AGENDA ITEM 7.

RESOLUTION AUTHORIZING AND APPROVING AN INTEREST RATE EXCHANGE AGREEMENT

Submitted for: Action

Summary: Staff recommends the adoption of the attached Resolution approving and directing the execution of an interest rate exchange agreement under the 2001 General Resolution adopted by the Commission on the 9th day of November 2001. Specifically, it is recommended that, in order to maximize program efficiencies, the Commission enter into a fixed payer interest rate exchange agreement with a term of approximately one year. This agreement would enable the Commission to synthetically convert the variable rate paid on certain of its taxable Auction Rate Certificates to a fixed rate, thereby providing the Commission with a cost-effective means of matching its one-year fixed rate Parent Loans to Undergraduate Students (PLUS) assets with corresponding bond interest liabilities. The interest rate exchange agreement would enable the Commission to lock in the spread between the PLUS loans and the related borrowing costs until the PLUS loans' next annual reset date in 2004.

Staff notes that the proposed interest rate exchange agreement would be the second such agreement entered into by the Commission. The initial interest rate exchange agreement was approved at the Commission's meeting on June 14, 2002 and will mature on July 1, 2003.

Action requested: That the Commission approve the following resolution:

"**BE IT RESOLVED** that the Illinois Student Assistance Commission approves the execution and delivery of a Resolution authorizing and directing that the Commission enter into an interest rate exchange agreement with respect to the General Resolution adopted by the Commission on the 9th day of November, 2001, and the execution and delivery of certain standard agreements in connection therewith as set forth in such Resolution. The Commission further delegates the authority to execute such agreements, take certain actions, and to make certain determinations with respect to such agreements, to the Chairman of the Commission or, if so designated in writing by said Chairman with respect to any or all of the actions or determinations described herein, the Executive Director of the Commission; and

"**BE IT RESOLVED** that this Resolution authorizes the Agreement to be executed and delivered with a notional amount not to exceed $150,000,000 and have a term set to expire on or about July 1, 2004."

ILLINOIS STUDENT ASSISTANCE COMMISSION

RESOLUTION AUTHORIZING AND APPROVING AN INTEREST RATE EXCHANGE AGREEMENT

Background

A component of ISAC's loan portfolio consists of PLUS loans. PLUS loans are loans to parents of dependent undergraduate students. The basic provisions applicable to PLUS loans are similar to those of Guaranteed Student Loans with respect to the involvement of guaranty agencies and the Secretary of Education in providing federal insurance on the loans. However, PLUS loans differ significantly from Student Loans in that Federal Interest Subsidy Payments are not available under the PLUS loan program and Special Allowance Payments are more restricted. While the interest rate for PLUS loans depends upon the date of issuance of the loan and the period of enrollment for which the loan is to apply, the interest rate on PLUS loans disbursed on or after July 1, 1998 resets annually on each July 1 and is 4.22% for the coming FY 2004. Special Allowance Payments are available if the interest rate calculated under that formula exceeds a 9% cap on the interest rate to the parent.

Given the current interest rate environment, the $150 million PLUS loan portfolio subject to the anticipated interest rate exchange agreement will not be entitled to receive Special Allowance Payments through June 30, 2004 (the time of the next reset). Accordingly, these loans are essentially fixed rate assets for one year. ISAC's primary funding vehicle for PLUS loans is Auction Rate Certificates, which are variable rate securities which reset every 28 days. ISAC can protect itself from this interest rate mismatch (i.e. fixed rate assets being funded with variable rate securities) and lock in a spread on these assets until their next annual reset by entering into a one year interest rate exchange agreement or by extending the auction rate period on a component of its outstanding Auction Rate Certificates from 28 days to 1 year. Given the current interest rate environment, Staff recommends that the Commission enter into an interest rate exchange agreement. Should an interest rate exchange agreement not be executed in connection with the Auction Rate Certificates, Staff anticipates eliminating the risk by extending the term of the auction period.

An interest rate exchange agreement will enable ISAC to synthetically convert a component of its variable rate cost of funds to a fixed rate, thereby providing ISAC with a cost-effective means of matching its fixed rate PLUS loans with its liabilities. Such action would ensure ISAC of earning a known, specific spread on a portion of its portfolio of "fixed" rate PLUS loans. ISAC would therefore be removing the risk of its debt service obligations rising while the return on related assets remained fixed.

Proposed Transaction. Staff proposes that ISAC enter into an interest rate exchange agreement with UBS AG (the parent company of UBS Financial Services Inc., formerly UBS PaineWebber). Staff is confident that UBS AG has excellent technical expertise in interest rate exchange agreements, an outstanding reputation in the industry, and high credit ratings of Aa2/AA+/AAA from Moody's Investors Service, Standard & Poor's and Fitch Inc., respectively. All of these factors were reviewed when UBS AG

submitted their competitive bid to provide investment banking services including interest rate exchange agreements.

UBS AG will pay ISAC an interest rate which will approximately match the interest rate ISAC will owe on its bonds. In exchange, ISAC will pay UBS AG a fixed rate (which will be determined at the time the agreement is entered into and will be based on market conditions at that time). The net result of this interest rate exchange agreement will be to fix ISAC's interest rate for approximately one year. This locks in a spread between the yield on the underlying PLUS loans and the interest expense on ISAC's debt. This spread will be sufficient to cover all corresponding servicing and administrative expenses for FY 2004.

ILLINOIS STUDENT ASSISTANCE COMMISSION

RESOLUTION

RESOLUTION PROVIDING FOR THE EXECUTION AND DELIVERY OF A DERIVATIVE PRODUCT IN ACCORDANCE WITH THE TERMS OF THE RESOLUTION, AS AMENDED.

WHEREAS, on November 9, 2001, the Commission adopted a resolution authorizing the issue of Student Loan Revenue Bonds (as supplemented and amended from time to time, the "2001 Resolution"); and

WHEREAS, on January 9, 2002, the Commission issued its Tax-Exempt Student Loan Revenue Bonds, Series 2001A and Taxable Student Loan Revenue Bonds, Series 2001B (the *"Series 2001B Bonds"*) pursuant to a First Supplemental Resolution adopted November 9, 2001; and

WHEREAS, the Commission is entitled to enter into a Derivative Product in accordance with the provisions of the Resolution and the Commission now desires to enter into a Derivative Product (the *"Derivative Product"*) with respect to not to exceed $150,000,000 of the Series 2001B Bonds in order to enhance program efficiencies; and

WHEREAS, any Derivative Product issued under the Resolution must be approved in advance by the Rating Agencies in the form of a Rating Confirmation; and

WHEREAS, the Commission represents that the Derivative Product shall not be entered into until such Rating Confirmation is obtained; and

WHEREAS, all capitalized terms not otherwise defined herein shall have the same meaning as set forth in the Resolution;

NOW, THEREFORE Be It and It Is Hereby Resolved by the Illinois Student Assistance Commission, as follows:

Section 1. **Approval of Derivative Product.** The Commission hereby approves the execution and delivery of a Derivative Product with respect to the Series 2001B Bonds of a term of approximately one year, with a notional amount not to exceed $150,000,000, and with UBS AG as the Counterparty.

Section 2. Terms of Derivative Product. The Derivative Product shall be entered into under the Master Agreement (the "*Master Agreement*"), dated as of June, 17, 2002, between the Commission and UBS AG, the Schedule to the Master Agreement (the "*Schedule*"), dated as of June 17, 2002, between the Commission and UBS AG, the Credit Support Annex to the Schedule (the "*Annex*"), dated as of June 17, 2002, between the Commission and UBS AG, and the Transaction Confirmation (the "*Transaction Confirmation*") to be entered into by the Commission and UBS AG on the trade date relating to the Derivative Product.

Section 3. Approval of Documents. The Commission hereby ratifies the prior execution of and approves, for purposes of the Derivative Product, the use of the Master Agreement, the Schedule, and the Annex. Further, the Commission hereby approves the execution of the Transaction Confirmation by the Chairman or by his designee pursuant to Section 4 below.

Section 4. Delegation of Authority. The Commission hereby delegates final authority to execute the Transaction Confirmation and all other documents and certificates relating to the Derivative Product, and to make all determinations with respect to such agreements, to the Chairman of the Commission or, if so designated in writing by said Chairman with respect to any or all of the actions or determinations described herein, the Executive Director of the Commission.

Section 5. Effective Date. This Resolution shall be in full force and effect forthwith upon its adoption.

ADOPTED and APPROVED this 23rd day of June, 2003

By _____
Chairman, Illinois Student Assistance Commission

Attest:

By _____
Executive Director, Illinois Student Assistance Commission