THE OHIO STATE UNIVERSITY

University Derivatives, 5.80

University Policy

Applies to: All university personnel responsible for the management of university debt and financial assets excluding the Office of Investments.

Responsible Office — Office of Business and Finance

POLICY

Issued: 06/07/2013
Reviewed: 01/01/2015
Edited: 04/10/2017

Derivative agreements are sometimes used to hedge against financial risk and to better manage assets and liabilities and lower overall costs.

Purpose of the Policy

To implement a policy to use derivative instruments to accomplish the hedging of certain financial transactions in an effort to reduce or manage financial risk and or lower costs.

Definitions

Term	Definition
Derivative	A contract, security, or payment exchange whose value is derived from another security, underlying asset, reference rate or index. There are three fundamental classes of derivatives – futures, options, and swaps – each with many variations. Some variations include but are not limited to: interest rate caps, floors, collars, and rate locks.

Policy Details

I. Purpose for Use of Derivatives
  A. Reduce exposure to changes in interest rates on a particular or anticipated future financial transaction.
  B. Lower net cost of borrowing.
  C. Achieve higher rate of return on investment.
  D. Manage variable rate exposure on debt issuance.
  E. Manage the risk of future cash inflows and outflows.
  F. Reduce exposure to changes in foreign currency prices.
  G. Reduce exposure to fluctuations in price for commodity purchases.
  H. Achieve a better matching of assets and liabilities.

II. Scope
  A. Applies to derivatives on university financial transactions, excluding those transactions conducted through the Office of Investments.
  B. This policy does not apply to derivatives included within operating fund investments as a component of investment strategies by third-party investment managers or publically traded mutual funds.

III. Principles Governing Use of Derivatives
  A. Derivatives are to be used for hedging purposes and not for speculation.
  B. Derivatives may be used to better manage assets and liabilities and to lower overall costs and reduce interest rate risk.
  C. Derivatives must be documented except as otherwise provided herein. Most derivatives will be documented using agreements that contain terms and conditions as set forth in the International Swaps and Derivatives Association (ISDA) Master Agreement, as modified by an appropriate ISDA schedule, confirmation, and/or credit support annex. This documentation requirement does not apply to standardized exchange-traded products such as futures contracts executed through a trading exchange.

D. Counterparties to any derivative agreement must have a long-term credit rating of A or above by a nationally recognized rating agency if the swap is uncollateralized. Counterparties with a lower rating will be required to post collateral.
E. A swap dealer may be deemed to be acting as an advisor to the university under certain circumstances with respect to a specific swap or trading strategy involving a swap. The university may engage a third party, or use a university employee, to serve as a qualified independent representative to provide advice and oversight of any swap or trading strategy involving a swap, in which case the swap dealer will not be deemed to be acting as an advisor to the university.
F. Derivative agreements should not require the university to post collateral unless approved by the deputy chief financial officer, treasurer, and vice president of financial services and innovation or the senior vice president for business and finance and chief financial officer.

IV. Risks Associated with Derivatives

A. Counterparty risk – the risk of a failure by a counterparty to perform as required under the agreement.
B. Termination risk – the ability of either party to terminate the agreement prior to maturity. Early termination could result in adverse results.
C. Amortization risk – the risk that the cash flow schedule of the derivative does not exactly match the cash flow schedule of the asset/liability. This can result in a less than satisfactory hedge and create unnecessary risk.
D. Basis risk – arises as a result of movements in interest rates that may not be in tandem between the asset/liability and the derivative instrument. This could create a favorable or unfavorable cost differential.
E. Tax risk – the risk that tax laws may change resulting in an unexpected movement in the value of the hedge.
F. Liquidity risk – the risk that collateral is not posted when due resulting in possible exposure to loss.
G. Regulatory risk – the risk that laws and regulations may change resulting in unexpected movement in the value of the hedge and/or additional compliance requirements.
H. Compliance risk – not complying with laws and regulations can result in penalties, fines or the inability to do additional transactions.

PROCEDURE

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I. Approval and Oversight

A. The deputy chief financial officer, treasurer, and vice president of financial services and innovation in collaboration with the senior vice president of business and finance and chief financial officer will make the determination if any derivative transaction is in the best interests of the university.
B. The material terms of any derivative transaction must receive prior approval of the chair of the Finance Committee of the Board of Trustees. All completed derivative transactions will be reported to the chair of the Finance Committee of the Board of Trustees within five business days of execution.
C. All derivative agreements must be reviewed and approved by legal counsel prior to execution.
D. Derivative agreements may be executed only by the deputy chief financial officer, treasurer, and vice president of financial services and innovation or the senior vice president of business and finance and chief financial officer.
E. Derivative agreements may be terminated before maturity upon approval of the senior vice president of business and finance and chief financial officer.
F. The deputy chief financial officer, treasurer, and vice president of financial services and innovation or the senior vice president of business and finance and chief financial officer will determine whether to engage a third party or use a university employee to serve as a qualified independent representative regarding a specific derivative or trading strategy involving a derivative. In the event the determination is made to engage a third party, the applicable agreement may be executed only by the deputy chief financial officer, treasurer, and vice

president of financial services and innovation or the senior vice president of business and finance and chief financial officer.

G. The Office of Financial Services is responsible for oversight, monitoring and compliance with applicable rules and regulations for any derivative transaction.

Responsibilities

Position or Office	Responsibilities
Deputy chief financial officer, treasurer, and vice president of financial services and innovation	1. Collaborate with the senior vice president of business and finance and chief financial officer to determine if any derivative transaction is in the best interests of the university. 2. Execute derivative agreements as appropriate. 3. Determine whether to engage a third party or use a university employee to serve as a qualified independent representative regarding a specific derivative or trading strategy involving a derivative. 4. Execute applicable agreement with third party engaged to serve as a qualified independent representative regarding a specific derivative or trading strategy involving a derivative.
Senior vice president of business and finance and chief financial officer	1. Collaborate with the vice president for financial services and treasurer to determine if any derivative transaction is in the best interests of the university. 2. Execute derivative agreements as appropriate. 3. Terminate derivative agreements before maturity as appropriate. 4. Determine whether to engage a third party or use a university employee to serve as a qualified independent representative regarding a specific derivative or trading strategy involving a derivative. 5. Execute applicable agreement with third party engaged to serve as a qualified independent representative regarding a specific derivative or trading strategy involving a derivative.
Chair of the Finance Committee of the Board of Trustees	1. Review and approve the material terms of any derivative transaction prior to execution. 2. Receive reports on all completed derivative transactions within five business days of execution.
Qualified independent representative	Provide an evaluation of the transaction and risk, including fair pricing and appropriateness of the transaction.
Office of Financial Services	Oversee, monitor, and ensure compliance with applicable rules and regulations for any derivative transaction.
Office of Legal Affairs	Review and approve all derivative agreements prior to execution.

Resources

Contacts

Subject	Office	Telephone	E-mail/URL
Policy questions	Office of Financial Services	614-292-6261 800-678-6009	treasurer.ohio-state.edu

History

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