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I. INTRODUCTION (Purpose and Intent)

Mission of the University

The University of South Florida (the “University”) is a multi-campus national research university that supports the development of the metropolitan Tampa Bay Region, the United States and the world. Building upon unique strengths inherent in Florida’s population, location, and natural resources, the university is dedicated to excellence in:

- Teaching and lifelong learning in a student-centered environment
- Research to advance knowledge and promote social, cultural, economic, educational, health, and technological development
- Service based on academic excellence and the ethic of community responsibility
- Community engagement to build university-community partnerships and collaborations.

Purpose of the Policy

The purpose of this document is to establish a policy for the University for the management of corporate risk associated with derivative instruments and hedging activities by limiting exposures and positions that can be taken in derivative instruments, controlling balance sheet risks by managing the asset-liability structure of the University, identifying responsible parties and defining the scope of their authority, defining exposures that should be avoided, measuring them and defining appropriate actions to control this risk (the “Policy”).

The Policy establishes accounting and reporting standards for derivative instruments, a financial instrument which derives its value from the value of some other financial instrument, variable or index, including certain derivative instruments embedded in other contracts (collectively referred to as “derivatives”), and for hedging activities.

The Policy requires the recognition of all derivatives as either assets or liabilities in the statement of financial position and measurement of those instruments at fair value. The accounting for changes in the fair value of a derivative (gains and losses) depends on the intended use of the derivative and the resulting designation. Furthermore, this Policy is established to minimize the income statement impact of fluctuating derivative values, cash flows and rates.
In June 1998, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“FAS 133”). FAS 133 establishes accounting and reporting standards for derivative instruments. Pursuant to FAS 133, hedging relationships are designated and documented. The University and its direct support organizations and component units will complete implementation plans, which include identifying all derivatives, evaluating risk management hedging strategies and determining appropriate valuation methodologies to assess the impact that this statement will have on its financial position and results of operations.

Positions in derivative instruments such as interest rate swaps are maintained to reduce exposure to particular markets and financial instruments. Involvement with derivative instruments and transactions is intended to reduce or eliminate risk. Derivative instruments and contracts may not be used for speculative purposes.

II. STATEMENT OF POLICY

It is the policy of the University of South Florida that derivative instruments, contracts and hedging activities conform to the authority granted by Florida and Federal laws, its Board of Trustees and applicable policies of the Board of Governors including, but not limited to, the Board of Governors’ Debt Management Guidelines for Capital Outlay Projects approved on April 27, 2006, and that the derivative instruments and hedging activities be conducted in such a manner as to promote the interests of the University.

The Policy is established to define allowable derivative transactions or positions. A secondary consideration would be to minimize the risk of fluctuating derivative values, cash flows and rates.

It is the University’s Policy for all entities covered hereunder that:

A. Derivative transactions are to be used to hedge, mitigate or reduce risk exposures.

B. Derivative transactions may not be used for speculative purposes or to assume risks that are not prudent considering the purposes for which the transaction is intended.

C. Open, unhedged derivative transactions should be avoided.

D. Derivative instrument contracts should only be entered into with an associated underlying exposure.

E. Preferred hedge transactions are those determined to be effective hedges.

F. Derivative instruments and contracts should be constructed to minimize liquidity and cash flow risks associated with hedging activities. The following risks should
be considered for each derivative transaction: Counterparty Risk – the risk that the counterparty will not fulfill its obligations under the contract, Termination Risk – the risk that the contract could be terminated as a result of various events, Basis Risk – the mismatch between the interest received under the contract and the interest paid on the related bonds, Tax Risk – the risk due to changes in income tax rates and other changes in tax policies, Amortization Risk – the mismatch between the principal payments on the related bonds and the payments due under the contract, Rollover Risk – the risk that the term of the contract does not match the term of the related bonds and that a new contract cannot be secured, and Liquidity Risk – the risk that the University cannot secure a cost-effective renewal of a letter or line of credit or suffers a failed auction or remarketing of the variable-rate bonds. The following strategies at a minimum should be considered to mitigate these risks: analyzing collateral exposure under various rate shocks; establishing minimum counterparty credit ratings; diversifying counterparties; defining acceptable termination events; providing for an optional termination provision for the University; providing limits on counterparty termination options; use of insurance policies, collateral requirements or third-party guarantees; and describing termination payment terms.

G. All derivative instruments and hedging activities will be employed in a manner consistent with this Policy and the provisions of the University’s Debt Management Policy.

H. Legal and financial experts will be utilized to ensure that the University’s derivative instruments and contracts accomplish their intended purpose and protect the interests of the University.

Not all financial exposure or transaction exposure should be hedged. Measuring financial exposure depends upon forecasted future events; attempts to limit all exposures may introduce other risks to the University.

Only certain, known transactions will be hedged, such as the interest rate risk associated with the variable rate component of a University debt hedged via an interest rate swap. Procedures for measuring financial exposure on a periodic basis will be established. The results will be reported to management on a periodic basis such that management is aware of the potential exposure.

This Policy will be implemented, reviewed and monitored by the University Chief Financial Officer, the Office of the Treasurer (“Treasurer”) and the CFO of the DSO or CU.

III. ENTITIES COVERED BY THIS POLICY

The Policy applies to all units within the University, to direct support organizations (“DSO”), to component units (“CU”) and units for which the University is legally and
financially accountable. DSOs are separate not-for-profit corporations organized and operated exclusively to assist the University achieve its mission. CUs are organizations operated exclusively to assist the University achieve its mission. In accordance with Florida Statutes and Rules and University Regulations and Policies, these organizations receive, hold, invest and administer property and make expenditures to or for the benefit of the University.

All DSO and CU derivative instruments and hedging activities, to the extent such instruments and activities are allowed by applicable law, require approval by the DSO and CU Boards and such instruments and activities shall be managed by the designated chief financial officer (“CFO”) of the DSO and CU.

IV. STRUCTURE, RESPONSIBILITIES AND AUTHORITY

A. Responsibilities of the University Chief Financial Officer

The University Chief Financial Officer has the following responsibilities with respect to the management of the University’s derivatives exposure:

1. Recommend the University’s Derivatives Policy to the President.
2. Ensure implementation of the Policy by all applicable units.
3. Approve each University derivative position and review periodic derivative exposure reports.
4. Review each DSO and CU derivative transaction reported to the University Chief Financial Officer and periodic derivative exposure reports submitted by the DSO and CU.
5. Approve in advance, University derivative transactions that are inconsistent with the guidelines prescribed in this Policy.
6. Review DSO and CU derivative transactions reported to the University Chief Financial Officer that are inconsistent with the guidelines prescribed in this Policy.

C. Responsibilities of the Treasurer

The Treasurer has the following responsibilities with respect to the management of the University’s derivatives exposure:

1. Recommend the University’s Derivatives Policy to the University Chief Financial Officer.
2. Implement and monitor implementation of the Policy.

3. Approve all University relationships with banks and other financial institutions (counterparties) established for the purpose of conducting derivative business.

4. Review each University derivative transaction for Policy compliance.

5. Provide periodic derivative exposure reports to the University Chief Financial Officer.

6. Review each DSO and CU derivative transaction reported to the University Chief Financial Officer and periodic derivative exposure reports submitted by each DSO and CU.

D. Responsibilities of the CFO of the DSO or CU

The CFO of the DSO or CU has the following responsibilities with respect to the management of the derivatives exposure of the DSO or CU.

1. Approve each DSO or CU derivative transaction and review periodic derivative exposure reports with the DSO or CU Boards.

2. Report each DSO or CU derivative transaction and provide periodic derivative exposure reports to University Chief Financial Officer and Treasurer.

3. Review each DSO or CU derivative transaction for Policy compliance.

4. Approve in advance, DSO or CU derivative transactions that are inconsistent with the guidelines prescribed in this Policy and report such transactions to the DSO or CU Board and the University Chief Financial Officer.

5. Approve DSO or CU relationships with banks and other financial institutions (counterparties) established for the purpose of conducting derivative business with the DSO or CU and report such relationships to the Treasurer.

The Treasurer, in accordance with the University Controller’s responsibilities for compliance, and the CFO of the DSO or CU will implement control systems and procedures that provide for an appropriate level of segregation of duties related to the conduct of, accounting for, and reporting of derivative activity.
V. REPORTING

The Treasurer and the CFO of the DSO or CU, as appropriate, will prepare a periodic Derivative Exposure Report (“Report”), on at least a quarterly basis, and provide the Report to the University Chief Financial Officer on derivative accounting exposures that contains the following information:

A. A summary of the net derivative transaction exposure by type and description of appropriate hedging actions.

B. The number of transactions (contract purchases and sales) made during the period.

C. A summary of the current open derivative instrument contracts and explanation of the strategy behind the open positions.

D. The net results of derivative positions that have been closed during the period.

E. The status of any derivative position that might require management attention.

F. The financial exposure to derivative risk. The measurement of financial exposure will consist of the derivative components of forecasted revenue, allocated operating expenses and acquisitions, as appropriate.

The Report will contain information with respect to all derivative transactions occurring during the period, whether or not they have been fully settled as of the end of the period.

The Report will contain a management summary that will describe the status of the hedged positions and derivative transactions made during the previous period. The summary should be presented in a manner that will allow the University Chief Financial Officer to determine whether derivative activity during the period has adhered to the University’s Policy.

VI. INTERNAL CONTROLS:

The University Chief Financial Officer is responsible for recommending and approving all University hedging strategies and overseeing all DSO and CU hedging strategies reported in accordance with this Policy. The CFO of the DSO or CU is responsible for recommending and approving all DSO and CU hedging strategies. Only the University Chief Financial Officer and Treasurer, or the CFO of the DSO or CU, as appropriate, shall have the authority to enter into derivative instrument contracts that provide hedging coverage. The Treasurer, in accordance with the University Controller, is responsible for implementing internal control procedures.

Once a hedging strategy has been approved by the University Chief Financial Officer, or applicable CFO of the DSO or CU, the University Chief Financial Officer, Treasurer, or,
as appropriate, CFO of the DSO or CU is authorized to execute the contracts with an approved bank or other financial institution. The following procedures shall be followed:

A. All derivative transactions will be recorded by the Treasurer or CFO of the DSO or CU on the Derivative Contract Log (“Contract Log”) immediately upon execution. The Treasurer or DSO or CU CFO will approve and initial all contracts recorded on the Contract Log within 2 days of execution. The aggregate amounts of hedge contracts should not deviate from the approved level. The Contract Log will contain, at a minimum, the objective and strategy for the derivative, the designation of the type of hedge transaction, effective and maturity dates, initial amount, payment/reset dates, interest rate, index rate and a description of the underlying corresponding asset or liability critical terms and cash flows, and how the University or DSO or CU will assess whether the hedge is and remains effective throughout its term.

B. Bank confirmations of derivative transactions will be sent directly to the Treasurer or CFO of the DSO or CU. The Treasurer or DSO or CU CFO will cross-check the confirmations against the Contract Log. If the confirmation has not been received within 48 hours after the execution date of the contract, the Treasurer or DSO or CU CFO will personally contact the derivatives desk at the appropriate bank to verify that the trade is indeed reflected on the bank’s records, and to request a confirmation in writing. If there is a discrepancy, the Treasurer or DSO or CU CFO will personally contact both the derivative trader at the bank and determine whose records are in error. The University Chief Financial Officer and DSO or CU Board, as appropriate, shall be notified when any problems occur.

C. At the end of the period, the Treasurer or CFO of the DSO or CU shall review all incoming and outgoing cash transfers pertaining to derivatives. The Treasurer or DSO or CU CFO shall ensure that the appropriate amounts were received/paid on the appropriate dates. Specifically, cash transfers related to derivative contracts should be reconciled with the Contract Log and supported by copies of the confirmations. The same procedure should be performed at the end of each period for the entry supporting the unrealized gains/losses on open derivative contracts.

D. The University Controller and the CFO of the DSO or CU and their auditors will audit the hedging activity and ensure compliance with this Policy and consistency with FAS 133.

E. Each bank or other financial institution will be specifically approved to conduct derivative business with the University or DSO or CU and will be a counterparty that meets the requirements described in the Debt Management Policy. The approved counterparty will be advised of the employees of the University or DSO or CU who are authorized to transact derivative business on behalf of the University or DSO or CU. The approved counterparty will be notified immediately, both verbally and in writing, with respect to the change in status of any employee authorized to conduct business with that institution.
VII. DERIVATIVE POLICY EXCEPTIONS

A. Policy Exceptions:

This Policy provides guidelines for the management of derivative hedging. Any exception to this Policy requires the written approval, in advance, of the University Chief Financial Officer. If the Policy is breached inadvertently, the University Chief Financial Officer will be notified immediately.

B. Policy Review:

This Policy will be reviewed annually and may be reviewed and updated more frequently if conditions dictate.

Proposed amendments to the Policy shall be prepared and recommended by the Treasurer, and shall be reviewed and ratified by the University Chief Financial Officer.

VIII. DEFINITIONS OF DERIVATIVE EXPOSURES AND HEDGES

For purposes of this Policy, the following words shall have the following meanings:

A. “Economic Exposure”
The unexpected change between anticipated net cash flows and actual results, fluctuating asset values and/or liquidity events that are entered on the University’s consolidated financial statements. The economic risk concerns the impact that fluctuating values can have on future operations. The most visible example of this type of exposure to the University or DSO or CU is in the reporting of actual results against budget. The budget is based on historical values or future assumptions that will not be the same as the actual results. For example, higher borrowing rates than budget will increase expenses and reduce net operating results, while lower borrowing rates will have the opposite effect.

B. “Transaction Exposure”
The net cash flow change between the time the transaction is entered on the University’s or DSO’s or CU’s financial statements and the time the actual cash payment is made. This exposure also occurs when both revaluation and settlement of financial instrument accounts will result in a gain or loss, which will be recorded to the income statement, between the delivery of a proposal and the signing of a contract, and between the signing of a contract and revenue recognition.

C. “Fair Value Hedge”
A derivative designated as hedging the exposure of the University or DSO or CU to the changes in the fair value of a recognized asset or liability or a firm commitment. The gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The effect of that accounting is to reflect in earnings the extent to which the hedge is not effective in achieving offsetting changes in fair value.

D. “Cash Flow Hedge”
A derivative designated as hedging the exposure of the University or DSO or CU to variable cash flows of a forecasted transaction. The effective portion of the derivative’s gain or loss is initially reported as a component of other comprehensive income (outside earnings) and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.

E. “Non-Designated Hedging Instrument”
A derivative not designated as a hedging instrument. The gain or loss is recognized in earnings in the period of change.

F. “Highly Effective Hedge”
The critical terms of the hedging instrument and the related asset, liability, cash flows or forecasted transactions are the same: same quantity, same commodity, same time, same location and that the fair value of the derivative contract at inception is zero, and either the change in the discount or premium on the derivative contract is excluded from the assessment of effectiveness and included directly in earnings (pursuant to paragraph 63 of FAS 133) or the change in expected cash flows on the derivative transaction is based on the forward price of the commodity. Thus, the changes in fair value or cash flows attributable to the risk being hedged are expected to be completely offset at inception and on an ongoing basis.