SIFMA Model Risk Disclosures Pursuant to MSRB Rule G-17

(as of January 13, 2021)

**Interest Rate Swaps**

[BACKGROUND INFORMATION – DELETE BEFORE SENDING: Under MSRB Rule G-17, underwriters must provide an issuer with disclosures about complex municipal securities financings that they recommend to the issuer for a negotiated offering. Interest rate swaps entered in connection with an offering will generally be treated as a complex municipal securities financing. The interpretive guidance to Rule G-17, *Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities (Aug. 2, 2012)* provides that the underwriter satisfies its disclosure obligation if the required disclosure has been provided to an issuer by the underwriter’s affiliated swap dealer or the issuer's independent swap or other financial advisor, as long as the underwriter has a reasonable basis for belief in the truthfulness and completeness of such disclosure. Note that these disclosures can also be delivered, as applicable, in connection with material amendments of existing swaps. DELETE ANY DRAFTER’S NOTES/FOOTNOTES BEFORE SENDING.]

The following is a description of the characteristics of interest rate swaps, as well as a description of certain financial risks that are known to us and reasonably foreseeable at this time and that you should consider before deciding whether to enter into an interest rate swap in connection with your Bonds. If you decide that you would like to pursue this financing alternative,] [the swap dealer (Swap Dealer)] or your municipal advisor and qualified independent representative, as applicable] will provide you with additional information describing the material terms of your particular interest rate swap. If you have any questions or concerns about these disclosures, please make those questions or concerns known immediately to us. There may be accounting, legal and other risks associated with a swap and you should consult with your financial and/or municipal, legal, accounting, tax, and other advisors, as applicable, to the extent you deem appropriate concerning such risks.

Under the CFTC Business Conduct Standards, the Swap Dealer is required to have a reasonable basis to believe that you have a “qualified independent representative” in connection with your swap. *See* Other Considerations -- Compliance with Dodd-Frank herein.

**Characteristics of Interest Rate Swaps; Rights and Obligations of Swap Parties**

*Financial Characteristics.* An interest rate swap is a two-party agreement by and between you and a Swap Dealer to exchange payments based on periodic changes in interest rates or indices on the dates and for the term specified in the swap agreement. Interest rate swaps typically involve an exchange of payments calculated based upon fixed and floating rates or upon two different floating rates. In the municipal market, the floating rates commonly used are the SIFMA Index and the London Interbank Offered Rate (LIBOR).[[1]](#footnote-2) New indices, including the Secured Overnight Financing Rate (SOFR)[[2]](#footnote-3), may also be used now or in the future. Swap payments are calculated based on a “Notional Amount” specified in the swap agreement; the Notional Amount is not, however, exchanged by the parties. Payment obligations on your swap will generally be netted so that only one party makes a payment on each payment date.

*Nature of the Swap Obligation*. The execution of a swap typically will not affect the nature of your obligation or legal liability to your Bondholders. Upon the execution of a swap, you continue to be legally obligated to your Bondholders to make debt service payments. From an economic perspective, the swap enables you to effectively convert your rate payment obligation, for example, from floating to fixed or from fixed to floating, but your bond and swap obligations are separate and distinct.

*Master Agreements.* Your swap will be executed under the terms of a Master Agreement, using the documents published by the International Swaps and Derivatives Association, Inc. (ISDA). Multiple swap transactions may be documented under one Master Agreement by the execution, from time to time, of separate confirmations executed by the parties. Swaps are typically aggregated and, if applicable, netted under one Master Agreement, with the effect that parties that have executed multiple swaps may treat them as one single agreement. This is consistent with the treatment of swaps, generally, under principles of U.S. bankruptcy law.

*Swap Termination*. A swap may be terminated by you or the Swap Dealer prior to its scheduled

termination date upon the occurrence, as to the other party, of one or more of the following Events of Default: Failure to Pay or Deliver, Breach of Agreement, Credit Support Default, Misrepresentation, Default Under Specified Transactions, Cross Default, Bankruptcy, and Merger Without Assumption and one or more of the following Termination Events: Illegality, Credit Event Upon Merger and any other event specified in the swap documents, typically including certain ratings downgrades. Consistent with the aggregation of swaps under a Master Agreement, the occurrence of an Event of Default or of certain Termination Events in respect of a party to a Master Agreement may have the effect of terminating all the swaps under such Master Agreement.

*Termination Payments*.Upon a swap termination, a payment may be owed by either party depending upon market conditions at the time of termination, regardless, generally, of which party is the defaulting party or the party affected by a Termination Event. The amount that would be payable by one party to the other if a swap were terminated on any particular day is typically referred to as the “Termination Payment” for the swap. A Termination Payment typically reflects the then-current mark-to-market value of a swap upon its termination in light of then-prevailing market conditions. For example, if you agree to pay a fixed rate on a swap and, following swap execution, fixed rates in the relevant market decline, it would be expected that the mark-to-market of the swap would be “against” you (*i.e.*, you would owe a Termination Payment if the swap were terminated because your obligation under the swap is to pay a fixed rate at a time when market rates are lower).

*Mark-to-Market Amounts*. A calculation of the mark-to-market value of a swap that would be payable if the swap were terminated may be used for various purposes. Among other things, it reflects, on any given date, the amount of any unrealized loss or gain on the swap for purposes of your financial statements; it may be used for purposes of establishing compliance with financial covenants and other terms of your indenture and other credit agreements; and it may be used to calculate the amount of collateral you are required to deliver to secure your payment obligations under the swap.

*Tax Considerations*. Consideration should be given as to whether a swap should be “integrated” with the Bonds which the swap is hedging for purposes of yield calculation on the Bonds for U.S. federal tax purposes. You should consult with your Bond Counsel regarding the tax implications of entering into the swap.

**Material Economic and Operational Terms of Interest Rate Swaps**

OPTION 1: Fixed Payer Swap

In a fixed payer swap, an issuer makes payments based on a fixed rate determined at the pricing of the swap and receives payments based on a floating rate index such as the SIFMA Index, LIBOR, SOFR, or such other indices that may exist in the future. An issuer typically enters into a fixed payer swap to hedge against the interest rate volatility of variable rate debt. The floating rate payments made by the Swap Dealer are intended to offset an issuer’s variable rate debt exposure, so that, as a result of the variable rate debt taken together with the swap, an issuer makes payments based on a net fixed rate.

*[Describe material economic and operational terms of the fixed payer swap.]*

OPTION 2: Fixed Receiver Swap

In a fixed receiver swap, an issuer makes payments based on a floating rate index such as the SIFMA Index, LIBOR, SOFR, or such other indices that may exist in the future and receives payments based on a fixed rate determined at the pricing of the swap. An issuer typically enters into a fixed receiver swap in connection with fixed rate debt. As a result of the fixed rate debt taken together with the swap, the issuer makes payments based on a net floating rate.

*[Describe material economic and operational terms of the fixed receiver swap.]*

OPTION 3: Basis Swap

In a basis swap, an issuer makes payments based on one floating rate index such as the SIFMA Index, LIBOR, SOFR, or such other indices that may exist in the future and receives payments based on a different floating rate index.

*[Describe material economic and operational terms of the basis swap.]*

OPTION 4: Interest Rate Cap

In an interest rate cap, one party agrees to pay the other an amount determined by the degree, if any, that a floating rate exceeds a predetermined fixed rate, called the strike rate. Interest rate caps are typically purchased by an issuer in connection with variable rate debt to economically provide a maximum rate payable on variable rate debt without actually subjecting the terms of the debt to a maximum rate.

*[Describe material economic and operational terms of the interest rate cap.]*

OPTION 5: [Other Swaps]

*[Insert description of Rate Lock, Swaption, Interest Rate Floor, Yield Curve Swap,*

*Security-Based Swap, etc.]*

*[Describe material economic and operational terms of the swap.]*

**Risk Considerations of Interest Rate Swaps**

*Credit/Counterparty Risk.* Counterparty risk is the risk that the Swap Dealer (or its Credit Support Provider or Guarantor) will not fulfill its obligations as specified by the terms of the swap. An issuer that elects not to clear its swap is exposed to the credit and counterparty risk of the Swap Dealer. If an Event of Default or Termination Event occurs as to the Swap Dealer, including, without limitation, as a result of the Swap Dealer’s bankruptcy or significant ratings downgrade, you will generally have the right to terminate the swap, but the amount of any payment you receive, if any termination payments are owed to you, would be subject to the Swap Dealer’s ability to make the required payment. Upon the bankruptcy or other insolvency of a Swap Dealer, among other things, your obligation to make payments to your insolvent counterparty, the timing of swap terminations and the valuation of a swap upon its termination

as well as your right to the return of any excess collateral you may have posted, may be determined, or affected, by principles of relevant bankruptcy or other insolvency law. You may not receive amounts from the Swap Dealer to which you would otherwise be entitled, including but not limited to ongoing payments under the swap, termination payments and the return of any excess collateral. You should consult with your counsel regarding these and other considerations, and your rights, in the event of the Swap Dealer’s bankruptcy or other applicable insolvency proceeding.

*Termination Risk.* Termination risk is the risk that the swap (or multiple swaps under a Master

Agreement) could be terminated prior to its (or their) scheduled termination date(s) as a result of any of several events relating to either you or the Swap Dealer, including your payment default on a swap or the Bonds or a downgrade of your ratings and other events specified by the terms of the swap and the Master Agreement. Upon an early termination, a substantial Termination Payment could be due and payable; you may either owe a Termination Payment to the Swap Dealer or receive a Termination Payment from the Swap Dealer depending on then-prevailing market rates in the relevant market for a swap with the same term and structure. You may be able to fund a Termination Payment from the proceeds of borrowings. However, your contractual obligation to make a Termination Payment is unconditional and is not subject to your ability to incur debt or access the public markets.

*Interest Rate Risk.* Interest rate risk is the risk that rates will increase or decrease, and such fluctuations will affect the swap’s cash flow, mark-to-market value and upon an early termination, the required Termination Payment. On a fixed payer swap, you also forgo the opportunity to take advantage of lower rates if rates decrease.

*Basis Risk.* Basis risk arises from the mismatch between the rate you receive under the swap and the rate you pay on the bonds which the swap is hedging. For example, basis risk describes the risk in a fixed payer swap that the floating rate you receive under the swap may not equal the floating rate you pay on the variable rate bonds that you are hedging. The two rates may not fluctuate the same way or to the same extent. Basis risk will also be impacted by the ratings of any credit enhancer or liquidity provider on the variable-rate bonds, a failed remarketing, as well as general market conditions.

*Tax Risk.* Tax risk is a specific basis risk stemming from the potential mismatch between, for example, the percentage of LIBOR or other rate you receive on a swap and the interest rate you pay on your tax-exempt variable rate bonds as a result of the occurrence of tax events affecting your bonds or tax-exempt bonds generally, including changes in marginal income tax rates and other changes in the Federal and state tax systems. For example, a reduction in marginal Federal income tax rates, a reduction of the Federal tax rate on interest income, a change in the treatment of tax-exempt municipal bond interest or a change in the structure of the Federal tax system may cause tax-exempt interest rates and the SIFMA Index to rise relative to taxable interest rates or LIBOR, increasing basis risk, as the amounts you receive under the swap may be less than the amounts you then owe on the bonds.

*Liquidity Risk.* Liquidity risk is the risk that it may be difficult to terminate a swap or to assess the market value of a swap under certain market conditions. The Swap Dealer may but is not obligated (unless specifically agreed to under the swap documentation) to unwind or terminate the swap at market at your request. Generally, you may not assign, amend, or novate the swap without the prior written consent of the Swap Dealer. There can be no assurance, and the Swap Dealer does not guarantee, that another swap dealer will be willing to accept the rights and obligations under your swap or that the Swap Dealer would consent to such a transfer.

*Collateral Risk*. [Include when an issuer agrees to deliver collateral to secure its obligations under the swap] Under certain circumstances, you may be required to deliver collateral to secure your payment obligations under the swap. Your obligation to post collateral on a swap will be calculated, from time to time, on the basis of the mark-to-market value of the swap (and on other swaps under the Master Agreement) and may be substantial. Since you deliver collateral [directly to the Swap Dealer] [to a third-party custodian], the return of your collateral is subject to the [credit and bankruptcy risks of the Swap Dealer] [and the credit and operational risks of the third-party custodian.] [If a third-party custodian were to default in its obligations to return collateral in connection with the swap, you could suffer losses, and such losses could be substantial.] You should consult with your counsel regarding your rights with respect to collateral.

*Operational Risk.* Operational risk is the risk of loss arising from failures of systems and controls for recording, monitoring, and quantifying the risks and contractual obligations associated with swaps, for valuing transactions and transferring funds or for detecting human error or system failures. Monitoring and management of a swap or your swap portfolio may require the dedication of resources and personnel on an ongoing basis.

*Amortization Risk.* Amortization risk is the risk of a mismatch between the principal amount of the Bonds and the Notional Amount of the related swap.

**Other Considerations**

[Delete the following sentence if the Issuer is not issuing VRDOs: [If you are contemplating entering into a swap in connection with your VRDOs, you should consider the financial risk considerations discussed in the *SIFMA Model Risk Disclosures Pursuant to MSRB Rule G-17 related to Variable Rate Demand Obligations*.] [Delete the following sentence if the Issuer is not issuing Fixed Rate Bonds: [If you are contemplating entering into a swap in connection with your Fixed Rate Bonds, you should consider the financial risk considerations discussed in the *SIFMA Model Risk Disclosures Pursuant to MSRB Rule G-17 related to Fixed Rate Bonds*.] [Delete the following sentence if the Issuer is not issuing FRNs: [If you are contemplating entering into a swap in connection with your FRNs, you should consider the financial risk considerations discussed in the *SIFMA Model Risk Disclosures Pursuant to MSRB Rule G-17 related to Floating Rate Notes*.] Certain other considerations may also arise in connection with your execution of a swap, including some or all the following:

*Pricing of Swaps.* Price and other terms of swaps are individually negotiated between you and the Swap Dealer. The Swap Dealer does not represent or warrant to you that the prices at which the Swap Dealer may offer to enter into a swap with you will be the best prices available to you. Similarly, provision of an indicative valuation or price by the Swap Dealer should not be considered to be an offer to enter into or terminate the relevant transaction at that value or price. Because swaps are not standardized or publicly traded, their value at any time may not be precisely ascertainable; different market participants, using different pricing models, may arrive at different values. The transaction costs associated with a swap may be material and may impact the level at which a swap is executed or terminated. Transaction costs include, but are not necessarily limited to, trading costs, hedging costs, funding charges, swap dealer fees

and legal expenses.

*Upfront Payment.*[[3]](#footnote-4)Consideration should be given as to the characterization of an upfront payment made by the Swap Dealer on any swap. To the extent that that the Swap Dealer makes an upfront payment to you that constitutes an off-market payment, such amount could be considered to be a loan from the Swap Dealer to you. You should consult with your counsel regarding any upfront payment you may receive from the Swap Dealer in connection with the swap.

*Trading for Swap Dealer’s Own Account; Swap Dealer’s Financial Market Activities.* The Swap Dealer may act in various capacities throughout the financial markets and these activities may, in certain circumstances, adversely affect the value of the swap. The Swap Dealer may engage in proprietary trading for its own accounts in instruments similar to the swap, subject to regulatory restrictions on such proprietary trading activities, engage in similar or offsetting transactions with other counterparties or act as calculation agent with respect to Events of Default, Termination Events, or other events. Such trading and hedging activities can adversely affect the value of the swap.

*Index Risk.* The Swap Dealer may provide data that is used to compile the floating rate index on the swap, such as the SIFMA Index, LIBOR, SOFR, or other such indices that might exist in the future. [INCLUDE IF APPLICABLE [The Swap Dealer or an affiliate of the Swap Dealer may be a reference bank for purposes of setting LIBOR.]] [INCLUDE IF APPLICABLE [In the Underwriter’s capacity as a remarketing agent, the Underwriter may remarket bonds that are included in the calculation of the SIFMA Index.]]

The method of establishing indices used in the municipal market may change over time. A change in the SIFMA Index, LIBOR, SOFR, or other such indices that may exist in the future, may affect the rate that you pay, or receive, as the case may be, on the swap. In fact, the regulatory authority that oversees financial services firms and financial markets in the UK announced that, after [insert date], it would no longer persuade or compel contributing banks to make rate submissions for the purposes of determining the LIBOR rate. As a result, it is possible that commencing [insert date], LIBOR may no longer be available or no longer considered or deemed an appropriate reference rate upon which to determine the interest rate on your transaction.

In addition, there is a risk that, at any point in time, the indices (and therefore the rate that you pay, or receive on the swap, as the case may be) may be affected by factors that are unrelated to the market for swaps generally. For example, SOFR, a replacement for LIBOR, may be subject to volatility and other factors. One such factor is that the pricing and market terms for debt securities indexed to SOFR (such as the spread over SOFR reflected in the interest rate provisions) may evolve over time. Until the SOFR-linked FRN market is more mature with a greater number of issued and traded instruments, trading prices may be low or more volatile. You should consider with your counsel and financial advisors what effect specific risks related to SOFR may have on your FRN transaction or the value of any related transactions that reference SOFR, as well as other changes you may want to include in any such transactions in contemplation thereof.

*Compliance with Dodd-Frank.* Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank”), which was signed into law in July 2010, regulatory agencies, including the U.S. Commodity Futures Trading Commission (the “CFTC”) and the Securities and Exchange Commission are required to adopt, and are in the process of promulgating, regulations governing multiple aspects of swap transactions and the functioning of the swap market. More specifically, the CFTC adopted regulations which enumerate certain business conduct standards applicable to swap dealers (the “CFTC Business Conduct Standards”) when dealing with counterparties generally, and additional requirements applicable to swap dealers when dealing with Special Entities (as such term is defined in Dodd-Frank and the CFTC Business Conduct Standards), including municipal market issuers. Under the CFTC Business Conduct Standards, the Swap Dealer is required to have a reasonable basis to

believe that you have a “qualified independent representative” for the swap that has, among other things, undertaken a duty to act in your best interests and to evaluate the pricing and appropriateness of the swap. The [Underwriter] [Swap Dealer] reserves the right to supplement these disclosures or request certain additional representations from you and your qualified independent representative.

*Role of the Swap Dealer].* The Swap Dealer is acting solely as a principal, and not as your agent, advisor, or fiduciary in connection with the swap. Neither the Underwriter nor the Swap Dealer has assumed a fiduciary responsibility in your favor with respect to the swap and nothing in the swap documents or in any prior relationship between you and the Underwriter or Swap Dealer] creates an advisory, fiduciary or agency relationship between you and the Underwriter or Swap Dealer in respect of the swap (whether or not the Swap Dealer or any affiliate of the Underwriter [or Swap Dealer] has provided or is currently providing other services to you on related or other matters). In connection with the swap, the Swap Dealer is your arm’s length contractual counterparty. Both the Swap Dealer and Underwriter have different financial interests than you do. You should determine, without reliance upon the Underwriter, the Swap Dealer or any of their affiliates, the financial and economic risks and merits, as well as the legal, tax and accounting characterizations and consequences, of the swap and that you are capable of assuming such risks and should consult, to the extent you deem necessary, with your own legal, tax, accounting and financial advisors, qualified independent representatives and municipal advisors] to determine whether the swap is in your best interest and make an independent analysis and decision to enter into the swap based on such advice. Neither the Swap Dealer nor the Underwriter] is expressing an opinion as to whether you should enter into a swap.

1. “*SIFMA Index*” is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics. The Index is calculated and published by Bloomberg on Wednesdays at approximately 4pm EST. The Index is overseen by SIFMA’s Municipal Swap Index Committee*.* “*LIBOR*” is the London-Interbank Offered Rate, which is an interest rate for a specified period for US Dollar investments that is administered by the ICE Benchmark Administration Limited (IBA). LIBOR is determined each day at 11am (London time) and is the average rate (with some adjustments) derived from the quotations provided by certain reference banks that are determined by the IBA. In most cases, swap documents refer to an alternate mechanism for establishing the index in the event that the SIFMA Index or LIBOR, as applicable, is not calculated. See the Alternative Reference Rates Committee’s (ARRC) fallback language for a description of the effects of Benchmark Transition Events, <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/FRN_Fallback_Language.pdf> [↑](#footnote-ref-2)
2. SOFR is the broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. It is calculated by the Federal Reserve as a volume-weighted median of transaction-level tri-party repo data. Each business day, the New York Fed publishes the SOFR on the New York Fed website at approximately 8am EST. [↑](#footnote-ref-3)
3. Include if the swap includes an upfront payment. [↑](#footnote-ref-4)