Policies and Procedures

SECTION: **Financial**	*NO.* **3.1.21.**		
CHAPTER: **General**	*ISSUED:* 3/27/13	*REV. A* 4/5/17	*REV. B*
POLICY: **Hedging Policy**	*PAGE 1 OF 4*		

PURPOSE

As part of the University's enterprise risk management program, the use of hedging tools (i.e. derivatives) can play a key role in managing the University's financial risk.

The University's philosophy is to use hedging tools strategically to reduce financial risk on existing exposures. Hedging tools will not be used to create leverage or to speculate on the movement of prices.

SCOPE

The Hedging Policy applies to the use of hedging tools (derivatives) used for the purpose of reducing financial risk due to the University's exposure to market factors such as commodity prices and foreign exchange rates. The Hedging Policy does not apply to the management of interest rate exposures which is governed by The Interest Rate Risk Management Policy included as part of the University's Debt Policy.

OBJECTIVES

This policy is intended to:

(i) Outline the University's philosophy on hedging;

(ii) Provide guidelines on the use of derivatives; and

(iii) Establish a control framework related to the use of derivatives.

The University considers hedging a tool to transform unacceptable risks into an acceptable form. The goal of any hedging program should be to help the University achieve the optimal risk profile that balances the benefits of protection against the costs of hedging. The University will not use hedging tools to speculate on the movement of prices or to create leverage. The University recognizes that the prudent and selective use of derivatives may help it to mitigate exposure to price movements of certain commodities or indices and to lower its operating costs.

OVERSIGHT

The Senior Vice President of Operations ("SVP Operations") is responsible for implementing this policy. The policy and any subsequent, material changes to the policy are approved by the Budget and Finance Committee of the University's Board of Trustees ("Board"). The SVP Operations may delegate responsibilities for administration of this policy.

The Budget and Finance Committee of the Board will review the policy on an annual basis to ensure that the provisions are consistent with the goals of the University and market conditions.

The SVP Operations provides oversight and monitors all derivative transactions. Annual reviews of outstanding hedging programs will be submitted to the Budget and Finance Committee to ensure the program design continues to be effective.

DERIVATIVE USE GUIDELINES

Pursuant to this policy, derivatives may be used to manage price volatility of commodities or foreign currencies used in the operation of the University. Items to consider in deciding whether to hedge the risk include:

i) Materiality of the potential loss or exposure that might occur if the exposure is not hedged;
ii) The costs of hedging;
iii) The volatility of the exposure being hedged; and
iv) Any risks inherent to the derivative, such as counterparty risk.

When evaluating its hedging options, the University generally prefers the lowest cost, most liquid, and most flexible hedging strategy available. In instances where no one hedging strategy meets all these needs, the University prioritizes these requirements to decide on an optimal strategy.

ALLOWABLE DERIVATIVE INSTRUMENTS

The University recognizes that there are numerous derivatives of varying degrees of complexity. The University attempts to avoid structural complexity in its use of derivatives and believes the following instruments, used alone or in combination with each other, allow for sufficient flexibility to help the University meet its commodity price risk management objectives. These derivatives may take the form of stand-alone transactions or as contractual provisions of a service or purchase agreement.

- ***Forward Purchase Contracts***–Contract determining the volume and /or price of an underlying commodity to be paid or received on an obligation beginning at a future start date.

- ***Futures*** - Obligation to buy or sell an underlying instrument at a certain price and date. Transactions are exchange traded and consist of standardized contract terms specifying quantity and quality of the instrument, price per unit, date and method of delivery (if any).

- ***Swaps*** –Contract to exchange payments based on different indices or prices, generally with one price fixed at a specific level for the term of the contract and the other that is to be adjusted from time to time throughout the term of the contract.

- ***Call or Put Options*** – An option gives the holder a right, but not an obligation, to buy or sell a commodity or currency at or by a specified date(s) at an agreed upon price in exchange for the payment of a premium. Options, typically in the form of caps or floors, are designed to provide protection against prices being above a certain cap or below a certain floor. Options to enter into swaps, or swaptions, give the buyer the right to enter into a swap depending on the buyer's exposure. Pursuant to this policy, the University will not sell options.

Before entering into a derivative transaction, the University first gains a full understanding of the transaction and performs appropriate due diligence, such as (i) a quantification of potential risks and benefits; and (ii) an analysis of the impact on the University's risk exposure and cost structure.

EXPOSURE CONTROLS

The University has established exposure controls to address program risks. With respect to the University's energy hedging program, the attached Appendix A establishes the hedge parameters as approved by the Board Budget and Finance Committee.

The University manages its derivatives exposure by looking at its derivatives portfolio independently and also in the context of its overall asset and liability portfolios. Prior to entering into a derivative transaction, the University will examine the impact of such trade independently and on the asset and liability portfolios as a whole.

To the extent practicable, derivative transactions shall be governed by and subject to the terms and conditions set forth in an International Swap and Derivative Association, Inc. ("ISDA") Master Agreement, Credit Support Annex (if required) and Confirmation. Such ISDA documents will be established with each counterparty with which the University transacts derivatives. In those cases where the derivative transaction is embedded in the contract structure and terms governing the purchase and sale of the underlying commodity, the University will ensure that the contract affords reasonable legal protection in the event of termination or default.

Counterparty Credit Exposure – All derivative counterparties will be rated A3 or better by Moody's and A- or better by Standard & Poors. The maximum allowable credit exposure, determined by the net mark-to-market of all trades with a single counterparty, will be $10 million for counterparties rated Aa2/AA or better and $5 million for counterparties rated less than Aa2/AA. If a counterparty does not have a public credit rating, the maximum net exposure will be $2 million and the University will perform a credit review prior to entering into a derivative transaction.

The University may takes steps to reduce its exposure to a counterparty by either (i) requiring the counterparty to post collateral in the full amount of the exposure (all the while abiding by the terms of any Credit Support Annex between the University and the counterparty), (ii) terminating all or a portion of its outstanding contract(s) with the counterparty, or (iii) requiring the counterparty to obtain swap insurance or provide another form of third-party security agreeable to the University.

APPROVAL PROCESS

All new derivative transactions or major modifications to existing derivative agreements shall be reviewed with and approved by the Budget and Finance Committee. Further, derivative transactions embedded in existing contractual arrangements shall be approved by the Budget and Finance Committee on an annual basis.

APPENDIX A – ENERGY HEDGING PARAMETERS

Amount & Term of Energy Hedges

The University will assess its energy requirements for future periods based upon historical usage patterns and forecasted changes in demand. In consultation with its advisors, the University will hedge its energy exposure within the following ranges using any or all of the instruments set forth in Section V:

Time Period	Minimum Hedged %	Maximum Hedged %
Current Fiscal Year	50%	75%
Current Fiscal Year + 12 months	25%	50%
Current Fiscal Year + 24 months	25%	50%
Current Fiscal Year + 36 months	0%	25%