

**NEW JERSEY TURNPIKE AUTHORITY**  
**INTEREST RATE SWAP MANAGEMENT PLAN**

**November 2015**

**1. PURPOSE**

This Interest Rate Swap Management Plan sets forth the manner of execution of interest rate swaps and related agreements, provides for security and payment provisions, and sets forth certain other provisions related to interest rate swap agreements between the New Jersey Turnpike Authority ("Authority") and qualified swap counterparties. The Interest Rate Swap Management Plan also outlines procedures to be followed to insure compliance with all applicable federal and state laws. This Interest Rate Swap Management Plan will be reviewed by the Authority no less than once every two (2) years and any changes to this Interest Rate Swap Management Plan will be presented to the Authority's Board of Commissioners for approval. This Interest Rate Swap Management Plan will be made available on the Authority's website, <http://www.state.nj.us/turnpike>.

**2. BEST INTERESTS OF THE AUTHORITY**

Although adherence to this Interest Rate Swap Management Plan ("Plan") is desirable, deviations from this Plan may be appropriate from time to time to address: (i) changing financial goals; (ii) emerging financial products/debt structures; and (iii) unique market opportunities. As a result, the general best interests of the Authority shall supersede any provision of this Swap Management Plan.

**3. THE AUTHORITY**

The Authority is a public body corporate and politic of the State Of New Jersey operated under and by virtue of the New Jersey Turnpike Authority Act of 1948, constituting Chapter 454 of the Laws of New Jersey of 1948, as amended and supplemented (the "Act"). Pursuant to Section 5 of the Act, and Section 201 of the General Bond Resolution, the Authority is authorized to enter into interest rate swap transactions as it deems fit in order to obtain lower costs of capital or other advantages associated with this financing technique. The Authority may only enter into a swap transaction in connection with a specifically identified series of Authority bonds issued under its senior lien General Bond Resolution.

**4. INTEREST RATE SWAP MANAGEMENT GOALS**

The Authority intends to execute interest rate swaps if the transaction can be expected to result in the following:

- A. Hedging to reduced exposure to changes in interest rates on a particular financial transaction;

- B. Reduction in interest rate risk in order to maintain from the Authority's overall asset/liability balance;
- C. Obtain a lower net cost of borrowing with respect to the Authority's debt; and
- D. Manage variable interest rate exposure consistent with prudent debt practices.

The Authority shall not enter into interest rate swaps for speculative purposes or not in connection with a specified bond issue.

## **5. PROCUREMENT OF INTEREST RATE SWAP AGREEMENTS**

The Authority will award interest rate swap transactions to one or more qualified counterparties (as herein defined) through competitive or negotiated procurement methods. The general method of procurement and the specific procurement process will be determined based on the prevailing market conditions at the time. Regardless of the procurement method employed, the Authority shall endeavor to obtain the best pricing and execution possible, diversify counterparty exposure and minimize aggregate counterparty risk. To that end, before entering into a transaction, the Authority, with input from its financial advisor and/or swap advisor, will evaluate the prevailing market conditions to determine the optimal procurement process and will evaluate how the proposed transaction would affect the Authority's aggregate counterparty exposure.

## **6. INTEREST RATE SWAP RISK FACTORS**

The Authority recognizes that there are certain risks associated with interest rate swap transactions that it will consider prior to entering into each transaction. Such risks include:

- A. **Counterparty risk** is the risk that the swap counterparty will not fulfill its obligation to honor its obligations as specified under the contracts. Failure of a counterparty could result in an unplanned change in the expected costs of funds of a particular transaction that could increase debt service costs to the Authority, depending upon the interest rate environment when this occurred.

In order to mitigate against this risk the Authority intends to diversify its counterparties and expects that going forward, no more than 25% of its interest rate swap exposure will be with any one counterparty. An exception will be made for fully collateralized swaps or if market conditions are such that it is not economically feasible to diversify or the interest rate swap market is such that no additional counterparties exist.

In order to diversify the Authority's counterparty risk, and to limit the Authority's credit exposure to any one counterparty, limits will be established by the Executive Director based in part upon the credit rating of the counterparty as well as the relative level of risk associated with each existing interest rate swap transaction.

The Authority shall be authorized to enter into interest swap transactions only with qualified swap counterparties rated at least A1/A+, or equivalent, by any two (2) of the nationally recognized rating agencies (e.g. Moody's, Standard and Poor's, or Fitch); or a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency.

**B.) Termination risk** is the risk that the interest rate swap could be terminated by the counterparty due to any of several events, which may include issuer or counterparty ratings downgrade, covenant violation by either party, bankruptcy of either party, swap payment default by either party, and default events as defined in the issuer's bond indenture.

In order to mitigate against these risks the Authority will require collateral postings from counterparties if the counterparties ratings decline below A2/A and other protection measures. As a general rule, the Authority will not enter into swaps where the counterparty has any optional right of termination.

The Authority shall consider including in all interest rate swap transactions provisions granting the Authority the right to optionally terminate a swap agreement at any time over the term of the agreement. The Executive Director shall determine if it is financially advantageous for the Authority to terminate a swap agreement.

A termination payment to or from the Authority may be required in the event of termination of a interest rate swap agreement due to a default or a decrease in credit rating of either the Authority or the counterparty. It is the intent of the Authority not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Executive Director shall evaluate whether it is financially advantageous for the Authority to obtain a replacement counterparty to avoid making such termination payment.

As part of any interest rate swap agreement, the Authority may require collateralization or other credit enhancement to secure any or all swap payment obligations. As appropriate, the Authority may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:

- i. Each counterparty to the Authority may be required to post collateral if the credit rating of the counterparty or parent falls below the A2/A category. Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each interest rate swap agreement with the Authority.
- ii. The Collateral shall consist of cash, U.S. Treasury securities and Federal agency securities.

- iii. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the Authority and each counterparty.
- iv. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty.
- v. The market value of the collateral shall be determined on at least a monthly basis.
- vi. The Authority will determine reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.

The Executive Director shall determine on a case by case basis whether other forms of credit enhancement are more beneficial to the Authority

- C. **Basis risk** refers to a mismatch between the interest rate received from the interest rate swap contract and the interest actually owed on the Authority's variable rate bonds. Prior to the execution of any interest rate swap, the Authority will undertake any analysis of both the starting basis risk match and the historical basis risk match in order to select an index payment of the interest rate swap and a mode mechanic for the variable rate debt that most closely approximates a zero basis risk profile, while still maintaining the economic advantages of the interest rate swap.
- D. **Tax event risk.** All issuers who issue tax-exempt variable rate bonds that trade accept risk stemming from changes in marginal income tax rates. These risks are best mitigated by limiting the amount of variable rate debt as a percentage of the Authority's total debt outstanding. The Authority does not expect to issue more than 20% of its total debt in a variable rate mode of any form.
- E. **Rollover risk is** the risk that the swap contract is not coterminous with related bonds. The Executive Director shall determine the appropriate term for an interest rate swap agreement on a case-by-case basis. The slope of the interest rate swap curve, the marginal change in interest rate swap rates from year to year along the interest rate swap curve, and the impact that the term of the interest rate swap has on the overall exposure of the Authority shall be considered in determining the appropriate term of any interest rate swap agreement. In connection with the issuance or carrying of bonds, the term of the interest rate swap agreement between the Authority and a qualified interest rate swap counterparty shall not extend beyond the final maturity date of existing debt of the Authority, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds. The Authority does not intend to execute interest rate swaps that have rollover risk.
- F. **Amortization risk** represents the cost to the issuer of servicing debt or honoring interest rate swap payments due to a mismatch between bonds and the notional

amount of the interest rate swap. The Authority intends to always match the principal amount of bonds with the notional amount of the interest rate swap.

**G. Liquidity risk** refers to the issuer's inability to continue or renew a liquidity facility to assist in the sale of outstanding debt. The Authority will endeavor to provide sufficient liquidity available for swapped debt.

## **7. PAYMENT OBLIGATIONS**

Pursuant to Section 201 of the General Bond Resolution, the Authority's payment obligation under any qualified interest rate swap shall be made from the Debt Service Fund.

## **8. LEGAL MATTERS**

Each interest rate swap executed by the Authority shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including any schedules and confirmations. The interest rate swap agreements between the Authority and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Executive Director or his/her designee deems necessary or desirable. The Executive Director is authorized to sign all representations and disclosures as required.

## **9. REGULATORY COMPLIANCE**

Following is a list of regulatory requirements imposed at the Federal level with which the Authority shall make every reasonable effort to comply:

A.) **Dodd-Frank Compliance.** Pursuant to the authority of Section 731 of Title VII of Dodd-Frank Act, which includes amendments to the Commodity Exchange Act ("CEA") regarding over-the-counter derivative instruments, regulations were published by the Commodities Futures Trading Commission ("CFTC") that define business conduct between Swap Dealers or Major Swap Participants and their counterparties, including Swap Dealers or Major Swap Participants engaged in transactions with state and local governmental counterparties such as the Authority (referred to in the regulations as "Special Entities"). The new business conduct rules are far ranging and they can impact the Authority on several fronts as the Authority enters into or modifies transactions. The following sections are included in this Swap Management Plan in order to assist the Authority in complying with the CEA as amended by Dodd-Frank:

### (1) Qualified Independent Representative

- a) In accordance with the CEA and as amended by Dodd-Frank, the Authority shall select a QIR that meets the following enumerated criteria:

- i. has sufficient knowledge to evaluate the transaction and risks;
- ii. is not subject to a statutory disqualification;
- iii. is independent of the interest rate swap provider or major interest rate swap participant. To be independent the QIR must currently not, and was not with a one-year look back, an associated person of the swap dealer; has no principal relationship with the swap dealer, provides timely disclosures of all potential conflicts of interest, complies with procedures designed to manage and mitigate conflicts of interest, is not controlled by, in control of, or under common control with the swap dealer, and was not recommended to the issuer by the swap dealer within one year of the transaction date;
- iv. undertakes a duty to act in the best interests of the Authority;
- v. makes appropriate and timely disclosures to the Authority;
- vi. evaluates, consistent with any guidelines provided by the Authority, fair pricing and the appropriateness of the transaction; and
- vii. is subject to restrictions on certain political contributions imposed by the CFTC, the SEC, or a self-regulatory organization subject to the jurisdiction of the CFTC or the SEC.

b) At least annually, or as required by the Board of Commissioners, the Authority shall conduct a review of its QIR to ensure that the QIR still meets the above enumerated criteria. In the event that it is determined that the QIR no longer meets the enumerated criteria, then prior to the execution of any transaction the Authority shall select a replacement QIR that meets the enumerated criteria.

(2)Written Representations. In order to ensure that the Authority is in compliance with the new regulations imposed by Dodd-Frank, the Authority may, but is not required to, execute a ISDA August 2012 DF Protocol Agreement with its QIR and each Counterparty prior to executing any transactions. If the Authority elects not to execute a ISDA August 2012 DF Protocol Agreement with a counterparty, then the Authority shall provide an alternate form of written representation to such Counterparty that meets all applicable disclosure requirements as required by Dodd-Frank.

(3)Derivative Clearing Requirement.

(a) The CEA, as amended by Dodd-Frank, requires that certain derivative transactions, including those commonly entered into by state and local

governmental entities, must be cleared through a derivatives clearing organization unless otherwise exempt from clearing under the "End User Exception" as specified in Section 2(h)(7) of the CEA. In order to qualify for the End User Exception to the clearing requirements of the CEA, the Special Entity must report to the CFTC on either an annual or a transaction-by-transaction basis that it:

- (i) is not a financial entity;
  - (ii) is using swaps to hedge or mitigate commercial risk; and
  - (iii) will notify the CFTC, in a manner set forth by the CFTC, how it generally meets its financial obligations associated with entering into non-cleared swaps.
- (b) The Authority, in consultation with its QIR, shall make its best efforts to comply with the applicable derivative clearing requirements of the CEA as amended by Dodd-Frank.

## **10. SELECTION OF QIR**

The Authority will competitively procure the services of a financial advisor or a swap advisor, whose scope of work shall include swap advisory services which will allow the firm to serve as the Authority's QIR under Dodd-Frank.

## **11. RECORD KEEPING**

Written records noting the status of all interest rate swap agreements will be maintained by the Authority and shall include the following information:

1. Highlights of all material changes to swap agreements or new swap agreements entered into by the Authority since the last report
2. Market value of each of the Authority's interest rate swap agreements.
3. For each counterparty, the Authority shall provide the total notional amount position, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
4. The credit rating of each swap counterparty and credit enhancer insuring swap payments
5. Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.

6. A summary of each swap agreement, including but not limited to the type of swap, the rates paid by the Authority and received by the Authority, and other terms.
7. results of the default, including but not limited to the financial impact to the Authority, if any.
8. A summary of any swap agreements that were terminated.

## **12. COMPLIANCE WITH ACCOUNTING STANDARDS**

Any interest rate swap agreement entered into by the Authority under this Interest Rate Swap Management Plan shall be described in the Authority's annual audited financial statements in accordance with applicable accounting standards. This Interest Rate Swap Management plan shall be reviewed on an annual basis with the Authority's external auditor and any necessary changes shall be promptly implemented.