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# Financial Services Reform and its Impact on the Municipal Market

“Secondary Effect - Swaps”

**CDIAC Workshop**

October 6, 2010

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# 2010 – Dodd/Frank Act and GASB 53

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## \* Dodd/Frank Act

- Who will it affect?
- Will it affect existing transactions?
- How will it affect future transactions?
- When does it take effect?

## \* GASB 53

- When will it be implemented?
- Who will it effect?
- How do I complete the analysis?
- What impact will it have on my balance sheet and income statement?

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# Dodd/Frank: Exchange Requirement

- \* None, if the muni is an “eligible contract participant”:
  - \* the muni has \$50 million in discretionary assets; OR
  - \* the counterparty is a bank (or guaranteed by a bank)

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# Dodd/Frank: Clearance Requirement

- \* None, if an “end user exemption” is claimed:
  - \* one of the counterparties is not a financial entity;
  - \* using swaps to hedge a “commercial risk”; AND
  - \* issuer notifies the SEC or CFTC how it meets its financial obligations

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# Dodd/Frank - Capital and Margin Requirements

- \* Margin Requirement – none for municipal counterparties, unless:
  - the municipal counterparty qualifies as a swap dealer
  - the municipal counterparty qualifies as a major swap participant
- \* Impact on dealers could significantly increase execution costs
- \* Collateral requirements are not intended to impact “end users”

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# Dodd/Frank: Fiduciary Responsibilities

- \* Swap Dealers, unless.....the issuer uses a Financial Advisor.
- \* Swaps regulated by CFTC and SEC (Advisors by MSRB)

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# Dodd/Frank - Municipal Disclosure

- \* GAO to study “enhanced disclosure” in the Municipal Markets
- \* GOA to study the Municipal Securities market
  - an analysis of the mechanisms for trading, quality of trade execution, market transparency, trade reporting, price discovery, settlement, clearing, and credit enhancements
  - provide recommendations on how to improve transparency, fairness and liquidity
  - potential uses of derivatives

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# ALERT: Floating Rate Debt Disclosure

- \* Types of Variable Rate Debt
  - Auction Rate Securities
    - Status
  - Variable Date Demand Notes
    - LOC providers w/ratings
    - LOC rollover dates
    - Notes subject to “self liquidity”
  - Other types of variable rate exposure
    - Indexed Notes
    - “Direct Purchase” Notes w/terms
    - Synthetic Floating
    - other

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# GASB 53 - What You Should Know

- Begins FY2010
- The “Fair Value” of Derivatives is to be Reported in the Financial Statements
- If the Derivative is a “Hedge”
  - Annual Changes in Fair Value are Deferred
- If the Derivative is not a “Hedge”
  - Annual Changes in Fair Value Represented as a Gain or Loss

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# GASB 53 -Evaluating Effectiveness

- Consistent Critical Terms
- Quantitative Methods
  - Synthetic Instrument Method
  - Dollar-Offset Method
  - Regression Analysis
  - Other?