Chapter 145: Debt and Derivatives

145.020 Derivatives Policy

Bd. Min. 1-31-13, Amended Bd. Min. 4-17-25

A. **Introduction** - This policy is designed to provide a framework for the management of risk associated with derivative instruments and hedging activities in connection with debt transactions. This policy is adopted pursuant to and is intended to be compliant with Section 108.170(8~~7~~)(3) of the Revised Statutes of Missouri, as the same may be amended from time to time.

This policy shall be applicable to agreements providing for payments based upon levels of or changes in interest rates, including without limitation derivative agreements commonly referred to as interest rate swaps, hedges, caps, floors or collars, entered into in connection with bonds, notes or other obligations issued by or on behalf of the University, which bonds, notes or other obligations are either presently outstanding or expected to be issued, and bearing interest at fixed or variable rates of interest (individually a "Contract", "Agreement" or "Derivative Transaction", and collectively "Contracts", "Agreements" or "Derivative Transactions").

B. **Responsibilities and Authorities** – See CRR 145.010 "*Policy for Management and Oversight of Debt and Derivatives.*"

C. **General Guidelines** - The following non-exclusive list provides certain guidelines that the University will follow in the evaluation and recommendation of Derivative Transactions as defined in this policy:

1. Legality - Any proposed Contract must comply within the legal constraints imposed by state laws, University resolutions, and existing covenants, bond resolutions, indentures and other contracts.

2. Permitted Purposes and Financial Strategy - Derivative Transactions may be used to manage the University's risk profile, including but not limited to tax risk, liquidity risk, and interest rate risk. The University will evaluate Derivative Transactions on a standalone basis, in the context of the debt portfolio, and in the context of the

University as a whole (e.g., institutional tax risk and interest rate risk).

3. Mitigation of Risk Factors - The University recognizes that certain risks will be assumed if it enters into a Derivative Transaction. In order to mitigate the associated risks, the University will follow the guidelines described below:

   a. *Counterparty Risk*: Counterparty risk is the risk that a counterparty fails to meet its obligations as described in the Contract. The University will seek to mitigate this risk by (a) evaluating the credit quality of any counterparty, including, but not limited to, public credit ratings, preferring higher creditworthiness for transactions which may have a significant financial impact, (b) diversifying its counterparty exposure among different financial institutions and (c) including, when appropriate, swap collateralization requirements which protect the University and counterparty.

   b. *Termination Risk*: Termination risk is the risk that an event of default or credit rating downgrade below a set threshold triggers a termination event. Except for extenuating circumstances, it is the intent of the University not to make a termination payment to a counterparty that has failed to meet its contractual obligations. At a minimum, prior to making any termination payment, the University will determine whether it is financially advantageous to obtain a replacement counterparty.

   c. *Collateralization Risk*: Collateralization risk is the risk that the University must post collateral to secure a negative mark-to-market (or manage the receipt of collateral from a counterparty). Collateral thresholds will be selected to avoid significant portfolio burden arising from posting of collateral.

   d. *Interest Rate Risk:* Many Derivative Transactions involve the assumption or removal of interest rate risk. Portfolio impact must be evaluated as well as institutional asset positions (or other investments) which may be impacted by changes in short or long interest rate risks.

   e. *Basis Risk*: Basis risk is the risk that the index chosen as the basis for floating rate payments in the Derivative Transaction does not match the floating rate of the underlying liability. The University will mitigate this risk by requiring that any index chosen as part of a Derivative Transaction must be a recognized market index, including but not limited to Securities Industry and Financial Markets Association ("SIFMA") or Secured Overnight Financing Rate ("SOFR")~~London Interbank Offering Rate ("LIBOR")~~. The University will not enter into a Derivative Transaction without considering the potential incremental cost and risk to the University of basis risk.

f. *Tax Risk*: Tax risk is the risk that tax-exempt bond rates may unexpectedly increase or fluctuate due to changes in the tax code. Tax risk is present in all tax-exempt debt issuances. When entering into Derivative Transactions associated with tax- exempt bonds, tax risk involves tax-exempt bond rates consequently diverging from the specified swap index (a form of basis risk), resulting in a reduction in the derivative's effectiveness as a hedge or as a risk management financial product. The University will mitigate this risk by managing the total tax risk that the University assumes in its overall debt portfolio.

g. *Bankruptcy Risk*: Bankruptcy risk is the risk that the University may fail to recover any amount due, potentially including collateral that has been posted, due to bankruptcy proceedings of a counterparty. The University will mitigate this risk by:

(a) evaluating the credit quality of any counterparty, including, but not limited to, public credit ratings, preferring higher creditworthiness for transactions which may have a significant financial impact, (b) diversifying its counterparty exposure among different financial institutions and (c) including reasonable swap collateralization requirements.

h. *Amortization Risk:* Mismatched amortization schedules between the debt principal and the associated swap notional can result in a less than satisfactory hedge and create unnecessary risk by exposing the University to cash flows that do not offset. To mitigate this risk, the notional amount of the swap and principal should be aligned at inception and throughout the life of the instruments.

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As part of its efforts to mitigate risk, the University will also require the counterparty to disclose in writing the potential costs and risks associated with any Derivative

Transaction.

In addition, in its consideration of whether or not to enter into a Derivative Transaction, and in the actual entrance into such a Derivative Transaction if so determined, the University shall consider recommended practices with respect to the use of debt-related derivative products published by the Government Finance Officers Association.

D. **Reporting** – The Annual Financial Report prepared by the University and presented to the Board of Curators will discuss the status of all swaps. The report shall include a list of all swaps with notional value and interest rates, and other key terms.

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E. **Qualified Independent Representative (QIR)** – In connection with Futures Trading Commission Rules, a qualified independent representative (QIR) will be selected to advise the University on derivative transactions, and staff will monitor the performance of such QIR on an ongoing basis. The University will consult with the QIR prior to entering into or modifying any derivative transaction.

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~~D.~~F. **Market Disclosure** - The Treasurer will establish procedures to provide timely disclosure of material information related to executed Derivative Transactions to credit rating agencies and investors. Audited financial statements will include disclosure of any Derivative Transactions consistent with accounting practice. Any offering documents used in connection with new debt financings will include disclosure of any material information related to Derivative Transactions expected or anticipated at the time of issuance of the obligations.

~~E.~~G. **Exclusions -** Nothing in this policy shall be applied or interpreted to diminish or alter the special or general power the University may otherwise have under any other provisions of law to use derivative instruments and engage in hedging activities other than Derivative Transactions covered by this Policy as defined in Section A.