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Memorandum

TO: BATA Oversight Committee

DATE: April 1, 2009

FR: Executive Director

RE: Reauthorization of BATA Debt Policy, Resolution No. 51, Revised

Staff recommends this Committee's referral of Resolution No. 51, Revised to the Authority for approval.

BATA adopted a debt policy in May 2004 that outlined debt and swap guidelines as proposed by Government Finance Officers Association (GFOA), Municipal Securities Rulemaking Board (MSRB), and nationally recognized rating agencies (Fitch, Moodys and Standard & Poors) and was set forth in BATA Resolution No. 51. The debt policy details the credit standards for corporations to participate as BATA counterparties in swap transactions.

Currently, BATA's debt policy requires a two pronged test. The counterparty's ratings, or the ratings of an entity controlling the counterparty, must be the equivalent of "A+" or better from three nationally recognized rating agencies at the time of the execution of the documents for the transaction, and the counterparty must maintain ratings that are equal to or better than BATA's current ratings from any two nationally recognized rating agencies.

The credit turmoil of the past two years has had significant negative impact on the financial sector, including banks and bond insurance companies used as swap counterparties. The "AAA" corporate rating is virtually gone, replaced by "AA" and "A" ratings, with "A" corporate ratings now the most common. Ambac, the current counterparty on \$1.08 billion in swaps, has seen its ratings drop from "AAA/Aaa" to a current corporate rating of A/Baa1, well below our credit criteria. To be clear, Ambac has not missed a payment or failed to perform under the swap contract; however, it is their reduced credit standing that cannot be ignored.

BATA does have termination rights when credit rating levels drop; however, these rights have to be evaluated very carefully. Simple termination and cancellation of the swap contract by BATA could result in a significant termination payment under current market conditions. A preferable alternative would be for BATA to novate or assign the swaps to new counterparties. If BATA secures a sufficient number of counterparties to novate all of the Ambac swaps, the transfer will take place without any impact to BATA.

BATA is currently working to assign the Ambac swaps to new counterparties. The market reality, however, is that there are very few corporate counterparties with ratings as high as BATA's. While a counterparty downgrade does not trigger a default, we believe it is in the long term interest of BATA to allow assignment (novation) of swap contracts from the weaker credit position of Ambac to a new counterparty, so long as all existing contract terms are maintained and the new counterparty has minimum ratings of "A-" from at least two rating agencies.

The new corporate credit standards also require adjustment to the counterparty limits in Section 1A of Resolution No. 51. The portfolio limits were established at a time when financial firms carried significantly higher ratings. The recommended changes reflect the current market conditions. No changes to contract protections are suggested as BATA would retain full rights to terminate and require counterparties to post collateral in the appropriate collateral situation.

The recommended procedures will provide BATA an orderly process to change swap counterparties from weaker to stronger credits under current market conditions. BATA staff requests the Committee to approve forwarding Resolution No. 51, Revised, to the Authority for its approval.



Steve Heminger

SH/BM/cj