmation by the date specified in the Schedule or such Confirmation or, if none is specified, as soon as reasonably practicable.
- (b) ***Maintain Authorisations.*** It will use all reasonable efforts to maintain in full force and effect all consents of any governmental or other authority that are required to be obtained by it with respect to this Agreement or any Credit Support Document to which it is a party and will use all reasonable efforts to obtain any that may become necessary in the future.
- (c) ***Comply with Laws.*** It will comply in all material respects with all applicable laws and orders to which it may be subject if failure so to comply would materially impair its ability to perform its obligations under this Agreement or any Credit Support Document to which it is a party.

Annotation:

Some state laws include requirements that must be met by governmental entities, on an ongoing basis, throughout the term of certain swap or other derivative transactions, such as requirements for ongoing reporting or monitoring of transactions and certain ongoing educational requirements.

5. Events of Default and Termination Events

Annotation:

The Master Agreement distinguishes between Events of Default and Termination Events, both of which can provide a basis for one or both parties having the option of terminating transactions entered under the Master Agreement. “Events of Default” are generally those types of events that would ordinarily constitute a default under financial contracts. On the other hand, “Termination Events” are less “fault related” in nature. The existence of an Event of Default or Termination Event will generally not in and of itself trigger a termination of any transactions entered under the Master Agreement, but will provide an opportunity for one or both of the parties to choose to designate a “Termination Date” with the results outlined in Section 6 below.

However, if the parties specify that “Automatic Early Termination” applies with respect to a party, then the occurrence of certain bankruptcy-type events relative to that party can cause the Transactions governed by the Master Agreement to be automatically terminated. Certain implications concerning the election of “Automatic Early Termination” are discussed in greater detail in the Annotations below.

- (a) ***Events of Default.*** The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any of the following events constitutes an event of default (an “Event of Default”) with respect to such party:

Annotation:

Section 5(a) of the Master Agreement lists the standard Events of Default, including failure to pay or deliver, breach of agreement, credit support default, misrepresentation, default under “Specified Transaction” (generally unless modified by the Schedule, derivative-type transactions between the parties), Cross Default, bankruptcy and merger without assumption. In accordance with the introductory language to Section 5 above, these events may be triggered by, in addition to circumstances involving the party to the Master Agreement itself, a party’s Credit Support Providers and Specified Entities. The terms “Credit Support Provider” and “Specified Entity” are not defined in the Master Agreement itself (other than by cross reference to the Schedule) and include those parties, if any, respectively named as such in the Schedule.

A “Credit Support Provider” of a party would typically include any guarantor of such party’s obligations under the transactions entered into under the Master Agreement. Other parties that are relevant to the credit of a party, but which do not provide credit support relative to the swap, are often named in the Schedule as “Specified Entities.” For example, the Schedule to the Master Agreement might name a significant tenant to a city’s municipal project to constitute a “Specified Entity” as to the city. The Schedule might also, more broadly, include “all Affiliates” of a party as constituting the Specified Entities of such party. Because actions of a Credit Support Provider can trigger defaults and other consequences under the Master Agreement, parties often deem it appropriate to evaluate the consequences of including an unrelated third party (such as an insurer) as a Credit Support Provider.

(i) ***Failure to Pay or Deliver.*** Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(d) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party;

(ii) ***Breach of Agreement.*** Failure by the party to comply with or perform any agreement or obligation (other than an obligation to make any payment under this Agreement or delivery under Section 2(a)(i) or 2(d) or to give notice of a Termination Event) to be complied with or performed by the party in accordance with this Agreement if such failure is not remedied on or before the thirtieth day after notice of such failure is given to the party;

(iii) ***Credit Support Default.***

(1) Failure by the party or any Credit Support Provider of such party to comply with or perform any agreement or obligation to be complied with or performed by it in accordance with any Credit Support Document if such failure is continuing after any applicable grace period has elapsed;

(2) the expiration or termination of such Credit Support Document or the failing or ceasing of such Credit Support Document to be in full force and effect for the purpose of this Agreement (in either case other than in accordance with its terms) prior to the satisfaction of all obligations of such party under each Transaction to which such Credit Support Document relates without the written consent of the other party; or

(3) the party or such Credit Support Provider disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenges the validity of, such Credit Support Document;

Annotation:

The term “Credit Support Document” is not specifically defined in the Master Agreement and is this ordinarily defined, where applicable, in the Schedule to the Master Agreement. In turn, the Schedule may set forth the list of specific documents and instruments that are to constitute “Credit Support Documents” with respect to a party, such as a guaranty, mortgage, security agreement or other document providing collateral or other security. This may be to support the obligations of either the issuer or the swap provider. In addition, counterparties may decide to attach an ISDA form “Credit Support Annex” to the Master Agreement that sets forth certain standardized methodologies, subject to the parties’ ability to negotiate certain thresholds and other elections, for the posting of collateral securities as security for a party’s exposure in respect of outstanding Transactions under the Master Agreement. See paragraph IV above and Annex C attached hereto.

In some situations the parties may define “Credit Support Document” in the Schedule in a broader, more generic fashion by using language that, in essence, states that any document or instrument that provides security or other benefits relative to any transaction entered into under the Master Agreement shall constitute a “Credit Support Document”.

A primary consequence of a document being designated as “Credit Support Document” is that defaults with respect to such documents are likely to create an Event of Default under Section 6(a)(iii) of the Master Agreement. In addition, “Credit Support Documents” are taken into account more generally for purposes of various standard representations and covenants in the Master Agreement, as well as for purposes of the “Merger Without Assumption” Event of Default and “Illegality” Termination Event.

(iv) **Misrepresentation.** A representation made or repeated or deemed to have been made or repeated by the party or any Credit Support Provider of such party in this Agreement or any Credit Support Document proves to have been incorrect or misleading in any material respect when made or repeated or deemed to have been made or repeated;

(v) **Default under Specified Transaction.** The party, any Credit Support Provider of such party or any applicable Specified Entity of such party (1) defaults under a Specified Transaction and, after giving effect to any applicable notice requirement or grace period, there occurs a liquidation of, an acceleration of obligations under, or an early termination of, that Specified Transaction, (2) defaults, after giving effect to any applicable notice requirement or grace period, in making any payment or delivery due on the last payment, delivery or exchange date of, or any payment on early termination of, a Specified Transaction (or such default continues for at least three Local Business Days if there is no applicable notice requirement or grace period) or (3) disaffirms, disclaims, repudiates or rejects, in whole or in part, a Specified Transaction (or such action is taken by any person or entity appointed or empowered to operate it or act on its behalf);

Annotation:

The “Default under Specified Transaction” provision creates a cross-default to any “Specified Transaction” between a party (or its Credit Support Provider or Specified Entity) and the other party to the Master Agreement. The term “Specified Transactions” is generally defined in Section 12 of the Master Agreement to include transactions, between such parties, that are derivative-like in nature. However, swap providers may propose expanding the scope of this term in the Schedule to include additional types of transactions, such as transactions for the reinvestment of bond proceeds or obligations for borrowed money. Note that no threshold amount is required to be met to trigger a cross default under a Specified Transaction (unlike the “Threshold Amount” applicable to a Cross Default as more particularly described below). See annotated Schedule Part 1(b).

(vi) **Cross Default.** If “Cross Default” is specified in the Schedule as applying to the party, the occurrence or existence of (1) a default, event of default or other similar condition or event (however described) in respect of such party, any Credit Support Provider of such party or any applicable Specified Entity of such party under one or more agreements or instruments relating to Specified Indebtedness of any of them (individually or collectively) in an aggregate amount of not less than the applicable Threshold Amount (as specified in the Schedule) which has resulted in such Specified Indebtedness becoming, or becoming capable at such time of being declared, due and payable under such agreements or instruments, before it would otherwise have been due and payable or (2) a default by such party, such Credit Support Provider or such Specified Entity (individually or collectively) in making one or more payments on the due date thereof in an aggregate amount of not less than the applicable Threshold Amount under such agreements or instruments (after giving effect to any applicable notice requirement or grace period);

Annotation:

The “Cross Default” provisions apply to one or both of the parties *only* if elected as being applicable in the Schedule to the Master Agreement. The “Cross Default” provisions are often among the most negotiated provisions of the swap documentation between the parties to a Master Agreement.

Variables applicable in determining the scope of the Cross Default provision, if elected, are generally set forth in the Schedule to the Master Agreement. The two primary variables include (a) the “Threshold Amount” of the payment default (or amount subject to acceleration) that must occur in order to trigger a Cross Default and (b) the “Specified Indebtedness” to which the Cross Default applies. The parties to the Master Agreement may choose to conform the “Threshold Amount” applicable to the issuer with that included in comparable provisions of other agreements binding upon the issuer, such as cross default provisions of a master bond ordinance or indenture. Different swap providers have different formulations as to the “Threshold Amount” they prefer to apply to their own Specified Indebtedness; however, one common formulation involves designating the swap provider’s “Threshold Amount” at some percentage (e.g., 3.0%) of its stockholders’ equity (with “stockholders’ equity” in turn being, in such instances, typically defined in the Schedule).

Section 12 of the Master Agreement defines “Specified Indebtedness” generally as including any obligation for borrowed money; however, swap counterparties frequently modify this language in the Schedule to the Master Agreement to include additional types of obligations that might trigger a Cross Default or to exclude certain obligations. See the Annotation to Part 1(b) of the form of Schedule attached to this publication as [Annex B](#).

(vii) **Bankruptcy.** The party, any Credit Support Provider of such party or any applicable Specified Entity of such party:

- (1) is dissolved (other than pursuant to a consolidation, amalgamation or merger);
- (2) becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due; (3) makes a general assignment, arrangement or composition with or for the benefit of its creditors; (4) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors’ rights, or a petition is presented for its winding up or liquidation, and, in the case of any such proceeding or petition instituted or presented against it, such proceeding or petition (A) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding up or liquidation or (B) is not dismissed, discharged, stayed or restrained in each case within 30 days of the institution

or presentation thereof; (5) has a resolution passed for its winding up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger); (6) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets; (7) has a secured party take possession of all or substantially all its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced or sued on or against all or substantially all its assets and such secured party maintains possession, or any such process is not dismissed, discharged, stayed or restrained, in each case within 30 days thereafter; (8) causes or is subject to any event with respect to it which, under the applicable laws of any jurisdiction, has an analogous effect to any of the events specified in clauses (1) to (7) (inclusive); or (9) takes any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the foregoing acts; or

Annotation:

In the context of municipal swap transactions, the “Bankruptcy” Event of Default provisions are often modified in the Schedule to the Master Agreement to take the governmental nature of the applicable party into account. For example, Part 1(h) of the form of Schedule attached as Annex B provides a common reformulation of the above paragraph to include, as an Event of Default with respect to a municipal issuer, instances when “(I) there shall be appointed or designated with respect to it, an entity such as an organisation, board, commission, authority, agency or body to monitor, review, oversee, recommend or declare a financial emergency or similar state of financial distress with respect to it or (II) there shall be declared or introduced or proposed for consideration by it or by any legislative or regulatory body with competent jurisdiction over it, the existence of a state of financial emergency or similar state of financial distress in respect of it.”

Issuers often desire uniformity among the bankruptcy-related defaults contained in their various ordinances, indentures and other contracts pertaining to indebtedness and related obligations. On the other hand, swap providers often prefer the ability to exercise remedies, upon a bankruptcy type event, on a basis prior to that of other potential creditors of the issuer, chiefly with the goal that the swap provider may obtain preferential early access to the issuer’s sources and collateral for satisfying the issuer’s obligations to the swap provider. However, the import of this issue may be mitigated, from the perspective of many swap participants, in light of certain special protections afforded interest rate swap contracts under the U.S. Bankruptcy Code discussed briefly in the Annotation to Part 1(h) of this Master Agreement below.

(viii) ***Merger Without Assumption.*** The party or any Credit Support Provider of such party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer:

- (1) the resulting, surviving or transferee entity fails to assume all the obligations of such party or such Credit Support Provider under this Agreement or any Credit Support Document to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other party to this Agreement; or
- (2) the benefits of any Credit Support Document fail to extend (without the consent of the other party) to the performance by such resulting, surviving or transferee entity of its obligations under this Agreement.

Annotation:

The “Merger Without Assumption” language above triggers an Event of Default if a party (or its Credit Support Provider) merges or comparably reorganizes and the surviving entity does not assume the party’s obligations under the Agreement. Swap providers may be more likely to merge than issuers, but there may be unique considerations in the event of the merger of an issuer that is a governmental entity. A merger or similar transaction may occur at the level of an issuer’s Credit Support Provider, or if the swap provider has a Credit Support Provider, its Credit Support Provider. See Part 1(h)(ii) of the form of Schedule to Master Agreement attached as Annex B.

(b) **Termination Events.** The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any event specified below constitutes an Illegality if the event is specified in (i) below, and, if specified to be applicable, a Credit Event Upon Merger if the event is specified pursuant to (ii) below or an Additional Termination Event if the event is specified pursuant to (iii) below:

Annotation:

The 1992 ISDA[®] Master Agreement specifies two types of “Termination Events”: “Illegality” and “Credit Event Upon Merger”. In addition, the Master Agreement includes a mechanism by which any “Additional Termination Events” may be custom-tailored for inclusion in the Schedule. As discussed above, “Termination Events” are comparable to Events of Default in that they can result in the termination of transactions governed by the Master Agreement. However, Termination Events are treated, in certain respects, differently from Events of Default given the relatively “no fault” nature of the former, such as the fact that under Part 6(b)(iii) a party may terminate transactions under the Master Agreement following a Termination Event (including an Additional Termination Event) only if the applicable circumstances continue to be in effect.

(i) **Illegality.** Due to the adoption of, or any change in, any applicable law after the date on which a Transaction is entered into, or due to the promulgation of, or any change in, the interpretation by any court, tribunal or regulatory authority with competent jurisdiction of any applicable law after such date, it becomes unlawful (other than as a result of a breach by the party of Section 4(b)) for such party (which will be the Affected Party):

- (1) to perform any absolute or contingent obligation to make a payment or delivery or to receive a payment or delivery in respect of such Transaction or to comply with any other material provision of this Agreement relating to such Transaction; or
- (2) to perform, or for any Credit Support Provider of such party to perform, any contingent or other obligation which the party (or such Credit Support Provider) has under any Credit Support Document relating to such Transaction;

Annotation:

An “Illegality” is generally a change in law that results in all or a portion of a party’s obligations under a transaction becoming unlawful. In light of their governmental nature, municipalities may be more susceptible to a change in law authorizing municipal swaps than swap providers or other corporate entities. A more detailed discussion of the “legal authority” issue is included in paragraph III(A) of this publication above.

(ii) ***Credit Event Upon Merger.*** If “Credit Event Upon Merger” is specified in the Schedule as applying to the party, such party (“X”), any Credit Support Provider of X or any applicable Specified Entity of X consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and such action does not constitute an event described in Section 5(a)(viii) but the creditworthiness of the resulting, surviving or transferee entity is materially weaker than that of X, such Credit Support Provider or such Specified Entity, as the case may be, immediately prior to such action (and, in such event, X or its successor or transferee, as appropriate, will be the Affected Party); or

Annotation:

As is the case with the provisions for “Cross Default” described above, the “Credit Event Upon Merger” provisions apply to a party (or its Credit Support Provider or Specified Entity) only to the extent that the parties so elect in the Schedule to the Master Agreement. A “Credit Event Upon Merger” generally occurs upon the merger or comparable reorganization of a party (or Credit Support Provider or Specified Entity) if the surviving entity has “materially weaker” creditworthiness. There may be unique considerations in the applicable of this type of provision to an issuer, particularly a governmental entity. For example, if two governmental entities merge, the parties may consider whether the sources of revenue for the issuer’s payment obligations are to be the same or substantially equivalent. The parties may likewise consider under what circumstances the revenue stream may be sufficient for the counterparty. In some instances, the swap counterparties may determine not to specify “Credit Event Upon Merger” as applying in light of any ratings-based or comparable Additional Termination Events included in the Schedule to the Master Agreement. See Part 1(g) of the form of Schedule to the Master Agreement attached as Annex B.

(iii) ***Additional Termination Event.*** If any “Additional Termination Event” is specified in the Schedule or any Confirmation as applying, the occurrence of such event (and, in such event, the Affected Party or Affected Parties shall be as specified for such Additional Termination Event in the Schedule or such Confirmation).

Annotation:

Whereas the ISDA[®] Master Agreement only includes two relatively “no fault” types of Termination Events (Illegality and Credit Event Upon Merger), as described above Section 5(b)(iii) of the Master Agreement enables swap counterparties to include additional events that will constitute “Additional Termination Events” which are, when applicable, typically included within the Schedule to the ISDA[®] Master Agreement (although they may likewise be included in a Confirmation applicable to a specific transaction). Such Additional Termination Events may include ability for one party to require the termination of a swap in the event of a downgrade of the credit rating of the other party (or its Credit Support Provider or Specified Entity) below a negotiated threshold. Another common Additional Termination Event is a requirement that a swap transaction be terminated in part, upon the payment of any related hedged indebtedness so that at no time is the swap transaction based upon a notional principal amount in excess of the obligations being hedged.

In addition, municipal issuers at times negotiate an Additional Termination Event consisting of a right to terminate one or more transactions under the Master Agreement, at any time or from time to time, either at “par” or subject to the payments of a termination amount as described in paragraph II(B)(2)(c)(iv) of this publication above. To the extent that one or both parties’ obligations under a swap transaction may be credit enhanced by swap insurance or similar credit enhancement, the insurer or other credit enhancer will frequently request its own provisions setting forth circumstances under which a swap may or may not be terminated without such credit enhancer’s consent, and in some cases circumstances under which the transaction must be terminated at such credit enhancer’s direction. See paragraph II(B)(2)(d)(v) of this publication above.

In the case of a swap that is entered into *prior* to the issuance of the bonds or other obligations being hedged (a so-called “forward starting swap”), the Schedule may include an Additional Termination Event providing one or both of the parties the right to terminate the swap in the event that such obligations are not issued within a specified timeframe.

(c) ***Event of Default and Illegality.*** If an event or circumstance which would otherwise constitute or give rise to an Event of Default also constitutes an Illegality, it will be treated as an Illegality and will not constitute an Event of Default.

6. Early Termination

Annotation:

Section 6 of the Master Agreement sets forth the provisions governing the early termination of a transaction following the occurrence of an Event of Default or Termination Event under Section 5 above. Importantly, such consequences vary depending upon whether the event results from an Event of Default versus a Termination Event as set forth below.

(a) ***Right to Terminate Following Event of Default.*** If at any time an Event of Default with respect to a party (the “Defaulting Party”) has occurred and is then continuing, the other party (the “Non-defaulting Party”) may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions. If, however, “Automatic Early Termination” is specified in the Schedule as applying to a party, then (subject to applicable bankruptcy and insolvency laws) an Early Termination Date in respect of all outstanding Transactions will occur immediately upon the occurrence with respect to such party of an Event of Default specified in Section 5(a)(vii)(1), (3), (5), (6) or, to the extent analogous thereto, (8), and as of the time immediately preceding the institution of the

relevant proceeding or the presentation of the relevant petition upon the occurrence with respect to such party of an Event of Default specified in Section 5(a)(vii)(4) or, to the extent analogous thereto, (8).

Annotation:

The parties' rights upon an Event of Default are set forth in the Section 6(a) above, as opposed to the rights following a Termination Event which are covered in Section 6(b) below. In general, if an Event of Default occurs with respect to a party, then the non-defaulting party has the right to cause the transactions governed by the Master Agreement to be terminated. In addition, upon an Event of Default, the non-defaulting party may choose to immediately designate an Early Termination Date for *all* Transactions governed by the Master Agreement. See Part 1(e) of the annotated form of ISDA[®] Schedule attached as Annex B.

If "Automatic Early Termination" is elected with respect to the defaulting party in the Schedule, then certain bankruptcy-type events may result in the *automatic* termination of the transactions. In negotiating "Automatic Early Termination", the parties are likely to take into account the relative likelihood with which either party may be perceived to be susceptible to such an event. On the other hand, the importance attributed to the "Automatic Early Termination" provisions of the Master Agreement are generally perceived to be mitigated in light of certain statutory protection afforded to swap counterparties under amendments effected to the U.S. Bankruptcy Code in 1990 and 2005. Absent these additional protections, a filing for bankruptcy would ordinarily trigger an automatic stay on enforcement of the debtor's contracts. A lender or other party to the contract is prevented from exercising its remedies such as terminating the contract or liquidating collateral, unless the bankruptcy court agrees to lift the stay. The debtor instead has the option to "assume" or "reject" its contracts. Congress provided several "safe harbors" for certain types of financial contracts including swaps, through exemptions from the automatic stay provision. If a swap provider files for bankruptcy, the issuer or other party may proceed to exercise its termination remedies, including using held collateral to set off against obligations owed to it. The involvement of counsel experienced in bankruptcy matters may be useful in reviewing these provisions of the Master Agreement and, if applicable, the Schedule thereto.

(b) ***Right to Terminate Following Termination Event.***

(i) ***Notice.*** If a Termination Event occurs, an Affected Party will, promptly upon becoming aware of it, notify the other party, specifying the nature of that Termination Event and each Affected Transaction and will also give such other information about that Termination Event as the other party may reasonably require.

(ii) ***Two Affected Parties.*** If an Illegality under Section 5(b)(i)(1) occurs and there are two Affected Parties, each party will use all reasonable efforts to reach agreement within 30 days after notice thereof is given under Section 6(b)(i) on action to avoid that Termination Event.

(iii) ***Right to Terminate.*** If:

(1) an agreement under Section 6(b)(ii) has not been effected with respect to all Affected Transactions within 30 days after an Affected Party gives notice under Section 6(b)(i); or

(2) an Illegality other than that referred to in Section 6(b)(ii), a Credit Event Upon Merger or an Additional Termination Event occurs,

either party in the case of an Illegality, any Affected Party in the case of an Additional Termination Event if there is more than one Affected Party, or the party which is not the Affected Party in the case of a Credit Event Upon Merger or an Additional Termination Event if there is only one Affected Party may, by not more than 20 days notice to the

other party and provided that the relevant Termination Event is then continuing, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all Affected Transactions.

Annotation:

The parties' rights upon an Event of Default are set forth in Section 6(b) above. The consequences first depend upon whether it relates to an "Illegality" described above. If an Illegality occurs with respect to *both* parties, then the parties must use reasonable efforts to reach agreement (within 30 days of notice thereof) on action to avoid the Termination Event. If the parties can not reach such an agreement, or any other type of Termination Event occurs then, except as modified by the Schedule or a Confirmation, the following termination rights arise:

- Either party may terminate the transactions based on an Illegality
- An "Affected Party" may terminate based on an Additional Termination Event where both parties are "Affected Parties" (with "Affected Party" being generally defined in connection with the definition of the applicable Termination Event)
- The non-"Affected Party" may terminate based on an Additional Termination Event where the other party is the only "Affected Party"

In any of these enumerated instances, however, a termination may be declared *only* if the relevant termination event is then continuing.

A special rule applies for Termination Event with two "Affected Parties", under which both parties make their independent calculations of Market Quotation or Loss, whichever applies, and then the ultimate payment amounts are determined as described in Section 6(e)(ii)(2) of the Master Agreement.

(c) ***Effect of Designation.***

(i) If notice designating an Early Termination Date is given under Section 6(a) or (b), the Early Termination Date will occur on the date so designated, whether or not the relevant Event of Default or Termination Event is then continuing.

Annotation:

Once a notice designating a termination of a transaction following an Event of Default or a Termination Event, the termination may occur regardless of whether (or not) the event precipitating the termination is continuing.

(ii) Upon the occurrence or effective designation of an Early Termination Date, no further payments or deliveries under Section 2(a)(i) or 2(d) in respect of the Terminated Transactions will be required to be made, but without prejudice to the other provisions of this Agreement. The amount, if any, payable in respect of an Early Termination Date shall be determined pursuant to Section 6(e).

(d) **Calculations.**

(i) **Statement.** On or as soon as reasonably practicable following the occurrence of an Early Termination Date, each party will make the calculations on its part, if any, contemplated by Section 6(e) and will provide to the other party a statement (1) showing, in reasonable detail, such calculations (including all relevant quotations and specifying any amount payable under Section 6(e)) and (2) giving details of the relevant account to which any amount payable to it is to be paid. In the absence of written confirmation from the source of a quotation obtained in determining a Market Quotation, the records of the party obtaining such quotation will be conclusive evidence of the existence and accuracy of such quotation.

Annotation:

In most municipal swap transactions, the swap provider will be designated as the Calculation Agent in the ISDA[®] Schedule, although in some circumstances the Schedule will provide the issuer the right, subject to any applicable conditions, to designate an entity to act as the Calculation Agent upon, e.g., an Event of Default occurring with respect to the swap provider. Given that the municipal issuer will ordinarily not be the Calculation Agent, it may be required for policy or other audit purposes to request or require some reasonable detail regarding the calculation. Municipal issuers should assess the extent to which the level of documentation described in Section 6(d)(i) will satisfy any requirements of state law and all issuers should verify that it satisfies any applicable recordkeeping requirements. Depending on the complexity of the swap, disputes may arise with respect to calculations, and some swap counterparties choose to include detailed dispute resolution mechanisms into the ISDA[®] Schedule.

(ii) **Payment Date.** An amount calculated as being due in respect of any Early Termination Date under Section 6(e) will be payable on the day that notice of the amount payable is effective (in the case of an Early Termination Date which is designated or occurs as a result of an Event of Default) and on the day which is two Local Business Days after the day on which notice of the amount payable is effective (in the case of an Early Termination Date which is designated as a result of a Termination Event). Such amount will be paid together with (to the extent permitted under applicable law) interest thereon (before as well as after judgment), from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid; at the Applicable Rate. Such interest will be calculated on the basis of daily compounding and the actual number of days elapsed.

Annotation:

Unless otherwise modified in the ISDA[®] Schedule or elsewhere, the Master Agreement requires two Local Business Days' notice prior to payment resulting from a Termination Event. An Early Termination Date resulting from an Event of Default may require payment on the same day that the notice is effective. Given the relatively short time permitted to raise a Settlement Amount and the fact that many issuers in the context of municipal finance transactions have stronger access to revenues than cash and often cannot raise cash quickly, the time afforded to them to pay a Settlement Amount following early termination is sometimes extended in the Schedule.

(e) **Payments on Early Termination.** If an Early Termination Date occurs, the following provisions shall apply based on the parties' election in the Schedule of a payment measure, either "Market Quotation" or "Loss", and a payment method, either the "First Method" or the "Second Method". If the parties fail to designate a payment measure or payment method in the Schedule, it will be deemed that

“Market Quotation” or the “Second Method”, as the case may be, shall apply. The amount, if any, payable in respect of an Early Termination Date and determined pursuant to this Section will be subject to any Set-off.

Annotation:

Section 6(e) of the Master Agreement sets forth the means of determining the amount of any settlement payments upon the termination of transactions governed by the Master Agreement. Terminations based upon an Event of Default are covered by Section 6(e)(i) whereas those based upon a Termination Event are covered by Section 6(e)(ii). In the case of a termination following an Event of Default, the applicable measure will depend upon whether the parties elect “First Method” versus “Second Method” in the Schedule as well as whether the parties elect “Market Quotation” or “Loss” in the Schedule. In the case of a termination following a Termination Event only the election of “Market Quotation” versus “Loss” is applicable:

- “Market Quotation”/“Loss” – These terms are defined in detail in Section 12 and are often modified in various respects in the Schedule. In general, however, “Market Quotation” involves a market-quotation based methodology, whereas “Loss” involves an internal assessment of a party’s losses and expenses incurred in connection with the termination of transactions.
- “First Method”/“Second Method” – Under First Method, only a defaulting party is required to pay a termination amount to the other party upon an Event of Default. Under Second Method, either a defaulting party *or* a non-defaulting party may be required to pay a termination amount. Market participants commonly refer to “First Method” and “Second Method” termination as “One-Way” and “Two-Way” termination, respectively.

Under the above language, if the parties fail to designate a payment measure or payment method in the Schedule, “Market Quotation” and “Second Method” are deemed to apply.

These elections are considered by many swap participants to be among the most important parts of the ISDA® Schedule. The elections most commonly made in the documents pertaining to municipal swap transactions are “Second Method” and “Market Quotation”. Certain large issuers such as large governmental units that provide essential services and are unlikely to default under any transaction under the Master Agreement, may prefer First Method to apply. Moreover, some states may have laws or policies that restrict the ability of a state or local entity to make a termination payment to a defaulting party. Note that the Market Quotation valuation method averages (or ignores the best and worse) quotation and otherwise may reward a non-defaulting party an amount that exceeds actual provable damages resulting from a default under the Master Agreement. For that reason, depending on state law, counsel to a party may qualify their opinion as to the enforceability of the party’s obligation to make a termination payment. See Part 1(g) of the form of ISDA® Schedule attached as [Annex B](#).

Municipal issuers, in particular, should carefully review any state laws bearing on the method by which termination amounts may be calculated under swaps or other derivative transactions. Some state laws and/or regulations deal specifically with this matter and may dictate what type of termination “elections” are made in the Schedule to the Master Agreement. Moreover, statutes or court decisions concerning liquidated damages (as well as the courts’ general equitable powers) may affect whether a court, in any given state, may employ the provisions of Section 6 of the Master Agreement in computing the amounts properly payable by the parties on terminating any Transaction.

(i) **Events of Default.** If the Early Termination Date results from an Event of Default:

(1) **First Method and Market Quotation.** If the First Method and Market Quotation apply, the Defaulting Party will pay to the Non-defaulting Party the excess, if a positive number, of (A) the sum of the Settlement Amount (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Unpaid Amounts

owing to the Non-defaulting Party over (B) the Unpaid Amounts owing to the Defaulting Party.

(2) **First Method and Loss.** If the First Method and Loss apply, the Defaulting Party will pay to the Non-defaulting Party, if a positive number, the Non-defaulting Party's Loss in respect of this Agreement.

(3) **Second Method and Market Quotation.** If the Second Method and Market Quotation apply, an amount will be payable equal to (A) the sum of the Settlement Amount (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Unpaid Amounts owing to the Non-defaulting Party less (B) the Unpaid Amounts owing to the Defaulting Party. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.

(4) **Second Method and Loss.** If the Second Method and Loss apply, an amount will be payable equal to the Non-defaulting Party's Loss in respect of this Agreement. If that amount is a positive number, the Defaulting Party will pay it to the Non-defaulting Party; if it is a negative number, the Non-defaulting Party will pay the absolute value of that amount to the Defaulting Party.

(ii) **Termination Events.** If the Early Termination Date results from a Termination Event:

(1) **One Affected Party.** If there is one Affected Party, the amount payable will be determined in accordance with Section 6(e)(i)(3), if Market Quotation applies, or Section 6(e)(i)(4), if Loss applies, except that, in either case, references to the Defaulting Party and to the Non-defaulting Party will be deemed to be references to the Affected Party and the party which is not the Affected Party, respectively, and, if Loss applies and fewer than all the Transactions are being terminated, Loss shall be calculated in respect of all Terminated Transactions.

(2) **Two Affected Parties.** If there are two Affected Parties:

(A) if Market Quotation applies, each party will determine a Settlement Amount in respect of the Terminated Transactions, and an amount will be payable equal to (1) the sum of (a) one half of the difference between the Settlement Amount of the party with the higher Settlement Amount ("X") and the Settlement Amount of the party with the lower Settlement Amount ("Y") and (b) the Unpaid Amounts owing to X less (II) the Unpaid Amounts owing to Y; and

(B) if Loss applies, each party will determine its Loss in respect of this Agreement (or, if fewer than all the Transactions are being terminated, in respect of all Terminated Transactions) and an amount will be payable equal to one half of the difference between the Loss of the party with the higher Loss ("X") and the Loss of the party with the lower Loss ("Y").

If the amount payable is a positive number, Y will pay it to X; if it is a negative number, X will pay the absolute value of that amount to Y.

Annotation:

The means for determining the amount to be paid by a party following a Termination Event are, as a general matter, the same as those that would be applicable with respect to Events of Default under Section 6(e)(i) above had the parties elected “Second Method”. A special rule applies for Termination Events with two “Affected Parties”, under which both parties make their independent calculations of Market Quotation or Loss, whichever applies, and then the ultimate payment amounts are determined as described in Section 6(e)(ii)(2) of the Master Agreement.

(iii) **Adjustment for Bankruptcy.** In circumstances where an Early Termination Date occurs because “Automatic Early Termination” applies in respect of a party, the amount determined under this Section 6(e) will be subject to such adjustments as are appropriate and permitted by law to reflect any payments or deliveries made by one party to the other under this Agreement (and retained by such other party) during the period from the relevant Early Termination Date to the date for payment determined under Section 6(d)(ii).

(iv) **Pre-Estimate.** The parties agree that if Market Quotation applies an amount recoverable under this Section 6(e) is a reasonable Pre-Estimate of loss and not a penalty. Such amount is payable for the loss of bargain and the loss of protection against future risks and except as otherwise provided in this Agreement neither party will be entitled to recover any additional damages as a consequence of such losses.

Annotation:

Swap counterparties sometimes include additional findings in the Schedule to the Master Agreement to enable the settlement mechanisms of Section 6(e) of the Master Agreement as a means of helping comport with state law requirements concerning the validity of “liquidated damages” provisions. Such findings may be included in the Schedule to the Master Agreement as an amendment of Section 6(e) above.

7. Transfer

Neither this Agreement nor any interest or obligation in or under this Agreement may be transferred (whether by way of security or otherwise) by either party without the prior written consent of the other party, except that:

- (a) a party may make such a transfer of this Agreement pursuant to a consolidation amalgamation with, or merger with or into, or transfer of all or substantially all its assets to, another entity (but without prejudice to any other right or remedy under this Agreement); and
- (b) a party may make such a transfer of all or any part of its interest in any amount payable to it from a Defaulting Party under Section 6(e).

Any purported transfer that is not in compliance with this Section will be void.

Annotation:

Although Section 7 of the Master Agreement includes a general restriction on transfer, governmental entities should be particularly mindful of the implications of Section 7(b), which would enable a swap provider to effect certain transfers upon a merger or comparable reorganization. State laws (or the issuer's own ordinances or debt documents) may impose certain requirements regarding the issuer's swap counterparties (such as ratings requirements) and/or limit the extent to which the issuer may be exposed to any one swap provider.

In addition, in some instances, parties to a Master Agreement may request that language be included in the Schedule to the Master Agreement (or, if the issue pertains only to a single transaction, in the related Confirmation), allowing one or both parties to transfer or assign its position in a transaction to another swap provider under certain circumstances in lieu of terminating the swap. That is, to permit a party to liquidate its position without reaching agreement as to a settlement price with the counterparty or being subject to the risks of Market Quotation, parties sometimes negotiate a right to transfer its position to a third party that satisfies the other party's credit and any other enumerated criteria.

8. Miscellaneous

- (a) **Entire Agreement.** This Agreement constitutes the entire agreement and understanding of the parties with respect to its subject matter and supersedes all oral communication and prior writings with respect thereto.
- (b) **Amendments.** No amendment, modification or waiver in respect of this Agreement will be effective unless in writing (including a writing evidenced by a facsimile transmission) and executed by each of the parties or confirmed by an exchange of telexes or electronic messages on an electronic messaging system.

Annotation:

Parties to swap and other derivative agreements should be mindful of the extent to which a court in any given jurisdiction might, in the exercise of its equitable powers, deem a non-written departure from the terms of the Master Agreement or any related document to be binding upon the parties under equitable theories such as estoppel or "course of conduct."

- (c) **Survival of Obligations.** Without prejudice to Sections 2(a)(iii) and 6(c)(ii), the obligations of the parties under this Agreement will survive the termination of any Transaction.

Annotation:

The Master Agreement does not set forth a termination date, and a termination date (as to the Master Agreement and Schedule, as opposed to that to apply to any particular transaction) is generally not set forth in the Schedule to the Master Agreement. Parties should be mindful of this fact to avoid any confusion that might otherwise arise upon the negotiation and execution of multiple Master Agreements and accompanying Schedules over a period of time. For example, a Schedule to a later Master Agreement might make clear that such later documents either supersede and replace the prior documents or, alternatively, that such later documents govern only certain types of derivatives Transactions between the parties. See the annotation underneath the date on page 1 of this form Master Agreement above.

(d) **Remedies Cumulative.** Except as provided in this Agreement, the rights, powers, remedies and privileges provided in this Agreement are cumulative and not exclusive of any rights, powers, remedies and privileges provided by law.

(e) **Counterparts and Confirmations.**

(i) This Agreement (and each amendment, modification and waiver in respect of it) may be executed and delivered in counterparts (including by facsimile transmission), each of which will be deemed an original.

(ii) The parties intend that they are legally bound by the terms of each Transaction from the moment they agree to those terms (whether orally or otherwise). A Confirmation shall be entered into as soon as practicable and may be executed and delivered in counterparts (including by facsimile transmission) or be created by an exchange of telexes or by an exchange of electronic messages on an electronic messaging system, which in each case will be sufficient for all purposes to evidence a binding supplement to this Agreement. The parties will specify therein or through another effective means that any such counterpart, telex or electronic message constitutes a Confirmation.

Annotation:

Depending on the applicable jurisdiction, state laws concerning statutes of frauds as well as manual signature requirements may implicate the above provisions of Section 8(e) of the Master Agreement.

(f) **No Waiver of Rights.** A failure or delay in exercising any right, power or privilege in respect of this Agreement will not be presumed to operate as a waiver, and a single or partial exercise of any right, power or privilege will not be presumed to preclude any subsequent or further exercise, of that right, power or privilege or the exercise of any other right, power or privilege.

Annotation:

As mentioned above with respect to amendments under Section 8(b) of the Master Agreement, a court in any particular jurisdiction might have precedent to deem a non-written departure from the terms of the Master Agreement or any related document to be binding upon the parties under equitable theories such as estoppel or “course of conduct”.

(g) **Headings.** The headings used in this Agreement are for convenience of reference only and are not to affect the construction of or to be taken into consideration in interpreting this Agreement.

9. Expenses

A Defaulting Party will, on demand, indemnify and hold harmless the other party for and against all reasonable out of pocket expenses, including legal fees, incurred by such other party by reason of the enforcement and protection of its rights under this Agreement or any Credit Support Document to which the Defaulting Party is a party or by reason of the early termination of any Transaction, including, but not limited to, costs of collection.

Annotation:

Laws applicable in any particular jurisdiction may have implications on the validity of aspects of Section 9 of the Master Agreement above as well as any related indemnification language in the Schedule to the Master Agreement and accompanying documents, particularly with respect to any limitations that may be applicable upon the ability of governmental entities to indemnify others.

10. Notices

(a) **Effectiveness.** Any notice or other communication in respect of this Agreement may be given in any manner set forth below (except that a notice or other communication under Section 5 or 6 may not be given by facsimile transmission or electronic messaging system) to the address or number or in accordance with the electronic messaging system details provided (see the Schedule) and will be deemed effective as indicated:

- (i) if in writing and delivered in person or by courier, on the date it is delivered;
- (ii) if sent by telex, on the date the recipient’s answerback is received;
- (iii) if sent by facsimile transmission, on the date that transmission is received by a responsible employee of the recipient in legible form (it being agreed that the burden of proving receipt will be on the sender and will not be met by a transmission report generated by the sender’s facsimile machine);
- (iv) if sent by certified or registered mail (airmail, if overseas) or the equivalent (return receipt requested), on the date that mail is delivered or its delivery is attempted; or

- (v) if sent by electronic messaging system, on the date that electronic message is received,

unless the date of that delivery (or attempted delivery) or that receipt, as applicable, is not a Local Business Day or that communication is delivered (or attempted) or received, as applicable, after the close of business on a Local Business Day, in which case that communication shall be deemed given and effective on the first following day that is a Local Business Day.

Annotation:

It is possible that, particularly insofar as notices concerning matters of litigation are concerned, various state procedural laws may override the full effectiveness of the notice procedures of Section 10(a) above.

- (b) **Change of Addresses.** Either party may by notice to the other change the address, telex or facsimile number or electronic messaging system details at which notices or other communications are to be given to it.

11. Governing Law and Jurisdiction

- (a) **Governing Law.** This Agreement will be governed by and construed in accordance with the law specified in the Schedule.

Annotation:

A substantial share of municipal swap transactions entered into under the ISDA[®] Master Agreement purport to be governed by New York law as elected in the ISDA[®] Schedule. However, laws concerning the ability of a governmental entity to elect that a contract be governed by laws of another state vary from state to state and may have implications in connection with this Section 11(a) and any related language in the Schedule. Such state law restrictions may be included as a part of legislation dealing specifically with swaps or other derivative transactions and/or may be included as a part of more general “choice of laws” statutes.

- (b) **Jurisdiction.** With respect to any suit, action or proceedings relating to this Agreement (“Proceedings”), each party irrevocably:

(i) submits to the jurisdiction of the English courts, if this Agreement is expressed to be governed by English law, or to the non exclusive jurisdiction of the courts of the State of New York and the United States District Court located in the Borough of Manhattan in New York Government, if this Agreement is expressed to be governed by the laws of the State of New York; and

(ii) waives any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, waives any claim that such Proceedings have been brought in an inconvenient forum and further waives the right to object, with respect to such Proceedings, that such court does not have any jurisdiction over such party.

Nothing in this Agreement precludes either party from bringing Proceedings in any other jurisdiction (outside, if this Agreement is expressed to be governed by English law, the Contracting States, as defined in Section 1(3) of the Civil Jurisdiction and Judgments Act 1982 or any modification, extension or re

enactment thereof for the time being in force) nor will the bringing of Proceedings in any one or more jurisdictions preclude the bringing of Proceedings in any other jurisdiction.

Annotation:

Section 11(b) of the Master Agreement provides that if English law is named as the governing law for the agreement, then the parties are deemed to consent to the jurisdiction of English courts. If the agreement provides that New York law governs, then the parties are deemed to consent to the non-exclusive jurisdiction of courts of the State of New York and to the United States District Court located in the Borough of Manhattan. However, the laws concerning the ability of governmental entities (and others) to consent to the courts of other jurisdictions vary from state to state and may have implications in connection with this Section 11(b) and any related language in the Schedule. Such state law restrictions may be included as a part of legislation dealing specifically with swaps or other derivative transactions and/or may be included as a part of a more general “choice of forum” statute. For these reasons, the parties to a municipal swap transaction frequently modify the effect of this Section 11(b) in the Schedule to the Master Agreement by either “being silent” on the issue of forum or, in some instances, requiring that the consent to jurisdiction be to that of the governmental entity’s home state. See Part 4(d) of the form of ISDA® Schedule attached as Annex B.

(c) **Waiver of Immunities.** Each party irrevocably waives, to the fullest extent permitted by applicable law, with respect to itself and its revenues and assets (irrespective of their use or intended use), all immunity on the grounds of sovereignty or other similar grounds from (i) suit, (ii) jurisdiction of any court, (iii) relief by way of injunction, order for specific performance or for recovery of property, (iv) attachment of its assets (whether before or after judgment) and (v) execution or enforcement of any judgment to which it or its revenues or assets might otherwise be entitled in any Proceedings in the courts of any jurisdiction and irrevocably agrees, to the extent permitted by applicable law, that it will not claim any such immunity in any Proceedings.

Annotation:

Various states have differing laws as to the extent to which governmental entities (and among them, governmental entities of different types) may have rights of sovereign immunity with respect to themselves or their assets. Such state laws, where applicable, may have implications on a given transaction for a particular governmental entity with respect to Section 11(c) of the Master Agreement above, as well as any comparable language in the ISDA® Schedule or other swap documents. Although the above language is qualified “to the fullest extent permitted by applicable law”, ISDA® Schedules and other documents (as well as legal opinion forms) commonly include more stringent representations, waivers and other provisions concerning matters of sovereign immunity. For example, under such language the governmental entity may be requested to represent that it has no right to raise a defense of sovereign immunity. Many governmental entities are sensitive to this issue and such representations and much attention is often given to these types of provisions in swap documents. The laws in any particular state may indeed limit the ability of a governmental entity to waive immunity or may require statutory authority for the waiver. And under statutes or common law, a governmental entity may in any event be limited in the ability to waive the defense of sovereign immunity in cases brought under theories of tort as opposed to in contract (*ex contractu*).

12. Definitions

As used in this Agreement:

“Additional Termination Event” has the meaning specified in Section 5(b).

“Affected Party” has the meaning specified in Section 5(b).

“Affected Transactions” means (a) with respect to any Termination Event consisting of an Illegality, all Transactions affected by the occurrence of such Termination Event and (b) with respect to any other Termination Event, all Transactions.

“Affiliate” means, subject to the Schedule, in relation to any person, any entity controlled, directly or indirectly, by the person, any entity that controls, directly or indirectly, the person or any entity directly or indirectly under common control with the person. For this purpose, “control” of any entity or person means ownership of a majority of the voting power of the entity or person.

Annotation:

The parties to a municipal swap transaction may deem it appropriate to modify this definition, in the Schedule to the Master Agreement, to exclude agencies, public corporations, or other entities related to the issuer who is the party to the swap, with the effect of excluding such entities from being taken into account for purposes of the “Absence of Litigation” representation in Section 3(c) of the Master Agreement or any other provisions applicable to “Affiliates”. The standard definition of Affiliate can have important implications with respect to issuers that may desire to confine “Affiliate” status to a single or limited number of entities. For example, in the context of a municipal utility or similar revenue producing system the parties may modify the term “Affiliate” (in the ISDA[®] Schedule) to avoid the inclusion of entities outside the scope of such system. It may likewise be appropriate for the parties to limit the scope of “Affiliates” in the case of a governmental entity that issues debt based on the credit of conduit borrowers or with limited recourse to revenues from less creditworthy enterprises. Private borrowers benefiting from conduit loans from the proceeds of tax-exempt bonds may have multiple subsidiaries and other affiliates that should be considered in any custom tailoring of the term “Affiliates” in the ISDA[®] Schedule (e.g., particularly when an overall conduit financing structure is intended to be “self contained” within a special purpose entity or the like).

“Applicable Rate” means:

- (a) in respect of obligations payable or deliverable (or which would have been but for Section 2(a)(iii)) by a Defaulting Party, the Default Rate;
- (b) in respect of an obligation to pay an amount under Section 6(e) of either party from and after the date (determined in accordance with Section 6(d)(ii)) on which that amount is payable, the Default Rate;
- (c) in respect of all other obligations payable or deliverable (or which would have been but for Section 2(a)(iii)) by a Non-defaulting Party, the Non default Rate; and
- (d) in all other cases, the Termination Rate.

Annotation:

The term “Applicable Rate” is used in the Master Agreement for purposes of computing interest that may accrue on certain amounts owing following a termination of a Transaction under Section 6(d)(ii) of the Master Agreement. Practitioners should consider whether these provisions calling for interest at the Applicable Rate may implicate state law limitations on interest rates or liquidated damages, or state or federal laws in the event of bankruptcy or insolvency proceedings.

“**Consent**” includes a consent, approval, action, authorisation, exemption, notice, filing, registration or exchange control consent.

“**Credit Event Upon Merger**” has the meaning specified in Section 5(b).

“**Credit Support Document**” means any agreement or instrument that is specified as such in this Agreement.

“**Credit Support Provider**” has the meaning specified in the Schedule.

“**Default Rate**” means a rate per annum equal to the cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount plus 1 % per annum.

Annotation:

The term “Default Rate” is used in the Master Agreement for purposes of computing interest that may accrue on certain amounts owing in respect of a Transaction but not paid when due. As previously discussed, practitioners should consider whether these provisions calling for interest at a Default Rate may implicate state law limitations on interest rates or liquidated damages, or state or federal laws in the event of bankruptcy or insolvency proceedings.

“**Defaulting Party**” has the meaning specified in Section 6(a).

“**Early Termination Date**” means the date determined in accordance with Section 6(a) or 6(b)(iii).

“**Event of Default**” has the meaning specified in Section 5(a) and, if applicable, in the Schedule.

“**Illegality**” has the meaning specified in Section 5(b).

“**Law**” includes any treaty, law, rule or regulation and “lawful” and “unlawful” will be construed accordingly.

Annotation:

Unless modified, this definition does not include ordinances or other possible sources of limitation on a governmental party’s legal authority.

“Local Business Day” means, subject to the Schedule, a day on which commercial banks are open for business (including dealings in foreign exchange and foreign currency deposits) (a) in relation to any obligation under Section 2(a)(i), in the place(s) specified in the relevant Confirmation or, if not so specified, as otherwise agreed by the parties in writing or determined pursuant to provisions contained, or incorporated by reference, in this Agreement, (b) in relation to any other payment, in the place where the relevant account is located, (c) in relation to any notice or other communication, including notice contemplated under Section 5(a)(i), in the Government specified in the address for notice provided by the recipient and, in the case of a notice contemplated by Section 2(b), in the place where the relevant new account is to be located and (d) in relation to Section 5(a)(v)(2), in the relevant locations for performance with respect to such Specified Transaction.

“Loss” means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party’s legal fees and out of pocket expenses referred to under Section 9. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

Annotation:

The term “Loss” is used in the calculating of amounts owing upon the termination of a Transaction entered into under the Master Agreement, in the event that the parties elect “Loss” (as opposed to “Market Quotation” – see below) in the Schedule to the Master Agreement for such purpose. This measure is generally considered more “subjective” in nature than “Market Quotation” and involves a party determining its losses from the termination of a Transaction. There are important implications as to such term and election as more particularly described in the annotations to Section 6 above.

“Market Quotation” means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party (taking into account any existing Credit Support Document with respect to the obligations of such party) and the quoting Reference Market maker to enter into a transaction (the “Replacement Transaction”) that would have the effect of preserving for such party the economic equivalent of any payment or delivery (whether the underlying obligation was absolute or contingent and assuming the satisfaction of each applicable condition precedent) by the parties under Section 2(a)(i) in respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. For this purpose, Unpaid Amounts in respect of the Terminated Transaction or group of Terminated Transactions are to be excluded but, without limitation, any payment or delivery that would, but for the relevant Early Termination Date, have been required (assuming satisfaction of each applicable condition precedent) after that Early Termination Date is to be

included. The Replacement Transaction would be subject to such documentation as such party and the Reference Market maker may, in good faith, agree. The party making the determination (or its agent) will request each Reference Market maker to provide its quotation to the extent reasonably practicable as of the same day and time (without regard to different time zones) on or as soon as reasonably practicable after the relevant Early Termination Date. The day and time as of which those quotations are to be obtained will be selected in good faith by the party obliged to make a determination under Section 6(e), and, if each party is so obliged, after consultation with the other. If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.

Annotation:

The term “Market Quotation” is used in the calculating of amounts owing upon the termination of a Transaction entered into under the Master Agreement, in the event that the parties elect “Market Quotation” (as opposed to “Loss” – see above) in the Schedule to the Master Agreement for such purpose. This measure is generally considered more “market based” and less subjective than “Loss” and sets forth a quotation-based mechanism for determining amounts owing upon the termination of a Transaction. There are important implications as to such term and election as more particularly described in the annotations to Section 6 above. Parties should keep in mind that, under the final sentence of this definition, if the Market Quotation process “fails”, then under such sentence and clause (b) of the definition of “Settlement Amount” below, the “Loss” methodology will apply.

“Non default Rate” means a rate per annum equal to the cost (without proof or evidence of any actual cost) to the Non-defaulting Party (as certified by it) if it were to fund the relevant amount.

“Non-defaulting Party” has the meaning specified in Section 6(a).

“Potential Event of Default” means any event which, with the giving of notice or the lapse of time or both, would constitute an Event of Default.

“Reference Market makers” means four leading dealers in the relevant market selected by the party determining a Market Quotation in good faith (a) from among dealers of the highest credit standing which satisfy all the criteria that such party applies generally at the time in deciding whether to offer or to make an extension of credit and (b) to the extent practicable, from among such dealers having an office in the same Government.

“Scheduled Payment Date” means a date on which a payment or delivery is to be made under Section 2(a)(i) with respect to a Transaction.

“Set-off” means set off, offset, combination of accounts, right of retention or withholding or similar right or requirement to which the payer of an amount under Section 6 is entitled or subject (whether arising under this Agreement, another contract, applicable law or otherwise) that is exercised by, or imposed on, such payer.

Annotation:

The term “Set-off” appears only once in the Master Agreement, in the provisions of Section 6(e) that provide that the amount, if any, payable in respect of a termination date are “subject to any Set-off”. To the extent that the parties to a swap transaction do, or do not, anticipate that one or both parties will have the right to set-off amounts owing upon termination of any transaction entered into under the Master Agreement against amounts owing under any other contract, these potential set-offs should be specifically considered and, if deemed appropriate, delineated in the Schedule to the Master Agreement. For example, the parties may deem it inappropriate (and state law may not enable them) to allow set-off to apply across revenue and general obligation security structures, across revenue lien levels, and against certain reserves or other funds.

“Settlement Amount” means, with respect to a party and any Early Termination Date, the sum of

- (a) the Market Quotations (whether positive or negative) for each Terminated Transaction or group of Terminated Transactions for which a Market Quotation is determined; and
- (b) such party’s Loss (whether positive or negative and without reference to any Unpaid Amounts) for each Terminated Transaction or group of Terminated Transactions for which a Market Quotation cannot be determined or would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result.

“Specified Entity” has the meaning specified in the Schedule.

Annotation:

As discussed in greater detail in the Master Agreement and annotations above, the term “Specified Entity” is not defined in the Master Agreement itself (other than by cross reference to the Schedule to the Master Agreement) and thus includes those parties, if any, respectively named as such in the Schedule. The primary effect of a party being named as a “Specified Entity” to an issuer in the Schedule is the inclusion of events pertaining to such party among those that would constitute grounds for an Event of Default and/or Termination Event, as to such Specified Entity, under the Master Agreement.

“Specified Indebtedness” means, subject to the Schedule, any obligation (whether present or future, contingent or otherwise, as principal or surety or otherwise) in respect of borrowed money.

Annotation:

The terms “Specified Indebtedness” and “Threshold Amount” each appear only once in the Master Agreement, each in the Cross Default provisions of Section 5(a)(vi). As discussed in the annotation to Section 5(a)(vi) above, such Cross Default provisions only apply in the event that the parties so elect in the Schedule to the Master Agreement. When so elected, the Schedule typically sets out the definitions of such two terms. The “Threshold Amount” is generally the extent of the payment default (or amount subject to acceleration) that must occur in order to trigger a Cross Default, whereas the “Specified Indebtedness” is the term used to describe the obligations to which the Cross Default applies. Section 12 of the Master Agreement defines “Specified Indebtedness” generally to include any obligation for borrowed money; however, swap counterparties often propose modifying this language in the Schedule to the Master Agreement to include additional types of obligations that might trigger a Cross Default.

These provisions are frequently the subject of negotiations in the ISDA Schedule. For example, the term “Specified Indebtedness” is sometimes modified in the Schedule to include all financial obligations of a party to the Master Agreement, as opposed to being limited solely to obligations for borrowed money. On the other hand, because the definition of Specified Indebtedness ties to the cross default provision of the Master Agreement, the parties to a transaction may determine to limit the definition of Specified Indebtedness by excluding obligations for borrowed money based on a credit unrelated to the transaction or a related series of hedged obligations, such as obligations of a municipality’s separate utility system or having different lien priority levels.

As discussed above, it is also common for parties to swap agreements to conform the “Threshold Amount” applicable to an issuer with that provided in the comparable provisions of other agreements binding upon such party, such as any applicable cross default provisions of a master bond ordinance or indenture (or to resist including a cross-default if such a default is not provided for the benefit of bondholders or credit enhancers). From the other perspective, because many issuers are not well-positioned to evaluate the appropriate Threshold Amount to apply to their swap providers, the input of an issuer’s outside advisor can be helpful in this regard.

“Specified Transaction” means, subject to the Schedule, (a) any transaction (including an agreement with respect thereto) now existing or hereafter entered into between one party to this Agreement (or any Credit Support Provider of such party or any applicable Specified Entity of such party) and the other party to this Agreement (or any Credit Support Provider of such other party or any applicable Specified Entity of such other party) which is a rate swap transaction, basis swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, currency swap transaction, cross currency rate swap transaction, currency option or any other similar transaction (including any option with respect to any of these transactions), (b) any combination of these transactions and (c) any other transaction identified as a Specified Transaction in this Agreement or the relevant confirmation.

Annotation:

The term “Specified Transactions” appears only once in the Master Agreement (outside of Section 12), in the “Default under Specified Transaction” provisions of Section 5(a)(v). As discussed in the annotation to such Section 5(a)(v), this provision creates a cross-default in the event a party (or its Credit Support Provider or Specified Entity) defaults under any Specified Transactions entered into between the parties. The term “Specified Transactions” is generally defined in this Section 12 to include transactions between such parties that are derivative like in nature. However, swap counterparties sometimes propose expanding the scope of this term in the Schedule to include additional types of transactions, such as transactions for the reinvestment of bond proceeds. Note that there is no threshold amount that is required to be met to trigger a default under a Specified Transaction (unlike the “Threshold Amount” applicable to a Cross Default as more particularly described herein). See Part 1(b) of the annotated form of ISDA Schedule attached as [Annex B](#).

“Terminated Transactions” means with respect to any Early Termination Date (a) if resulting from a Termination Event, all Affected Transactions and (b) if resulting from an Event of Default, all Transactions (in either case) in effect immediately before the effectiveness of the notice designating that Early Termination Date (or, if “Automatic Early Termination” applies, immediately before that Early Termination Date).

“Termination Event” means an Illegality or, if specified to be applicable, a Credit Event Upon Merger or an Additional Termination Event.

“Termination Rate” means a rate per annum equal to the arithmetic mean of the cost (without proof or evidence of any actual cost) to each party (as certified by such party) if it were to fund or of funding such amounts.

“Unpaid Amount” owing to any party means, with respect to an Early Termination Date, the aggregate of (a) in respect of all Terminated Transactions, the amounts that became payable (or that would have become payable but for Section 2(a)(iii)) to such party under Section 2(a)(i) on or prior to such Early Termination Date and which remain unpaid as at such Early Termination Date and (b) in respect of each Terminated Transaction, for each obligation under Section 2(a)(i) which was (or would have been but for Section 2(a)(iii)) required to be settled by delivery to such party on or prior to such Early Termination Date and which has not been so settled as at such Early Termination Date, an amount equal to the fair market value of that which was (or would have been) required to be delivered as of the originally scheduled date for delivery, in each case together with (to the extent permitted under applicable law) interest, in the currency of such amounts, from (and including) the date such amounts or obligations were or would have been required to have been paid or performed to (but excluding) such Early Termination Date, at the Applicable Rate. Such amounts of interest will be calculated on the basis of daily compounding and the actual number of days elapsed. The fair market value of any obligation referred to in clause (b) above shall be reasonably determined by the party obliged to make the determination under Section 6(e) or, if each party is so obliged, it shall be the average of the fair market values reasonably determined by both parties.

IN WITNESS WHEREOF the parties have executed this document on the respective dates specified below with effect from the date specified on the first page of this document.

[PARTY A]

[PARTY B]

By: _____

By: _____

Name:

Name:

Title:

Title:

Date:

Date:

Annotation:

The parties to any municipal swap or other derivative transaction should ensure that the respective parties named in the final documentation are, in fact, the parties authorized in accordance with state law as well as any resolution, ordinance or similar authorizing document on the part of the issuer. Moreover, state law and such authorizing actions, on the part of the issuer, should be reviewed to confirm that the official (or officials) who finally executes the documents is, indeed, the proper official (or officials) duly authorized to execute such documentation, and that any appurtenant procedural requirements (such as a seal and attestation), to the extent applicable, are properly satisfied.

Annex B

ANNOTATED FORM OF SCHEDULE TO ISDA[®] MASTER AGREEMENT

Attached is an annotated form of U.S. Municipal Counterparty Schedule to the ISDA[®] Master Agreement. The annotations included in separate “text boxes” are provided by the NABL Committee authors to highlight various issues for consideration with regard to the documentation of typical municipal swap transactions and certain particular considerations bearing on state laws. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects surrounding the topic of interest rate swaps, derivatives or their documentation or the issues summarized or annotations set forth herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

The attached form of Schedule to Master Agreement (other than the annotations referred to above) is the property of ISDA[®]. This Annex B and all other International Swaps and Derivatives Association, Inc. (ISDA[®]) form documentation included within this publication (other than such annotations) is provided by special permission under a non-exclusive license from ISDA[®] and is subject to the following copyright notice and any other proprietary legends set forth thereon.

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NO PART OF THE PUBLICATION TO WHICH THIS ANNEX B IS ATTACHED NOR ANY OF THE ANNOTATIONS INCLUDED WITHIN THIS ANNEX B MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN CONSENT OF THE NATIONAL ASSOCIATION OF BOND LAWYERS IN EACH INSTANCE. MOREOVER, NO PART OF THIS ANNEX B (OTHER THAN SUCH ANNOTATIONS) MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN PERMISSION OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC. IN EACH INSTANCE.

Section 5(a)(v) (Default under Specified Transaction), _____
Section 5(a)(vi) (Cross Default), _____
Section 5(a)(vii) (Bankruptcy), _____
Section 5(b)(ii) (Credit Event Upon Merger), _____

Annotation:

As discussed in greater detail in the Master Agreement and annotations above, the term “Specified Entity” is not defined in the Master Agreement itself (other than by cross reference to the Schedule to the Master Agreement) and thus includes those parties, if any, respectively named as such in the Schedule. The primary effect of a party being named as a “Specified Entity” to an issuer in the Schedule is the inclusion of events pertaining to such party among those that would constitute grounds for an Event of Default and/or Termination Event, as to such Specified Entity, under the Master Agreement. The above blanks in this form of Schedule set forth those Events of Default and Termination Events to which the concept of a “Specified Entity” may be applicable and the elections as to such applicability are made here, respectively as to “Party A” and to “Party B” and each such applicable Event of Default and Termination Event. In many situations, an Affiliate is designated as a “Specified Entity” only if its credit is material to the credit of the party for whom it is designated.

(b) **“Specified Transaction”** will have the meaning specified in Section 12 of this Agreement unless another meaning is specified here _____

Annotation:

The term “Specified Transaction” appears only once in the Master Agreement (outside of Section 12), in the “Default under Specified Transaction” provisions of Section 5(a)(v). As discussed in the annotation to such Section 5(a)(v), this provision creates a cross-default in the event a party (or its Credit Support Provider or Specified Entity) defaults under any Specified Transactions between the parties. Although “Specified Transactions” is generally defined in Section 12 of the Master Agreement to include transactions, between such parties, that are derivative-like in nature, parties may expand the scope of this term here in the Schedule to additional types of transactions. Note that there is no threshold amount that is required to be met to trigger a default under a Specified Transaction (unlike the “Threshold Amount” applicable to a Cross Default as more particularly described herein). There is also no requirement that the terms be bilateral. That is, the term may have the meaning in Section 12 with respect to Party A and none with respect to Party B, or may be limited with respect to Party A or Party B to exclude transactions between the parties that are supported by a different source or pledge of funds than transactions under the Master Agreement.

(c) The **“Cross Default”** provisions of Section 5(a)(vi): will/will not * apply to Party A
will/will not * apply to Party B

If such provisions apply:

* Delete as applicable

“Specified Indebtedness” will have the meaning specified in Section 12 of this Agreement unless another meaning is specified here _____

“Threshold Amount” means _____

Annotation:

The above section enables the parties to elect the extent to which “Cross Default” will apply to one or both parties to the Master Agreement, which creates a potential termination right upon default by party of its obligations under “Specified Indebtedness” that exceed the specified “Threshold Amount”. If the Cross Default provisions apply to both parties, the foregoing terms may be defined differently for Party A and Party B. For example, if Party A is a bank, “Specified Indebtedness” might not include obligations in respect of deposits in the ordinary course of business, while “Specified Indebtedness” of Party B that is an issuer may exclude obligations of a separate municipal system, obligations payable at a different lien level or from a different payment source, or conduit obligations on behalf of unrelated borrowers. “Threshold Amount” may be reflected, e.g., in absolute dollar terms or as a percentage of shareholders’ equity. For a detailed discussion of these elections, see the annotation to Section 5(a)(vi) of the form of Master Agreement attached above.

(d) The “Credit Event Upon Merger” provisions of Section 5(b)(ii):

will/will not * apply to Party A
will/will not * apply to Party B

Annotation:

The above section enables the parties to elect the extent to which “Credit Event Upon Merger” will apply to the parties to the Master Agreement. Generally stated, this election with respect to a party provides a potential termination right to the other party upon merger or comparable reorganization of the party for whom the election is made (or its Credit Support Provider or Specified Entity, if applicable) in a manner in which the surviving entity has “materially weaker” creditworthiness. For a detailed discussion of these elections, see the annotation to Section 5(b)(ii) of the form of Master Agreement attached above. There may be unique considerations under which this provision should apply to the issuer. For example, if two governmental entities merge, will the sources of revenue for payment obligations be the same or substantially equivalent? Under what circumstances will the revenue stream be sufficient for the counterparty? If the Schedule includes ratings-based additional termination events, it may be appropriate not to specify “Credit Event Upon Merger” as applying, but rather to rely on the more objective additional termination event.

* Delete as applicable

(e) The “Automatic Early Termination” provision of Section 6(a):

will/will not * apply to Party A
will/will not * apply to Party B

Annotation:

The above section enables the parties to elect the event to which “Automatic Early Termination” will apply to the parties to the Master Agreement. As a general matter, the bankruptcy-related Events of Default set forth in Section 6(a) of the Master Agreement provide the non-defaulting party with the option of terminating the transactions entered into under the agreement. However, if “Automatic Early Termination” is elected above as applying to a party, then an early termination date in respect of all outstanding transactions will (subject to applicable bankruptcy and insolvency laws) occur *immediately* upon the occurrence with respect to such party of the bankruptcy-type defaults specified in Sections 5(a)(vii)(1), (3), (5), (6) or, to the extent analogous thereto, (8) of the Master Agreement. Given the consequences, perhaps unintended, of an Automatic Early Termination, the parties should consider whether Automatic Early Termination should apply at all.

(f) **Payments on Early Termination.** For the purpose of Section 6(e) of this Agreement:

- (i) Market Quotation/Loss * will apply.
- (ii) The First Method/The Second Method * will apply.

Annotation:

The above section enables the parties to elect the event to which “Market Quotation” versus “Loss” will be used as the methodology in calculating any payment or receipt potentially owing upon the termination of Transactions, as well as whether “First Method” or “Second Method” will apply. These elections are among the most important aspects of swaps documentation, and their meanings are more particularly summarized in the annotation to Section 6(e) of the Master Agreement above. The elections most commonly made in the documents pertaining to municipal swap transactions are “Second Method” and “Market Quotation”. Certain issuers such as governmental entities providing essential services that are unlikely to default under any transaction under the Master Agreement, may prefer First Method to apply. Moreover, some states may have laws or policies that restrict the ability of a state or local entity to make a termination payment to a defaulting party. The parties may also consider the “Close-Out” methodology set forth in the 2002 Master Agreement.

(g) **Additional Termination Event** will/will not apply*. The following shall constitute an Additional Termination Event: _____

For the purpose of the foregoing Termination Event, the Affected Party or Affected Parties shall be:

* Delete as applicable.

Annotation:

Whereas the Master Agreement only includes two relatively “no fault” types of Termination Events (Illegality and Credit Event Upon Merger), swap counterparties frequently custom tailor certain “Additional Termination Events” into the above part of the Schedule. Additional Termination Events (or “ATEs”) may be negotiated for all transactions between the parties under the Master Agreement, in which case they are included in the Schedule, or on a transaction-by-transaction basis, in which case they are typically included in the Confirmations. A common ATE permits one party to require the termination of a swap transaction in the event of a downgrade of the credit rating of the other party (or its Credit Support Provider or Specified Entity) below a negotiated threshold. Structured swap dealers often have specially tailored ATEs to give all counterparties equal access to their credit and to support their credit ratings. When applicable to municipal issuers, the type and lien priority of the benchmark rated debt are often specified. Another common Additional Termination Event is a requirement that a swap transaction be terminated in part, upon the payment of any related hedged indebtedness on a faster basis than that which was previously contemplated at the time of entering the transaction, so that at no time is the swap transaction based upon a notional principal amount in excess of the obligations being hedged. See the annotation to Section 5(b)(3) of the Master Agreement above.

Any Additional Termination Events should be analyzed to ensure compliance with any applicable requirements of state law. From another perspective, an issuer and/or its counsel should take care to *include* any Additional Termination Events that may be necessary to ensure compliance with state law restrictions. For example, as mentioned above, the ability for an issuer to terminate a forward starting swap, in the event that the obligations intended to be hedged are not ultimately issued, may enable satisfaction of any applicable state law requirement that a swap not be in place without a related series of bonds hedged by such swap.

(h) Events of Default

(iii) Bankruptcy. Clause (6) of Section 5(a)(vii) of this Agreement is hereby amended to read in its entirety as follows: —

“(6)(A) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets or (B) in the case of a Government Entity, any Credit Support Provider of such Government Entity or any applicable Specified Entity of such Government Entity, (I) there shall be appointed or designated with respect to it, an entity such as an organisation, board, commission, authority, agency or body to monitor, review, oversee, recommend or declare a financial emergency or similar state of financial distress with respect to it or (II) there shall be declared or introduced or proposed for consideration by it or by any legislative or regulatory body with competent jurisdiction over it, the existence of a state of financial emergency or similar state of financial distress in respect of it;”.

Annotation:

The above language modifies the standard bankruptcy Event of Default language in the Master Agreement as applied to governmental entities. Parties to Master Agreements commonly deem it appropriate to narrow the scope of this language to avoid a potential (or automatic, if applicable) termination being triggered by the mere introduction of legislation or by appointment of a monitoring board that is not indicative of true financial distress, or mere statements made by persons not acting in any official capacity nor having any reasonable likelihood of affecting the governmental entity.

(iv) **Merger Without Assumption.** Section 5(a)(viii) of this Agreement is hereby amended to read in its entirety as follows:

“(viii) **Merger Without Assumption.** The party or any Credit Support Provider of such party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity (or, without limiting the foregoing, if such party is a Government Entity, an entity such as an organisation, board, commission, authority, agency or body succeeds to the principal functions of, or powers and duties granted to, such party or any Credit Support Provider of such party) and, at the time of such consolidation, amalgamation, merger, transfer or succession:

(1) the resulting, surviving, transferee or successor entity fails to assume all the obligations of such party or such Credit Support Provider under this Agreement or any Credit Support Document to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other party to this Agreement; or

(2) the benefits of any Credit Support Document fail to extend (without the consent of the other party) to the performance by such resulting, surviving, transferee or successor entity of its obligations under this Agreement.”

Annotation:

The above language modifies the standard “Merger Without Assumption” language in the Master Agreement as applied to governmental entities. This language in the Master Agreement, generally stated, creates an Event of Default if a party (or its Credit Support Provider) merges or comparably reorganizes and the surviving entity does not assume the party’s obligations under the Agreement. The modification effected by the above language of the Schedule adds the first parenthetical, to address transactions that are more appropriately tailored to situations involving municipal swap counterparties.

(i) **Termination Events.** Section 5(b)(ii) of this Agreement is hereby amended to read in its entirety as follows:

“(ii) **Credit Event Upon Merger.** If “Credit Event Upon Merger” is specified in the Schedule as applying to the party, such party (“X”), any Credit Support Provider of X or any applicable Specified Entity of X consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity (or, without limiting the foregoing, if X is a Government Entity, an entity such as an organisation, board, commission, authority, agency or body succeeds to the principal functions of, or powers

and duties granted to, X, any Credit Support Provider of X or any Specified Entity of X) and such action does not constitute an event described in Section 5(a)(viii) but the creditworthiness of the resulting, surviving, transferee or successor entity is materially weaker than that of X, such Credit Support Provider or such Specified Entity, as the case may be, immediately prior to such action (and, in such event, X or its successor or transferee, as appropriate, will be the Affected Party); or”.

Annotation:

The above language modifies the standard “Credit Event Upon Merger” language in the Master Agreement as applied to governmental entities. See Part 1(d) above. If this termination event does not apply, then this amendment is moot. If Credit Event Upon Merger is elected, the language in the Master Agreement, generally stated, creates a Termination Event (if elected by the parties as being applicable in the Schedule – see above) with respect to a party if it (or its Credit Support Provider or Specified Entity, if applicable) merges or engages in a comparable reorganization in a manner in which the surviving entity has “materially weaker” creditworthiness. The modification effected by the above language of the Schedule adds the parenthetical beginning of the fifth line of the above paragraph, to address situations that are more appropriately tailored to transactions involving municipal swap counterparties.

[Remainder of page left blank intentionally]

2. Agreement to Deliver Documents.

For the purpose of Section 4(a) of this Agreement, each party agrees to deliver the following documents, as applicable:

| Party Required to Deliver | Form/Document/Certificate | Date by Which to be Delivered | Covered by Section 3(d) Representation |
|---------------------------|---|---|--|
| Party A and Party B | Evidence of authority of signatories | Upon execution of this Agreement and as deemed necessary for any further documentation | Yes |
| Party A and Party B | Any Credit Support Document specified in Part 3(c) herein | Upon execution of this Agreement | No |
| Party A and the Party B | Audited annual financial statements prepared in accordance with [specify applicable accounting principles] | Within 10 days after receipt (provided that, if such statements are posted on a publicly accessible website, then such posting shall constitute delivery). | Yes, as amended herein |
| Party A | Report containing an estimate, determined in good faith by Party A according to Party A's valuation policies, of the then-current mark-to-market value of outstanding Transactions. | Monthly [Annually], no later than the 10th day after the end of each calendar month [fiscal year] and, in addition, upon request of the Party B or its agent. | [Yes/No] |
| Party B | Legal opinion with respect to Party B in form attached hereto | With respect to any Transaction effected under this Agreement, on or before the Trade Date for each Transaction. | No |
| Party A | Legal opinion(s) with respect to Party A in form and substance acceptable to the Party B. | Upon execution of this Agreement. | No |
| Party B | Certified copies of the resolution(s) of the Party B's governing body (i) authorizing any Transaction under this Agreement, and (ii) authorizing a specified person or persons to execute and deliver (as appropriate) on its behalf this Agreement, the exhibits, supplements, and attachments hereto, the documents incorporated by reference herein, and any Confirmation. | With respect to any Transaction on or before the Trade Date for each Transaction. | Yes |
| Party A and the Party B | Such other documents as the other party may reasonably request. | Upon such reasonable request | No |

Annotation:

The above table (which is left blank in the ISDA® Form but has been completed with sample language by the NABL Committee authors) allows the parties to designate financial information and other documents and other items required to be delivered at the times specified in such table. The items shown in the table above are intentionally shaded because such items are *not* a part of the form of U.S. Municipal Counterparty Schedule to the ISDA® Master Agreement; rather, such items are included as illustrative of the types of items that are frequently required to be delivered by the parties to a Master Agreement. The rightmost column of the table is to enable the parties to elect which of the information is subject to the factual representation of Section 3(b) of the Master Agreement, which provides that “applicable information that is furnished in writing by or on behalf of it to the other party and is identified for the purpose of this Section 3(d) in the Schedule is, as of the date of the information, true, accurate and complete in every material respect.” See annotation to Section 3(d) of the Master Agreement above.

3. **Miscellaneous.**

(a) **Addresses for Notices.** For the purpose of Section 10(a) of this Agreement:

Address for notices or communications to Party A:

Address: _____
Attention: _____
Telex No.: _____ Answerback: _____
Facsimile No.: _____ Telephone No.: _____
Electronic Messaging System Details: _____

Address for notices or communications to Party B:

Address: _____
Attention: _____
Telex No.: _____ Answerback: _____
Facsimile No.: _____ Telephone No.: _____
Electronic Messaging System Details: _____

Annotation:

Parties often include language that outlines the circumstances under which courier transmissions, facsimile, electronic messaging and regular or certified mail is permitted and the parameters for each.

(b) **Calculation Agent.** The Calculation Agent is _____ unless otherwise specified in a Confirmation in relation to the relevant Transaction.

Annotation:

The above provision permits the parties to designate who will act in the role of calculating certain amounts in connection with Transactions governed by the Master Agreement. The Calculation Agent determines regularly scheduled payments, not termination amounts. In most municipal swap transactions, the swap provider is designated as the Calculation Agent above. However, parties to such transactions often deem it suitable to provide an alternative Calculation Agent to the extent that the swap provider is a defaulting party or certain other events may have occurred. Counterparties sometimes choose to include a dispute resolution provision, permitting the parties to challenge calculations and have recourse to an independent calculation.

(c) **Credit Support Document.** Details of any Credit Support Document:

Annotation (continued):

The most immediate consequence of a document being designated as “Credit Support Document” is the fact that defaults with respect to such documents may trigger an Event of Default under Section 6(a)(iii) of the Master Agreement. In addition, “Credit Support Documents” are taken into account for purposes of the standard representations and covenants in the Master Agreement, as well as for purposes of the “Merger Without Assumption” Event of Default and “Illegality” Termination Event.

State law considerations should always be taken into account in determining what types of collateral may be legally pledged to (or accepted by) governmental parties to swap or other derivative transactions. For example, an analysis may need to be made as to whether certain public funds, revenues or other assets may be posted as collateral, *i.e.*, whether permitted under state law or governing indentures, and whether, if a governmental entity in fact realizes upon collateral posted by its swap provider, such collateral is a permitted investment for the governmental entity under state law, governing indentures or policies.

(d) **Credit Support Provider.** Credit Support Provider means in relation to Party A,

Credit Support Provider means in relation to Party B, _____

Annotation:

The above section enables the parties to designate any “Credit Support Providers” that are respectively applicable to the parties under transactions entered into under the Master Agreement. Typically the Credit Support Providers with respect to a party are those entities or persons providing collateral or guaranty support under a Credit Support Document. The primary implication of a party being named as a “Credit Support Provider” is that such party will then be taken into account for purposes of various Events of Default and Termination Events.

(e) **Governing Law.** This Agreement will be governed by and construed in accordance with the laws of the State of New York (without reference to choice of law doctrine).

Annotation:

As mentioned in the annotation to Section 11(a) of the Master Agreement above, many swap transactions entered into under the ISDA® Master Agreement purport to be governed by New York law, and the above language in this form of Schedule follows such convention. However, the laws concerning the ability of a governmental entity (or others) to select the laws to govern any particular contractual relationships vary from state to state and should be examined in connection with this election. Such state law restrictions may be included as a part of legislation dealing specifically with swaps or other derivative transactions and/or may be included as a part of a more general “choice of laws” statute.

In addition and as discussed in the annotation to Section 11(b) of the Master Agreement above, such Section 11(b) provides that if that New York law is named as the governing law for the agreement, then the parties are *deemed* to consent to the non-exclusive jurisdiction of courts of the State of New York and to the United States District Court located in the Borough of Manhattan. However, the laws concerning the ability of governmental entities (and others) to consent to the courts of other jurisdictions vary from state to state and should be examined in connection with this Section 11(b) and any related language in the Schedule. For these reasons, the parties to a municipal swap transaction frequently modify the effect of this Section 11(b) in the Schedule to the Master Agreement by either “being silent” on the issue of forum or, in some instances, requiring that the consent to jurisdiction be to that of the governmental entity’s home state. An example of one approach to this issue is included in Paragraph 4(d) of this Schedule below.

Finally, certain parties to swap transactions deem it preferable to include language by which parties agree to waive their rights to a jury trial in connection with any dispute that might arise in the course of any Transaction entered into under the Master Agreement. Although a careful review should be undertaken to determine the extent to which governmental (or other) parties to a contract may waive their rights to a jury trial, any such waiver is typically included at this part of the Schedule or in Part 4.

(f) **Netting of Payments.** Subparagraph (ii) of Section 2(c) of this Agreement will not apply to the following Transactions or groups of Transactions (in each case starting from the date of this Agreement/in each case starting from _____) *

* Delete as applicable.

Annotation:

While most parties will prefer to implement payment netting, certain parties may not be able to do so as a practical matter. In addition, if insured and uninsured transactions are entered into under the same Master Agreement, no netting is typically permitted between insured and uninsured transactions.

(g) **“Affiliate”** will have the meaning specified in Section 12 of this Agreement unless another meaning is specified here _____

Annotation:

Absent any additional language being included in a Schedule or other attachment to the Master Agreement, the only operative use of the term “Affiliate” in the Master Agreement is with respect to the parties’ representation concerning the absence of litigation in Section 3(c) of the Master Agreement. The term “Affiliate” is defined broadly in Section 12 of the Master Agreement by employing the concept of “control”. However, the parties often custom tailor this definition in the above space in the Schedule.

(h) **“Covered Indenture”** means _____

Annotation:

This term is typically defined as the ordinance, resolution, order or indenture that authorizes the hedged bonds or pledges revenues or includes financial and operating covenants for the benefit of the swap provider to secure swap transactions. The term may also include an agreement governing credit enhancement for the hedged bonds.

(i) **“Covered Indenture Incorporation Date”** means _____

Annotation:

The terms “Covered Indenture” and “Covered Indenture Incorporation Date” are included in the event that the parties determine to amend the Master Agreement, to include the “Compliance with Covered Indenture” covenant pursuant to Paragraph 4(c)(ii) of the Schedule below. This is typically completed with the date of the Master Agreement.

(j) **“Governmental Entity”** means Party A/Party B.*

Annotation:

As noted in the annotated Master Agreement, Party B is typically the “Governmental Entity” as defined in the Schedule. Although the Master Agreement itself does not make special accommodations with respect to a party that is named as a “Government Entity”, as described throughout the annotations to this form of Schedule, the Schedule to the Master Agreement will frequently include provisions that are specially tailored to address certain particularities of the party named as a Government Entity. Namely, the party designated as a “Government Entity” will often be subject to special provisions applicable to such entities, within the Schedule, with respect to the Event of Default for bankruptcy-related events as well as “Merger Without Assumption”, the Termination Event for “Credit Event Upon Merger”, the provisions pertaining to “Incipient Illegality” described below, certain representations concerning non-speculation, the covenant for “Compliance With Covered Indenture” below, and standardized language often included in the Schedule under which the parties consent to the non-exclusive jurisdiction of courts in the jurisdiction in which the “Governmental Entity” is located.

4. Other Provisions.

Annotation:

To the extent that the parties may determine to add additional provisions to the Schedule or amendments and modifications to the Master Agreement, those are frequently included as a part of this Paragraph 4 to the Schedule. This form of U.S. Municipal Counterparty Schedule to the ISDA[®] Master Agreement includes special language concerning the effect of an “Incipient Illegality”, certain representations concerning powers, absence of defaults and non-speculation, a waiver of sovereign immunity, a covenant to comply with the “Covered Indenture”, special language amending the consent to jurisdiction provisions of Section 11(b) of the Master Agreement, and corresponding definitions at the end.

The parties are by no means limited to such matters in setting forth any additional undertakings that may be included as a part of the Master Agreement. For example, in municipal swap transactions, language is often included making clear the extent of the funds, revenues or other sources of payment (or limitations thereof) to which the swap provider may have recourse with respect to the governmental entity’s obligations. For example, an issuer may obligate itself solely from a pledged source of revenues. The nature and content of that pledge, and a limitation of recourse to pledged revenue, would often be included in this Paragraph 4.

(a) **Obligations.** Section 2(a)(iii) of this Agreement is hereby amended to read in its entirety as follows:

“(iii) Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default, Potential Event of Default or Incipient Illegality with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant Transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.

Annotation:

In municipal swap transactions, the above language modifies the corresponding provision in the Master Agreement to condition the swap provider's obligations upon the absence of the occurrence of an "Incipient Illegality" as defined below.

(b) Representations.

(i) The introductory clause of Section 3 of this Agreement is hereby amended to read in its entirety as follows:

"Each party represents to the other party (which representations will be deemed to be repeated by each party on each date on which a Transaction is entered into and, in the case of the representations in Section 3(a) and 3(e), at all times until the termination of this Agreement) that:—".

Annotation:

The above language modifies the corresponding language, in the representations portion of the Master Agreement, such that the representations in Sections 3(a) and 3(e) of the Master Agreement are deemed made by the parties "at all times until the termination of this Agreement". Section 3(a) includes the "basic" representations concerning the parties' status and powers, the absence of certain violations or conflicts, all consents having been obtained and the binding nature of the obligations. Section 3(e) is added to the Master Agreement by this form of Schedule below, applying only to the "Government Entity" (see above) and sets forth the representation that it is not entering into any Transaction under the agreement for purposes of speculation. Practitioners should consider the ability of a governmental entity, under applicable state statutory or common law, to make a "factual" representation to a party covering a period of time in the *future*.

(ii) Section 3(a)(ii) of this Agreement is hereby amended to read in its entirety as follows:

"(ii) **Powers.** It has the power to execute this Agreement and any other documentation relating to this Agreement to which it is a party, to deliver this Agreement and any other documentation relating to this Agreement that it is required by this Agreement to deliver and to perform its obligations under this Agreement and any obligations it has under any Credit Support Document to which it is a party and has taken all necessary action and made all necessary determinations and findings to authorise such execution, delivery and performance;"

(iii) Section 3(b) of this Agreement is hereby amended to read in its entirety as follows:

"(b) **Absence of Certain Events.** No Event of Default or Potential Event of Default or, to its knowledge, Incipient Illegality (in the case of a Government Entity) or Termination Event with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or

performing its obligations under this Agreement or any Credit Support Document to which it is a party.”

Annotation:

In municipal swap transactions, the above language modifies the corresponding provision in the Master Agreement to include a representation, made by the Government Entity, as to the absence of any “Incipient Illegality” as defined below.

(iv) Section 3 of this Agreement is hereby amended by adding the following subsection “(e)” thereto, which subsection shall only apply to the Government Entity:

“(e) **Non-Speculation.** This Agreement has been, and each Transaction hereunder will be (and, if applicable, has been), entered into for purposes of managing its borrowings or investments and not for purposes of speculation.”

Annotation:

In states in which the laws expressly permit swap or other derivative transactions to be entered into for certain enumerated purposes, the parties may determine to modify the above subparagraph (e) for purposes of harmonization to take such enumerated purposes into account. Consider whether the purposes for the swap are relevant to the legal authority of the Governmental Entity.

(v) Section 3 of this Agreement is hereby amended by adding the following subsection “(f)” thereto:

“(f) **No Immunity.** It is not entitled to claim immunity on the grounds of sovereignty or other similar grounds with respect to itself or its revenues or assets (irrespective of their use or intended use) from (i) suit, (ii) jurisdiction of any court, (iii) relief by way of injunction, order for specific performance or for recovery of property, (iv) attachment of its assets (whether before or after judgment) or (v) execution or enforcement of any judgment to which it or its revenues or assets might otherwise be made subject to in any Proceedings (as defined in Section 11(b)) in the courts of any jurisdiction and no such immunity (whether or not claimed) may be attributed to such party or its revenues or assets.”

Annotation:

This form of Schedule includes the above subparagraph (f) as an additional “sovereign immunity” representation that is more strictly worded than the waiver of sovereign immunity language included in Section 11(c) of the Master Agreement, the latter of which is qualified “to the fullest extent permitted by applicable law”. As discussed in the annotation to such Section 11(c) to the Master Agreement above, an issuer should consider the extent to which the entity is capable of making this representation consistent with any type of immunity actually available under state law. Many governmental entities are sensitive to this issue and such representations and/or waivers often are thoroughly negotiated in the documents. The laws in any particular state may limit the ability of a governmental entity to waive immunity or may require statutory authority for the waiver. Under statutes or common law, a governmental entity may in any event be limited in the ability to waive the defense of sovereign immunity with respect to certain assets, as well as in cases brought in tort as opposed to in contract (or *ex contractu*).

(c) Agreements.

(i) The introductory clause of Section 4 of this Agreement is hereby amended to read in its entirety as follows:

“Each party agrees with the other (or, in the case of Section 4(d) and (e), the Government Entity agrees with the other party) that, so long as either party has or may have any obligation under this Agreement or under any Credit Support Document to which it is a party:--”.

(ii) Section 4 of this Agreement is hereby amended by adding the following subsections “(d)” and “(e)” thereto:--”

“(d) **Compliance with Covered Indenture.** The Government Entity will observe, perform and fulfill each provision in the Covered Indenture applicable to such Government Entity in effect on the Covered Indenture Incorporation Date, as any of those provisions may be amended, supplemented or modified for purposes of this Agreement with the prior written consent of the other party hereto (the “Incorporated Provisions”), with the effect that such other party hereto will have the benefit of each of the Incorporated Provisions (including without limitation, covenants, right to consent to certain actions subject to consent under the Covered Indenture and delivery of financial statements and other notices and information). In the event the Covered Indenture ceases to be in effect prior to the termination of this Agreement, the Incorporated Provisions (other than those provisions requiring payments in respect of bonds, notes, warrants or other similar instruments issued under the Covered Indenture) will remain in full force and effect for purposes of this Agreement as though set forth herein until such date on which all of the obligations of the Government Entity under this Agreement and any obligations of the Government Entity or any Credit Support Provider of the Government Entity under a Credit Support Document have been fully satisfied. The Incorporated Provisions are hereby incorporated by reference and made a part of this Agreement to the same extent as if such provisions were set forth herein. For purposes of this Agreement, the Incorporated Provisions shall be construed as though (i) all references therein to any party making loans, extensions of credit or financial accommodations thereunder or commitments therefor (the “Financings”) were to the other party

hereto and (ii) to the extent that such Incorporated Provisions are conditioned on or relate to the existence of such Financings or the Government Entity having any obligations in connection therewith, all references to such Financings or obligations were to the obligations of the Government Entity under this Agreement. Any amendment, supplement, modification or waiver of any of the Incorporated Provisions without the prior written consent of the other party hereto shall have no force and effect with respect to this Agreement. Any amendment, supplement or modification for which such consent is obtained shall be part of the Incorporated Provisions for purposes of this Agreement.**

(Annotation appears on the following page)

** This provision may require modification or deletion depending on the circumstances.

Annotation:

The above “Compliance with Covered Indenture” provisions are often the subject of much negotiation among the parties to the Master Agreement and Schedule. After the parties have designated the “Covered Indenture” (which may consist of one or multiple documents) and “Covered Indenture Incorporation Date” in Paragraphs 3(g) and 3(h) of this form of Schedule, the above language commits the Government Entity to comply with its obligations within such Covered Indenture as they existed at such Covered Indenture Incorporation Date (defined with greater particularity above as the “Incorporated Provisions”).

On the one hand, this provision avoids requiring the reproduction within the swap documents of contractual undertakings that are already set forth in the Covered Indenture. On the other hand, the above language obligates the Government Entity to comply with the Covered Indenture (a) without taking into account any amendments, modifications or replacements unless the swap provider consents (for purposes of the Master Agreement) and (b) after the Covered Indenture has terminated or expired. It also provides the swap provider the “right to consent to certain actions subject to consent under the Covered Indenture”, which without careful review of the provisions of the Covered Indenture could result in a frustration of the rights and remedies of, for example, a trustee or group of bondholders under a master bond ordinance or indenture.

For reasons such as these, the above language is often negotiated in detail between the parties to the Master Agreement to determine the most appropriate level of covenant protection to be afforded the swap provider in relation to the Covered Indenture. Certain points of negotiation often include the specification of only certain enumerated *provisions* of the Covered Indenture that will be included within the meaning of “Incorporated Provisions”, as well as provisions under which the swap provider will not withhold its consents to supplements or amendments to the Covered Indenture required in connection with the issuance of additional bonds or other obligations thereunder. Another point of negotiation is the extent to which a swap provider may be willing to agree not to unreasonably withhold its consent to the amendment, modification or replacement of the Covered Indenture for purposes of this language in the Master Agreement. Such “not to be unreasonably withheld language” could, for example, apply in particular to any amendments required to conform to changes in state law or other requirements.

In some instances, state law may limit, or any applicable bond ordinance, resolution or similar official action may not contemplate, the ability of the Government Entity to bind itself in as broad a manner as that contemplated by the above form of “Compliance With Covered Indenture” language in the absence of careful review and necessary modifications. Another approach is not to incorporate all or a portion of any Covered Indenture, but rather treat the swap contract as a stand-alone document. The covenants and security provided for the benefit of the swap provider would be set forth directly in the Schedule.

(e) **Notice of Incipient Illegality.** If an Incipient Illegality occurs, the Government Entity will, promptly upon becoming aware of it, notify the other party, specifying the nature of that Incipient Illegality and will also give such other information about that Incipient Illegality as the other party may reasonably require.”

(d) **Jurisdiction.** Section 11(b) of this Agreement is hereby amended to read in its entirety as follows:

“(b) **Jurisdiction.** With respect to any suit, action or proceedings relating to this Agreement (‘Proceedings’), each party irrevocably:--”

(i) submits, to the fullest extent permitted by applicable law, to the non-exclusive jurisdiction of each of the courts of the State of New York, the United States District Court located in the Borough of Manhattan in New York City, the courts of the state in which the Government Entity or the other party’s principal

executive offices are located and the United States District Court with jurisdiction over the location of the Government Entity or the other party's principal executive offices; and

(ii) waives, to the fullest extent permitted by applicable law, (1) any objection which it may have at any time to the laying of venue of any Proceedings brought in any such court, (2) any claim that such Proceedings have been brought in an inconvenient forum and (3) the right to object, with respect to such Proceedings, that such court does not have any jurisdiction over such party.

Nothing in this Agreement precludes either party from bringing Proceedings in any other jurisdiction nor will the bringing of Proceedings in any one or more jurisdictions preclude the bringing of Proceedings in any other jurisdiction.”

Annotation:

As previously described above, Section 11(b) of the Master Agreement provides that if that New York law is named as the governing law for the agreement, then the parties are *deemed* to consent to the non-exclusive jurisdiction of courts of the State of New York and to the United States District Court located in the Borough of Manhattan. However, the laws concerning the ability of governmental entities (and others) to consent to the courts of other jurisdictions vary from state to state and should be examined in connection with such Section 11(b) and any related language in the Schedule.

The above language provides an example of one approach to this issue, in which the parties agree to the non-exclusive jurisdiction of the courts of the State of New York, the United States District Court located in the Borough of Manhattan in New York City, the courts of the state in which the Government Entity or the other party's principal executive offices are located and the United States District Court with jurisdiction over the location of the Government Entity or the other party's principal executive offices. In any case, such language should always be reviewed to determine its consistency with applicable provisions of state law concerning the consent to any jurisdiction.

(e) **Definitions.** Section 12 of this Agreement is hereby amended to add the following definitions in their appropriate alphabetical order:

“**Covered Indenture**’ has the meaning specified in the Schedule.”

“**Covered Indenture Incorporation Date**’ has the meaning specified in the Schedule.”

“**Government Entity**’ has the meaning specified in the Schedule.”

“**Incipient Illegality**’ means (a) the enactment by any legislative body with competent jurisdiction over a Government Entity of legislation which, if adopted as law, would render unlawful (i) the performance by such Government Entity of any absolute or contingent obligation to make a payment or delivery or to receive a payment or delivery in respect of a Transaction or the compliance by such Government Entity with any other material provision of this Agreement relating to such Transaction or (ii) the performance by a Government Entity or a Credit Support Provider of such Government Entity of any contingent or other obligation which the Government Entity (or such Credit Support Provider) has under any Credit Support Document relating to such Transaction, (b) any

assertion in any proceeding, forum or action by a Government Entity, in respect of such Government Entity or in respect of any entity located or organised under the laws of the state in which such Government Entity is located to the effect that performance under this Agreement or similar agreements is unlawful or (c) the occurrence with respect to a Government Entity or any Credit Support Provider of such Government Entity of any event that constitutes an Illegality.”

Annex C

ANNOTATED FORM OF CREDIT SUPPORT ANNEX TO ISDA[®] MASTER AGREEMENT

Attached is an annotated form of ISDA[®] Credit Support Annex to the ISDA[®] Master Agreement. The annotations included in separate “text boxes” are provided by the NABL Committee authors to highlight various issues for consideration with regard to the documentation of typical municipal swap transactions and certain particular considerations bearing on state laws. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects surrounding the topic of interest rate swaps, derivatives or their documentation or the issues summarized or annotations set forth herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in the structural, legal, documentary, economic, tax, bankruptcy, disclosure and other issues applicable to these complex types of transactions.

The attached form of Credit Support Annex (other than the annotations referred to above) is the property of ISDA[®]. This Annex C and all other International Swaps and Derivatives Association, Inc. (ISDA[®]) form documentation included within this publication (other than such annotations) is provided by special permission under a non-exclusive license from ISDA[®] and is subject to the following copyright notice and any other proprietary legends set forth thereon.

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NO PART OF THE PUBLICATION TO WHICH THIS ANNEX C IS ATTACHED NOR ANY OF THE ANNOTATIONS INCLUDED WITHIN THIS ANNEX C MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN CONSENT OF THE NATIONAL ASSOCIATION OF BOND LAWYERS IN EACH INSTANCE. MOREOVER, NO PART OF THIS ANNEX C (OTHER THAN SUCH ANNOTATIONS) MAY BE REPRODUCED WITHOUT THE PRIOR WRITTEN PERMISSION OF THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC. IN EACH INSTANCE.

Annotation:

The Credit Support Annex is used to document a requirement, where applicable, by one or both parties to post securities-type collateral to secure payment under the ISDA Master Agreement. Commonly, the collateral posting requirement is unilateral, rather than bilateral, in municipal interest rate swaps. That is, the counterparty is required to post collateral but the governmental entity is not. Posting requirements in other municipal finance transactions may be bilateral.

(Bilateral Form)

(ISDA Agreements Subject to New York Law Only)

ISDA[®]

International Swaps and Derivatives Association, Inc.

CREDIT SUPPORT ANNEX

to the Schedule to the

_____ dated as of _____

between

_____ and _____

("Party A")

("Party B")

This Annex supplements, forms part of, and is subject to, the above-referenced Agreement, is part of its Schedule and is a Credit Support Document under this Agreement with respect to each party.

Accordingly, the parties agree as follows:—

Paragraph 1. Interpretation

(a) **Definitions and Inconsistency.** Capitalized terms not otherwise defined herein or elsewhere in this Agreement have the meanings specified pursuant to Paragraph 12, and all references in this Annex to Paragraphs are to Paragraphs of this Annex. In the event of any inconsistency between this Annex and the other provisions of this Schedule, this Annex will prevail, and in the event of any inconsistency between Paragraph 13 and the other provisions of this Annex, Paragraph 13 will prevail.

Annotation:

Note that the Credit Support Annex controls over the Schedule, and that Paragraph 13 of the Credit Support Annex controls over the balance of the Annex. Just as the ISDA Master Agreement is modified only in the Schedule, the Credit Support Annex is typically modified only in Paragraph 13.

(b) **Secured Party and Pledgor.** All references in this Annex to the “Secured Party” will be to either party when acting in that capacity and all corresponding references to the “Pledgor” will be to the other party when acting in that capacity; provided, however, that if Other Posted Support is held by a party to this Annex, all references herein to that party as the Secured Party with respect to that Other Posted Support will be to that party as the beneficiary thereof and will not subject that support or that party as the beneficiary thereof to provisions of law generally relating to security interests and secured parties.

Annotation:

If the collateral obligation is unilateral (e.g., the governmental entity is not required to post collateral), a section is added to Paragraph 13 specifying that the Secured Party will only refer to the governmental entity and the Pledgor will only refer to the counterparty.

Paragraph 2. Security Interest

Each party, as the Pledgor, hereby pledges to the other party, as the Secured Party, as security for its Obligations, and grants to the Secured Party a first priority continuing security interest in, lien on and right of Set-off against all Posted Collateral Transferred to or received by the Secured Party hereunder. Upon the Transfer by the Secured Party to the Pledgor of Posted Collateral, the security interest and lien granted hereunder on that Posted Collateral will be released immediately and, to the extent possible, without any further action by either party.

Annotation:

This paragraph requires that any collateral posted not be subject to prior liens. If the governmental entity is posting collateral, consider what steps need to be taken to grant the requisite security interest.

Paragraph 3. Credit Support Obligations

(a) **Delivery Amount.** Subject to Paragraphs 4 and 5, upon a demand made by the Secured Party on or promptly following a Valuation Date, if the Delivery Amount for that Valuation Date equals or exceeds the Pledgor’s Minimum Transfer Amount, then the Pledgor will Transfer to the Secured Party Eligible Credit Support having a Value as of the date of Transfer at least equal to the applicable Delivery Amount (rounded pursuant to Paragraph 13). Unless otherwise specified in Paragraph 13, the “**Delivery Amount**” applicable to the Pledgor for any Valuation Date will equal the amount by which:

- (i) the Credit Support Amount exceeds

(ii) the Value as of that Valuation Date of all Posted Credit Support held by the Secured Party.

Annotation:

The amount of collateral to be posted is the difference between what has already been posted by the Pledgor less the amount that is required under the definition of Credit Support Amount. Credit Support Amount is defined with specificity below but, generally, means the amount of the Secured Party's "Exposure" less the Pledgor's Threshold Amount (specified in Paragraph 13), adjusted to reflect any independent amount (also specified in Paragraph 13). Exposure is also defined with more specificity below.

Note that the Secured Party must make a demand for delivery of Collateral. The requirement of the counterparty to post collateral is not automatic, and needs to be triggered by a demand. An issuer will, therefore, need to monitor its exposure under each swap and the ratings levels of each counterparty to be in a position to act quickly when a counterparty meets the exposure and ratings prerequisites to posting. As soon as the counterparty meets the prerequisites, the issuer will need to demand collateral to receive it. This is a key point in designing a swap monitoring program. A collateral obligation by the counterparty will not be useful if the issuer fails to demand collateral. Note that the Pledgor need not post collateral if the incremental change in the Delivery Amount to be posted is less than the Minimum Transfer Amount specified in Paragraph 13.

(b) **Return Amount.** Subject to Paragraphs 4 and 5, upon a demand made by the Pledgor on or promptly following a Valuation Date, if the Return Amount for that Valuation Date equals or exceeds the Secured Party's Minimum Transfer Amount, then the Secured Party will Transfer to the Pledgor Posted Credit Support specified by the Pledgor in that demand having a Value as of the date of Transfer as close as practicable to the applicable Return Amount (rounded pursuant to Paragraph 13). Unless otherwise specified in Paragraph 13, the "*Return Amount*" applicable to the Secured Party for any Valuation Date will equal the amount by which:

(i) the Value as of that Valuation Date of all Posted Credit Support held by the Secured Party exceeds

(ii) the Credit Support Amount.

Annotation:

Just as the Secured Party needs to make a demand to receive collateral, the Pledgor needs to make a demand to have all or a portion of its collateral returned to it, if the collateral is more than required (for example, if the amount of Exposure is reduced as a result of changes in interest rate levels or if the Pledgor's ratings improve to a different threshold level).

"**Credit Support Amount**" means, unless otherwise specified in Paragraph 13, for any Valuation Date (i) the Secured Party's Exposure for that Valuation Date plus (ii) the aggregate of all Independent Amounts applicable to the Pledgor, if any, minus (iii) all Independent Amounts applicable to the Secured Party, if any, minus (iv) the Pledgor's Threshold; provided, however, that the Credit Support Amount will be deemed to be zero whenever the calculation of Credit Support Amount yields a number less than zero.

Annotation:

As noted above, Credit Support Amount provides the basis for determining how much collateral needs to be posted. The Credit Support Amount equals the Secured Party's Exposure (the amount of the termination payment that a Pledgor would need to pay), adjusted to take into account Independent Amounts specified in Paragraph 13, and less any Pledgor Threshold specified in Paragraph 13.

Paragraph 4. Conditions Precedent, Transfer Timing, Calculations and Substitutions

(a) **Conditions Precedent.** Each Transfer obligation of the Pledgor under Paragraphs 3 and 5 and of the Secured Party under Paragraphs 3, 4(d)(ii), 5 and 6(d) is subject to the conditions precedent that:

(i) no Event of Default, Potential Event of Default or Specified Condition has occurred and is continuing with respect to the other party; and

(ii) no Early Termination Date for which any unsatisfied payment obligations exist has occurred or been designated as the result of an Event of Default or Specified Condition with respect to the other party.

Annotation:

Any Specified Condition is noted in Paragraph 13. These noted Specified Conditions are additional events that may suspend a party's collateral posting, return or other performance under the Credit Support Annex.

(b) **Transfer Timing.** Subject to Paragraphs 4(a) and 5 and unless otherwise specified, if a demand for the Transfer of Eligible Credit Support or Posted Credit Support is made by the Notification Time, then the relevant Transfer will be made not later than the close of business on the next Local Business Day if a demand is made after the Notification Time, then the relevant Transfer will be made not later than the close of business on the second Local Business Day thereafter.

Annotation:

Any transfer of collateral must generally be made within one business day (unless negotiated otherwise). If a municipality is required to post collateral under a Credit Support Annex, the municipality will need sufficient liquidity to meet this timeline, either through a line of credit or available reserves, or have a letter of credit available for use as eligible collateral. Consider also whether the issuer's governing board may delegate authority to staff to draw on the line or reserve, transfer the collateral, or deliver or increase the letter of credit. If the governing board cannot approve the action in advance, the standard one business day transfer timing will not accommodate public meeting schedules and notice requirements. The timing for transfers may be extended in Paragraph 13.

(c) **Calculations.** All calculations of Value and Exposure for purposes of Paragraphs 3 and 6(d) will be made by the Valuation Agent as of the Valuation Time. The Valuation Agent will notify each party

(or the other party, if the Valuation Agent is a party) of its calculations not later than the Notification Time on the Local Business Day following the applicable Valuation Date (or in the case of Paragraph 6(d), following the date of calculation).

(d) ***Substitutions.***

(i) Unless otherwise specified in Paragraph 13, upon notice to the Secured Party specifying the items of Posted Credit Support to be exchanged, the Pledgor may, on any Local Business Day, Transfer to the Secured Party substitute Eligible Credit Support (the “Substitute Credit Support”); and

Annotation:

Note that this provision permits the Pledgor to substitute collateral.

(ii) subject to Paragraph 4(a), the Secured Party will Transfer to the Pledgor the items of Posted Credit Support specified by the Pledgor in its notice not later than the Local Business Day following the date on which the Secured Party receives the Substitute Credit Support, unless otherwise specified in Paragraph 13 (the “Substitution Date”); provided that the Secured Party will only be obligated to Transfer Posted Credit Support with a Value as of the date of Transfer of that Posted Credit Support equal to the Value as of that date of the Substitute Credit Support.

Paragraph 5. Dispute Resolution

If a party (a “Disputing Party”) disputes (I) the Valuation Agent’s calculation of a Delivery Amount or a Return Amount or (II) the Value of any Transfer of Eligible Credit Support or Posted Credit Support, then (1) the Disputing Party will notify the other party and the Valuation Agent (if the Valuation Agent is not the other party) not later than the close of business on the Local Business Day following (X) the date that the demand is made under Paragraph 3 in the case of (I) above or (Y) the date of Transfer in the case of (II) above, (2) subject to Paragraph 4(a), the appropriate party will Transfer the undisputed amount to the other party not later than the close of business on the Local Business Day following (X) the date that the demand is made under Paragraph 3 in the case of (I) above or (Y) the date of Transfer in the case of (II) above, (3) the parties will consult with each other in an attempt to resolve the dispute and (4) if they fail to resolve the dispute by the Resolution Time, then:

(i) In the case of a dispute involving a Delivery Amount or Return Amount, unless otherwise specified in Paragraph 13, the Valuation Agent will recalculate the Exposure and the Value as of the Recalculation Date by:

(A) utilizing any calculations of Exposure for the Transactions (or Swap Transactions) that the parties have agreed are not in dispute;

(B) calculating the Exposure for the Transactions (or Swap Transactions) in dispute by seeking four actual quotations at mid-market from Reference Market-makers for purposes of calculating Market Quotation, and taking the arithmetic average of those obtained; provided that if four quotations are not available for a particular Transaction (or Swap Transaction), then fewer than four quotations may be used for that Transaction (or Swap Transaction); and if no quotations are available for

a particular Transaction (or Swap Transaction), then the Valuation Agent's original calculations will be used for that Transaction (or Swap Transaction); and

(C) utilizing the procedures specified in Paragraph 13 for calculating the Value, if disputed, of Posted Credit Support.

(ii) In the case of a dispute involving the Value of any Transfer of Eligible Credit Support or Posted Credit Support, the Valuation Agent will recalculate the Value as of the date of Transfer pursuant to Paragraph 13.

Following a recalculation pursuant to this Paragraph, the Valuation Agent will notify each party (or the other party, if the Valuation Agent is a party) not later than the Notification Time on the Local Business Day following the Resolution Time. The appropriate party will, upon demand following that notice by the Valuation Agent or a resolution pursuant to (3) above and subject to Paragraphs 4(a) and 4(b), make the appropriate Transfer.

Annotation:

Parties should consider whether this alternate dispute resolution method is authorized by state law and, if not, should qualify it in Paragraph 13.

Paragraph 6. Holding and Using Posted Collateral

(a) ***Care of Posted Collateral.*** Without limiting the Secured Party's rights under Paragraph 6(c), the Secured Party will exercise reasonable care to assure the safe custody of all Posted Collateral to the extent required by applicable law, and in any event the Secured Party will be deemed to have exercised reasonable care if it exercises at least the same degree of care as it would exercise with respect to its own property. Except as specified in the preceding sentence, the Secured Party will have no duty with respect to Posted Collateral, including, without limitation, any duty to collect any Distributions, or enforce or preserve any rights pertaining thereto.

(b) ***Eligibility to Hold Posted Collateral; Custodians.***

(i) ***General.*** Subject to the satisfaction of any conditions specified in Paragraph 13 for holding Posted Collateral, the Secured Party will be entitled to hold Posted Collateral or to appoint an agent (a "Custodian") to hold Posted Collateral for the Secured Party. Upon notice by the Secured Party to the Pledgor of the appointment of a Custodian, the Pledgor's obligations to make any Transfer will be discharged by making the Transfer to that Custodian. The holding of Posted Collateral by a Custodian will be deemed to be the holding of that Posted Collateral by the Secured Party for which the Custodian is acting.

Annotation:

Paragraph 13 identifies any minimum requirements for a custodian. If the issuer's custodian meets the minimum requirements, the issuer or its custodian may hold the posted collateral.

(ii) ***Failure to Satisfy Conditions.*** If the Secured Party or its Custodian fails to satisfy any conditions for holding Posted Collateral, then upon a demand made by the Pledgor, the Secured Party will, not later than five Local Business Days after the demand, Transfer or cause its Custodian to Transfer all Posted Collateral held by it to a Custodian that satisfies those conditions or to the Secured Party if it satisfies those conditions.

(iii) ***Liability.*** The Secured Party will be liable for the acts or omissions of its Custodian to the same extent that the Secured Party would be liable hereunder for its own acts or omissions.

Annotation:

Parties should consider whether Party B is authorized effectively to guaranty the performance of its Custodian as provided in Paragraph 6(b)(iii).

(c) ***Use of Posted Collateral.*** Unless otherwise specified in Paragraph 13 and without limiting the rights and obligations of the parties under Paragraphs 3, 4(d)(ii), 5, 6(d) and 8, if the Secured Party is not a Defaulting Party or an Affected Party with respect to a Specified Condition and no Early Termination Date has occurred or been designated as the result of an Event of Default or Specified Condition with respect to the Secured Party, then the Secured Party will, notwithstanding Section 9-207 of the New York Uniform Commercial Code, have the right to:

Annotation:

So long as the Secured Party is not in default or subject to a Specified Condition or Early Termination Date, the Secured Party has broad rights to use collateral posted to it, including the right to sell or pledge the collateral itself. Consider whether this action is appropriate or permitted by state law in the case of Collateral pledged by Party B.

(i) sell, pledge, rehypothecate, assign, invest, use, commingle or otherwise dispose of, or otherwise use in its business any Posted Collateral it holds, free from any claim or right of any nature whatsoever of the Pledgor, including any equity or right of redemption by the Pledgor; and

(ii) register any Posted Collateral in the name of the Secured Party, its Custodian or a nominee for either.

For purposes of the obligation to Transfer Eligible Credit Support or Posted Credit Support pursuant to Paragraphs 3 and 5 and any rights or remedies authorized under this Agreement, the Secured Party will be deemed to continue to hold all Posted Collateral and to receive Distributions made thereon, regardless of whether the Secured Party has exercised any rights with respect to any Posted Collateral pursuant to (i) or (ii) above.

(d) ***Distributions and Interest Amount.***

(i) ***Distributions.*** Subject to Paragraph 4(a), if the Secured Party receives or is deemed to receive Distributions on a Local Business Day, it will Transfer to the Pledgor not later than the following Local Business Day any Distributions it receives or is deemed to receive to the extent that a

Delivery Amount would not be created or increased by that Transfer, as calculated by the Valuation Agent (and the date of calculation will be deemed to be a Valuation Date for this purpose).

(ii) **Interest Amount.** Unless otherwise specified in Paragraph 13 and subject to Paragraph 4(a), in lieu of any interest, dividends or other amounts paid or deemed to have been paid with respect to Posted Collateral in the form of Cash (all of which may be retained by the Secured Party), the Secured Party will Transfer to the Pledgor at the times specified in Paragraph 13 the Interest Amount to the extent that a Delivery Amount would not be created or increased by that Transfer, as calculated by the Valuation Agent (and the date of calculation will be deemed to be a Valuation Date for this purpose). The Interest Amount or portion thereof not Transferred pursuant to this Paragraph will constitute Posted Collateral in the form of Cash and will be subject to the security interest granted under Paragraph 2.

Annotation:

If an issuer receives cash collateral, it will need to pay interest on the cash to the counterparty. The amount of interest is determined based on the definition of Interest Rate in Paragraph 13, not based on the actual interest earned by the issuer through investment of the cash. The definition of Interest Rate should be reviewed to determine whether it will result in the issuer paying the counterparty more than the issuer is earning on the cash collateral or the maximum rate, if any, permitted by state law.

Paragraph 7. Events of Default

For purposes of Section 5(a)(iii)(1) of this Agreement, an Event of Default will exist with respect to a party if:

(i) that party fails (or fails to cause its Custodian) to make, when due, any Transfer of Eligible Collateral, Posted Collateral or the Interest Amount, as applicable, required to be made by it and that failure continues for two Local Business Days after notice of that failure is given to that party;

(ii) that party fails to comply with any restriction or prohibition specified in this Annex with respect to any of the rights specified in Paragraph 6(c) and that failure continues for five Local Business Days after notice of that failure is given to that party; or

(iii) that party fails to comply with or perform any agreement or obligation other than those specified in Paragraphs 7(i) and 7(ii) and that failure continues for 30 days after notice of that failure is given to that party.

Paragraph 8. Certain Rights and Remedies

(a) **Secured Party's Rights and Remedies.** If at any time (1) an Event of Default or Specified Condition with respect to the Pledgor has occurred and is continuing or (2) an Early Termination Date has occurred or been designated as the result of an Event of Default or Specified Condition with respect to the Pledgor, then, unless the Pledgor has paid in full all of its Obligations that are then due, the Secured Party may exercise one or more of the following rights and remedies:

(i) all rights and remedies available to a secured party under applicable law with respect to Posted Collateral held by the Secured Party;

(ii) any other rights and remedies available to the Secured Party under the terms of Other Posted Support, if any;

(iii) the right to Set-off any amounts payable by the Pledgor with respect to any Obligations against any Posted Collateral or the Cash equivalent of any Posted Collateral held by the Secured Party (or any obligation of the Secured Party to Transfer that Posted Collateral); and

(iv) the right to liquidate any Posted Collateral held by the Secured Party through one or more public or private sales or other dispositions with such notice, if any, as may be required under applicable law, free from any claim or right of any nature whatsoever of the Pledgor, including any equity or right of redemption by the Pledgor (with the Secured Party having the right to purchase any or all of the Posted Collateral to be sold) and to apply the proceeds (or the Cash equivalent thereof) from the liquidation of the Posted Collateral to any amounts payable by the Pledgor with respect to any Obligations in that order as the Secured Party may elect.

Each party acknowledges and agrees that Posted Collateral in the form of securities may decline speedily in value and is of a type customarily sold on a recognized market, and, accordingly, the Pledgor is not entitled to prior notice of any sale of that Posted Collateral by the Secured Party, except any notice that is required under applicable law and cannot be waived.

(b) ***Pledgor's Rights and Remedies.*** If at any time an Early Termination Date has occurred or been designated as the result of an Event of Default or Specified Condition with respect to the Secured Party, then (except in the case of an Early Termination Date relating to less than all Transactions (or Swap Transactions) where the Secured Party has paid in full all of its obligations that are then due under Section 6(e) of this Agreement):

(i) the Pledgor may exercise all rights and remedies available to a pledgor under applicable law with respect to Posted Collateral held by the Secured Party;

(ii) the Pledgor may exercise any other rights and remedies available to the Pledgor under the terms of Other Posted Support, if any;

(iii) the Secured Party will be obligated immediately to Transfer all Posted Collateral and the Interest Amount to the Pledgor; and

(iv) to the extent that Posted Collateral or the Interest Amount is not so Transferred pursuant to (iii) above, the Pledgor may:

(A) Set-off any amounts payable by the Pledgor with respect to any Obligations against any Posted Collateral or the Cash equivalent of any Posted Collateral held by the Secured Party (or any obligation of the Secured Party to Transfer that Posted Collateral); and

(B) to the extent that the Pledgor does not Set-off under (iv)(A) above, withhold payment of any remaining amounts payable by the Pledgor with respect to any Obligations, up to the Value of any remaining Posted Collateral held by the Secured Party, until that Posted Collateral is Transferred to the Pledgor.

(c) ***Deficiencies and Excess Proceeds.*** The Secured Party will Transfer to the Pledgor any proceeds and Posted Credit Support remaining after liquidation, Set-off and/or application under Paragraphs 8(a) and 8(b) after satisfaction in full of all amounts payable by the Pledgor with respect to any Obligations; the Pledgor in all events will remain liable for any amounts remaining unpaid after any liquidation, Set-off and/or application under Paragraphs 8(a) and 8(b).

(d) **Final Returns.** When no amounts are or thereafter may become payable by the Pledgor with respect to any Obligations (except for any potential liability under Section 2(d) of this Agreement), the Secured Party will Transfer to the Pledgor all Posted Credit Support and the Interest Amount, if any.

Paragraph 9. Representations

Each party represents to the other party (which representations will be deemed to be repeated as of each date on which it, as the Pledgor, Transfers Eligible Collateral) that:

(i) it has the power to grant a security interest in and lien on any Eligible Collateral it Transfers as the Pledgor and has taken all necessary actions to authorize the granting of that security interest and lien;

Annotation:

If the issuer is required to post collateral under the Credit Support Annex, consider whether it is able —and has taken all necessary steps — to grant a security interest in the collateral it posts.

(ii) it is the sole owner of or otherwise has the right to Transfer all Eligible Collateral it Transfers to the Secured Party hereunder, free and clear of any security interest, lien, encumbrance or other restrictions other than the security interest and lien granted under Paragraph 2;

(iii) upon the Transfer of any Eligible Collateral to the Secured Party under the terms of this Annex, the Secured Party will have a valid and perfected first priority security interest therein (assuming that any central clearing corporation or any third-party financial intermediary or other entity not within the control of the Pledgor involved in the Transfer of that Eligible Collateral gives the notices and takes the action required of it under applicable law for perfection of that interest); and

(iv) the performance by it of its obligations under this Annex will not result in the creation of any security interest, lien or other encumbrance on any Posted Collateral other than the security interest and lien granted under Paragraph 2.

Paragraph 10. Expenses

(a) **General.** Except as otherwise provided in Paragraphs 10(b) and 10(c), each party will pay its own costs and expenses in connection with performing its obligations under this Annex and neither party will be liable for any costs and expenses incurred by the other party in connection herewith.

(b) **Posted Credit Support.** The Pledgor will promptly pay when due all taxes, assessments or charges of any nature that are imposed with respect to Posted Credit Support held by the Secured Party upon becoming aware of the same, regardless of whether any portion of that Posted Credit Support is subsequently disposed of under Paragraph 6(c), except for those taxes, assessments and charges that result from the exercise of the Secured Party's rights under Paragraph 6(c).

(c) **Liquidation/Application of Posted Credit Support.** All reasonable costs and expenses incurred by or on behalf of the Secured Party or the Pledgor in connection with the liquidation and/or application of any Posted Credit Support under Paragraph 8 will be payable, on demand and pursuant to

the Expenses Section of this Agreement, by the Defaulting Party or, if there is no Defaulting Party, equally by the parties.

Paragraph 11. Miscellaneous

(a) **Default Interest.** A Secured Party that fails to make, when due, any Transfer of Posted Collateral or the Interest Amount will be obligated to pay the Pledgor (to the extent permitted under applicable law) an amount equal to interest at the Default Rate multiplied by the Value of the items of property that were required to be Transferred, from (and including) the date that Posted Collateral or Interest Amount was required to be Transferred to (but excluding) the date of Transfer of that Posted Collateral or Interest Amount. This interest will be calculated on the basis of daily compounding and the actual number of days elapsed.

Annotation:

Consider whether this default rate is consistent with any state limitations on interest rate.

(b) **Further Assurances.** Promptly following a demand made by a party, the other party will execute, deliver, file and record any financing statement, specific assignment or other document and take any other action that may be necessary or desirable and reasonably requested by that party to create, preserve, perfect or validate any security interest or lien granted under Paragraph 2, to enable that party to exercise or enforce its rights under this Annex with respect to Posted Credit Support or an Interest Amount or to effect or document a release of a security interest on Posted Collateral or an Interest Amount.

(c) **Further Protection.** The Pledgor will promptly give notice to the Secured Party of, and defend against, any suit, action, proceeding or lien that involves Posted Credit Support Transferred by the Pledgor or that could adversely affect the security interest and lien granted by it under Paragraph 2, unless that suit, action, proceeding or lien results from the exercise of the Secured Party's rights under Paragraph 6(c).

(d) **Good Faith and Commercially Reasonable Manner.** Performance of all obligations under this Annex, including, but not limited to, all calculations, valuations and determinations made by either party, will be made in good faith and in a commercially reasonable manner.

(e) **Demands and Notices.** All demands and notices made by a party under this Annex will be made as specified in the Notices Section of this Agreement, except as otherwise provided in Paragraph 13.

(f) **Specifications of Certain Matters.** Anything referred to in this Annex as being specified in Paragraph 13 also may be specified in one or more Confirmations or other documents and this Annex will be construed accordingly.

Paragraph 12. Definitions

As used in this Annex—

“**Cash**” means the lawful currency of the United States of America.

“**Credit Support Amount**” has the meaning specified in Paragraph 3.

“*Custodian*” has the meaning specified in Paragraphs 6(b)(i) and 13.

“*Delivery Amount*” has the meaning specified in Paragraph 3(a).

“*Disputing Party*” has the meaning specified in Paragraph 5.

“*Distributions*” means with respect to Posted Collateral other than Cash, all principal, interest and other payments and distributions of cash or other property with respect thereto, regardless of whether the Secured Party has disposed of that Posted Collateral under Paragraph 6(c). Distributions will not include any item of property acquired by the Secured Party upon any disposition or liquidation of Posted Collateral or, with respect to any Posted Collateral in the form of Cash, any distributions on that collateral, unless otherwise specified herein.

“*Eligible Collateral*” means, with respect to a party, the items, if any, specified as such for that party in Paragraph 13.

“*Eligible Credit Support*” means Eligible Collateral and Other Eligible Support.

“*Exposure*” means for any Valuation Date or other date for which Exposure is calculated and subject to Paragraph 5 in the case of a dispute, the amount, if any, that would be payable to a party that is the Secured Party by the other party (expressed as a positive number) or by a party that is the Secured Party to the other party (expressed as a negative number) pursuant to Section 6(e)(ii)(2)(A) of this Agreement as if all Transactions (or Swap Transactions) were being terminated as of the relevant Valuation Time; provided that Market Quotation will be determined by the Valuation Agent using its estimates at mid-market of the amounts that would be paid for Replacement Transactions (as that term is defined in the definition of “Market Quotation”).

Annotation:

This definition provides the Market Quotation methodology for determining what the termination amount would be for the Agreement at a point in time. This termination amount is a key component in determining the value of collateral that must be posted. The general concept is that collateral is posted to cover the exposure of the other party to the risk that a termination payment would not be paid, less any “Threshold” specified in Paragraph 13 for the posting party. The Threshold represents that portion of any termination payment that will be uncollateralized.

“*Independent Amount*” means, with respect to a party, the amount specified as such for that party in Paragraph 13; if no amount is specified, zero.

Annotation:

If the parties desire more collateral than would be posted based on the exposure described above, the parties may specify additional “Independent Amounts” to be posted.

“**Interest Amount**” means, with respect to an Interest Period, the aggregate sum of the amounts of interest calculated for each day in that Interest Period on the principal amount of Posted Collateral in the form of Cash held by the Secured Party on that day, determined by the Secured Party for each such day as follows:

- (x) the amount of that Cash on that day; multiplied by
- (y) the Interest Rate in effect for that day; divided by
- (z) 360.

“**Interest Period**” means the period from (and including) the last Local Business Day on which an Interest Amount was Transferred (or, if no Interest Amount has yet been Transferred, the Local Business Day on which Posted Collateral in the form of Cash was Transferred to or received by the Secured Party) to (but excluding) the Local Business Day on which the current Interest Amount is to be Transferred.

“**Interest Rate**” means the rate specified in Paragraph 13.

“**Local Business Day**”, unless otherwise specified in Paragraph 13, has the meaning specified in the Definitions Section of this Agreement, except that references to a payment in clause (b) thereof will be deemed to include a Transfer under this Annex.

“**Minimum Transfer Amount**” means, with respect to a party, the amount specified as such for that party in Paragraph 13; if no amount is specified, zero.

Annotation:

This minimum transfer amount is typically set at a level that is high enough to permit transfer of non-cash collateral in available denominations. This minimum transfer amount should not be set so high as to undercut the requirement to post collateral to cover meaningful exposure.

“**Notification Time**” has the meaning specified in Paragraph 13.

“**Obligations**” means, with respect to a party, all present and future obligations of that party under this Agreement and any additional obligations specified for that party in Paragraph 13.

Annotation:

Unless modified in Paragraph 13 or in the Confirmation for a particular trade, the obligations covered by the Credit Support Agreement will include all transactions under the Master Agreement.

“**Other Eligible Support**” means, with respect to a party, the items, if any, specified as such for that party in Paragraph 13.

“**Other Posted Support**” means all Other Eligible Support Transferred to the Secured Party that remains in effect for the benefit of that Secured Party.

“**Pledgor**” means either party, when that party (i) receives a demand for or is required to Transfer Eligible Credit Support under Paragraph 3fa) or (ii) has Transferred Eligible Credit Support under Paragraph 3(a).

“**Posted Collateral**” means all Eligible Collateral, other property, Distributions, and all proceeds thereof that have been Transferred to or received by the Secured Party under this Annex and not Transferred to the Pledgor pursuant to Paragraph 3(b), 4(d)(ii) or 6(d)(i) or released by the Secured Party under Paragraph 8. Any Interest Amount or portion thereof not Transferred pursuant to Paragraph 6(d)(ii) will constitute Posted Collateral in the form of Cash.

“**Posted Credit Support**” means Posted Collateral and Other Posted Support.

“**Recalculation Date**” means the Valuation Date that gives rise to the dispute under Paragraph 5; provided, however, that if a subsequent Valuation Date occurs under Paragraph 3 prior to the resolution of the dispute, then the “Recalculation Date” means the most recent Valuation Date under Paragraph 3.

“**Resolution Time**” has the meaning specified in Paragraph 13.

“**Return Amount**” has the meaning specified in Paragraph 3(b).

“**Secured Party**” means either party, when that party (i) makes a demand for or is entitled to receive Eligible Credit Support under Paragraph 3(a) or (ii) holds or is deemed to hold Posted Credit Support.

“**Specified Condition**” means, with respect to a party, any event specified as such for that party in Paragraph 13.

“**Substitute Credit Support**” has the meaning specified in Paragraph 4(d)(i).

“**Substitution Date**” has the meaning specified in Paragraph 4(d)(ii).

“**Threshold**” means: with respect to a party, the amount specified as such for that party in Paragraph 13; if no amount is specified, zero.

“**Transfer**” means, with respect to any Eligible Credit Support, Posted Credit Support or Interest Amount, and in accordance with the instructions of the Secured Party, Pledgor or Custodian, as applicable:

(i) in the case of Cash, payment or delivery by wire transfer into one or more bank accounts specified by the recipient;

(ii) in the case of certificated securities that cannot be paid or delivered by book-entry, payment or delivery in appropriate physical form to the recipient or its account accompanied by any duly executed instruments of transfer, assignments in blank, transfer tax stamps and any other documents necessary to constitute a legally valid transfer to the recipient;

(iii) in the case of securities that can be paid or delivered by book-entry, the giving of written instructions to the relevant depository institution or other entity specified by the recipient, together with a written copy thereof to the recipient, sufficient if complied with to result in a legally effective transfer of the relevant interest to the recipient; and

(iv) in the case of Other Eligible Support or Other Posted Support, as specified in Paragraph 13.

“*Valuation Agent*” has the meaning specified in Paragraph 13.

“*Valuation Date*” means each date specified in or otherwise determined pursuant to Paragraph 13.

“*Valuation Percentage*” means, for any item of Eligible Collateral, the percentage specified in Paragraph 13.

“*Valuation Time*” has the meaning specified in Paragraph 13.

“*Value*” means for any Valuation Date or other date for which Value is calculated and subject to Paragraph 5 in the case of a dispute, with respect to:

- (i) Eligible Collateral or Posted Collateral that is:
 - (A) Cash, the amount thereof; and
 - (B) a security, the bid price obtained by the Valuation Agent multiplied by the applicable Valuation Percentage, if any;
- (ii) Posted Collateral that consists of items that are not specified as Eligible Collateral, zero; and
- (iii) Other Eligible Support and Other Posted Support, as specified in Paragraph 13.

Paragraph 13. Elections and Variables

Annotation:

This Paragraph 13 is used to modify the general terms of the Credit Support Annex. Typically the parties will exchange drafts of only Paragraph 13, as it is the only section of the Credit Support Annex subject to revision.

(a) **Security Interest for “Obligations”**. The term “*Obligations*” as used in this Annex includes the following additional obligations:

Annotation:

Without further revision, the term “Obligations” includes all Transactions under the Master Agreement. The following blanks are filled in to add other obligations to be secured by the posted collateral.

With respect to Party A: _____

With respect to Party B: _____

(b) **Credit Support Obligations.**

(i) Delivery Amount, Return Amount and Credit Support Amount.

(A) “**Delivery Amount**” has the meaning specified in Paragraph 3(a), unless otherwise specified here: _____.

Annotation:

This section can be used to revise the Delivery Amount of collateral to be posted to the Secured Party.

(B) “**Return Amount**” has the meaning specified in Paragraph 3(b), unless otherwise specified here: _____.

Annotation:

This section can be used to revise the Return Amount of collateral to be returned to the Pledgor.

(C) “**Credit Support Amount**” has the meaning specified in Paragraph 3, unless otherwise specified here: _____.

Annotation:

Consider whether the Credit Support Amount satisfies any collateralization requirements under applicable state law.

(ii) **Eligible Collateral.** The following items will qualify as “Eligible Collateral” for the party specified:

| | | Party A | Party B | Valuation Percentage |
|-----|--|----------------|----------------|-----------------------------|
| (A) | Cash | [] | [] | []% |
| (B) | negotiable debt obligations issued by the U.S. Treasury Department having an original maturity at issuance of not more than one year (“Treasury Bills”) | [] | [] | []% |
| (C) | negotiable debt obligations issued by the U.S. Treasury Department having an original maturity at issuance of more than one year but not more than 10 years (“Treasury Notes”) | [] | [] | []% |
| (D) | negotiable debt obligations issued by the U.S. Treasury Department having an original maturity at issuance of more than 10 years (“Treasury Bonds”) | [] | [] | []% |

(E) other: _____ [] [] []%

Annotation:

This section is used to list all collateral that will be accepted, and to assign percentages (or “haircuts”) to be applied in valuing each category of collateral to provide a buffer against changes in market value of the collateral. Securities with more risk or price volatility are generally assigned lower percentages (i.e., greater “haircuts”). In reviewing eligible collateral to be posted to an issuer, consider whether the issuer may hold the collateral under state law. If the issuer needs to realize on the collateral it may end up with securities that are not permitted investments under state law or the issuer’s investment policy, forcing the issuer to liquidate securities at an inopportune time. If the issuer is posting collateral, consider whether the issuer will be able to post cash or designated securities within the standard one business day timeline, or whether cash may be posted with an entity other than its depository. Issuers sometimes post letters of credit as eligible collateral. Again, attention should be paid to whether the letter of credit may be delivered or increased within one business day (if the standard transfer timing is not extended).

(iii) **Other Eligible Support.** The following items will qualify as “**Other Eligible Support**” for the party

| | | Party A | Party B |
|-----|-------|----------------|----------------|
| (A) | _____ | [] | [] |
| (B) | _____ | [] | [] |

(iv) **Thresholds.**

(A) “**Independent Amount**” means with respect to Party A: \$_____.

“**Independent Amount**” means with respect to Party B: \$_____.

Annotation:

As discussed above, this section is used to add a requirement that an “Independent Amount” above and beyond the amount of collateral required to cover the Secured Party’s exposure.

(B) “**Threshold**” means with respect to Party A: \$_____

“**Threshold**” means with respect to Party B: \$_____

Annotation:

It is common for a matrix to be inserted here that specifies different Thresholds for each party, depending on its credit rating. Governmental parties sometimes negotiate higher Thresholds for themselves than for the nongovernmental counterparty at the same credit level. The amount of collateral to be posted is the exposure above the Threshold identified here (taking into account "Independent Amounts" as discussed above. In other words (apart from any such Independent Amounts) the Secured Party will be unsecured in its exposure up to the Threshold amount. The Pledgor will not have to post collateral until the exposure exceeds the Threshold.

(C) "*Minimum Transfer Amount*" means with respect to Party A: \$ _____.

"*Minimum Transfer Amount*" means with respect to Party B: \$ _____.

Annotation:

By specifying a Minimum Transfer Amount the parties can avoid having to transfer inefficiently small amounts of collateral.

(D) ***Rounding***. The Delivery Amount and the Return Amount will be rounded [down to the nearest integral multiple of \$_____/up and down to the nearest integral multiple of \$_____, respectively*].

Annotation:

Rounding can be used to avoid having to transfer odd amounts.

(c) Valuation and Timing.

(i) "*Valuation Agent*" means, for purposes of Paragraphs 3 and 5, the party making the demand under Paragraph 3, and, for purposes of Paragraph 6(d), the Secured Party receiving or deemed to receive the Distributions or the Interest Amount, as applicable, unless otherwise specified here:

_____.

* Delete as applicable.

Annotation:

Unless further modified, this definition will result in the party making the demand serving as the valuation agent for the collateral. Counterparties may propose that they always serve as valuation agent, but governmental entities (or their custodian) may be equipped to serve in this role.

(ii) **“Valuation Date”** means: _____.

(iii) **“Valuation Time”** means:

the close of business on the Local Business Day before the Valuation Date or date of calculation, as applicable;

the close of business in the city of the Valuation Agent on the Valuation Date or date of calculation, as applicable;

provided that the calculations of Value and Exposure will be made as of approximately the same time on the same date.

Annotation:

This provision will specify whether calculations regarding collateral posting obligations be done on a daily, weekly or monthly basis. The standard timing for demands provides that a demand for collateral may be made “on or promptly following a Valuation Date” so a more frequent valuation date will permit demands to be made more frequently in response to changes in exposure and collateral value.

(iv) **“Notification Time”** means 1:00 p.m., New York time, on a Local Business Day, unless otherwise specified here: _____.

(d) **Conditions Precedent and Secured Party’s Rights and Remedies.** The following Termination Event(s) will be a **“Specified Condition”** for the party specified (that party being the Affected Party if the Termination Event occurs with respect to that party):

| | Party A | Party B |
|----------------------------------|----------------|----------------|
| Illegality | [] | [] |
| Tax Event | [] | [] |
| Tax Event Upon Merger | [] | [] |
| Credit Event Upon Merger | [] | [] |
| Additional Termination Event(s): | | |
| _____ | [] | [] |
| _____ | [] | [] |

Annotation:

If conditions are specified in this section, they will be additional prerequisites for performance under the Credit Support Annex.

(e) **Substitution.**

(i) “**Substitution Date**” has the meaning specified in Paragraph 4(d)(ii), unless otherwise specified here: _____.

(ii) **Consent.** If specified here as applicable, then the Pledgor must obtain the Secured Party’s consent for any substitution pursuant to Paragraph 4(d): [applicable/inapplicable*]

Annotation:

Parties should consider selecting “applicable” where substitution without consent could give rise to a registration requirement to perfect properly the security interest in Posted Collateral (e.g., where a party to the Annex is the New York branch of an English bank).

(f) **Dispute Resolution.**

(i) “**Resolution Time**” means 1:00 p.m., New York time, on the Local Business Day following the date on which the notice is given that gives rise to a dispute under Paragraph 5, unless otherwise specified here: .

(ii) **Value.** For the purpose of Paragraphs 5(i)(C) and 5(ii), the Value of Posted Credit Support will be calculated as follows: .

(iii) **Alternative.** The provisions of Paragraph 5 will apply, unless an alternative dispute resolution procedure is specified here: .

(g) **Holding and Using Posted Collateral.**

(i) **Eligibility to Hold Posted Collateral; Custodians.** Party A and its Custodian will be entitled to hold Posted Collateral pursuant to Paragraph 6(b); provided that the following conditions applicable to it are satisfied:

- (1) Party A is not a Defaulting Party.
- (2) Posted Collateral may be held only in the following jurisdictions:
_____.
- (3) _____.

* Delete as applicable.

Initially, the **Custodian** for Party A is _____.

Party B and its Custodian will be entitled to hold Posted Collateral pursuant to Paragraph 6(b); provided that the following conditions applicable to it are satisfied:

- (1) Party B is not a Defaulting Party.
- (2) Posted Collateral may be held only in the following jurisdictions:
_____.
- (3) _____.

Initially, the **Custodian** for Party B is _____.

Annotation:

This section is used to specify any minimum requirements for the parties or the respective custodians to hold posted collateral. Often minimum capitalization and ratings requirements are provided for any custodian. Consider whether any state statute dictates who will hold posted collateral and who may serve as a custodian for a governmental entity.

(ii) **Use of Posted Collateral.** The provisions of Paragraph 6(c) will not apply to the [party/parties] specified here:

Party A

Party B

and [that party/those parties*] will not be permitted to: _____.

(h) **Distributions and Interest Amount.**

(i) **Interest Rate.** The “Interest Rate” will be: _____.

Annotation:

This is the interest rate that will need to be paid to the Pledgor who posts cash collateral. If a municipality accepts cash collateral, consider whether it can actually achieve the interest rate on investment of the cash and whether it may agree to pay the specified rate under state law.

(ii) **Transfer of Interest Amount.** The Transfer of the Interest Amount will be made on the last Local Business Day of each calendar month and on any Local Business Day that Posted Collateral in the form of Cash is Transferred to the Pledgor pursuant to Paragraph 3(b), unless otherwise specified here: _____.

(iii) **Alternative to Interest Amount.** The provisions of Paragraph 6(d)(ii) will apply, unless otherwise specified here: _____.

(i) **Additional Representation(s).**

[Party A/Party B*] represents to the other party (which representation(s) will be deemed to be repeated as of each date on which it, as the Pledgor, Transfers Eligible Collateral) that:

(i) _____.

(ii) _____.

(j) **Other Eligible Support and Other Posted Support.**

(i) **“Value”** with respect to Other Eligible Support and Other Posted Support means:

_____.

(ii) **“Transfer”** with respect to Other Eligible Support and Other Posted Support means: _____.

(k) **Demands and Notices.** All demands, specifications and notices under this Annex will be made pursuant to the Notices Section of this Agreement, unless otherwise specified here:

Party A: _____.

Party B: _____.

(l) **Addresses for Transfers.**

Party A: _____.

Party B: _____.

(m) **Other Provisions.**

* Delete as applicable.

Annex D

ANNOTATED FORM OF SAMPLE INTEREST RATE SWAP CONFIRMATION ("SHORT FORM")

ISDA[®] has published various templates to assist parties in crafting their own confirmations for transactions, including the well-known forms included as exhibits to the 1992 ISDA[®] U.S. Municipal Counterparty Definitions publication. The attached "short-form" interest rate swap confirmation is based upon those ISDA[®] exhibits commonly used as templates in a "plain vanilla" swap transaction.³⁴ The annotations included in separate "text boxes" are provided by the NABL Committee authors to highlight various issues for consideration. However, this publication in general, and such annotations in particular, are introductory in nature and therefore do not address all aspects surrounding the topic of interest rate swaps, derivatives or their documentation or the issues summarized or annotations set forth herein. Participants to derivative transactions and their counsel should independently obtain, to their own satisfaction, a sufficient level of comfort in issues applicable to these complex types of transactions.

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³⁴ As mentioned in paragraph IV(F) of the front part of this publication above, in lieu of entering into a Master Agreement and Schedule, in some instances counterparties may execute and deliver a "long-form confirmation", which is a single self-contained agreement setting forth all the provisions to govern a specific swap or other derivative transaction. Long-form Confirmations have historically been employed, for example, for transactions having such a degree of complexity that they are more appropriately handled outside of the standardized Master Agreement / Schedule document architecture. However, long-form confirmations are less commonly employed in municipal finance transactions.

**Form of Confirmation for
1992 ISDA U.S. Municipal Counterparty Schedule**

**Introduction, Standard Paragraphs and Closing for a
Letter Agreement Confirming an Interest Rate Swap Transaction**

Heading for Letter

[Letterhead of Party A]

[Date]

[Transaction]

[Name and Address of Party B]

Heading for Telex

Telex:

Date:

To: [Name and Telex Number of Party B]

From: [Party A]

Re: [Transaction]

Dear _____:

The purpose of this [letter agreement / telex] is to confirm the terms and conditions of the transaction (the "Transaction") entered into between us on the Trade Date specified below. This [letter agreement / telex] constitutes a "Confirmation" as referred to in the Master Agreement specified below.

The definitions and provisions contained in the 1992 ISDA U.S. Municipal Counterparty Definitions (as published by the International Swaps and Derivatives Association, Inc.) are incorporated into this Confirmation. In the event of any inconsistency between those definitions and provisions and this Confirmation, this Confirmation will govern.

Annotation:

In some instances, often due to timing constraints or other issues, the parties to a swap transaction may lock in the primary economic terms of the transaction in advance of the execution and delivery of an ISDA® Master Agreement and Schedule, in which event the following commonly used language may be inserted here: “This Confirmation evidences a complete and binding agreement between you and us as to the terms of the Transaction to which this Confirmation relates. In addition, you and we agree to use all reasonable efforts promptly to negotiate, execute and deliver an agreement in the form of the 1992 ISDA® Master Agreement (Local Currency – Single Jurisdiction) (the “ISDA Form”), with such modifications as you and we will in good faith agree. Upon the execution by you and us of such an agreement, this Confirmation will supplement, form a part of and be subject to that agreement. All provisions contained in or incorporated by reference in that agreement upon its execution will govern this Confirmation except as expressly modified below. Until we execute and delivery that agreement, this Confirmation, together with all other documents referring to the ISDA Form (each a “Confirmation”) confirming transactions (each a “Transaction”) entered into between us (notwithstanding anything to the contrary in a Confirmation), shall supplement, form a part of, and be subject to, an agreement in the form of the ISDA Form as if we had executed an agreement in such form (but without any Schedule except for the election of the laws of the State of [New York] as the governing law) on the Trade Date of the first such Transaction between us. In the event of any inconsistency between the provisions of that agreement and this Confirmation, this Confirmation will prevail for purposes of this Transaction.”

1. This Confirmation supplements, forms part of, and is subject to, the Master Agreement dated as of [date], as amended and supplemented from time to time (the “Agreement”), between you and us. All provisions contained in the Agreement govern this Confirmation except as expressly modified below.

2. The terms of the particular Transaction to which this Confirmation relates are as follows:

Annotation:

The below section includes the key “economic” terms of the interest rate swap, including notional amount, fixed and floating rates or indices, and payment dates. Additional economic terms, such as any option to terminate the trade at par or other predetermined amount, may likewise be listed below.

Notional Amount:

Trade Date:

Effective Date:

Termination Date:

_____, [subject to adjustment in accordance with the [Following/Modified Following/Preceding] Business Day Convention*

* If the parties want to provide that the Termination Date will be adjusted in accordance with a Business Day Convention (and, accordingly, that the Final Calculation Period will be shortened or lengthened), the appropriate Business Day Convention must be specified.

Fixed Amounts:

Fixed Rate Payer: [Party A/B]
Fixed Rate Payer Payment Dates: _____ [, subject to adjustment in accordance with the [Following/Modified Following/Preceding] Business Day Convention **

Fixed Amount [or Fixed Rate and Fixed Rate Day Count Fraction]:

Floating Amounts:

Floating Rate Payer: [Party B/A]
Floating Rate Payer Payment Dates: _____ [, subject to adjustment in accordance with the [Following/Modified Following/Preceding] Business Day Convention **

[Floating Rate for Initial Calculation Period:]

Floating Rate Option:

Designated Maturity:

Floating Rate Day Count Fraction:

Reset Dates: _____ [, subject to adjustment in accordance with the [Following/Modified Following/Preceding] Business Day Convention ***

[Method of Averaging:] [Unweighted/Weighted Average]

[Business Days:]

[Business Day Convention:] [Following/Modified Following/Preceding]†

Calculation Agent: _____

Annotation:

In some instances various “Additional Termination Events” may be included here, particularly if such events pertain to a single transaction entered under the Master Agreement; Additional Termination Events that would apply to *all* transactions under the same Master Agreement are more likely to be included within the Schedule to the Master Agreement.

** Bracketed language is not necessary if Payment Dates are to be adjusted in accordance with the Modified Following Business Day Convention, as provided in the 1992 ISDA U.S. Municipal Counterparty Definitions.

*** Bracketed language is not necessary if Reset Dates are to be adjusted in accordance with the Business Day Convention applicable to Payment Dates.

† If a Business Day Convention is to apply to all dates that are stated in the 1992 ISDA U.S. Municipal Counterparty Definitions to be adjusted in accordance with the applicable Business Day Convention, that Business Day Convention can be specified here.

Annotation:

A common type of termination event that may be included in a Confirmation is the right of a municipal issuer to terminate the transaction at “par” or at “market” as discussed in greater detail in paragraph II(B)(2)(c)(iv) and elsewhere in the front part of this publication above. For example, a common type of language that might provide the issuer a “market termination” option is the following:

“Optional Termination. Party B may, upon at least two (2) Business Days’ written notice to Party A, terminate any Transaction in whole or in part, on any Business Day, by designating to Party A the termination date for such Transaction. In the event Party B exercises its right of optional termination hereunder, such termination shall constitute an Additional Termination Event under Section 6(e) of this Agreement with Party B as the sole Affected Party, and the identified Transaction as the sole Affected Transaction.

“In such case, Party A will determine a U.S. Dollar value for the terminated portion of the Transaction (the “Cash Settlement Amount”) in accordance with Section 6(e)(i)(4) of the Agreement, where Party B is the sole Affected Party and the Transaction is the sole Affected Transaction. If such Cash Settlement Amount is not mutually acceptable to Party A and Party B, Party A shall determine the Cash Settlement Amount with respect to the Transaction in accordance with Section 6(e)(i)(3) of the Agreement, where Party B is the sole Affected Party and the Transaction is the sole Affected Transaction and the Reference Market Makers providing quotations are reasonably acceptable to both Party A and Party B.

“If upon a termination by Party B pursuant to Section 6, Party B would owe a Cash Settlement Amount, then Party B may terminate pursuant to Section 6 of the Agreement only upon demonstrating to the reasonable satisfaction of Party A its ability to pay any amount due under Section 6(e) of the Agreement.”

[3. _____ agrees to provide the following Credit Support Document [or agrees to provide the following in accordance with [specify Credit Support Document]]:]

[4.] Account Details

Account for payments to Party A:

Account for payments to Party B:

[5. Broker/Arranger.]

Annotation:

Any additional provisions may be included here.

Closing for Letter

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Confirmation enclosed for that purpose and returning it to us or by sending to us a letter or telex substantially similar to this letter, which letter or telex sets forth the material terms of the Transaction to which this Confirmation relates and indicates agreement to those terms.

Yours sincerely,

[PARTY A]

By: _____
Name: _____
Title: _____

Confirmed as of the date first above written:

[PARTY B]

By: _____
Name: _____
Title: _____

Closing for Telex

Please confirm that the foregoing correctly sets forth the terms of our agreement by sending to us a letter or telex substantially similar to this telex, which telex sets forth the material terms of the Transaction to which this Confirmation relates and indicates agreement to those terms, or by sending to us a return telex substantially to the following effect:

“Re:

We acknowledge receipt of your telex dated [_____] with respect to the above-referenced Transaction between [Party A] and [Party B] with an Effective Date of [_____] and a Termination Date of [_____] and confirm that such telex correctly sets forth the terms of our agreement relating to the Transaction described herein. Very truly yours, [Party B], by [specify name and title of authorized officer].”

Your sincerely,

[PARTY A]

By: _____
Name: _____
Title: _____

