



Joseph P. Bort MetroCenter  
 101 Eighth Street  
 Oakland, CA 94607-4700  
 TEL 510.817.5700  
 TDD/TTY 510.817.5769  
 FAX 510.817.7848  
 E-MAIL info@mtc.ca.gov  
 WEB www.mtc.ca.gov

**Memorandum**

TO: BATA Authority  
 FR: Deputy Executive Director  
 RE: Financial Markets Update

DATE: July 18, 2012  
 W. I. 1254

There have been two significant recent events in the financial markets that may have an impact on how BATA manages its debt portfolio. The first event is Moody’s downgrade of 15 banks including four senior banks used by BATA. The second event is allegations of widespread manipulation of the London Interbank Offered Rate (LIBOR), including an admission by Barclays Bank and its payment of a fine exceeding over \$450 million.

Moody’s Downgrades

On June 21, Moody’s Investor Service announced a massive “repositioning” of 15 banks including American banks with significant global capital market operations. The rating changes involved both long-term deposit ratings as well as short-term ratings. The impact on BATA banking partners includes:

	<b>Long-Term</b>	<b>Short-Term</b>	<b>LOC Support</b>	<b>Swap Amount</b>
Bank of America	Baa2(Baa1)*	P2(A)*	\$310 Million	\$405 Million
Barclays PLC	A3(A1)*	P1	\$150 Million	-0-
Citibank	Baa2(A3)*	P2(P1)*	-0-	\$375 Million
Goldman Sachs	A3(A1)*	P1	-0-	\$145 Million
JP Morgan	A2(Aa3)*	P1	\$385 Million	\$386 Million
Morgan Stanley	Baa1	P2(P1)*	\$100 Million	\$75 Million

\* former rating

The most immediate issue is the bank short-term ratings. Banks provide BATA with Letters of Credit (LOC) facilities covering variable rate bonds as a means of guaranteeing payment to the bondholders.

In order for variable rate bonds to qualify as “tier 1” investments eligible for institutional money market funds, securities must carry the highest short-term ratings (P-1/A-1/F-1) from at least two rating agencies. Despite the P2 ratings from Moody’s, all of our bank credit support remain

money fund eligible because they still maintain the highest short-term rating (A-1) from Standard & Poors (S&P) or F-1 from Fitch.

So far we have not noticed any real trading differential resulting from any of the downgrades. Rather than wait to see if S&P follows Moody's lead, there are some options available to avoid the interest rate spikes that could result from a loss of both short-term ratings, including:

- Replace downgraded LOC banks with higher rated providers;
- Convert the variable rate bonds to a mode that does not require credit support; or
- Direct bank loans structured to replace the variable rate bonds.

We believe there are sufficient options to replace all of the "P2" rated LOCs without negative impact to the portfolio. We will be evaluating these options over the coming months, and will keep the Authority informed of any actions we take along those lines.

### Swap Counterparties

BATA has a current swap portfolio of \$1.9 billion of which \$1.2 billion has been affected by the Moody's ratings adjustment. Despite the ratings adjustment, all swap contracts continue to perform according to their agreements.

With the exception of JP Morgan, a counterparty rating below A-/A3 would trigger an Alternative Termination Event (ATE). JP Morgan's ATE rating trigger is below BBB/Baa2. An ATE would allow BATA to terminate the swaps at a discount on the market rate. However, an ATE is not a bank default nor does it require BATA to terminate a swap. The termination value of the entire swap portfolio would require an outlay of approximately \$561 million as of June 2012, so a termination now is not in our financial interest.

While the swap payments continue as contracted, BATA does have options on dealing with low rated counterparties, including:

- Novate the swap to a higher rated counterparty. BATA has successfully novated \$705 million in notional value maintaining the same strict contract standards and at no cost to BATA.
- Terminate the swap when the contracts reach positive market value.

BATA is constantly looking for highly rated swap counterparties for contract novations. However, until there are sufficient banks with stronger ratings or the swap contract value reaches a positive market value, staff recommends maintaining the contracts in their current condition. The risk associated with the lower ratings are outweighed by the millions BATA would pay in termination payments.

LIBOR Manipulation

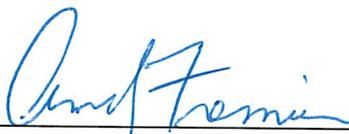
Recently, Barclays bank admitted to manipulating LIBOR and paid a fine in excess of \$450 million to British and American regulators. LIBOR is the benchmark borrowing rate established in London on a daily basis through a process of banks submitting estimates of what they would be charged if they borrowed from other banks. A total of 16 banks are involved with the four high and four low rates being eliminated and the remainder averaged to produce the LIBOR rate. Barclays has admitted to conspiring with other banks to artificially “lowball” the submissions in order to mask financial conditions as well as to improve trading positions.

In an environment of artificially lowered LIBOR rates, BATA could have been underpaid on our LIBOR-based swap contracts. At the time in question (2008), BATA had \$2.9 billion in a swap portfolio whose payments were mainly based on a percent of one month LIBOR. A one basis point (0.01%) change in the payment stream equates to potentially \$290,000 on the BATA portfolio per year.

The investigation into the LIBOR manipulation is widespread and involves U.S. banks with global operations including Citi Bank, JP Morgan and Bank of America. The extent to which BATA may have been harmed by underpayments will depend on how long rates were manipulated and how much the manipulation affected the actual LIBOR rate. For many, the manipulation was actually beneficial by lowering mortgage or credit card rates. However, in the case of LIBOR- based swap payments, the manipulation could be detrimental depending on overall payments BATA was required to make. A lawsuit has been filed in Baltimore alleging manipulation during a multi-year period in the past decade.

Staff will be conducting additional due diligence, consulting with other municipal issuers, and discussing options with our financial advisors and attorneys over the next several weeks. We intend to return to the BATA Authority in September to share the results of our review and seek your direction on what next steps to pursue.

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Andrew B. Fremier