

# Derivatives Use Report

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- Dashboard

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November 30, 2014

Prepared By Enterprise Risk Management

**Introduction**

As determined by the University's Derivatives Use Policy (The Policy) which was approved by the Board of Trustees in July 2010 and updated November 2014, the University's exposure to an individual counterparty is measured by the Net Termination Exposure (NTE). The Prairieland Energy, Inc. (PEI) Board of Directors approved a PEI-specific derivatives use policy at their October 20, 2014 meeting (The PEI Policy). The PEI Policy is similar to the University policy, but also provides requirements for physical delivery transactions (which apply to the PEI forward purchase contracts). This report provides information on the University's financial position and potential obligations should there be an early termination of any or all of its existing financial and physical derivative transactions, including positions held by PEI. This is a snapshot of counterparty exposure, only as it relates to derivatives.

**Counterparty Financial Health**

The Policy requires regular due diligence reviews of the financial strength of University/PEI counterparties. It is the responsibility of the departments that originate each hedging transaction to review the related counterparties regularly in compliance with §12 of the Policy.

Bond credit ratings are used as a proxy for counterparty financial strength. The Policy requires an A-/A3 rating to qualify as a counterparty. The financial institutions (JPMorgan Chase Bank, Loop Financial Products, and Morgan Stanley) meet this requirement. Morgan Stanley however, does have a split rating of A-/Baa2 and should be monitored by Capital Financing.

The PEI Policy requires an A-/A3 rating to qualify for financial transactions and a BBB-/Baa3 or BB+/Ba1 with LOC for physical delivery transactions. The energy companies all meet the PEI Policy qualifying credit rating for physical delivery transactions. PEI should continue to monitor the financial condition and outlook of their counterparties.

**University Total NTE**

The combined current notional value of these derivative agreements is \$212.96 million. Should there be immediate termination of all agreements, the combined NTE for all outstanding agreements is a negative \$23.42 million, unfavorable to the University. The obligation is nearly entirely due to the MTM on the interest rate swaps, which is in line with the current market environment. The overall immediate risk of termination is low since the counterparties have no ability to terminate these transactions unilaterally unless certain triggers are met (see Financial Hedging NTE).

**Financial Hedging NTE (Interest Rate Swaps)**

The total NTE of all interest rate swaps is a negative \$22.86 million, which would be an obligation for the University to each of the swap counterparties. This is a result of the current market environment. The immediate risk of all swaps terminating is low since the counterparties cannot unilaterally terminate these contracts unless certain triggers are met, including: (i) a University default, or (ii) the long-term rating on the University's bonds is withdrawn, suspended or reduced below BBB+/Baa1 on the COPs 2004 and UIC SC 2008 and reduced below BBB/Baa2 on the HSFS 2008 bonds.

**Physical Hedging NTE (Energy Commodity Transactions)**

The total NTE of all physical energy hedges is a negative \$0.55 million, unfavorable to PEI/The University. If the agreements were terminated as of November 30, 2014 PEI would have an obligation to Sequent and NRG of \$0.90 and \$0.05 million respectively. Exelon and Shell would have an obligation to PEI of \$0.38 and \$0.01 million respectively.

**Counterparty Concentration**

Morgan Stanley, with a total notional value of \$126.64 million, exceeds the 50% limit with 60% of the current notional total of \$212.96 million. The University has two interest rate swaps with this counterparty; both predate The Policy and are coincident with related bond issues. Future use of Morgan Stanley as a hedging counterparty would require approval by the VP/CFO as an exception to The Policy.

**Material Events**

None reported.

**Summary of Collateral Posted by the University (Thresholds)**

With respect to the University, the threshold requirement in all of the interest rate swap agreements is infinite, which means the University is never required to post collateral. Threshold requirements are not addressed in the energy forward purchases contracts, except for Shell which is \$10 million, the same as the University guarantee.

The University does provide guaranty agreements to PEI's energy commodity vendors including \$35 million with Sequent, \$10 million with Shell, \$1 million with NRG, and an unlimited agreement with Exelon. PEI has \$1 million collateral posted with the Midcontinent Independent System Operator (MISO), but this arrangement is for physical procurement and is unrelated to financial or physical hedging.

**Summary of Collateral Held by the University (Thresholds)**

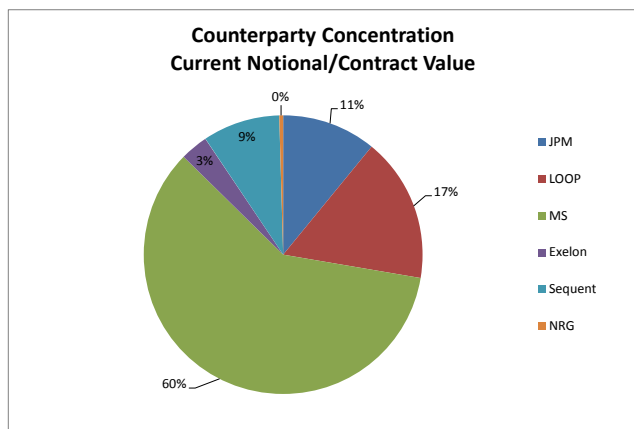
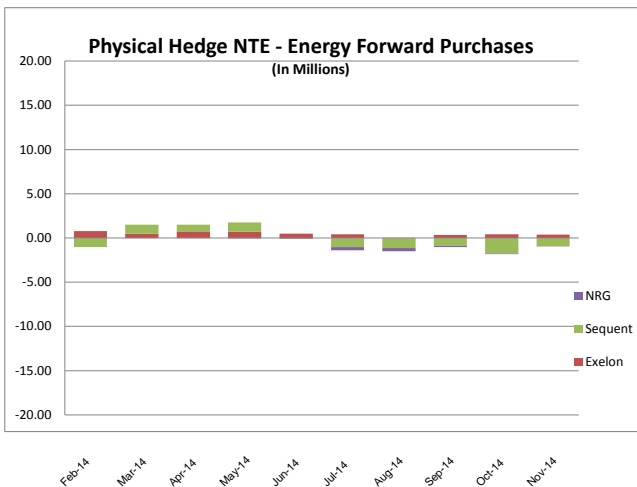
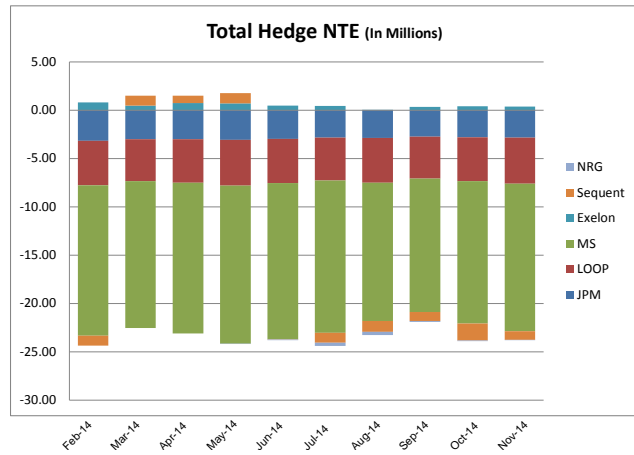
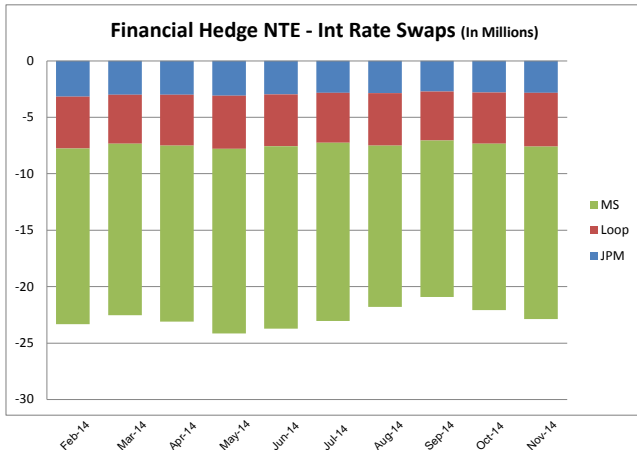
The collateral requirements for counterparties on the interest rate swaps are more risk tolerant than The Policy (see table below). All of the swap agreements were approved by the Board of Trustees and executed prior to The Policy, so this is noted as a predated-exception on the Dashboard report. Morgan Stanley's current credit rating would cause the University's exposure to exceed the contracted limits should those positions come "in the money" (that is, the counterparty would owe the University in the event of swap termination). If this were to happen, the swap agreement provides for the University to demand collateral. The pledge and delivery of collateral would mitigate the risk that Morgan Stanley would fail to perform its obligations under the swap agreement. If Morgan Stanley was unable to deliver collateral, the University would continue to be at risk. A further decline in Morgan Stanley's credit rating could trigger the transfer (Novation) of the swap agreement to a replacement counterparty.

The contracts with Sequent, Exelon, and NRG do not address collateral thresholds with bond rating triggers, however, they provide recourse through Credit Assurances provisions if reasonable grounds exist regarding unsatisfactory creditworthiness or performance. It is incumbent upon PEI to request Performance Assurance if a rating change triggers the Policy collateral requirements. This provision allows PEI to be proactive, and not necessarily wait for a downgrade event before requesting Performance Assurance. NRG has provided an LOC. The Shell contract does provide bond rating triggered collateral thresholds in line with The PEI Policy.

The only collateral reported to be held by the University is the letter of credit from Barclays Bank for \$2.1 million to back the forward purchase transaction with NRG Power Marketing, LLC which expires 6/30/15. Exelon and Shell are "in the money" at \$0.38 million and \$0.01 million NTE obligation; however, collateral has not been requested since the NTE does not exceed The PEI Policy limitations for physical delivery transactions.

**Collateral Requirements of Counterparties / Thresholds**

Counterparty Credit Rating S&P / Moody's	The Policy	The PEI Policy	Interest Rate Swaps	
	Maximum NTE - Net of Collateral FINANCIAL	Maximum NTE - Net of Collateral PHYSICAL	Counterparty Credit Rating S&P / Moody's	Maximum NTE - Net of Collateral
AAA / Aaa Category	\$35 million	\$35 million		
AA / Aa Category	\$30 million	\$30 million	A / A2 and above	Infinite
A / A Category	\$20 million	\$20 million	A- / A3	\$10 million
BBB+ / Baa1 or Below	\$0 million	NA	BBB+ / Baa1 or Below	\$0 million
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BBB/Baa Category		\$10 million		
BB+/Ba1 or Below		\$0 million		



Org	Responsible Unit	Counterparty	Rated Entity	Bond Rating (S&P / Moody's)	Derivative Type	Expires	Underlying Asset/Liability	Orig Contract (in Millions)	Current Notional / Contract (in Millions)	Market Value (in Millions)	MTM or NTE (in Mill)	Univ Guarantee Limit (in Mill)	CP Threshold	
<b>Financial Hedges (Interest Rate Swaps):</b>				<b>Qualifying Rating A- / A3</b>										
Univ	Capital Financing	Morgan Stanley Capital Services, Inc.	Morgan Stanley Capital Services, Inc.	A- / Baa2	Int Rate Swap	8/15/2021	COPs 2004	\$ 143.67	103.04		(12.38)		Predated Exception	
Univ	Capital Financing	Morgan Stanley Capital Services, Inc.	Morgan Stanley Capital Services, Inc.	A- / Baa2	Int Rate Swap	1/15/2022	UIC SC 2008	\$ 27.40	23.60		(2.88)		Predated Exception	
								<b>SUBTOTAL MS</b>	<b>\$ 171.07</b>	<b>126.64</b>	<b>(15.27)</b>			
Univ	Capital Financing	JP Morgan Chase Bank, N.A.	JP Morgan Chase Bank, N.A.	A+ / Aa3	Int Rate Swap	1/15/2022	UIC SC 2008	\$ 26.85	23.18		(2.82)		Predated Exception	
Univ	Capital Financing	Loop Financial Products, I, LLC	Deutsche Bank (CSP)	A / A3	Int Rate Swap	10/1/2026	HSFS 2008	\$ 40.88	35.59		(4.77)		Predated Exception	
								<b>SUBTOTAL FINANCIAL</b>	<b>\$ 238.80</b>	<b>185.41</b>	<b>(22.86)</b>			
<b>Physical Hedges (Energy Forward Purchases):</b>				<b>Qualifying Rating BBB-/Baa3 or BB+/Ba1 with LOC</b>										
PEI	Utilities Admin	Sequent Energy Management, LP	AGL Resources Inc. (PCG)	BBB+ / Baa1	Forward Purchase	6/30/2015	Natural Gas Mult FY15	\$ 17.13	10.61					
PEI	Utilities Admin	Sequent Energy Management, LP	AGL Resources Inc. (PCG)	BBB+ / Baa1	Forward Purchase	6/30/2016	Natural Gas Mult FY16	\$ 7.63	7.63					
PEI	Utilities Admin	Sequent Energy Management, LP	AGL Resources Inc. (PCG)	BBB+ / Baa1	Forward Purchase	6/30/2017	Natural Gas Mult FY17	\$ 0.77	0.77					
								<b>SUBTOTAL Sequent</b>	<b>\$ 25.53</b>	<b>19.01</b>	<b>18.11</b>	<b>(0.90)</b>	<b>35.00</b>	Credit Assurance
PEI	Utilities Admin	Exelon Generation Company LLC	Exelon Generation Company LLC	BBB / Baa2	Forward Purchase	6/30/2015	Electricity Mult FY15	\$ 2.75	1.22					
PEI	Utilities Admin	Exelon Generation Company LLC	Exelon Generation Company LLC	BBB / Baa2	Forward Purchase	6/30/2016	Electricity Mult FY16	\$ 3.61	3.61					
PEI	Utilities Admin	Exelon Generation Company LLC	Exelon Generation Company LLC	BBB / Baa2	Forward Purchase	6/30/2017	Electricity Mult FY17	\$ 2.01	2.01					
								<b>SUBTOTAL Exelon</b>	<b>\$ 8.37</b>	<b>6.84</b>	<b>7.23</b>	<b>0.38</b>	<b>Unlimited</b>	Credit Assurance
PEI	Utilities Admin	NRG Power Marketing, LLC	Barclays Bank PLC (LOC)	A / A2	Forward Purchase	6/30/2015	Electricity Mult FY15	\$ 2.19	0.95	0.90	(0.05)	1.00	LOC	
								<b>SUBTOTAL NRG</b>	<b>\$ 2.19</b>	<b>0.95</b>	<b>0.90</b>	<b>(0.05)</b>	<b>1.00</b>	
PEI	Utilities Admin	Shell Energy North America (US), L.P.	Shell Energy North America (US), L.P.	AA- / A2	Forward Purchase	6/30/2015	Electricity Mult FY15	\$ 0.44	0.31					
PEI	Utilities Admin	Shell Energy North America (US), L.P.	Shell Energy North America (US), L.P.	AA- / A2	Forward Purchase	6/30/2016	Electricity Mult FY16	\$ 0.25	0.25					
PEI	Utilities Admin	Shell Energy North America (US), L.P.	Shell Energy North America (US), L.P.	AA- / A2	Forward Purchase	6/30/2017	Electricity Mult FY17	\$ 0.19	0.19					
								<b>SUBTOTAL Shell</b>	<b>\$ 0.88</b>	<b>0.76</b>	<b>0.77</b>	<b>0.01</b>	<b>10.00</b>	Meets Policy
								<b>SUBTOTAL PHYSICAL</b>	<b>\$ 36.97</b>	<b>\$ 27.56</b>	<b>27.00</b>	<b>(0.55)</b>	<b>46.00</b>	
								<b>GRAND TOTAL</b>	<b>\$ 275.77</b>	<b>212.96</b>	<b>(23.42)</b>			

\*Negative termination value means the University or PEI is obligated to the counterparty (transaction is "underwater").  
 CSP - Credit Support Provider  
 LOC - Letter of Credit provided  
 PCG - Parent Company Guarantee provided