

## DERIVATIVES CHECKLIST

### **Introduction**

*This checklist is a supplement to the Advisory on “Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy (2003, 2005 and 2010) (DEBT)” and is designed to be an attachment to a government issuer’s derivatives policy. It is designed to be used prior to entering into any derivatives transaction. This checklist presumes an issuer’s compliance with the Advisory—to wit, that the issuer has adopted a derivatives policy and that the issuer’s staff has been trained in the evaluation and use of derivative products. An issuer that cannot answer the questions in this checklist is advised to continue its training prior to completing a derivatives transaction.*

*While the principles enunciated in the Advisory are generally applicable to all derivatives transactions, it is impracticable to create a “one size fits all” checklist to address the specific issues of all derivatives transactions. First, over-the-counter derivatives transactions are not uniform. Each is customized to fit the needs of the parties. Second, the derivatives market and the products being used in that market change over time, sometimes quite quickly, in response to changes in the broader financial markets. Third, the experience and sophistication of users of derivative products varies. Many experienced users of derivatives will already have developed their own means of assuring that all relevant issues in a derivatives transaction have been considered and addressed. Therefore, this checklist is intended mostly to assist issuers that meet the presumptions described above but are relatively new to the derivatives market. The issues addressed in this checklist are broadly applicable, but the form of the checklist is one that issuers are encouraged to adapt to their particular circumstances.*

*Many of the capitalized terms used in this checklist are used as defined in International Swaps and Derivatives Association, Inc. (“ISDA”) documents, and this checklist presumes that an issuer is familiar with such documents.*

### **General Information**

1. Name of Governmental Issuer: \_\_\_\_\_
2. Date of most recent update to Issuer’s Derivatives Policy: \_\_\_\_\_
3. (a) Names of Official and Backup(s) Responsible for Procurement of Derivative:  
\_\_\_\_\_
- (b) Names of Official and Backup(s) Responsible for Monitoring Derivative:  
\_\_\_\_\_
- (c) Have all of them satisfied the training standards prescribed in the Issuer’s Derivatives Policy?                      Yes \_\_\_ No \_\_\_

- 4. Independent Derivatives Advisor, if any: \_\_\_\_\_
- 5. Independent Derivatives Monitor, if any: \_\_\_\_\_

**Authority**

- 1. Will the Issuer’s counsel deliver an unqualified opinion on the Issuer’s authority to enter into the derivative? Yes \_\_\_ No \_\_\_

**General Terms**

- 1. Type of Derivative: \_\_\_\_\_
- 2. Counterparty/ies: \_\_\_\_\_
- 3. (a) Expected Trade Date: \_\_\_\_\_  
(b) Effective Date: \_\_\_\_\_  
(c) Scheduled Termination Date: \_\_\_\_\_  
(d) If derivative is an option, Exercise Date(s): \_\_\_\_\_
- 4. Notional Amount: \_\_\_\_\_
- 5. Identify debt, or assets, with which the derivative is associated:  
\_\_\_\_\_

**Financial Terms**

- 1. (a) Basis for calculating Issuer’s payments: \_\_\_\_\_  
(b) Frequency of calculation: \_\_\_\_\_  
(c) Frequency of payment: \_\_\_\_\_  
(d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_ No \_\_\_  
If yes, explain: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- 2. (a) Basis for calculating Counterparty’s/ies’ payments: \_\_\_\_\_  
(b) Frequency of calculation: \_\_\_\_\_  
(c) Frequency of payment: \_\_\_\_\_  
(d) Can the passage of time or future market conditions cause the basis for calculating these payments to change? Yes \_\_\_ No \_\_\_  
If yes, explain: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- 3. Identify any embedded options in the derivative: \_\_\_\_\_

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4. Will either party make an upfront payment upon execution of the derivative?  
Yes \_\_\_ No \_\_\_

**Purpose**

1. State the reason(s) for entering into the derivative.

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2. Were other means considered for achieving such purpose(s)? Yes \_\_\_ No \_\_\_  
If yes, why was the derivative chosen? \_\_\_\_\_

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**Risks**

1. Has the Issuer evaluated the extent to which each of the following risks will be assumed upon execution of the derivative?

- |                            |         |        |
|----------------------------|---------|--------|
| (a) Basis Risk             | Yes ___ | No ___ |
| (b) Tax Risk               | Yes ___ | No ___ |
| (c) Interest Rate Risk     | Yes ___ | No ___ |
| (d) Collateralization Risk | Yes ___ | No ___ |
| (e) Counterparty Risk      | Yes ___ | No ___ |
| (f) Termination Risk       | Yes ___ | No ___ |
| (g) Market-access Risk     | Yes ___ | No ___ |
| (h) Rollover Risk          | Yes ___ | No ___ |
| (i) Credit Risk            | Yes ___ | No ___ |

2. Are the risks to be assumed within the risk parameters of the Issuer's Derivatives Policy? Yes \_\_\_ No \_\_\_

3. Has Issuer run, or had run for it, stress tests on how the derivative could affect Issuer's budget and financial position under various market conditions? Yes \_\_\_ No \_\_\_

4. How do the benefits of entering into the derivative outweigh the risks being assumed?

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5. Upon execution of this derivative,

- (a) How many derivatives will Issuer have outstanding? \_\_\_\_\_

- (b) What is the total notional amount of those derivatives? \_\_\_\_\_
- (c) What percent of Issuer's long-term debt will be associated with derivatives? \_\_\_\_\_

**Documentation**

- 1. Is Issuer's counsel experienced in derivatives transactions? Yes \_\_\_ No \_\_\_
- 2. Has Issuer discussed with its counsel:
  - (a) Required consents and approvals? Yes \_\_\_ No \_\_\_
  - (b) Relation of derivative payments to bond payments? Yes \_\_\_ No \_\_\_
  - (c) Default provisions? Yes \_\_\_ No \_\_\_
  - (d) Termination provisions? Yes \_\_\_ No \_\_\_
  - (e) Other remedies? Yes \_\_\_ No \_\_\_

**Counterparty/ies**

- 1. On what basis did Issuer select Counterparty/ies?
  - Competitive
  - Negotiated
- 2. If competitive,
  - (a) Who was bidding agent? \_\_\_\_\_
  - (b) How many firms were invited to bid? \_\_\_\_\_
  - (c) How many firms bid? \_\_\_\_\_
  - (d) Is bidding agent providing a closing certificate? Yes \_\_\_ No \_\_\_
- 3. If negotiated,
  - (a) State reasons for negotiating derivative: \_\_\_\_\_
  - (b) State reasons for choosing Counterparty/ies: \_\_\_\_\_
  - (c) Estimated spread relative to mid-market or benchmark rate? \_\_\_\_\_
  - (d) Is Derivatives Advisor providing a certificate as to fair market valuation?  
 Yes \_\_\_ No \_\_\_  
 If no, what comfort will Issuer receive that the terms for the derivative are commercially reasonable? \_\_\_\_\_
- 4. What are ratings of Counterparty/ies? \_\_\_\_\_
- 5. Does Counterparty/ies meet credit criteria of Issuer's Derivatives Policy? Yes \_\_\_ No \_\_\_
- 6. What percentage of Issuer's total notional amount of derivatives will be with the same Counterparty/ies? \_\_\_\_\_
- 7. If Issuer will have more than one derivatives transaction with Counterparty or any of the Counterparties, will there be netting between or among separate derivatives transactions? Yes

\_\_\_ No \_\_\_

**Credit Support**

1. Credit Support will be provided for:
  - (a) Issuer Yes \_\_\_ No \_\_\_  
If yes, name of provider: \_\_\_\_\_
  - (b) Counterparty/ies Yes \_\_\_ No \_\_\_  
If yes, name of provider: \_\_\_\_\_
  
2. Has Issuer's counsel reviewed Issuer's credit support obligations? Yes \_\_\_ No \_\_\_
  
3. Has Issuer established procedures sufficient to:
  - (a) Comply with any such obligations? Yes \_\_\_ No \_\_\_
  - (b) Renew or replace Credit Support, if required? Yes \_\_\_ No \_\_\_
  - (c) Monitor the credit level of the Counterparty/ies? Yes \_\_\_ No \_\_\_
  - (d) Receive the benefit of, and comply with any obligations relating to, any credit support obligations of Counterparty/ies? Yes \_\_\_ No \_\_\_

**Tax Issues**

1. Tax counsel reviewing the documentation: \_\_\_\_\_
  
2. Has Issuer discussed with tax counsel:
  - (a) Integration of the derivative with a bond issue? Yes \_\_\_ No \_\_\_
  - (b) Whether yield monitoring is required? Yes \_\_\_ No \_\_\_
  - (c) Whether the derivative's performance or mark-to-market value should be included in arbitrage compliance calculations? Yes \_\_\_ No \_\_\_
  
3. Will tax counsel deliver an opinion in connection with the derivative? Yes \_\_\_ No \_\_\_

**Operations and Monitoring**

1. If the Expected Trade Date and the Effective Date are different, is the derivative part of a series of transactions? Yes \_\_\_ No \_\_\_  
If yes,
  - (a) Describe the subsequent transactions being considered: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
  
  - (b) Has Issuer established procedures or mechanisms to:
    - (i) Determine how and when any subsequent transaction will occur? Yes \_\_\_ No \_\_\_
    - (ii) Evaluate and handle risks to completion of any subsequent transaction? Yes \_\_\_ No \_\_\_
    - (iii) Complete, and pay expenses of, any subsequent transactions? Yes \_\_\_ No \_\_\_

2. Has Issuer discussed the appropriate accounting treatment for the derivative with its independent auditor? Yes \_\_\_ No \_\_\_
3. Does the Issuer intend to use hedge accounting? Yes \_\_\_ No \_\_\_  
 If yes, has the issuer received or made arrangements to receive confirmation of hedge effectiveness? Yes \_\_\_ No \_\_\_  
 If yes, from: \_\_\_\_\_
4. Who is responsible for confirming payment amounts and making necessary payments?  
 \_\_\_\_\_
5. What is the source for Issuer's regular payments? \_\_\_\_\_
6. How are such payments budgeted? \_\_\_\_\_
7. Who is responsible for monitoring credit ratings of Counterparty/ies?  
 \_\_\_\_\_
8. Who is responsible for monitoring mark-to-market valuations? \_\_\_\_\_
9. What is the frequency of such monitoring? \_\_\_\_\_
10. Who is responsible for monitoring collateralization requirements of Issuer and Counterparty/ies?  
 \_\_\_\_\_
11. If Issuer must post collateral, what will be the source? \_\_\_\_\_
12. If Counterparty/ies must post collateral, who will monitor? \_\_\_\_\_
13. What is the frequency of:
  - (a) Reporting monitoring results to Chief Executive Officer/Chief Financial Officer?  
 \_\_\_\_\_
  - (b) Sharing monitoring results with independent auditor? \_\_\_\_\_
14. Has Issuer discussed this derivative with the rating agencies? Yes \_\_\_ No \_\_\_
15. Who is responsible for delivery of future documents required by the derivative's documentation?  
 \_\_\_\_\_
16. Who is responsible for answering investors' questions about Issuer's derivatives exposure?  
 \_\_\_\_\_  
 \_\_\_\_\_

Information Provided By:

\_\_\_\_\_  
 (signature)

