

Ascension Capital Enterprises' Executive Summary on Bond Swaps

Swaps, and most other financially engineered products, are neither good nor bad. Rather it is a lack of knowledge that allows these products to be sold by salesmen rather than prudently purchased by the governance team that creates situations where the outcome is good or bad.

Ascension has produced an *Introduction to Swaps* whose executive summary is provided below:

- * Swaps mitigate the volatility of variable rate debt to the statement of cash flows. The volatility remains with the organizations and shows up on the balance sheet.
- * A 1% fee on bond underwriting produces \$10,000 per \$1 million financed. A 0.10% fee on an amortizing swap to maturity may produce \$11,400 per \$1 million financed.
- * Beware of banks bearing gifts. Swaps should be independent of credit. Replacement of the credit provider should not be a termination event.
- * Have a swap policy, annual review and other best governance practices on swaps.
- * Do NOT enter into any transaction for which the organization does not have a sustainable understanding of its risk and rewards.

Organizations need to understand the risks associated with swaps. Sustainable understanding includes:

- * Counterparty Risk;
- * Basis Risk;
- * Termination Risk;
- * Rollover Risk;
- * Amortization Risk;
- * Tax Risk.

Four factors that might be considered when terminating a swap:

- The swap no longer serves its original (or alternative) purpose or is inconsistent with current policy;
- Unwinding the swap would produce a positive, risk-adjusted and portfolio-adjusted NPV;
- Rating agencies, creditors or other stakeholders have expressed

- concern; and
- The swap subjects the borrower to unacceptable risks and reduced flexibility

Swaps and other products are too complicated to cover fully in an article of this length. Rather, this is a checklist to test whether the organization understands what it has done or what it is considering doing.

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