

COUNCIL OF THE CITY OF PHILADELPHIA
COMMITTEE ON RULES

Room 400, City Hall
Philadelphia, Pennsylvania
Wednesday, October 23, 2012
10:00 a.m.

PRESENT:

COUNCILMAN WILLIAM K. GREENLEE, CHAIR
COUNCILWOMAN CINDY BASS
COUNCILMAN BILL GREEN
COUNCILMAN BOBBY HENON
COUNCILMAN JAMES KENNEY
COUNCILMAN DENNIS O'BRIEN
COUNCILWOMAN BLONDELL REYNOLDS BROWN
COUNCILMAN MARK SQUILLA

RESOLUTION 120147 - Resolution authorizing the
Committee on Rules to hold public hearings
investigating the use of qualified interest
rate management agreements by the City and
School District; assessing whether corrective
actions, including legal remedies, should be
pursued...

- - -

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2

COUNCILMAN GREENLEE: Good

3

morning, everyone. Can I have everyone's

4

attention. Folks, please have a seat.

5

Thank you.

6

This is the Committee on Rules.

7

First, let me make an announcement that

8

there were three other bills scheduled

9

today that will be continued - Bill Nos.

10

120720, 120727, and 120728 - because of

11

an advertising error will be continued

12

until Tuesday, November 13th at 10:00

13

a.m. So if you're here -- I don't think

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anybody is here for those bills, but if

15

they are, they will not be heard today.

16

They will be on Tuesday, November 13th at

17

10:00 a.m.

18

Ms. Marconi, will you please

19

read the resolution that's before us

20

today, the title of the resolution.

21

THE CLERK: Resolution No.

22

120147, resolution authorizing the

23

Committee on Rules to hold public

24

hearings investigating the use of

25

qualified interest rate management

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2 agreements by the City and School
3 District; assessing whether corrective
4 actions, including legal remedies, should
5 be pursued; and determining the
6 conditions, if any, under which it would
7 be appropriate to enter into future
8 agreements; and in furtherance of such
9 investigation, authorizing the issuance
10 of subpoenas to compel the attendance of
11 witnesses and the production of documents
12 to the full extent authorized under
13 Section 2-401 of the Home Rule Charter.

14 COUNCILMAN GREENLEE: Thank
15 you.

16 And before we take any
17 testimony, the Chair recognizes the
18 Vice-Chair of the Committee and the
19 sponsor of this resolution, Councilman
20 Kenney.

21 COUNCILMAN KENNEY: Thank you,
22 Mr. Chairman. I just want to state for
23 the outset that as reports have come out
24 in the past few years sounding the alarm
25 about huge losses experienced by our

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2 local governments due to these
3 complicated financial tools known as
4 swaps, it is vitally important that we
5 find out the facts. Investing public
6 funds is not like investing private
7 funds. We need to make sure that the
8 stewards of our taxpayers' dollars are
9 limiting risks.

10 There are two separate issues
11 here. One is taking appropriate risks in
12 the market to earn us more money or to
13 save us money. The other is being
14 defrauded by our banks, many of those
15 same ones that our taxpayer dollars have
16 had to prop up in the 2008 bailout.

17 And there's a couple different
18 aspects of this hearing. First of all,
19 the beginning of the hearing will be
20 trying to explain this very complicated
21 process or complicated instruments. I've
22 been dealing with them for months and
23 months now and still there's certain
24 nuances that I'm not aware of. And
25 there's been a 60 Minutes piece just

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2 recently talking about some of the banks
3 in New York and one of the Goldman Sachs'
4 Vice-Presidents quitting, because part of
5 their -- his view was part of their goal
6 was to find investors that were not
7 sophisticated and try to sell them
8 complicated instruments.

9 So there's all this underlying
10 of what really went on during the course
11 of this whole thing. It may turn out in
12 the end that the swap stuff that we
13 entered into was a good thing for the
14 taxpayer. I don't know. There's two
15 sides of that story, and we want to just
16 get started from an informational
17 perspective and then have some discussion
18 later on as to whether or not we did the
19 right thing.

20 The other issue is, far as I'm
21 aware of now, the City currently has ten
22 outstanding swap deals with a total
23 current national amount approximately
24 \$1.05 billion, and the School District
25 has two outstanding swaps with a total

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2 current national amount of approximately
3 500 million.

4 Also, the aspect of swaps that
5 are particularly galling to me is the
6 necessity of having to buy our way out of
7 a bad deal. I was here when we were
8 dealing with swaps back when it happened
9 and we were told it was a good deal for
10 the taxpayer. I believe that some of the
11 bad actions of the banking institutions
12 in our country threw our economy off the
13 cliff, which put governments and school
14 districts on the wrong side of swaps.
15 That's galling enough that they're making
16 money, we're losing money, but if we want
17 to get out of the deal, we have to pay
18 them to get out of the deal. On top of
19 that, taxpayers nationally were paying to
20 bail them out for their bad behavior with
21 TARP money. So all of this cumulative is
22 a big aggravation.

23 So maybe we can sort through
24 some of this today and be less aggravated
25 by the end of the hearing or more

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2 aggravated by the end of the hearing. I
3 don't know.

4 So thank you, Mr. Chairman.

5 COUNCILMAN GREENLEE: Thank
6 you, Councilman.

7 The record will also reflect
8 Councilman Henon, a member of the
9 Committee, is present.

10 Ms. Marconi, will you please
11 call the name of the first witness.

12 THE CLERK: Jeffrey Pearsall.

13 (Witness already seated at
14 witness table.)

15 COUNCILMAN GREENLEE:
16 Mr. Pearsall, good morning. Please
17 identify yourself for the record and
18 proceed.

19 MR. PEARSALL: Hi. My name is
20 Jeff Pearsall. I'm Managing Director at
21 PFM. I run our swap advisory practice.

22 COUNCILMAN GREENLEE: Proceed.

23 MR. PEARSALL: Stephanie, would
24 it be possible to get a copy of my
25 presentation, because I'm not sure I'm

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2 going to be able to read the screen from
3 back here. I promise I'll give it back
4 at the end.

5 COUNCILMAN GREENLEE: See,
6 that's the advantage of having to wear
7 glasses when I was in first grade, I
8 could see everything.

9 MR. PEARSALL: Okay. So what
10 I'm going to try to provide for the
11 Council is an overview of the swap
12 market, how it works, who are the
13 players, and then some observations from
14 the financial crisis that caused some of
15 these problems that the hearing is
16 investigating.

17 Why don't we flip to Page 4.
18 What is an interest rate swap? An
19 interest rate swap is a financial
20 contract, first and foremost. And what
21 we're going to focus on here is interest
22 rate swaps. There are a bunch of
23 different types of swaps, commodity
24 swaps, equity derivatives, things like
25 that. But in an interest rate swap, two

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2 parties to the contract agree to exchange
3 payments. Typically one side pays a
4 fixed rate, as you can see in the boxes
5 there, and the other side pays a floating
6 rate. The floating rate is represented
7 by the squiggly line there.

8 The principal amount of the
9 contract is defined as "notional." It's
10 another way of saying that it's not --
11 it's not real. It's not -- if you do a
12 hundred million dollar bond deal, an
13 issuer of bonds receives a hundred
14 million dollars from the investors and
15 then over time pays back that principal
16 amount. In a swap, no principal is
17 exchanged. The principal amount is
18 simply used as a placeholder against
19 which to calculate interest each period.

20 Historically, these swaps have
21 traded over the counter, meaning via
22 telephone or computer. Increasingly,
23 they -- well, the vast majority of them
24 after the Dodd-Frank Financial Reform Act
25 are going to have to trade either on an

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2 exchange or through a clearinghouse.
3 There will be certain exemptions, and
4 it's expected the municipal issuers will
5 be exempted from having to trade on an
6 exchange or a clearinghouse.

7 Page 5, who are the
8 participants in these contracts? Well,
9 obviously there's the issuer or the
10 customer, and then the other three key
11 players in these transactions are the
12 swap counterparty, which is a financial
13 institution, a bank or an investment
14 bank; the swap or bond counsel, the legal
15 counsel that advises the clients, the
16 issuer, on the legal ramifications of
17 using these contracts, makes sure that
18 they're in compliance with all
19 authorizations, and this is key, because
20 the providers won't enter into these
21 contracts without this. Also provides an
22 enforceability opinion that the contract
23 is legal, valid, and binding on the user,
24 on the municipality. And then the
25 other -- typically the other party

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2 involved in a swap will be the advisor,
3 and that advisor should be independent
4 and have no connection to the
5 counterparty or the financial provider.
6 And Dodd-Frank will mandate that.

7 The next page shows a list of
8 the currently active municipal swap
9 providers. It's a little small, so it
10 may be hard to see if you're looking at
11 the screen. But it's a shrinking list
12 than existed in 2008, before 2008. And
13 then the other salient feature of this
14 list is that the credit ratings of these
15 firms are significantly lower in almost
16 every case than they were pre-2008,
17 before the financial crisis.

18 Page 7, why use swaps? Why do
19 municipalities use these contracts?
20 There are several main reasons, the first
21 being expected savings. Frequently an
22 issuer can issue variable rate bonds, for
23 instance, and then enter into an interest
24 rate swap because they don't want to be
25 exposed to floating rates in the event

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2 that they should rise. And that
3 combination of variable rate bonds and
4 the interest rate contract produces a
5 lower expected all-in rate than if the
6 issuer had just gone out and done a
7 traditional fixed rate bond.

8 Similarly, an issuer might want
9 floating rate debt, but they might find
10 that they don't have access to the bank
11 letter of credit market, which is
12 typically required to issue floating rate
13 bonds. What could they do if they wanted
14 floating rate exposure? They could issue
15 a fixed rate bond, enter into a contract
16 to convert it to a floating rate.

17 And then swaps have other uses,
18 such as being able to hedge a future --
19 if you've got a big capital plan and
20 you're expecting to issue bonds three or
21 four years from now and you like today's
22 interest rates and you want to protect
23 yourself against a rise, you can do that.
24 The bottom line is, they're primarily
25 used for risk management, to increase

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2 budgeting certainty, and to avoid an
3 unexpected spike in interest rate, or the
4 case of commodities, energy costs.

5 COUNCILMAN GREENLEE: Sir,
6 Mr. Pearsall, just one second.

7 Councilman Kenney.

8 COUNCILMAN KENNEY: Just one
9 question at this juncture. Like with all
10 financial transactions, it's kind of a
11 bet. Is that a fair statement? That
12 you're betting something is going to
13 happen, and if it happens, you're okay,
14 and if it doesn't, you're not.

15 Can you give me an idea as to
16 where the bet went wrong and why you
17 think the paradigm wherein the bet was
18 made, what happened to take this, I
19 guess, relatively stable, dependable
20 operation or transaction, what pushed our
21 bet to the wrong side of the ledger?
22 Before you go on to who uses them. I
23 still need to know -- our financial
24 advisors and our treasurer at the time
25 was making a calculated bet that

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2 something would happen or continue to
3 stay the same. What changed? And
4 explain to me how it affected the dynamic
5 of the relationship, if you can.

6 MR. PEARSALL: I'll try. I
7 would differ, however, with the
8 characterization of swaps as a bet. I
9 mean --

10 COUNCILMAN KENNEY: I'm not
11 saying swaps are a bet. I'm saying all
12 financial transaction are a bet. You're
13 betting -- your actuary, they're betting
14 something. When you do a pension, you do
15 a DROP program, you're making a
16 calculation and you're betting -- "bet"
17 may be a bad word, but it's basically
18 what it is. You think something is going
19 to happen and you put your money where
20 you think it's going to happen, and it
21 doesn't. Sometimes you win the bet;
22 sometimes you lose the bet. How did we
23 lose the bet?

24 MR. PEARSALL: Right. Similar
25 to if you decided to issue all fixed rate

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2 bonds in your description, that would be
3 betting that interest rates are not going
4 to go lower.

5 Where these products
6 encountered problems was that unlike a
7 fixed rate bond, it required some
8 underlying raw material in order to make
9 this look like a fixed rate bond. That
10 underlying raw material was variable rate
11 bonds. And the variable rate bond market
12 pre-2008 relied on a couple of things to
13 make it successfully work. One was
14 insurers, bond insurers at the time, all
15 of whom were rated AAA, they primarily
16 insured auction rate securities. And
17 then the other form of credit support for
18 those variable rate bonds -- because the
19 investors wouldn't buy those variable
20 rate bonds even from highly rated issuers
21 typically unless they had this credit
22 backing. The other support for that was
23 bank letters of credit.

24 When both of those types of
25 financial institutions ran into trouble

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2 in 2008 and were severely downgraded, the
3 floating rate bonds were no longer
4 attractive to investors. Investors were
5 putting them back, meaning forcing
6 redemption of those bonds, and the
7 issuers who sold those variable rate
8 bonds had to refinance them somehow.

9 Now, the problem that swaps
10 created was, this all occurred in
11 declining interest rates. Rates were
12 lower. The contracts had negative
13 values, and so refinancing a variable
14 rate bond when there was no swap attached
15 would have been, if not relatively
16 straightforward, simpler. Refinancing a
17 variable rate bond that had a swap with a
18 negative value, an underwater value,
19 became more complicated.

20 COUNCILMAN KENNEY: Thank you.

21 MR. PEARSALL: Page -- and I'll
22 try to speed up here. Page 8, who uses
23 swaps? Financial institutions, banks,
24 mutual funds, hedge funds; corporations,
25 General Electric, Coca-Cola, Comcast

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2 Corp. Sovereign governments in some
3 cases have used interest rate or
4 cross-currency swaps; municipalities,
5 cities, states, airports, school
6 districts; not-for-profits, hospitals,
7 universities, museums, et cetera. Other
8 large cities besides Philadelphia that
9 have entered into swaps include
10 Baltimore, Detroit, the District of
11 Columbia, Houston, Miami, New York,
12 Oakland, San Francisco. I'm leaving some
13 off here, I'm sure, but they were widely
14 used by major cities.

15 COUNCILMAN KENNEY: Why doesn't
16 the U.S. government use swaps?

17 MR. PEARSALL: I think the U.S.
18 government doesn't use swaps because
19 they're such a huge player in the market,
20 especially the market for treasuries.
21 They would affect -- they would be the
22 elephant.

23 COUNCILMAN KENNEY: Are you
24 aware of any of the track records of any
25 of the other cities that have entered

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2 into these transactions?

3 MR. PEARSALL: I can speak to
4 Oakland and San Francisco where PFM was
5 the advisor. And in the case of both of
6 those, they encountered problems with
7 their variable rate bonds and had varying
8 degrees of success in refinancing them.
9 In the case of San Francisco,
10 specifically the airport there, they were
11 able to successfully restructure the
12 variable rate bonds, and the swaps
13 continue to work. Oakland, we haven't
14 been an advisor for a long time. I think
15 they're still working through some
16 difficulties there.

17 COUNCILMAN KENNEY: Thank you.

18 MR. PEARSALL: I won't spend
19 too much time here. Key terms of
20 interest rate swap on Page 10. These are
21 the elements of the contract. The
22 floating rate has to be defined, the
23 principal amount, the maturity date,
24 similar to a bond issue.

25 Page 12 shows the, what we

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2 call, the boxes and the arrows. This is
3 for a floating-to-fixed swap. It looks
4 complicated. What I always -- when I'm
5 teaching this, I always say if you just
6 cross out the squiggly lines here, what
7 you're left with, if everything is
8 working the way it should be, is just one
9 straight, solid line that looks like a
10 fixed rate bond.

11 The net effect in that box in
12 the corner on a swap like this is to
13 produce, again when the hedge is working
14 properly, a lower fixed rate than could
15 be obtained by issuing traditional fixed
16 rate bonds.

17 Page 13 talks about some of the
18 benefits and risks. We mentioned lower
19 expected cost savings, budgeting
20 certainty, the ability to customize the
21 terms. When you issue a bond, there's
22 certain features that maybe an investor
23 won't take. In a swap it allows for much
24 more customization.

25 The risks, we're aware of these

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2 now. There's termination payment risk if
3 you're forced to early terminate the
4 swap, if you're not allowed to, for
5 whatever reason, to let it run to
6 maturity. You have exposure to your
7 counterparty, credit exposure. Lehman
8 Brothers is the case that comes to mind
9 there.

10 You risk that the rates that
11 you're using to hedge and the rate that's
12 on your bonds, the floating rate bonds,
13 may not move exactly together. Those are
14 some of the risks.

15 The next page, Page 14, is the
16 one that everyone always seems confused
17 about. So we go to great lengths to
18 explain it to clients and rating agencies
19 and everyone else, is how do swap dealers
20 make money? They're not betting against
21 issuers. That's the key point to
22 understand. If they've done -- if their
23 trading desk has done their job properly,
24 they're running what's called a matched
25 book, which means they don't care which

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2 way interest rates go. In this example,
3 what they want to do, their objective is
4 to stand in the middle and make a spread
5 from each of the parties that trade with
6 them. In this example, the swap dealer
7 is receiving fixed from Counterparty A.
8 They find an offsetting trade for another
9 customer of the bank, which they're
10 paying fixed, and the rates -- the fixed
11 rate that they're receiving is higher
12 than the fixed rate that they're paying
13 and they earn a spread there.

14 What does that spread
15 compensate them for? It compensates them
16 for standing willing to trade, when you
17 want to trade as an issuer as opposed to,
18 okay, you can come back and trade in
19 three months when we've lined up somebody
20 on the other side. It covers their costs
21 of hedging their transaction and it
22 provides a shareholder -- a return on
23 their shareholders' equity. Those are
24 for-profit companies.

25 COUNCILMAN KENNEY: I'm sorry,

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2 Mr. Chairman.

3 How do advisors get paid?

4 MR. PEARSALL: Advisors are
5 typically paid a fee for arranging or
6 advising on the transaction.

7 COUNCILMAN KENNEY: A fixed
8 fee?

9 MR. PEARSALL: A fixed fee.

10 COUNCILMAN KENNEY: And they're
11 paid by the party issuing the debt?

12 MR. PEARSALL: That's correct.

13 COUNCILMAN KENNEY: They're not
14 paid by banks ever?

15 MR. PEARSALL: They're
16 occasionally paid by the banks, but it's
17 fully disclosed to the issuer.

18 COUNCILMAN KENNEY: Are you
19 aware of any in Philadelphia, both in the
20 School District and the City, are you
21 aware of any of those arrangements that
22 were fully disclosed about incentive
23 payment or payment by the bank in
24 addition to the fixed fee by the issuer,
25 if you're aware?

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2 MR. PEARSALL: I'm not. We
3 only advised the School District of
4 Philadelphia. In those swaps, all of the
5 fees were fully disclosed.

6 COUNCILMAN KENNEY: Thank you.

7 MR. PEARSALL: Flipping over to
8 the indexes, Page 11, the two primary
9 floating rate indices that are used in a
10 swap are a LIBOR, which is a corporate
11 rate. So if a municipality is going to
12 use a corporate rate, a taxable rate,
13 they'll use just a percentage of it,
14 because tax-exempt rates are lower than
15 taxable rates. LIBOR has been in the
16 news a lot recently. There are
17 allegations that it was understated or
18 artificially suppressed during the
19 financial crisis by banks to make them
20 look healthier than they were.

21 And then SIFMA is the other
22 major index that's used. It's a true
23 tax-exempt index. It's comprised of a
24 bunch of different variable rate bond
25 issues that go into a composite.

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2 Flipping ahead to the market,
3 Page 17, the market for muni swaps versus
4 muni bonds. There are two different
5 markets that's important to understand.
6 The offsetting counterparties for the
7 banks that enter into these swaps, they
8 tend to be other banks or other clients.
9 They don't tend to be municipal bond
10 investors. So the markets tend to trade
11 slightly separately. Credit differences
12 are treated differently. There are some
13 unique features in municipal market that
14 affect how those bonds trade versus
15 swaps.

16 Page 18 shows a chart of the
17 SIFMA Index, which is this short-term
18 rate. It's a one-week rate. And it
19 shows kind of how it should trade
20 relative to the implied tax rate. I
21 won't get into too much of the theory,
22 but in general, if you put your money in
23 a taxable money market fund and you put
24 your money in a tax-exempt money market
25 fund, at the end of the day when the dust

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2 settles, you should be indifferent
3 between the two rates. Otherwise,
4 everybody would move their money from one
5 fund to the other, which you can see the
6 red line here is the U.S. marginal tax
7 rate over the last 20-some years. What
8 you see is, this rate has moved around,
9 especially during periods of financial
10 crisis, but it's tended to be during sort
11 of normal times, pretty stable, and a
12 reasonable match for the -- where it
13 should trade.

14 Why don't we skip to Page 22 --
15 I'm sorry; 21, swap terminations. How is
16 a swap -- how is the value of a swap
17 determined? The day that you enter into
18 a swap, the value is approximately zero,
19 excluding the transactions costs. It's
20 deemed to be a fair exchange of value for
21 you and the bank. After that, however,
22 as interest rates move, the contract can
23 either add value to you or the bank.
24 What is that value? How is it
25 determined? Well, the fixed rate that

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2 you pay is compared -- that fixed rate
3 that's on your contract is compared to
4 the now current market rate. So if you
5 entered into it and you're paying fixed
6 at 5 percent and now rates are 4 percent,
7 the difference between those two rates,
8 present value; in other words, discounted
9 back to today, represents the value of
10 the contract.

11 Page 22 shows an example here,
12 very simple example. If you had entered
13 into a swap and were paying fixed at 5
14 percent and now interest rates have gone
15 down to 4 percent, the long-term rate --
16 that's what really drives the value of
17 these contracts. If the long-term rate
18 goes down to 4 percent, there's a 1
19 percent difference between what you
20 locked in and now what you could have
21 locked in. That difference represents
22 value to your counterparty, right?
23 Because if you were to break that
24 contract, they would now have to go out
25 and -- they could only replace your

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2 contract with a swap that pays them 4
3 percent, not 5 percent. The present
4 value of that difference represents a
5 value of the swap contract.

6 This concept of termination
7 value is very similar in the corporate
8 world. If you take out a fixed rate
9 loan, there's something called a
10 make-whole provision. You make whole the
11 difference. That value can be positive
12 to you or it can be negative. It's
13 analogous to that.

14 COUNCILMAN KENNEY: Mr.
15 Chairman?

16 COUNCILMAN GREENLEE:
17 Councilman Kenney.

18 COUNCILMAN KENNEY: Thank you.
19 Generally, in general terms,
20 how much of a reduction in rate creates
21 the discussion whether to terminate? One
22 point or more? Less than a point?

23 MR. PEARSALL: What I would say
24 is, the decision to terminate is really
25 independent of the value of the swap.

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2 The value of the swap is just an
3 accounting entry. If you're a
4 buy-and-hold issuer, you're intending to
5 keep that swap in place to maturity, the
6 value will fluctuate on your books, but
7 like a lot of other things on your books
8 or your financial records, you don't
9 really pay attention to it, unless you
10 have to terminate it early. What the
11 financial crisis did is, it forced many
12 issuers to have to terminate those swaps
13 early.

14 COUNCILMAN KENNEY: Can you
15 give me an example of during the
16 financial crisis what the fixed rate was
17 and what it fell to?

18 MR. PEARSALL: The fixed
19 rates -- if you look at like, for
20 instance, the ten-year U.S. Treasury,
21 before the financial crisis it was 4
22 percent or higher, and today that rate is
23 1.80, 1.80. So some two and a half
24 percent below where it was.

25 COUNCILMAN KENNEY: Were any of

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2 the swaps that we entered into, to your
3 knowledge, in a higher rate than 4
4 percent?

5 MR. PEARSALL: I don't --

6 COUNCILMAN KENNEY: If you
7 don't know it off the top of your head --

8 MR. PEARSALL: I don't believe
9 so.

10 COUNCILMAN KENNEY: Maybe the
11 Treasurer will be able to give me more
12 enlightenment.

13 Thank you.

14 MR. PEARSALL: Page 23 is an
15 important point. We've tried -- there's
16 been a lot of misinformation in the
17 financial press. We've tried to disabuse
18 people of the notion that this
19 termination payment somehow represents a
20 windfall gain to the bank or the
21 counterparty. It doesn't. Let me
22 emphasize that. It does not. If they've
23 hedged themselves properly, right, and
24 you're an issuer who owes a termination
25 payment, you make that payment to -- pick

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2 a financial institution -- Wells Fargo or
3 Goldman Sachs, they turn around and they
4 have to make a similar size payment to
5 whoever they hedge their transaction
6 with. Now, they'll make a small profit,
7 the spread, for trading that I talked
8 about earlier, but when I read some of
9 these policy papers and things that a
10 windfall gain of a hundred million
11 dollars was made by Goldman Sachs on a
12 termination swap, not true. They paid
13 away almost all of that to their hedging
14 counterparty.

15 Let's flip to general
16 considerations, documentation. The
17 documentation was developed in the late
18 '80s. It's standardized. It allows --
19 it's negotiated. You don't have to take
20 it or leave it when you're negotiating
21 with these contracts. It's called the
22 ISDA Agreement, and it should be reviewed
23 by legal advisors and financial advisors.

24 Again, I mention at the bottom
25 this point here that the counterparties

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2 won't enter into these contracts with
3 municipalities unless they believe that
4 the contract is enforceable, and they get
5 an opinion to that effect from the
6 issuer's bond counsel.

7 Page 27, swap procurement. It
8 can be done on either negotiated or
9 competitively bid basis. There may be
10 reasons to do it one way or another.
11 Typically when you do it on a
12 competitively bid basis, the cost is
13 lower to the issuer.

14 Page 28, we talked about the
15 costs. The dealers, the providers, are
16 in the spread. Just as you're buying or
17 selling stocks, there's a spread that's
18 earned by the middle man. There are
19 legal fees involved in executing one of
20 these swaps. There are swap advisory
21 fees, if you have a swap advisor. Not
22 every issuer in the past has hired a swap
23 advisor. Under Dodd-Frank, they'll be
24 required to hire a financial advisor.
25 And then there may be some fees to

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2 monitor the swap on an ongoing basis for
3 financial reporting and tracking it.
4 Why don't we flip to the last
5 section, the financial crisis, what
6 happened that was unusual and why did
7 these not work the way they were supposed
8 to. Well, during the great financial
9 crisis, Page 32, we saw a tremendous
10 increase in credit spreads and the cost
11 of borrowing. I have a graph here of the
12 three-month LIBOR rate compared to the
13 three-month Treasury bill rate. The
14 three-month LIBOR rate is a risky rate.
15 It involves bank risk. The three-month
16 Treasury bill rate, as you probably know,
17 is a risk-free rate. It's the U.S.
18 government's credit.

19 What you can see is that for
20 most of the time, the last three decades,
21 it was a relatively small difference
22 between those two rates. During the
23 financial crisis, that big spike, it
24 widened out quite a bit and became very
25 expensive for issuers, corporate

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2 municipalities, others to borrow.

3 Page 33 talks about one of the
4 other problems that occurred during the
5 financial crisis. In general, different
6 types of interest rates move similarly.
7 They move together. They're correlated,
8 is the term, the statistical term.

9 During 2008, what we saw -- for
10 instance, this is a chart of long-term
11 bond yields compared to long-term swap
12 rates. What we saw was, long-term bond
13 yields actually went up, while at the
14 same time long-term swap rates went down.
15 So what was the effect to issuers that
16 had swaps in which they were paying a
17 fixed rate? Well, it meant that the
18 values of their swaps became very
19 negative, large negative values, but if
20 they wanted to terminate those swaps and
21 issue fixed rate bonds, their cost of
22 borrowing had skyrocketed.

23 Now, what you note on this
24 chart is, that period didn't last for all
25 that long, six months or eight months,

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2 and then the rate started to normalize.
3 But if you were terminating a swap in
4 December of 2008, for instance, and going
5 into the fixed rate bond market, you
6 would have been hit with a double whammy.

7 COUNCILMAN KENNEY:
8 Mr. Chairman?

9 So it would have been better to
10 hang on to the swap, is what you're
11 saying?

12 MR. PEARSALL: Correct.

13 COUNCILMAN KENNEY: And who
14 advises the treasurer to hang on or to
15 cut bait?

16 MR. PEARSALL: Typically their
17 swap advisor, their financial advisor.

18 COUNCILMAN KENNEY: All right.

19 MR. PEARSALL: Page 34 shows
20 the -- I showed you that chart earlier of
21 who were the financial institutions that
22 acted as market makers or swap providers
23 in this business. The chart on the left
24 is from June 2008. The chart on the
25 right is from just a few weeks ago.

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2 What's interesting there, of course, is
3 the number of firms that have
4 disappeared, number one, and then number
5 two, a significant majority of the firms
6 that have all been downgraded either
7 the -- the one fact I look at on the left
8 is, there were five AAA rated financial
9 institutions that were swap providers in
10 June 2008. Today there are none that
11 carry that top rating.

12 So what are some of the
13 observations we saw during the financial
14 crisis? This has recurred throughout
15 sort of financial history. Credit crises
16 tend to be associated with lower interest
17 rates. We've seen that again and again.
18 The Fed -- it makes sense if you think
19 about it. The Fed comes in, it eases, it
20 lowers interest rates. Normally you'd
21 think that would be good, but if you have
22 a swap in which you're paying fixed, it's
23 bad, because it makes the swap's value
24 negative. If everything is working fine
25 with your underlying bonds, as I said,

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2 that raw material, then you don't care.
3 It's just a book entry. It's an
4 accounting matter. But if you have to
5 early terminate, then it becomes a
6 problem.

7 So the negative values of the
8 swaps created problems, potential
9 collateral calls for some issuers,
10 potential early termination events as
11 specified in the contracts.

12 The other thing that the
13 financial crisis caused was what we
14 describe as basis risk, which means that
15 the floating rates on the swap contracts
16 didn't follow the floating rates paid on
17 bonds. We had cases where some of these
18 auction rate securities, the rates were
19 resetting at 10, 11, 12 percent, with the
20 floating rate that an issuer was
21 receiving that was supposed to hedge that
22 rate, which is -- because it was based on
23 a market index, it wasn't based on a
24 particular issuer's credit, might have
25 only stayed at 2 or 3 percent. So that

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2 created some problems. That tended to be
3 a short-term problem and those two rates
4 normalized.

5 What we found is remedies to --
6 and this is common sense -- remedies to
7 restructure swaps during a credit crisis,
8 during a financial crisis, are going to
9 be expensive. This is the old example,
10 if you need an umbrella and it's a
11 monsoon, you're going to pay more for an
12 umbrella than if you're buying one on a
13 sunny day.

14 So a lot of issuers, to their
15 surprise -- and perhaps it shouldn't have
16 been to their surprise -- found that it
17 was very expensive to restructure these
18 contracts in 2008 when the world seemed
19 to be spinning off its axis.

20 And then the last point I would
21 make is that most swaps, the vast
22 majority of swaps, performed the way they
23 were supposed to, the way they were
24 advertised. When you enter into that
25 swap, your counterparty was contracting

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2 to make a payment to you at certain
3 intervals, and with the exception of
4 Lehman Brothers, that's the way it
5 worked. They continued to make payments,
6 Wall Street did, the financial
7 institutions, just as the contract said
8 they should, as I said, with the
9 exception of just a couple firms, Lehman
10 being the most notable.

11 So the last page is just the
12 summary of what -- if you're
13 contemplating using these products, what
14 should you know? Well, they can be
15 valuable tools for risk management.
16 There are potential risks as we saw in
17 them. You need to seek out independent
18 informed advice. In some cases -- we saw
19 the headlines -- that wasn't always true.
20 And the risks and rewards, the risks and
21 benefits should be clearly understood by
22 the issuer and by all the relevant
23 parties that are planning to make use of
24 the swap.

25 COUNCILMAN GREENLEE: Thank

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2 you, Mr. Pearsall.

3 Any other questions for

4 Mr. Pearsall?

5 Councilman Kenney.

6 COUNCILMAN KENNEY: Thank you.

7 Mr. Pearsall, just one second.

8 COUNCILMAN GREENLEE: Just a

9 couple more questions.

10 COUNCILMAN KENNEY: I'm trying

11 to wrap my arms around the issue of

12 advice, because I was here when we did

13 these transactions, and the advice was

14 then it was a solid thing for us to do,

15 was not exceptionally risky and that we

16 were advised to proceed.

17 Now, when that six-month,

18 eight-month really messy percentage

19 difference occurred, I assume we were

20 advised again to either hold or to get

21 out. Is that the same people giving us

22 the advice or is it different parties

23 giving us the advice? Were you guys

24 involved in that initial advice and the

25 "get out of the deal" advice?

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2 MR. PEARSALL: We weren't
3 involved here. We certainly had clients
4 nationwide where we advised either to get
5 out or to stay in it. In some cases
6 there were clients who were lower rated,
7 lower than the City of Philadelphia, who
8 had no choice, they had to get out.
9 Their financial institution, their
10 provider was going to force them to get
11 out of it. In those situations you look
12 at the least worst alternative.

13 In other cases the issuer just
14 decided, you know what, I don't want to
15 be in this anymore. There's too many
16 moving parts. I'm going to bite the
17 bullet, in some cases over our advice,
18 over our objections, but they just wanted
19 out, wanted to clear the decks.

20 COUNCILMAN KENNEY:

21 Historically, how long have swaps been
22 part of the, I guess, arsenal of tools to
23 be able to be used for any investor,
24 whether they're private or public?

25 MR. PEARSALL: Really the swap

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2 market developed in the 1980s, but
3 municipalities started using them in the
4 1990s.

5 COUNCILMAN KENNEY: So it's not
6 a long-term tried and tested?

7 MR. PEARSALL: It hasn't been
8 through multiple financial crises, yes.

9 COUNCILMAN KENNEY: Thank you.

10 COUNCILMAN GREENLEE: Thank
11 you.

12 First, the record will reflect
13 that Councilman Green, a member of the
14 Committee, is present, as is Councilman
15 Squilla.

16 Councilman Green.

17 COUNCILMAN GREEN: Yes.

18 Mr. Pearsall?

19 COUNCILMAN GREENLEE: I don't
20 blame you for wanting to get out of here,
21 but...

22 Councilman Green.

23 COUNCILMAN GREEN: I apologize
24 for missing the beginning of your
25 testimony. This is a very interesting

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2 topic. It seems to me that there's a lot
3 of demagoguery with respect to this
4 particular topic, and I just wanted to
5 see if I could understand some basic
6 principles while we have the benefit of
7 your expertise here at the table.

8 How much, when a city or a
9 school district reversed out of their
10 swap, did it hurt their current operating
11 funds?

12 MR. PEARSALL: I mean, the
13 answer, I think, would be it depends.

14 COUNCILMAN GREEN: In most
15 cases didn't they simply finance the cost
16 and not actually hurt their operating
17 expenses?

18 MR. PEARSALL: That's right.

19 COUNCILMAN GREEN: And is that
20 what happened at the School District?

21 MR. PEARSALL: I believe so.
22 We were no longer the transaction advisor
23 of the School District when they did
24 that, but I believe that's correct.

25 COUNCILMAN GREEN: So it didn't

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2 cost any current dollars. It did cost
3 dollars that have to be paid back over
4 time, which obviously slightly increases
5 carrying costs every year of whatever
6 that number is, a million, 2 million,
7 which I guess hurts operating cash flow,
8 but that is the extent of the cost of
9 reversing out of a swap on a yearly
10 basis?

11 MR. PEARSALL: That's right.

12 COUNCILMAN GREEN: Okay. The
13 other question I have is, who is really
14 responsible for advising cities to get
15 into swaps? We have a City Controller
16 who has to sign off on all these debt
17 deals and take a look at them. We have a
18 City Council that has to approve them.
19 We have a Mayor that has to -- or in the
20 case of the School District, the SRC that
21 has to think about these issues and
22 determine what's in the best interest of
23 the entity at the time. And if you could
24 take us back to that time, why were
25 firms -- I don't know if your firm

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2 advised any, but why were firms like
3 yours advising as the financial advisor?
4 I don't mean the investment banker,
5 because it wouldn't have been done if the
6 City's financial advisor, the School
7 District's financial advisor hadn't
8 agreed and their experts that it was in
9 the best interest of the District.

10 What was going on that would
11 cause people to advise them to go ahead
12 and do a swap?

13 MR. PEARSALL: I mean, I could
14 speak to the School District of
15 Philadelphia's swaps back when we advised
16 on those originally in 2004, and I
17 believe it was Michael Harris was the CFO
18 then. And the opportunity there for them
19 and the reason we thought it was a good
20 idea was, they had some callable bonds
21 that were not yet callable. They would
22 be callable in a few years, but if they
23 were to take action today, meaning back
24 in 2004, they could lock in savings, if
25 you're with me, that might not be

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2 available two or three years later when
3 the bonds actually became callable. So
4 the notion was that by locking in that
5 savings today, they can guarantee that
6 they would achieve their savings goal.
7 And we looked at the structure. We put
8 what we felt were belt and suspenders on
9 it. We had AAA insurance backing the
10 swap, and I believe that AAA insurance
11 had been purchased for the bonds that
12 would be issued in the future.

13 So we ran the numbers. The
14 market was functioning normally. No one
15 foresaw the storm on the horizon in 2004
16 that would occur. So we recommended it,
17 and we stand by that recommendation
18 today. It made economic sense.

19 COUNCILMAN GREEN: So what
20 you're really saying is, the School
21 District's hedge was against existing
22 debt and not sort of a bet on interest
23 rates in the future? It was locking in
24 specific savings for something that they
25 were going to refund two years down the

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2 road. Do you recall how much entering
3 into those swaps actually saved the
4 District?

5 MR. PEARSALL: Eight and a half
6 percent on a present-value basis, eight
7 and a half percent of the principal
8 amount of the bonds.

9 COUNCILMAN GREEN: Which was?

10 MR. PEARSALL: Fifty-six
11 million dollars, I believe.

12 COUNCILMAN GREEN: Fifty-six
13 millions dollars, okay.

14 So would you say that with
15 their -- and how are financial advisors
16 paid? Are they paid any more money if
17 swaps are done or not done or the
18 structuring of the deal? Is there an
19 incentive system for the financial
20 advisor of a school district or a city or
21 a state that would cause them to, in
22 their own financial interest, advise
23 their clients to take swaps?

24 MR. PEARSALL: Well, I can only
25 speak to our firm. At PFM, I'm a

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2 specialist within a firm of financial
3 advisors. We obviously are paid a
4 transaction fee if the swap is executed.
5 At the same time, you don't want to put
6 clients into bad deals, right? I mean,
7 you want repeat business, repeat
8 customers. And then the check and
9 balance within a firm like PFM, for
10 instance, is that the financial advisor,
11 the bond advisor, is also going to be
12 saying, hey, does this make sense for the
13 clients within their plan of finance.

14 COUNCILMAN GREEN: Well, it
15 seems to me that maybe one of the things
16 that needs to be looked at from the
17 perspective of the City or the School
18 District is not paying additional fees to
19 our advisors dependent upon the kind of
20 transaction that we do. In other words,
21 flat fees that don't depend upon any
22 particular transaction such that there's
23 no incentive to go one way or another may
24 be something that's worthwhile exploring
25 from the City's or School District's

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2 perspective.

3 I do not think that PFM did
4 anything that it wouldn't have advised if
5 it were on a flat fee basis, but just so
6 we can avoid any sorts of even appearance
7 of conflicts of interest in the future,
8 it may make sense for us to consider that
9 as a policy as a city.

10 I think those are all my
11 questions for you. Thank you.

12 COUNCILMAN GREENLEE: Thank
13 you, Councilman.

14 Councilman Kenney.

15 COUNCILMAN KENNEY: Thank you.

16 Mr. Pearsall, just in
17 conclusion of your testimony -- and thank
18 you for walking us through some
19 complicated stuff, and I appreciate your
20 time.

21 Overall would you argue that
22 the School District and the City did the
23 right thing in entering into the swaps
24 that they did?

25 MR. PEARSALL: Again, I can't

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2 speak --

3 COUNCILMAN KENNEY: Would you
4 do it again?

5 MR. PEARSALL: I can't speak to
6 the City's transactions.

7 COUNCILMAN KENNEY: The School
8 District.

9 MR. PEARSALL: The School
10 District? Yeah. I believe based on the
11 best information they had at the time,
12 that was the correct economic decision to
13 make for the School District.

14 COUNCILMAN KENNEY: Okay.
15 Thank you.

16 COUNCILMAN GREENLEE: Thank
17 you.

18 Any other questions?

19 (No response.)

20 COUNCILMAN GREENLEE: Seeing
21 none, Mr. Pearsall, thank you very much.
22 Thank you for your time and your
23 expertise.

24 Ms. Marconi, please call the
25 next witness.

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2 THE CLERK: Auditor General
3 Jack Wagner.

4 (Witnesses approached witness
5 table.)

6 COUNCILMAN GREENLEE: Mr.
7 Wagner, good morning.

8 AUDITOR GENERAL WAGNER: Good
9 morning.

10 COUNCILMAN GREENLEE: As you're
11 being seated, I just want to say I know
12 you're approaching the end of your terms
13 as Auditor General, so just for the
14 record, I'd like to thank you for all the
15 work you've done on behalf of the
16 Commonwealth.

17 AUDITOR GENERAL WAGNER: Thank
18 you. I appreciate that very much.

19 With me today is Nate Lipton,
20 Regional Special Investigator in charge
21 within my Office of Special
22 Investigation, and is really the expert
23 on staff related to interest rate swaps.

24 MR. LIPTON: Good morning.

25 COUNCILMAN GREENLEE: Good

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2 morning.

3 AUDITOR GENERAL WAGNER:

4 Chairman Greenlee, Vice-Chairman Kenney,

5 Councilmember Green, Councilmember Henon,

6 Councilmember Squilla, I know

7 Councilwoman Tasco is here, and other

8 members of Council, thank you for the

9 opportunity to come here today and to

10 testify on a very important issue,

11 interest rate swaps. And before I go any

12 further, I sincerely mean that. You are

13 the first government of any size to begin

14 to analyze this issue in Pennsylvania.

15 So my hat is off to all of you --

16 (Applause.)

17 AUDITOR GENERAL WAGNER: -- for

18 your scrutiny on this very important

19 issue.

20 A swap is a contract between a

21 bond issuer, such as a school district or

22 other public entity, and an investment

23 bank, in which the parties bet on which

24 way interest rates will move. In theory,

25 swaps allow government entities to enter

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2 into variable rate debt financing in
3 order to take advantage of low interest
4 rates and, at the same time, hedge
5 against the possibility of those same
6 interest rates going up. In many
7 instances, the public entity is given an
8 up-front financial incentive to enter
9 into the agreement. That was not
10 discussed earlier.

11 In reality, swaps are nothing
12 more than a form of gambling with public
13 funds. The party that guesses right wins
14 and gets paid. The party that guesses
15 wrong loses and must pay the other party.
16 How much is won or lost is determined by
17 the size of the underlying debt, how much
18 interest rates fluctuate, and other
19 factors related to the deal.

20 How risky are swaps? Just ask
21 President Obama's former top White House
22 Economic Advisor, Larry Summers, who, as
23 President of Harvard University from 2001
24 to 2006, approved swaps so toxic that the
25 school paid banks a total of almost 1

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2 billion, I repeat 1 billion, to terminate
3 the swaps.

4 Hardly a day goes by without a
5 news report of someone else getting
6 burned by a swaps deal gone sour.
7 Organizations of every stripe, public and
8 private; for-profit and not-for-profit;
9 universities; hospitals; state, local,
10 and even foreign governments such as
11 Greece; school districts; and public
12 authorities have been hurt and none are
13 immune to the toxic effects of these
14 transactions. Any benefits that these
15 deals may confer, even to the fortunate
16 few who do not lose money, pale in
17 comparison with the enormous risk
18 involved, risk that may lurk for
19 literally dozens of years in the future,
20 as I will indicate through a few
21 examples. Is it any wonder that many
22 commentators are now recognizing that the
23 only reason that swaps continue to be
24 sold so aggressively is the enormous fees
25 and profits that they generate for the

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2 investment banks and financial services
3 firms that sell them? Wall Street is
4 vehemently opposed to the elimination of
5 swaps with public entities for obvious
6 profit reasons.

7 The Department of Auditor
8 General's involvement in this issue began
9 with a special investigation, led by the
10 gentleman to my right, which we released
11 in November 2009, three years ago. In
12 addition, I should mention Act 23 of
13 2003, six years before that, enacted into
14 the Pennsylvania law, authorized local
15 governments to enter into qualified
16 interest rate management agreements, or
17 swaps. Our investigation three years ago
18 found that the Bethlehem Area School
19 District in Lehigh and Northampton
20 Counties -- it's in two different
21 counties -- had entered into the most
22 swaps of any school district in
23 Pennsylvania during a three-year period,
24 13 swaps in total. We reviewed just two
25 of the District's swaps because those

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2 were the only two that concluded by the
3 time of our investigation.

4 We found that the District was
5 the victim of a variety of deceptive
6 marketing tactics and that it lost at
7 least 10.2 million on those two swaps,
8 largely due to excessive fees and other
9 charges and a termination payment. The
10 taxpayers of the District were then hit
11 with property tax increases to pay for
12 the losses incurred.

13 Because the District still has
14 three swaps in effect, the ultimate
15 financial impact on the District's
16 taxpayers remains to be seen. The
17 District's three active swaps, which are
18 tied to 100 million in debt, had a net
19 negative fair value as of last month of
20 \$32 million. Since the issuance of our
21 report, the District has heeded our
22 advice and terminated many of its active
23 swaps, some with positive results and
24 some with negative results, but it still
25 has a long road ahead to correct its

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2 problems.

3 On a statewide basis, our 2009
4 investigation found that 107 of 500
5 school districts in Pennsylvania, a
6 shocking 21 percent, and 86 local
7 governments in the Commonwealth had 15
8 billion, and I repeat, billion in public
9 debt tied to swaps with at least 13
10 investment banks between the years of
11 October 2003 through 2009. The precise
12 number of different swaps and the precise
13 amount of debt could not be determined
14 because Department of Community and
15 Economic Development data may include
16 some double counting, and some of the
17 swaps agreements filed may not have been
18 fully acted upon. Furthermore, this
19 analysis does not include public
20 authorities because their use of swaps is
21 not tracked by state government.

22 All of you know there's 3,000
23 public authorities in Pennsylvania.

24 Regardless, these are large and
25 disconcerting numbers, and the numbers

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2 have since increased to over 17 billion
3 in public debt tied to swaps encompassing
4 108 school districts and 101 local
5 governments. Unfortunately, when it
6 comes to gambling taxpayer money in
7 swaps, Pennsylvania school districts and
8 municipalities are number one in the
9 nation, according to Moody's Investors
10 Service. That's not a good distinction.

11 The true extent of potential
12 losses to taxpayers across Pennsylvania
13 remains unknown, but could be
14 catastrophic. For example, consider the
15 enormous potential liabilities from swaps
16 entered into by three public entities
17 that are of particular interest right
18 here in Southeastern Pennsylvania.

19 Example number one: In March
20 2011, we released our cyclical
21 performance audit of the School District
22 of Philadelphia. We found that the
23 District had in excess of 1 billion in
24 debt tied to swaps. By comparison, the
25 Bethlehem Area School District debt tied

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2 to swaps, the second largest among the
3 school districts of the Commonwealth, was
4 one-quarter of that amount. Our audit
5 found that the Philadelphia School
6 District's use of swaps has cost
7 taxpayers 35 million more than if the
8 District had merely issued conventional
9 fixed rate debt, particularly because the
10 District had to make a termination
11 payment of 63 million to exit a batch of
12 sourred swap deals in 2010. While we are
13 pleased that the District has heeded our
14 recommendation to divest itself of its
15 remaining swap contracts, we are still
16 disappointed that it refused to renounce
17 the use of swaps in the future. The
18 Philadelphia School District, with its
19 long history of financial serious
20 problems, has an obligation not to gamble
21 away its limited resources on discredited
22 financial schemes.

23 Example No. 2 --

24 (Applause.)

25 AUDITOR GENERAL WAGNER:

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2 Example No. 2: Just two months ago,
3 August 2012, we released a performance
4 audit of the Southeastern Pennsylvania
5 Transit Authority, SEPTA. Our audit
6 found that SEPTA's use of swaps
7 associated with its issue in 1999 of 262
8 million in debt cost the taxpayers and
9 SEPTA fare-paying customers over \$40
10 million, and if SEPTA had -- than if
11 SEPTA had financed with conventional
12 fixed rate bonds. We also found that 27
13 million of the money that SEPTA lost by
14 terminating the swaps was merely rolled
15 into a refinancing of its debt,
16 disguising the fact and magnitude of the
17 losses and forcing SEPTA to incur an
18 additional 8 million in interest rate
19 costs over 18 years.

20 That happens quite commonly.
21 Where monies are lost, simply that loss
22 is rolled over into a refinancing of debt
23 within the particular organization.

24 Third example: The Delaware
25 River Port Authority, a bi-state agency

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2 between Pennsylvania and New Jersey,
3 entered into seven swaps in 2000 and 2001
4 related to over 1 billion in debt.
5 Although the DRPA collected 45 million in
6 up-front payments for those swaps, which
7 they thought was a great advantage, it
8 has now paid out 101 million in
9 termination fees and additional interest
10 to terminate several of them. The
11 remaining active swaps have a net
12 negative fair value of approximately \$248
13 million, nearly the equivalent of one
14 year, I repeat, one year of toll revenues
15 on all four of the agency's bridges. I,
16 as Auditor General, joined the DRPA Board
17 as an ex-officio member several years
18 after it entered into the swaps back in
19 2004, 2005. They entered into them three
20 or four years earlier. In December 2009,
21 I succeeded in passing a resolution to
22 prohibit the agency from entering into
23 future swaps agreements and to begin a
24 process of terminating its current swaps.

25 These are just a few examples

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2 gone bad in this region. I cannot
3 comment on other local agencies' use of
4 swaps because we have not examined all of
5 those deals. However, my position
6 remains the same: Swaps are inherently
7 dangerous financial instruments for
8 public entities and subject taxpayers to
9 enormous, and I repeat, enormous
10 potential loss.

11 I also want to mention that the
12 Department of Auditor General is
13 currently conducting an audit of the
14 Pennsylvania Turnpike Commission. We
15 will report updated data and information
16 on the Commission's experience with swaps
17 in our upcoming report, but the
18 Commission's financial report as of May
19 31, 2011 and 2010 shows that the Turnpike
20 Commission had more than 2 billion in
21 debt tied to 23 active swaps. If the
22 Turnpike Commission terminated or was
23 forced to terminate all those swaps, it
24 would cost approximately \$47 million,
25 which is equivalent to more than three

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2 weeks of toll revenues on the
3 Pennsylvania Turnpike.

4 These are important figures to
5 consider as the General Assembly in
6 Pennsylvania grapples with the issue of
7 transportation funding across
8 Pennsylvania. Public money that could be
9 funding transportation has been lost
10 through swaps, and additional tax dollars
11 are seriously at risk. Instead of
12 spending our money -- instead of sending
13 our money to Wall Street, we should be
14 investing obviously in our
15 infrastructure, including the
16 Pennsylvania Turnpike.

17 (Applause.)

18 AUDITOR GENERAL WAGNER: As the
19 Commonwealth's independent fiscal
20 watchdog, I have repeatedly urged the
21 General Assembly to immediately prohibit
22 school districts and other local
23 governments and municipal authorities
24 from entering into swaps. I have also
25 urged these entities to take the

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2 following actions on their own. As a
3 matter of fact, we sent a letter to every
4 School district, 500 school districts,
5 approximately two years ago indicating
6 the following points:

7 Stop using swaps and other
8 types of exotic financial instruments.
9 If you do not understand the risk, then
10 the instrument is not in the best
11 interest of taxpayers. We suggest that
12 City Council here in Philadelphia, along
13 with other councils across Pennsylvania,
14 enact a resolution banning the use of
15 interest rate swaps.

16 Number two --
17 (Applause.)

18 AUDITOR GENERAL WAGNER: Number
19 two, terminate any active swaps as soon
20 as it is fiscally responsible to do so
21 and refinance with conventional debt
22 instruments. And today more than ever
23 you can get great interest rates.

24 Number three, assess the
25 financial consequences of active swaps if

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2 they were to suffer the same negative
3 experience as Bethlehem Area School
4 District and other public entities.
5 There are a number of other issues
6 involved in Bethlehem that I can't
7 discuss today.

8 And number four, hire financial
9 advisors through a competitive selection
10 process and periodically evaluate the
11 quality, cost, and independence of the
12 service provided. We suggest that with
13 anyone involved in financial deals or
14 bond deals throughout Pennsylvania.

15 We have worked closely with
16 legislators in both houses of the General
17 Assembly to implement our
18 recommendations, primarily that swaps be
19 prohibited from public schools and local
20 governments. However, as of this date,
21 there has been no legislation, and, quite
22 frankly, the financial institutions have
23 been fighting us on that.

24 You may hear a different view
25 today from proponents of swaps and

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2 defenders of the status quo, as well as
3 from those who would argue for a reform
4 of swaps rather than a ban. We urge you
5 to ask them tough questions such as the
6 following:

7 Do the local elected officials
8 who vote to enter into these transactions
9 really understand them? And I have to
10 tell you, I've been dealing with this
11 issue, I've been dealing with this issue
12 for three years. I am fortunate to have
13 someone beside me who understands them,
14 but just to listen to the presentation --
15 and I know the presenter before me tried
16 to really explain swaps. They are
17 extremely complicated. You must work in
18 the field eight hours a day, 40 hours a
19 week to even be able to properly explain
20 them to taxpayers. And that is our first
21 responsibility.

22 Number two, none of the other
23 parties involved - the financial advisor,
24 bond counsel, swaps counsel, local
25 government solicitor or the investment

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2 bank - appear to get paid unless the deal
3 goes through. So everyone advocating
4 them wants the deal to go through, and
5 there are a variety of types of conflicts
6 involved in these transactions that are
7 inherent and must be avoided.

8 Number three, do the investment
9 banks or financial advisors involved in
10 swaps ever lose money with these
11 transactions? We haven't found any that
12 have lost money.

13 How much are the fees and
14 commissions to the various parties in the
15 average swap transaction? Every time
16 there's a transaction, from the
17 beginning, in between, throughout the
18 process, at the end, there are fees and
19 commissions, not similar to a
20 conventional fixed rate borrowing.

21 How do the fees and commissions
22 compare to the issuance of a simple
23 standard fixed rate bond? Obviously they
24 are greater over time.

25 Are fees and losses rolled into

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2 refinancing deals and, therefore, are
3 they transparent to the public? Does the
4 public know when money is lost? In most
5 instances, I would say no, they don't
6 know when money is lost.

7 Can there ever be enough
8 training, disclosure, and other types of
9 reforms to level the playing field
10 between local officials and Wall Street
11 financial experts? The answer to that
12 question is obvious. They are the dealer
13 here in this gambling event. They hold
14 the ace in the hole in every deal.

15 Are the benefits of a swap
16 worth exposing taxpayer funds to
17 potentially enormous risk if the local
18 government loses the bet? Absolutely
19 not.

20 Are you prepared to fully
21 explain the risk of swaps to taxpayers?
22 And as an elected official and I have to
23 say to all of you again, I commend you.
24 I was once a Councilmember in Pittsburgh.
25 If you can't explain something to your

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2 constituents, it's not in their best
3 interest.

4 (Applause.)

5 AUDITOR GENERAL WAGNER: The
6 fundamental guiding principle in handling
7 public funds is that they should never be
8 exposed to the risk of financial loss.
9 Swaps may be perfectly acceptable in the
10 private sector. Let me repeat that.
11 Swaps are perfectly acceptable in the
12 private sector with private funds, where
13 private citizens are free to decide how
14 much risk they can tolerate when their
15 money is at stake. But they should have
16 no role in government. Swaps should have
17 no role in government, where it is the
18 taxpayer money that is at stake. Public
19 debt should be financed with fixed
20 interest rates that are transparent,
21 reliable, and easily understood by
22 decision-makers and the public. And
23 guess what? Wall Street still makes
24 money. Everyone is still happy.

25 I also reject the

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2 counter-argument that we have heard over
3 and over and over again, that not all
4 swap deals turn sour and that many swap
5 deals have saved a great deal of money.
6 That position brings no comfort to the
7 many public entities that have been badly
8 served by swap deals that backfired. Any
9 finance vehicle that produces winners and
10 losers is, by definition, unsuitable for
11 the public sector. Unsuitable for the
12 public sector.

13 (Applause.)

14 AUDITOR GENERAL WAGNER: I will
15 continue to warn public entities of the
16 dangers of swaps and urge those entities
17 to avoid entering such agreements.
18 Remember that we, the public officials,
19 not the investment bankers on Wall
20 Street, are the stewards of public
21 dollars.

22 Thank you. We'd be happy to
23 answer any questions.

24 COUNCILMAN GREENLEE: Thank
25 you, Mr. Wagner. Thank you for your

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2 testimony.

3 Councilman Kenney.

4 COUNCILMAN KENNEY: Thank you
5 very much, General, for your testimony.
6 It certainly is totally the other side of
7 the coin that we've heard before and will
8 probably hear the rest of the day.

9 Does Act 23, in your opinion,
10 prohibit us from banning the use of swaps
11 in the municipal level, similar to some
12 of the things you try to do in our own
13 city and in Pittsburgh also where the
14 state supersedes because of an act of the
15 legislature allowing it? Do you believe
16 we can ban it on a local level?

17 AUDITOR GENERAL WAGNER: I
18 believe so, and we have suggested -- I
19 mean, the decisions that all of you make
20 in terms of the direction in which you
21 proceed, when you need to borrow money or
22 refinance money, is up to you. All that
23 has done is given you the opportunity to
24 use other forms of financing.

25 COUNCILMAN KENNEY: And I guess

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2 that would only apply to the City of
3 Philadelphia, because as the state
4 takeover of the School District, they are
5 now a state agency and not a city agency,
6 although we fund a substantial amount of
7 money into it. I'm wondering whether or
8 not they're independent of us enough to
9 be able to continue to do what they want
10 to do.

11 I guess we can put pressure
12 economically from them from a tax side,
13 because we do fund a lot of -- most of
14 the School District. So I'm just
15 wondering whether -- and SEPTA again,
16 another state agency that really
17 doesn't -- we have two members of the
18 Board there out of many members. I just
19 wondered --

20 AUDITOR GENERAL WAGNER: I
21 believe that at the end of the day, it's
22 what's in the taxpayers' best interest.

23 MR. LIPTON: I was going to say
24 that prior to Act 23 --

25 COUNCILMAN KENNEY: I'm sorry.

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2 Could you please identify yourself for
3 the stenographer.

4 MR. LIPTON: Nathan Lipton with
5 the Office of Special Investigations,
6 Department of the Auditor General.

7 Prior to Act 23, in order for
8 school districts and local government
9 units to enter into the agreements, they
10 had to run them through the authorities,
11 and that was an issue of great concern to
12 the Auditor General and us, because there
13 is no tracking of what authorities are
14 doing specifically with interest rate
15 swap agreements. There's no reporting to
16 DCED and, therefore, it's kind of hidden
17 and it lacks that transparency that I
18 think the public deserves.

19 COUNCILMAN KENNEY: Also, in
20 your investigation did you determine
21 whether or not there was any
22 actionable -- anything we could do from a
23 court proceeding, filing in federal court
24 or state court, to try to, number one,
25 recover some of the money; number two,

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2 get us out of these exit fees?

3 MR. LIPTON: Actually, I worked
4 very closely with the Securities and
5 Exchange Commission in Washington, DC and
6 their investigators and counsel to
7 provide them with the information that we
8 gathered during our Bethlehem Area School
9 District investigation, and I believe
10 that the evidence that I supplied to them
11 ultimately provided school districts in
12 Pennsylvania with a settlement of in
13 excess of a hundred million dollars that
14 was to be distributed amongst them
15 proportionately. I don't know the exact
16 figures, but I will say that it basically
17 had to do with the poor advice that was
18 given by the financial advisors and this
19 lack of transparency and conflicts of
20 interest that were inherent to the deals.

21 So, yeah, and it's continuing.
22 The FCC I believe is still continuing to
23 investigate financial advisors at school
24 districts like Bethlehem Area School
25 District and make sure that they're held

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2 accountable for the actions and decisions
3 that they made.

4 COUNCILMAN KENNEY: Have they
5 asked you to provide any information
6 relative to the School District of
7 Philadelphia or SEPTA?

8 MR. LIPTON: They have not.

9 COUNCILMAN KENNEY: Does that
10 have to be their request?

11 MR. LIPTON: That would have to
12 be their request. I only receive the
13 requests, and I honored them as we saw
14 fit.

15 COUNCILMAN KENNEY: Are you
16 aware of any statute of limitation issues
17 that we might be running into?

18 MR. LIPTON: I am not aware of
19 statute of limitation issues, but I'm
20 sure they exist. My guess would be that
21 they're in the five- to eight-year range
22 for any type of criminal activity.

23 COUNCILMAN KENNEY: The other
24 issue that was made aware to me by
25 talking to legal counsel about it is,

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2 some view that the statute doesn't start
3 to run until you're aware of the misdeed
4 or the potential misdeed.

5 MR. LIPTON: That's correct.

6 COUNCILMAN KENNEY: So the
7 clock doesn't start ticking until after
8 you find out about it?

9 MR. LIPTON: That's correct.

10 COUNCILMAN KENNEY: But I do
11 appreciate you coming in and enlightening
12 us on all the things that you've been
13 doing over the years, and we will be
14 looking at perhaps legislating a ban on
15 future such instruments based on what
16 you've been able to give us today, and we
17 hope to be able to use you as a source, a
18 resource moving forward as we muddle
19 through this.

20 AUDITOR GENERAL WAGNER:
21 Councilman, we're here to help.

22 COUNCILMAN KENNEY: Thank you.

23 MR. LIPTON: Absolutely.

24 COUNCILMAN GREENLEE: Thank
25 you. Thank you. Thank you both.

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2 (Applause.)

3 COUNCILMAN GREENLEE: Ms.

4 Marconi, the next witness, please.

5 THE CLERK: Nancy Winkler.

6 COUNCILMAN GREENLEE: And as

7 Ms. Winkler is approaching, I just want

8 to tell all future -- we still have a lot

9 of people who want to testify. We have a

10 hearing, a separate hearing, this

11 afternoon, which will probably have a lot

12 of people attending too. So if people --

13 I know this is a very complicated and

14 important matter, but if all witnesses

15 can be as concise as possible, we'd all

16 appreciate it. Thank you.

17 (Witnesses approached witness

18 table.)

19 COUNCILMAN GREENLEE:

20 Ms. Winkler, if you could just identify

21 yourself for the record and proceed.

22 MS. WINKLER: Hi. I'm Nancy

23 Winkler, City Treasurer.

24 Good afternoon, Chairman

25 Greenlee and members of the Committee on

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2 Rules. I'm Nancy Winkler, City
3 Treasurer. I'm here to testify at the
4 request of Councilman Jim Kenney.
5 Councilman Kenney asked me to provide
6 information regarding the City of
7 Philadelphia and its related entities'
8 historic use of swap agreements. I want
9 to thank Councilman Kenney's office for
10 providing an outline of topics to be
11 covered today in my testimony and for
12 participating with me in several planning
13 sessions, with me and with my staff, to
14 prepare and reviewing this complex
15 financial area.

16 Specifically, I have been asked
17 to describe the City's swap transactions,
18 to explain how these swaps have related
19 to the City's debt, and to indicate the
20 economic outcome of the swaps to date and
21 for us to then reasonably estimate by
22 projecting into the future the future
23 economic effect through the final
24 maturity of the swaps and the related
25 bonds.

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2 Just by way of background, I've
3 been asked to state my qualifications.

4 Prior to joining the City in 2011, I
5 served as an independent financial
6 advisor to state and local governments
7 since 1982. I was a Managing Director at
8 Public Financial Management and served
9 for approximately 15 years running PFM's
10 New York office.

11 Assisting me in the analysis of
12 the City's swaps is James Lanham, who I
13 have sitting here to my right. He is
14 Deputy City Treasurer. Prior to joining
15 the City, from 2008 to 2011, he was a
16 Quantitative Specialist at PFM in the New
17 York office supporting complex
18 transactions. He completed PFM's
19 challenging quantitative consultant
20 training program and is a graduate of
21 Yale University.

22 First, let me offer a general
23 background of swap activities for the
24 City of Philadelphia and related
25 entities. The City and PICA entered into

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2 20 separate swap transactions from 1990
3 to 2007, for a total amount of \$3.3
4 billion. With the exception of one \$148
5 million swap, which was entered into in
6 1990, all other swaps were entered into
7 between 2001 and 2007. The last swap
8 contract expires in 2031.

9 Since the Nutter Administration
10 came into office, the Office of the
11 Director of Finance and the Treasurer's
12 Office have had to manage the swaps and
13 the related bond programs. The 2008
14 credit crisis presented a series of
15 financial challenges for the City, which
16 I'll get into, including severe market
17 disruption that required the Finance
18 Department and Treasurer's Office to
19 restructure bond issues related to the
20 swaps and to terminate certain swap
21 transactions.

22 No new swap transactions have
23 been undertaken during Mayor Nutter's
24 administration. The economic recession
25 stressed the City's budget, threatening

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2 our credit rating and making it imprudent
3 to enter into new swap transactions. The
4 City's financial circumstances have now
5 stabilized, enabling us in the last 18
6 months to stabilize the remaining swap
7 transactions and enter into economically
8 advantageous terms for variable rate debt
9 that is associated with the swaps. So
10 our situation has now stabilized.

11 Given that neither I nor anyone
12 in Mayor Nutter's administration
13 participated in the establishment of the
14 City and PICA swaps, I'm not able to
15 provide an explanation of the actual
16 decision processes or considerations used
17 to select and execute the specific swap
18 transactions that were undertaken. While
19 there were transaction records on file,
20 there was insufficient documentation to
21 identify the precise decision-making
22 process or to justify or explain the
23 policy-maker's rationales for the
24 decisions made. However, through
25 considerable research and analysis, the

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2 Treasurer's Office has recreated a
3 comprehensive list of important swap
4 facts. We have completed a quantitative
5 analysis of the swaps since inception,
6 excluding the one swap which was
7 undertaken in 1990. My testimony is
8 based on our research, our analysis, our
9 actual historical cash flow, recreating
10 those historical cash flows and then
11 analyzing them, and then we've also made
12 a number of assumptions about how the
13 remaining swap transactions will perform
14 in the future in order to provide
15 responses to the questions about the
16 future economic performance of the swaps.

17 While we believe our
18 assumptions to be reasonable, we've
19 chosen to present a range of potential
20 future outcomes which reflects what we
21 believe to be a reasonable range of
22 future risks and costs. The assumptions
23 do not consider the effect of a future
24 financial crisis that could potentially
25 occur. We're unable to make those

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2 projections.

3 I'm about to now go into the
4 PowerPoint which I've provided to you,
5 but before we review that PowerPoint, I'd
6 like to make a couple of other comments
7 beyond my previously submitted written
8 testimony.

9 I want to assure you that I
10 share your concerns to understand the
11 history of the City's swap transactions
12 and to accurately determine the likely
13 effect on the City. The City's
14 Treasurer's Office, we've done our best
15 to prepare this presentation given the
16 limited amount of time that we have and
17 the limited amount of resources that we
18 have available to dedicate to this
19 effort.

20 While we believe our analyses
21 are reasonable and complete, they are
22 driven by many assumptions, including,
23 but not limited to, our estimates of how
24 alternative financings might have priced
25 in the market, assumptions about the

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2 future performance of the variable rate
3 market, and the future cost of credit
4 facilities. So, finally, also please
5 bear with me. A presentation of
6 financial transactions to non-financial
7 professionals is a challenge, and I'm
8 going to do my best.

9 Swaps and their interplay with
10 the credit markets is complicated. It's
11 a complicated subject and not one that
12 many non-financial people find easy to
13 follow, especially because we financial
14 people sometimes may lapse back into
15 financial lingo. So I'll try to do this
16 in plain English as I can.

17 COUNCILMAN GREENLEE: We deal
18 with lawyers a lot, so we understand.

19 MS. WINKLER: So even with
20 these challenges, I hope that by the end
21 of this presentation, you will be left
22 with a good overall history of the City's
23 swap transactions. And if you have
24 questions, I'm going to do my best to
25 answer them today, and if not, if the

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2 information is not available, we will
3 work with you to get you the answers
4 afterwards.

5 So now I'd like to begin. It
6 looks like we've managed to figure out
7 how to get the PowerPoint to work.

8 Saturation of the colors is a
9 little light, but why don't we move now
10 to an overview of the presentation on the
11 next page.

12 First what I'm going to do is
13 give an overview of the City's
14 outstanding debt and swaps. It's
15 important to do that, because as has been
16 mentioned, the dollars that we're talking
17 about need to be placed in context with
18 the overall dollars, overall debt
19 portfolio and overall budgets of the
20 City.

21 The second thing I'm going to
22 talk about are the City's financial
23 policies, the City's debt policy and the
24 City's swap policy, so you can be aware
25 of what kind of protections we currently

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2 have in place, new policies that have
3 been adopted under Mayor Nutter's
4 administration.

5 The third thing I'm then going
6 to go into is the Treasurer's Office
7 analysis of the financial performance of
8 the City's swaps, looking at the history
9 of the timing of these swaps, looking at
10 the cash flows of those swaps, and then
11 comparing the actual performance to date
12 and projected performance of the swaps to
13 fixed rate bond issues that we imagine,
14 we've estimated what the cost of fixed
15 rate bond issues may have been, and then
16 we tried to calculate the economic
17 effect.

18 I'd like to then talk about the
19 current status of the City's swaps and
20 then reflect a little bit on some of the
21 lessons that we've learned from this
22 exercise and from observing the financial
23 markets.

24 Thank you. Next page.

25 So the first thing to do is to

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2 place all of this in context with the
3 City's overall debt portfolio. I
4 mentioned earlier that we have a total --
5 had executed a total of \$3.3 billion
6 worth of swaps. The total amount of debt
7 outstanding for the City, I believe, is
8 approximately \$8.7 billion, including the
9 PICA debt. The City has approximately --
10 and I'm going to use my pointer here --
11 \$3.66 billion of General Fund-supported
12 debt. That General Fund-supported debt
13 is rated A2 by Moody's, BBB plus with
14 positive outlook from S&P, and A minus by
15 Fitch. During the fiscal crisis, the
16 City's ratings were a little lower, in
17 the BBB category, from some of the
18 other -- from the rating agencies, and I
19 think that's an important fact to hang on
20 to.

21 Then we have about 1.37 billion
22 of airport bonds outstanding, rated
23 slightly higher. Those bonds are secured
24 with the revenues of the airport system.

25 Then we have approximately 1.1

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2 billion of Philadelphia Gas Works debt
3 outstanding. Those bonds are supported
4 with the revenues of the Philadelphia Gas
5 Works.

6 And then we have approximately
7 1.86 billion of Water Revenue bonds, and
8 those bonds are supported with the
9 revenues of the water system.

10 The City primarily issues
11 traditional fixed rate debt. That debt
12 is structured with -- so that we pay debt
13 service each year, that we pay principal
14 and interest each year, and when we issue
15 the debt, we lock in the rates to
16 maturity. We also typically obtain the
17 right to call in those bonds. We get a
18 call option to call those bonds in.
19 Typically the right to exercise that call
20 option would be between eight and ten
21 years after the date we issue the bonds
22 and then would be available at any time
23 at the City's discretion thereafter. So
24 that provides the City with budgetary
25 certainty, fixed rate bonds. We know

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2 what the interest rates will be; we have
3 budgetary certainty.

4 The right to call the bonds
5 gives the City the right, albeit many,
6 many years after they issue the bond, but
7 the right in the future, should interest
8 rates be lower, to refinance those bonds
9 for budgetary savings.

10 The City does have a portion of
11 its total debt portfolio in variable rate
12 bonds, approximately 10 percent. And
13 virtually all of that debt has been, as
14 we say, synthetically converted to fixed
15 rate debt.

16 Now I'd like to just give you a
17 highlight of an overview of the City's
18 history with swaps, some of which I've
19 already mentioned.

20 The 3.3 billion had been
21 entered into, all but 148 million,
22 between 2001 and 2007. The total number
23 of swaps in aggregate, 20. The total
24 number of bond issues associated with the
25 swaps, 11. Eight swaps have been fully

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2 terminated. Six of the 12 outstanding
3 swaps have been partially terminated.
4 The total amount of swaps that have been
5 terminated is 1.7 billion.

6 The current amount of swaps
7 outstanding, aggregate, 1.405 million.
8 General Fund supports 583.2 million. The
9 revenue credits support 464 million of
10 swaps, and then PICA has 358.5 million of
11 swaps outstanding.

12 In going back and looking at
13 the swap transactions and trying to
14 imagine specifically why the City of
15 Philadelphia used these swaps, we believe
16 there were three reasons. The first was
17 to save interest costs versus fixed rate
18 bonds. The second was to lock in
19 interest rates today for a financing that
20 they wanted to do at some point in the
21 future where they weren't able -- they
22 hadn't gotten to that call date that I
23 referred to earlier. And then the third
24 option was to front-load savings; that
25 is, to extract a cash payment up front,

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2 sometimes tens of millions of dollars,
3 which was taken into the budget at that
4 time and used for other purposes. So
5 those were the three reasons that the
6 City entered into swaps.

7 Now, the next two pages provide
8 for you a fair amount of detail, although
9 still at a very high level, about each of
10 the 20 swap transactions that I have
11 referred to. They're presented in
12 alphabetical order by issuer. So we
13 start with the airport, then we do the
14 General Fund-supported swaps, then the
15 PGW, and then on the following page, we
16 cover the Water and then the PICA swaps.

17 So just to help you figure out
18 how to read this chart, I'm not going to
19 walk you through every single swap
20 transaction, but we provide you the name
21 of the credit, the date, the trade date.
22 That would be the date that the contract,
23 the swap contract, was entered into. The
24 next column gives you the size of the
25 swap, and in swap terms we call that

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2 notional amount rather than par or bond
3 par. And then we give you the type of
4 swap.

5 Almost all of these swaps were
6 fixed payer swaps in which the City
7 agreed to receive a floating rate and
8 make a fixed rate payment.

9 The next column gives you a
10 sense of why the City -- what the City
11 was using the swap to accomplish, and in
12 most cases, it was to do a refunding in
13 advance of the call date on the bonds,
14 and that's called an advanced refunding.

15 In some instances -- and you
16 can see this in the next column, which is
17 this column here -- the City received
18 up-front money.

19 If you could go to the next
20 page, please.

21 You can see there were, for the
22 Water and PICA swaps in particular, there
23 were a number of cases where the payments
24 were actually made up front.

25 The next column gives you the

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2 swap counterparty, the entity with whom
3 we entered the swap, and then the bond
4 insurance provider. As the prior witness
5 mentioned, the underlying mechanics
6 involved variable rate bonds. Those
7 bonds had bond insurance associated with
8 them, and it was the failure of the bond
9 insurance companies during the fiscal
10 crisis that really began to trigger the
11 problems that we experienced with the
12 swaps.

13 So with that, I'd like to move
14 on to the next page, which just
15 graphically presents to you, in
16 aggregate, the total City debt, excluding
17 PICA, and how much of that debt is
18 related to the swaps today. This is
19 our -- I'm sorry. It is including PICA.
20 And this light green shows how much of
21 the total debt has a swap associated with
22 it.

23 I think it's interesting to
24 note that at the time that the City was
25 doing these swaps, the rating agencies

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2 were evaluating the swap transactions and
3 they were rendering ratings on these
4 transactions, and then they were also
5 looking at the effect of the swap
6 transactions on the underlying credit
7 quality of the municipality, and, in
8 fact, they were doing their own
9 assessment of what the likelihood of risk
10 exposure was, and they -- for example,
11 Standard and Poor's assigned to each
12 issuer something called a DDP, a debt
13 derivatives profile, which could be from
14 one to four, one being the highest credit
15 quality, if you will, the least amount of
16 risk, and four being the riskiest. And
17 the City was assigned a two, which in my
18 experience was essentially -- I don't
19 really know how to say it other than an
20 external good keeping -- good
21 housekeeping stamp of approval.
22 Virtually all issuers who were using
23 swaps got a two, and nobody sort of
24 treated that as a red flag, and I've
25 extracted for you some of the particular

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2 rationale that S&P used for that.

3 On the next page, just a little
4 more detail. The General Fund in green,
5 Water in blue, Gas Works in red, and
6 Airport in yellow, the amount of swaps
7 relative to the total debt portfolio. So
8 you can see it is fairly evenly spread
9 out among all the different credits.

10 Now, I'd like to go to the next
11 slide, please. This slide is an attempt
12 to answer the question of why did the
13 City or really why did any entity choose
14 to go with the swap transaction rather
15 than a fixed rate transaction. The green
16 line along the top here is the relative
17 funding cost in basis points, incremental
18 additional basis points, that the City
19 would have had to pay versus the red
20 line, which is a AAA rating. So, in
21 other words, because the City has
22 relatively weak ratings related to most
23 municipalities and has had for many
24 years, for the City it was much more cost
25 effective to move from this funding line

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2 down to the purple funding line, fixed
3 rate funding line, 30-year costs. That's
4 the swap rate. Okay? In order to hit
5 that swap rate, though, they needed to
6 buy that bond insurance that I talked
7 about earlier. That bond insurance
8 insured the underlying bonds that were
9 being sold, those variable rate bonds.
10 So that at the time -- so the City paid
11 up-front bond premiums, in some instances
12 millions of dollars for each one of these
13 transactions, to the bond insurance
14 companies to get -- to buy AAA insurance
15 on the bonds, which would be used to pay
16 the bondholders, so that the City felt --
17 I think probably reasonably felt at the
18 time that they did this that they had
19 protected themselves from what they
20 perceived to be the biggest risk at the
21 time.

22 Now, there was one other thing
23 to notice here, is that this green line,
24 that green line is a callable line. In
25 other words, that funding rate, you have

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2 the right to call those bonds in the
3 future. This purple line down here, that
4 is not callable. And I think that what
5 happened -- and I have another slide on
6 the next page to show you what I'm
7 imagining happened -- is that many
8 issuers liked the interest rate at the
9 time, they liked this relative funding
10 difference, and they imagined, if you
11 could go to the next slide please, they
12 would be -- let's say this is -- I think
13 this year is, say, 2005 here, right
14 around here. Issuers may have been
15 looking at 20 years of declining interest
16 rates, and they looked at that time
17 period and they said, wow, interest rates
18 have been falling, in some cases very
19 precipitously, for many, many years.
20 Gee, this level of interest cost looks
21 very attractive. And then -- if you
22 could go back to the prior page, please.
23 And then whatever the funding difference
24 is, adding that benefit. Gee, I'll give
25 up the call option, because I like this

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2 rate and why do -- I don't think I'm
3 going to ever get a lower rate, because I
4 have the benefit of looking back over
5 time and seeing we're in such a low
6 interest rate environment.

7 So I'm speculating. I could
8 not find anything in the files to verify
9 this speculation, so it's just
10 speculation, but that is my guess. And
11 in my view, that's one of the very
12 unfortunate aspects of the swap
13 transactions, is that we were locked into
14 them to the final maturity because we
15 didn't obtain that right to call like we
16 had on our fixed rate bonds.

17 And then if we could go to the
18 next slide, please. Thank you.

19 So if you go to the next slide,
20 this slide is simply showing you a very
21 long history of short-term interest
22 rates. The tax-exempt interest rates are
23 the red line. Is that right? Sorry.
24 The blue line are the tax-exempt rates
25 and the red line are one-month LIBOR,

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2 which was sort of the benchmark against
3 which municipalities sort of looked at
4 their variable rate -- their likely
5 variable rates. And what you see is,
6 this is a period of the fed government
7 easing. This is a period of the Fed
8 raising rates, stable rates, Fed dropping
9 rates down again, and then you can see
10 here we're now in this extended period of
11 very low, near zero, short-term rates,
12 and that's due to the federal policy
13 associated with trying to provide
14 stimulus into the economy to provide for
15 recovery after the fiscal collapse in
16 2008.

17 And I should note, if you could
18 go back to the prior page, we see
19 extremely low interest rates today,
20 almost unimaginably low rates, well below
21 the average of the period. The average
22 for a municipal market over -- what is
23 this period of time, about 30 years -- is
24 5.41 percent. The current AAA rating is
25 about 3 percent. So we're in -- we are

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2 currently in an historically low interest
3 rate environment and now are standing
4 here today, looking back at these swap
5 transactions which were made between 2001
6 and 7 primarily and with the benefit of
7 knowing where we are today and evaluating
8 these swaps. That's where we are.

9 Could we go to the next page,
10 please.

11 So I apologize to the audience
12 for the difficulty in reading the slides.
13 We do have some copies of the books that
14 we can make available.

15 This slide just highlights some
16 of the City's key debt policies, which
17 were developed by the Finance Department,
18 the Treasurer's Office at the start of
19 Mayor Nutter's administration, and
20 they're designed to overall seek -- to
21 move the City into the A level credit
22 ratings, and in so doing, to provide what
23 I would consider to be fairly
24 conservative debt management practices,
25 including a specific set of criteria that

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2 are used for issuing variable rate bonds
3 and criteria for issuing refunding bonds,
4 minimum amount of savings, and
5 specifically providing the need for much
6 higher level of benefit associated with
7 any future financings that would be done
8 using swaps.

9 So the next slide provides you
10 with highlights of the swap policy, which
11 is -- both the swap policy and the debt
12 policy are quite lengthy, and they can be
13 obtained on the City Treasurer's website
14 if you would like to read them in detail.
15 But the highlights on the swap policy --
16 again, just to note, we have not entered
17 into any new swap transactions since
18 Mayor Nutter has been in office, but we
19 have built a new swap policy.

20 The first thing is documenting
21 compliance, and this is important. Prior
22 to entering into any swap going forward,
23 the policy requires written documentation
24 that the City evaluates the transaction
25 for compliance with the swap policy and

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2 adequately addresses a wide range of
3 risks and administrative responsibilities
4 that are highlighted in the policy.

5 So really, quite frankly, at
6 this point we're really not entertaining
7 doing any swaps, but that standard was
8 not in place before, and certainly in
9 going back and looking through the files,
10 we found it very difficult to find the
11 documentation I would have liked to have
12 seen about why the City chose to do the
13 swaps they did.

14 The policy also provides a cap
15 on the total number of -- total dollar
16 amounts of swaps and prohibits certain
17 types of swap structures. And it
18 requires substantial monitoring of the
19 swaps and certain risk management
20 activities as well.

21 So now getting into the meat of
22 the actual analysis that our office
23 undertook to measure the economic effect
24 of the swap transactions versus what we
25 believe to have been the expectations

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2 that the City had at the time they
3 entered into the swaps.

4 As the prior speaker testified,
5 beginning in 2007, the credit markets
6 began to experience substantial stresses.
7 At first, the bond insurers' credit
8 qualities became suspect, and auction
9 rate securities began to fail. Then that
10 cascaded over into the variable rate
11 market itself, markets where the bonds
12 had bond insurance and liquidity instead
13 of just an auction rate product which did
14 not have liquidity. And as that
15 occurred, interest rates kept rising on
16 variable rate bonds. And we go back to
17 that PowerPoint, the page -- two pages
18 before. You can see here, the short-term
19 interest rates began to just spike up
20 tremendously. And for the City, that
21 created very substantial fiscal stress.

22 Specifically, what were the
23 specific stresses that we had? We had
24 variable rate receipts based on an index
25 that did not match the variable rate

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2 expenses we were experiencing. Our
3 assessment, our economic assessments,
4 that produced about 36 percent of the
5 economic losses that the -- 36 percent of
6 the economic losses were incurred solely
7 with respect to the failure of the swap
8 variable rate receipt to match the
9 variable rate we were paying.

10 The second is that the bond
11 insurance where we had paid that premium
12 up front, that bond insurance became
13 valueless to us and we had to restructure
14 those deals with new credit. We believe
15 that was about 13 percent of the losses
16 that we incurred.

17 The next was that those new
18 letter of credits that we had to buy have
19 been much more expensive, although we've
20 brought those costs down recently, but
21 there was a period where they were much
22 more expensive, and we are projecting,
23 for the purpose of making the projections
24 out into the future, that they're going
25 to remain more expensive. And so that we

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2 think is about another 13 percent of the
3 losses that have incurred.

4 And then, last, the replacement
5 liquidity was not available for all of
6 our swaps. So we had to terminate swaps.
7 We had to make termination payments and
8 then we had to issue variable rate bonds
9 at high interest rates. I think one of
10 the -- it was Jeff Pearsall indicated to
11 you that while the rates -- we thought
12 rates would be correlated during the
13 period of time where the City did fix out
14 certain bonds. They weren't correlated,
15 and so our fixed rate -- we had to both
16 pay a termination payment and fix out at
17 higher rates, and that actually was about
18 80 percent.

19 Now, those numbers add up to
20 more than 100 percent, and the reason why
21 it adds up to more than 100 percent is,
22 we actually had savings in the beginning.
23 There was a period of time when those
24 swap transactions were performing well.
25 We had savings, so we factored that in,

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2 and we also received money up front,
3 those tens of millions of dollars that we
4 received up front. So we factored that
5 in.

6 So that is just a very high
7 summary. And then moving on, the next
8 page just gives you the methodology that
9 we used, which is to present the swap
10 transactions versus a fixed rate bond
11 issue, and we've identified what we -- we
12 are using our own Treasurer's Office
13 guesstimate of what the expected
14 economics would have been at the time the
15 swap was executed and then -- and we've
16 made assumptions around what we think a
17 theoretical fixed rate bond issue would
18 have been sold at. So it's a judgment
19 call. Honestly and admittedly, it's a
20 judgment call. We think it's reasonable.

21 And then we've tried to break
22 the economics down into two time periods,
23 from the inception of the swap until the
24 end of Fiscal '12 and then from issuance
25 to maturity. So the entire period of

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2 time the swap was outstanding. And
3 that's important because we talk about --
4 people talk, how much have we lost? How
5 much has the City lost? And we know we
6 can sort of speak to how much -- where
7 are we today versus what we think the
8 expectations were, and then we can make
9 some projections around where we think we
10 will wind up when all is said and done.

11 There are some limitations to
12 this methodology that we've used, and I'd
13 like to speak to them for a moment.

14 First, we really don't -- as
15 I've said before, we were not able to
16 locate the documents that demonstrate the
17 actual expected economics.

18 Second, we need to estimate
19 those fixed interest costs in a market
20 that could have been as much as ten years
21 ago. So there's going to be some
22 inaccuracy there.

23 The third point is that we
24 really -- we've made reasonable estimates
25 about what the future liquidity costs and

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2 other costs and performance of the
3 variable rate bonds will be. We have
4 assumed that the variable rate bonds will
5 not match the receipts. We have assumed
6 a loss going forward on the receipts for
7 the purposes of this exercise, ten basis
8 points per year.

9 We've also not evaluated any
10 future refundings that could occur, and
11 we have not factored in a future fiscal
12 crisis.

13 Could we go to the next two
14 pages. Thank you.

15 This page is very dense, but
16 it's really the meat of the analysis that
17 we've undertaken. Essentially what it
18 does is provide by credit -- so in some
19 instances, we've aggregated multiple swap
20 transactions into a single credit. And
21 on the left-hand side, under the heading
22 entitled Actual/Estimated Savings Versus
23 Hypothetical Fixed Rate Bond Issue, we've
24 valued what we believe to be the economic
25 gain or loss from inception of the swap

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2 to June 30th, 2012. That's under the
3 title To Date, which is really June 30th,
4 2012. And then we've made a projection
5 over the entire life of the swap
6 transaction. And what you can see is, in
7 aggregate, if you were to look at it in
8 aggregate, the City General Fund has
9 either lost 2.8 million or gained 10
10 million to date. But over the entire
11 life of the swap transaction, we estimate
12 that the City General Fund will lose,
13 versus fixed rate bonds that they could
14 have sold, between \$23 and \$84 million.
15 Now, why is that?

16 COUNCILMAN KENNEY: I'm sorry.
17 I just need some clarity on the page.
18 The page I'm looking at is Page 18?

19 MS. WINKLER: I'm on Page 17.

20 COUNCILMAN KENNEY: Oh, I'm
21 sorry. That's why I need clarity. Thank
22 you. Never mind. Thanks.

23 MS. WINKLER: Do you want me to
24 go back over that?

25 COUNCILMAN KENNEY: No.

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2 MS. WINKLER: So it's
3 interesting, right? So the City to date
4 probably hasn't really lost any money on
5 the General Fund on the swaps they've
6 done, but in aggregate -- because we're
7 taking into account money that's been
8 received up front, when some of these
9 swaps were done in that early period,
10 where there were years of benefit that
11 were aggregated up, where we were doing
12 better than we would have done if we had
13 done a fixed rate bond issue. But
14 largely all that benefit that was
15 accumulated from the start of those
16 General Fund-supported swaps to the
17 fiscal crisis have been wiped out by the
18 economic effects of the fiscal crisis.
19 And I'm just using the General Fund as an
20 example here. And the City was not able
21 to obtain liquidity to replace their bond
22 insurance that they lost when the bond
23 insurers became essentially insolvent.
24 And so the City both had to pay, I
25 believe it was, 14 times more on the

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2 General Fund, 14 times more for letters
3 of credit than they had to pay in the
4 past and, in addition, the City --
5 because the City could not get letters of
6 credit equal to the total amount of
7 variable rate debt that they had
8 outstanding, they had to terminate some
9 of the swaps, make swap termination
10 payments -- I'm sorry. Excuse me. 14
11 percent is the Water -- I'm sorry; not
12 percent, times; 14 times as much for the
13 Water, 14 times as much for PGW, for the
14 General Fund an average of about 10 times
15 as much expense.

16 COUNCILMAN KENNEY:
17 Mr. Chairman, what's the -- can you just
18 give me totals?

19 MS. WINKLER: Yeah. The total
20 is on Page 17.

21 COUNCILMAN KENNEY: And
22 that's -- okay. Go ahead.

23 MS. WINKLER: So do you want me
24 to -- I can just walk back through that
25 again.

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2 So what we're saying is that we
3 believe, for example, for the General
4 Fund, which is this first set of numbers
5 here for those of you in the audience,
6 2.8 million, that first box says 2.8
7 million negative. In other words, we may
8 have lost 2.8 million, but we also may in
9 this range that we've established made as
10 much as 10 million. However -- and
11 that's because we accumulated benefits
12 versus a fixed rate bond issue to today.
13 However, because we had to sell fixed
14 rate bonds into a high interest rate
15 environment and terminate those swaps at
16 the same time and we are carrying much
17 higher credit costs on the remaining
18 variable rate bonds, we're projecting
19 that the General Fund-supported debt in
20 aggregate is going to cost the City
21 versus a fixed rate bond issue somewhere
22 between \$23 and \$84 million over the
23 entire life of that swap.

24 COUNCILMAN GREEN: Mr.

25 Chairman?

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2 COUNCILMAN GREENLEE:

3 Councilman Green.

4 COUNCILMAN GREEN: Thanks.

5 Sorry. Are all these numbers
6 present value?

7 MS. WINKLER: No, they are not
8 present value. They're budgetary.

9 COUNCILMAN GREEN: So --

10 MS. WINKLER: We just thought
11 if we did present value, it would be just
12 two sets of numbers and then -- we can
13 provide -- we have run the present value
14 numbers and we can provide them.

15 COUNCILMAN GREEN: I think that
16 would be useful. If it's \$84 million in
17 30 years, that's a small number. So I'd
18 like to know -- I don't need -- if you
19 want to provide the numbers to the
20 Chair so we don't --

21 MS. WINKLER: We have them.

22 COUNCILMAN GREEN: Thank you.

23 MR. LANHAM: I have them if
24 you'd like, Councilman.

25 COUNCILMAN GREENLEE: Just

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2 identify yourself. I know it was
3 mentioned before.

4 MR. LANHAM: James Lanham,
5 Deputy City Treasurer.

6 Total General Fund present
7 value, present value over the life of the
8 transactions, they range between a loss
9 of \$45 million and a loss of \$2.6.

10 COUNCILMAN GREENLEE: That's a
11 big range, isn't it?

12 MR. LANHAM: As the Councilman
13 noted, these go out a very, very long
14 time. So the loss --

15 MS. WINKLER: We made -- right.

16 MR. LANHAM: The losses towards
17 the end of the transactions have --

18 MS. WINKLER: Let me help you
19 out on that as well. What we did, we
20 felt it was really important to create a
21 range, because we're making an estimate
22 about what that fixed rate bond issue
23 would have been in many instances many,
24 many years ago, and the municipal market
25 is just not -- it's not that precise like

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2 the bond market -- I mean like the
3 Treasury market is, where you can go and
4 look at what Treasury rates were on a
5 date ten years ago. You know exactly
6 what the borrowing rate would be. So we
7 had to create a range around that fixed
8 rate bond issue. So that's the only
9 difference, is the range that we've
10 created between what the theoretical
11 fixed rate might have priced at.

12 COUNCILMAN GREENLEE: Okay.
13 Thank you.

14 MS. WINKLER: So --

15 COUNCILMAN GREENLEE: I'm
16 sorry. Excuse me.

17 Councilwoman Reynolds Brown.

18 COUNCILWOMAN BROWN: Good
19 morning. On Page 12 of your document
20 here, you say that you engaged -- "you"
21 being the Treasury Department, is that
22 accurate -- engaged a nationally
23 recognized swap advisor --

24 MS. WINKLER: Yes.

25 COUNCILWOMAN BROWN: -- who

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2 rewrote -- what was the trigger for that?

3 MS. WINKLER: Well, the City
4 engaged around a competitive process at
5 the start of the Nutter Administration to
6 select a swap advisor, and we selected --
7 that was prior to my tenure, but we
8 selected Swap Financial of New Jersey as
9 our swap advisor. And it was very, very
10 important to us that we select an
11 advisory firm who had an independent
12 practice, that we knew had a reputation
13 in the market of being very aligned,
14 their interests being completely aligned
15 with issuers, and not tainted by some of
16 the prior transactions where there may
17 have been problems. As you may know, the
18 City did have a swap advisor before, and
19 that firm -- the principals of that firm
20 have been convicted, and most of them are
21 either in prison or awaiting sentencing.

22 COUNCILMAN KENNEY: I'm sorry.
23 I apologize.

24 COUNCILWOMAN BROWN: Please.

25 COUNCILMAN KENNEY: Just based

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2 on that statement, why aren't we as a
3 government -- and considering this
4 Administration didn't do any of this --
5 why wouldn't we as a government be
6 outraged and be looking for every
7 possibility to sue everybody and their
8 mother to get this money back?

9 (Applause.)

10 COUNCILMAN KENNEY: Or to do
11 something?

12 I mean -- and I'll say from the
13 outset, this is not a Nutter
14 Administration doing. I got it. So
15 there should be no reticence to going
16 after whoever we can go after. And it
17 seems to be there's this like, Well, you
18 know, over 30 years, it's not that much
19 money. But, I mean, these guys went to
20 jail, and they were advising us. I don't
21 understand why we wouldn't be going --
22 I'd hire every big law firm I can find to
23 go after everybody, including Merrill
24 Lynch and all of them.

25 (Applause.)

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2 COUNCILMAN KENNEY: And this is
3 not your policy decision, I understand.
4 I just don't understand the lack of kind
5 of like anger over it. It just seems to
6 be -- we should be more angry about what
7 these people -- if it were a doctor, we'd
8 be suing them for malpractice. But
9 that's not the case. It doesn't seem
10 like it's the case here.

11 I mean, Auditor General
12 Wagner's testimony was angry and he was
13 waving this thing around. He's mad about
14 the loss of taxpayers' money.

15 I mean, maybe you believe or
16 the Administration believes this is
17 de minimus. I don't know. But I tend to
18 disagree with you, and I'd --

19 MS. WINKLER: I hope you don't
20 take my tone to in any way imply that I
21 don't take this seriously --

22 COUNCILMAN KENNEY: No.

23 MS. WINKLER: -- or that I
24 don't --

25 COUNCILMAN KENNEY: I'm not

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2 saying that, but I know when I talked to
3 the Administration about the potential of
4 following up, following through with this
5 with a lawsuit, people are doing due
6 diligence, but it seems like it's just
7 like, Well, okay, we don't know if we'll
8 get to it or not. And that's to me my
9 concern, is that as the clock ticks, are
10 we losing opportunities to at least get
11 ourselves out of these buy-out deals?
12 Could a settlement in a lawsuit, a
13 settlement be potentially to get or
14 diminish or get us out of these exit
15 payments? Something?

16 I mean, I'm just -- I'm not
17 thinking you're not thinking this is
18 serious, but I just -- I didn't realize
19 the guys went to jail.

20 MS. WINKLER: Yeah. And my
21 understanding is that --

22 (Applause.)

23 MS. WINKLER: -- that
24 particular company, basically there are
25 no assets. There's nothing to attach.

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2 COUNCILMAN KENNEY: But there's
3 other bad doers in this whole thing, all
4 over, all throughout. We were advised
5 badly, I think. Now, you may disagree,
6 but I think we were advised badly, and I
7 think someone ought to stand up and take
8 that hit.

9 Sorry, Councilwoman.

10 COUNCILMAN GREENLEE:
11 Councilwoman, you still have questions?

12 COUNCILWOMAN BROWN: I do.

13 So given this harsh reality,
14 the one safeguard going forward is -- I
15 think you said it in here -- evaluating
16 transactions on an X basis. So what are
17 the safeguards?

18 MS. WINKLER: Well, I mean, I
19 think at this stage, the safeguards would
20 be the fact that we're not really
21 actively looking at this time to --

22 COUNCILMAN KENNEY: That's a
23 good safeguard.

24 MS. WINKLER: -- undertake
25 additional swap transactions, number one.

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2 And, number two, we do evaluate our
3 exposure to the swaps that we have and
4 the economic ability to extract ourselves
5 from the swaps in an economically neutral
6 manner. So, in other words, we don't
7 really want to lock in any more losses.
8 We did in the teeth of the fiscal crisis,
9 largely because we were not able to
10 obtain alternate liquidity to support the
11 variable rate bonds. Because we couldn't
12 get other letters of credit, because they
13 were -- the banks themselves were in free
14 fall in their own ratings, we were forced
15 to sell fixed rate bonds to pay
16 termination -- and pay termination
17 payments. So we've already locked in
18 some losses that are on my chart and on
19 my page here. We tried to value that.

20 COUNCILWOMAN BROWN: Sure.

21 MS. WINKLER: Right now we've
22 been working very aggressively over the
23 past really 18 months to two years to get
24 the City's credit rating improved and use
25 that to improve our relationship with the

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2 letter of credit bank providers to lower
3 the costs. And we've lowered, radically
4 lowered, the costs of liquidity, which we
5 have not fully reflected. We've assumed
6 maybe a little bit of deterioration in
7 the improvements that we've gotten in our
8 loss projections, but we've -- I think
9 it's really sustaining the City's credit
10 rating, trying to push S&P, push
11 ourselves to get into the A category so
12 that we can have a stable and very
13 diverse group of banks that we're doing
14 business with.

15 One of the problems the City
16 had in the past was, they only had a few
17 banks they were doing -- they had lined
18 up for liquidity, and when those banks
19 went away, they didn't have other banks
20 that were comfortable extending credit to
21 support the variable rate bonds.

22 We've substantially reduced the
23 City's risk by bringing in -- running
24 competitive processes and bringing in
25 many more banks, and that has lowered the

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2 costs and reduced our risk exposure,
3 because we don't have such huge amounts
4 exposed to one particular bank.

5 COUNCILWOMAN BROWN: When was
6 the last swap transaction?

7 MS. WINKLER: It was in
8 December of 2007, except we did terminate
9 some swaps since then.

10 COUNCILWOMAN BROWN: So none
11 during the Nutter Administration?

12 MS. WINKLER: Nothing other
13 than terminations of swaps. The last
14 swap we terminated, we terminated about
15 \$29 million worth of a PGW swap in 2011.

16 COUNCILWOMAN BROWN: And to
17 Councilman Kenney's question, is there or
18 does there remain active engagement in
19 the Law Department or in the
20 Administration to go after those who --

21 MS. WINKLER: Yes.

22 COUNCILWOMAN BROWN: Any read
23 on the status of that? Has that been
24 since 2008 and we're now 2012?

25 MS. WINKLER: Well, I'm not

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2 familiar with and it's probably not
3 appropriate for me to speak to the Law
4 Department's detailed legal analysis, but
5 I can assure you that there are a number
6 of people in the Law Department meeting
7 with outside firms and examining the
8 City's likely success in various suits.

9 COUNCILWOMAN BROWN: Okay. All
10 right, then. Thank you for your
11 testimony.

12 COUNCILMAN GREENLEE: Before
13 you continue, if I can just note for the
14 record obviously Councilwoman Reynolds
15 Brown is present, as is Councilwoman
16 Bass, and Councilman O'Brien was here,
17 also a member of the Committee. Thank
18 you.

19 I know we want to get to the
20 lessons learned. I know that's your
21 last -- I know Councilwoman Reynolds
22 Brown likes to talk about lessons
23 learned, so maybe you could go over
24 those.

25 MS. WINKLER: Sure.

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2 COUNCILMAN GREENLEE: Briefly.

3 Thank you.

4 MS. WINKLER: Would you like me
5 to at least just speak to the current
6 mark-to-market of our swaps? That's
7 fine. I don't --

8 COUNCILMAN GREENLEE: Maybe we
9 can just get --

10 MS. WINKLER: Okay. So on Page
11 18, we do provide you with the current
12 value of the swaps, and you can see
13 they're all negative. And the reason why
14 they're negative is because the rates
15 that we pay on those swaps is higher than
16 what a rate would be if we were to enter
17 into a new swap with the same terms
18 today. And that's because interest rates
19 have fallen and interest rates have
20 fallen, and we don't have any call option
21 on those swaps. We can't terminate them.
22 And because we have still a very large
23 total amount of swaps outstanding, the
24 aggregate mark-to-market is very high.

25 Now, this is relevant in the

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2 event we were to terminate the swaps, but
3 it is not relevant if we just stay in the
4 swap and stay through maturity, because
5 over time if the swaps do continue to
6 perform and we just keep the variable
7 rate bonds outstanding, we will never
8 incur these costs that are shown on this
9 page. This is almost like a bookkeeping
10 entry, if you will, of valuing where we
11 are today with the swaps. It's not an
12 economic loss. And if interest rates
13 instead of having gone down the way they
14 have and stayed down, if for some reason
15 they had instead gone up, these
16 mark-to-markets would have been positive,
17 and in the future if interest rates go
18 up, they can go up.

19 And then I can go to lessons
20 learned.

21 The first lesson is to have a
22 very rigorous and conservative swap
23 policy, which we have proceeded with.

24 The second is to make sure that
25 you comply with your swap policy, and we

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2 rigorously internally monitor our
3 compliance with the swap policy.

4 The third is to value a truly
5 independent third-party advisor, and we
6 think we've done that by procuring a
7 leading independent advisor. We are
8 currently RFP'ing now for -- as the term,
9 that four-year term is up on that
10 agreement.

11 Very importantly, we think the
12 City should, whether it's fixed rate
13 bonds or swaps or any other kind of debt
14 instrument, always try to preserve its
15 right to exit without penalties. So
16 preserve call options. And so from now
17 on, we will never -- we're going to look
18 to amend the swap policy to provide for
19 preservation of call options on swap
20 policy.

21 And then I think, very
22 importantly, we need to realize that the
23 rating agency information was less than
24 perfect, and that reliance that we had on
25 making those up-front payments for that

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2 bond insurance, that was probably a very
3 risky thing to do. So going forward, we
4 are not so likely to be using bond
5 insurance.

6 COUNCILMAN KENNEY: I'm sorry.
7 You're saying it was a risky thing to buy
8 insurance?

9 MS. WINKLER: I'm saying that
10 the bond insurance was not -- we relied
11 on the rating agencies.

12 COUNCILMAN KENNEY: So the
13 rating agencies gave us wrong
14 information?

15 MS. WINKLER: The rating
16 agencies' evaluation of the credit
17 worthiness of the bond insurers was
18 deeply flawed, because the bond insurers
19 took our premiums and the premiums of
20 many other municipalities around the
21 country and they invested them in
22 mortgage-backed securities, which the
23 rating agencies had rated AAA, which in
24 fact they weren't AAA. They were, as we
25 all know now --

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2 COUNCILMAN KENNEY: A lot of
3 bad actors there.

4 MS. WINKLER: -- bad
5 securities.

6 COUNCILMAN KENNEY: A lot of
7 bad actors in that process, including the
8 rating agencies. Do they have no
9 exposure for giving us such terrible
10 information or do we need them to get our
11 bond rating up? It's kind of like the
12 people who are rating us are the people
13 who helped cause the problem.

14 MS. WINKLER: Again, I think
15 it's probably best for me not to comment
16 on the legal hoots.

17 COUNCILMAN KENNEY: Okay.

18 MS. WINKLER: So that's it.
19 Thank you for your time. I'm happy to
20 answer any other questions you may have.

21 COUNCILMAN GREENLEE: Thank
22 you. Councilman Green had a question.

23 COUNCILMAN GREEN: Thank you.

24 Just so we're clear, there's a
25 couple of things mentioned that are

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2 related to the loss. One is the loss of
3 the premiums for bond insurance. You
4 could get bond insurance whether or not
5 there was a swap in the transaction. Is
6 that part of the loss calculation that
7 you're doing? Are those losses included
8 in what you're calling losses on swaps?

9 MS. WINKLER: The loss of bond
10 insurance?

11 COUNCILMAN GREEN: Yes.

12 MS. WINKLER: Yes.

13 COUNCILMAN GREEN: So that's
14 really not a loss at all related to
15 swaps, is it? Because we bought bond
16 insurance whether or not we had swaps in
17 the deal in order to improve our credit
18 rating.

19 MS. WINKLER: Yes, but we have
20 factored in the --

21 COUNCILMAN GREEN: I
22 understand.

23 MS. WINKLER: Well, I just want
24 to say, we have included an assumption on
25 that theoretical fixed rate bond issue

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2 that we would have had bond insurance on
3 that deal too.

4 COUNCILMAN GREEN: I
5 understand, but you're counting losses
6 that have nothing to do with swaps, that
7 have to do with the decision to buy bond
8 insurance.

9 MS. WINKLER: That's true.

10 COUNCILMAN GREEN: Which is not
11 at all what this hearing is about.

12 MS. WINKLER: That is true.

13 COUNCILMAN GREEN: So how much
14 of the losses are related to that?

15 MS. WINKLER: About 13 percent.

16 COUNCILMAN GREEN: Thirteen
17 percent?

18 MR. LANHAM: If I may make one
19 extra point --

20 COUNCILMAN GREEN: I'm not
21 being critical. I'm just trying to
22 understand the assumptions.

23 MR. LANHAM: And I believe the
24 difference is, yes, you're correct, that
25 the City would have bought insurance on a

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2 fixed rate transaction. However, on a
3 fixed rate transaction, it would still be
4 outstanding, whereas on the swap
5 transaction it no longer is.

6 MS. WINKLER: See, what
7 happened is, when you sell a fixed rate
8 bond issue, the investor is buying that
9 bond insurance. They're essentially
10 saying, okay, we'll take a little bit
11 lower interest rate because you bought
12 bond insurance. And then it's the
13 investor's problem that the bond
14 insurance is now worthless; it's not the
15 City's problem.

16 COUNCILMAN GREEN: Sure. Yeah.
17 Unless, of course, the deals are
18 structured the way they were structured
19 for us.

20 MS. WINKLER: Right.

21 COUNCILMAN GREEN: But still
22 you would have bought bond insurance
23 whether or not you did the swap
24 structure. That's my point.

25 MS. WINKLER: Right.

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2 COUNCILMAN GREEN: So it's not
3 really a loss related to swaps.

4 I guess my other question is
5 related to the current state of where we
6 are as a city. It seems to me that one
7 of the risks that you talk about in your
8 new policy or one of the reasons you say
9 we could buy permitted uses of swaps is
10 locking in interest rates, which really
11 is the subject of much of the testimony
12 that we've heard here today, that
13 sometimes it makes sense to lock in
14 interest rates. I don't know if we as a
15 city are qualified to like, Hey, interest
16 rate is really low now, let's make a
17 decision to lock them in. I mean, you
18 saw what happened when we made those
19 assumptions in 2005, 6, and 7.

20 So in terms of the City's
21 policy going forward, could you explain
22 why locking in interest rates is a
23 permitted use of swaps?

24 MS. WINKLER: Well, the City
25 does multi-year financial planning, and

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2 the Water Department does very long --
3 I'm just giving some example. We do very
4 long financial planning and often go --
5 for example, the Water Department goes
6 for multi-year rate increases, and it is
7 fairly common to try to keep -- to know
8 what your costs will be, because the
9 certainty of knowing what your costs will
10 be has value in planning.

11 Now, when you sell a fixed rate
12 bond issue, you're making a bet too,
13 right? You're making a bet at the time
14 that you -- if you want to use that term,
15 making a bet. You're making -- you like
16 those rates.

17 COUNCILMAN GREEN: You're happy
18 with that rate for the next 30 years, the
19 next 10 years, whatever it is.

20 MS. WINKLER: Right.

21 COUNCILMAN GREEN: And you're
22 happy to pay and your projections show
23 that you can afford to pay that, and so
24 you don't want to take -- you're taking
25 risk off the table when you issue a fixed

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2 rate bond, right?

3 MS. WINKLER: You're getting
4 certainty of what the expense will be,
5 yes.

6 COUNCILMAN GREEN: Right. You
7 have complete certainty.

8 So a swap essentially provides
9 that same certainty without a fixed rate
10 bond.

11 MS. WINKLER: It provides that
12 same certainty. The theory is that it
13 gets you much lower all-in costs. The
14 problem with that was that the underlying
15 mechanics, the credit that we were buying
16 to support the variable rate bonds, that
17 credit quality that we paid for didn't
18 really exist and we thought we were
19 buying AAA.

20 COUNCILMAN GREEN: I
21 understand, but what does that have to do
22 with swaps?

23 MS. WINKLER: It doesn't.
24 Well, I mean, it has to do because you
25 need that liquidity for the variable rate

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2 bond.

3 COUNCILMAN GREEN: I

4 understand, but what was the loss related
5 to? Was the loss related to swaps? Was
6 the loss related to the fact that we
7 locked in -- we made a decision like
8 you're just describing, which makes
9 perfect sense, we made a decision to lock
10 in interest rates for a long time because
11 we were happy with the cost that it was
12 going to be compared to the benefits we
13 were going to get from borrowing money
14 for a capital project or whatever it is?
15 My question is, what was the loss related
16 to? Was it related to the fact that we
17 bought swaps or was it related to the
18 fact that the underlying credit quality
19 that we were basing this whole
20 transaction on, which had nothing to do
21 with swaps, didn't really exist?

22 MS. WINKLER: Yes. Most of the
23 problems, most of the expenses were
24 associated with the underlying bonds and
25 their failure to perform.

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2 COUNCILMAN GREEN: So how much
3 of the loss was related to that as
4 opposed to the locked-in interest rate
5 which the swap represented?

6 MS. WINKLER: We'd have to go
7 back and --

8 COUNCILMAN GREEN: Because it
9 seems to me that that's really the loss
10 that for which, as Councilman Kenney
11 points out, we may have significant
12 damages and probably people, somebody
13 should have liability. But it's not -- I
14 don't want to take what is a valuable
15 tool for a city to have off the table for
16 reasons that have nothing to do with the
17 actual loss that the City incurred, which
18 was related to the underlying instrument
19 that had nothing to do with the swap.
20 The swap enabled that transaction, but
21 that transaction in itself was the
22 foolish transaction, not the swap, and I
23 want to make this point again, which is
24 the same thing as issuing a fixed rate
25 debt, except that you can lower the rate

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2 with a swap as compared to issuing fixed
3 rate debt. Would you agree with that
4 statement?

5 MS. WINKLER: I do.

6 COUNCILMAN GREEN: You do agree
7 with that?

8 MS. WINKLER: I do agree with
9 that.

10 COUNCILMAN GREEN: So if you
11 would get back to the Chair about how
12 much of the loss was actually related to
13 the instrument of underlying transaction
14 as opposed to the swap, I think then
15 we'll be talking apples to apples in
16 terms of policy discussions about whether
17 or not swaps make sense to have in the
18 financial tool belt of the City, even if
19 we as a policy say we're not going to use
20 it except to lock in a -- for example,
21 let's just say we do -- we know that
22 we'll be borrowing billions potentially
23 at the airport over the next ten years
24 for runway expansion and other things.
25 The airport could make a decision that

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2 interest rates are never going to be
3 lower or not likely to be lower for the
4 airport given where the economy is and
5 what we expect to happen in five years in
6 broader economics. They could make a
7 decision that we're happy with 4 percent
8 for all this infrastructure that we're
9 going to do, and so we want to do a swap
10 to lock in borrowing that we know is
11 going to happen. And that could make
12 rational sense. I'm not arguing for it,
13 but is that the sort of thing that we
14 might want to use a swap for in the
15 future?

16 MS. WINKLER: The City could
17 use that. The City could also say, Hey,
18 I really like that rate, but I wouldn't
19 mind providing some protection for myself
20 by paying a slightly higher rate, still
21 getting -- but getting a call option on
22 the swap. You can have a call option on
23 the swaps.

24 COUNCILMAN GREEN: But that
25 would still be on a swap.

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2 MS. WINKLER: And that would be
3 much lower -- could still be much lower
4 cost of funding than the fixed rate bond
5 market. And, yes, I think that is an
6 important tool -- I think what we don't
7 want to do is remove a financial tool
8 that, if properly managed and with
9 certain precautions taken to manage
10 risk -- I really do want to emphasize the
11 importance of maintaining credit quality
12 and embedding call rights in the swaps.
13 If you do those two things, I think in
14 certain scenarios there can be very wide
15 incremental benefit that could be derived
16 that would help both lower the cost of
17 capital and enable long-term planning,
18 which it could theoretically be useful.

19 So I would hope that we can
20 have a dialogue around how to maintain
21 some legal authority for the City to be
22 able to use its better understanding that
23 we have derived today with respect to how
24 to manage a swap portfolio and to have a
25 policy in place and apply that policy

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2 conservatively potentially in the future
3 for some swaps. I'm not -- although I'm
4 not here to present a swap or support
5 doing any new swaps at this point, I just
6 would hate the idea of forever removing
7 that as a tool.

8 COUNCILMAN GREEN: Okay. In
9 terms of accountability for the portion
10 of the transaction that I think you said
11 created most of the loss that we're
12 talking about, to the extent we realize a
13 loss -- I recognize we're not marking the
14 market -- but who are the people involved
15 in those transactions that really are
16 accountable? Obviously City Council
17 passed the bonds, so there's certainly
18 accountability here, the Administration.
19 But in terms of outside -- the City
20 Controller signed off on it. In terms of
21 outside of City government, who is
22 accountable? Is it the underwriters? Is
23 it the politically connected law firms
24 that we hire to represent us? Is it --
25 who are the people that should have

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2 accountability to us if we were to pursue
3 legal action? Who are the parties? Our
4 financial advisors?

5 MS. WINKLER: I don't think
6 we -- I mean, there are a number of
7 different financing participants, but
8 you'd have to go back and look and
9 understand what each one of those roles
10 were. It may be that some of those firms
11 may not have really had any role at all
12 in saying let's do this transaction.
13 There may have been some firms that were
14 very closely involved. We could not
15 ascertain any of that from looking at the
16 written record that was on file in our
17 office.

18 COUNCILMAN GREEN: Okay.
19 Because the one thing I absolutely agree
20 with Councilman Kenney on is if people
21 are accountable for structuring that
22 transaction that's not the swap but the
23 underlying financial instrument that the
24 swap applied to, I see no reason why we
25 should not pursue them vigorously, unless

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2 you advise us that it's going to impact
3 the City's ability to borrow or get
4 favorable interest rates in the future.

5 But I learned a lot today, and
6 I really appreciate the hard work you and
7 James put into this, and thank you very
8 much for your testimony.

9 MS. WINKLER: Thank you.

10 COUNCILMAN GREENLEE: Thank
11 you, Councilman.

12 Councilman Kenney.

13 COUNCILMAN KENNEY: Thank you.

14 In my view as far as exposure,
15 I would probably -- I'm not a plaintiff
16 lawyer. I would do what a plaintiff
17 lawyer would do, and that's sue everybody
18 and see what shakes out. That would be
19 just my advice. Whatever their roles
20 were, we can sort it out in depositions
21 as opposed to trying to figure out which
22 ones are the best. But that's not my
23 call.

24 Auditor General Wagner's
25 testimony you were here for was very,

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2 very clear on his position and his
3 investigator's position on the role of
4 swaps and the use of taxpayers' dollars.
5 He believes unequivocally we should never
6 use an instrument like that when it comes
7 to the use of taxpayers' dollars, that in
8 private sector, if you want to roll the
9 dice for your own company, that's up to
10 you and your shareholders and your
11 business partners, but that these types
12 of instruments that rely on people giving
13 us advice and making sure that they're
14 right and there's no nefarious
15 undercurrent intentionally trying to
16 screw things up, all that being the case,
17 it's a good instrument. But why would we
18 want to even continue looking at them
19 when -- unless you disagree with his
20 testimony on the losses of the School
21 District and SEPTA and the DRPA. If you
22 disagree with them, then you can tell me,
23 but it seems to me that this is something
24 that's -- as time goes on and the economy
25 gets better, we're going to be looking at

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2 everything and scrutinizing everything,
3 but assure you that some young person who
4 has not yet been born, who is going to
5 walk on Wall Street one day is going to
6 figure out a way to screw us, and that's
7 their -- money is king. That's their
8 life. They try to figure out ways to get
9 around the system. That's what all this
10 derivative stuff came from. That's where
11 all these giving people loans that they
12 couldn't afford to pay back, knowing it
13 going in. All that stuff created what
14 we're talking about now.

15 So my question is, if we had
16 all fixed rate securities and not any of
17 these swaps, would we be here even having
18 this discussion?

19 MS. WINKLER: No.

20 COUNCILMAN KENNEY: No. And I
21 guess my point is, I would rather err --

22 (Applause.)

23 COUNCILMAN KENNEY: I think I
24 would rather err on a conservative side
25 of a return for the taxpayer than trying

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2 to be Gordon Gekko and try to figure out
3 how to maximize all this stuff, because I
4 don't think we should be doing that. I
5 don't think as a government we should be
6 doing it. And I will say I am guilty for
7 voting for them, but as I go to my
8 doctor, if he tells me what to do, I
9 usually do it, until I like die or
10 something from what he told me to do.
11 Then I won't do it anymore. But, I mean,
12 when it comes to our legislative body and
13 taking people who are skilled and who are
14 experts and giving us advice, I generally
15 follow it, because I'm not an expert in
16 financial management.

17 So, I mean, my argument and
18 what I'm trying to figure out in my own
19 brain is whether or not we should be
20 doing these things at all ever. I know
21 you said you want to have it as part of
22 your toolbox, but I still think long term
23 we're going to run into this same problem
24 again when everybody forgets about the
25 fiscal calamity we just went through and

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2 things get a little better and people get
3 a little greedier, I think things then
4 tend to happen. That's just my opinion.
5 Thank you.

6 COUNCILMAN GREENLEE: Thank
7 you.

8 COUNCILMAN KENNEY: And thanks
9 for your testimony. I appreciate it.

10 COUNCILMAN GREENLEE: Thank
11 you. Thank you both for your time.

12 The next witness, Ms. Marconi.

13 THE CLERK: Sharon Ward.

14 COUNCILMAN GREENLEE: And,
15 again, as I said before, we are starting
16 to run up against a time limit. So if
17 you could hit the main points, because we
18 still have a number of people who would
19 like to testify.

20 (Witness approached witness
21 table.)

22 MS. WARD: I'd like to give you
23 copies of testimony.

24 COUNCILMAN GREENLEE: We will
25 get it. Go ahead. If you identify

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2 yourself for the record and proceed,
3 please. And, again, if you could
4 summarize any statement, it really helps.

5 MS. WARD: I will be as quick
6 as I can. Thank you very much,
7 Councilman Greenlee, Councilman Kenney,
8 and other members of the Rules Committee.
9 My name is Sharon Ward. I am the
10 Director of the Pennsylvania Budget and
11 Policy Center. We are a non-partisan,
12 non-profit policy and advocacy
13 organization. We focus on tax equity and
14 the impact of state and federal budget
15 decisions on working families in
16 Pennsylvania communities.

17 Let me go through my testimony
18 very briefly.

19 Our organization has looked at
20 the impact of the national recession on
21 Pennsylvania municipalities and on
22 Pennsylvania communities. And let me
23 express to you that part of what our
24 mission is is to take very complex but
25 very important information about the

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2 operations of federal, state, and local
3 government and try to make them
4 understandable to policymakers, to
5 advocates, and the public so that we can
6 better scrutinize the actions of
7 government. So I appreciate the
8 opportunity to speak today.

9 You see that we have issued a
10 report earlier this year, which attempted
11 to view -- look at the cost of both the
12 School District and the City interest
13 rate swaps to the taxpayers. So I want
14 to just make three points for you today.

15 The first is that the
16 instruments have been and are likely to
17 continue to be costly to City taxpayers.
18 You've heard testimony about that today
19 both from City Treasurer Winkler and also
20 from Auditor General Jack Wagner.

21 The second is that the use of
22 these instruments has been widespread in
23 Pennsylvania, and it is the result of a
24 deliberate attempt by the financial
25 services industry to de-regulate a

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2 practice that was for many years
3 considered to be a form of gambling, and
4 we have seen the results.

5 And the third is that
6 Philadelphia ought to take action to
7 recover some of the losses that it
8 incurred as a result of these financial
9 transactions.

10 So first I just want to remind
11 you about the impact and the cost of the
12 recession to people in the City of
13 Philadelphia. You need to look at the
14 table to fully understand unemployment
15 because of this recession. Unemployment
16 in the City rose from 6.4 percent to 11.1
17 percent where it sat in September of
18 2012, with unemployment among African
19 Americans and Latinos much higher. Over
20 the period before the recession to
21 current -- the most recent data, poverty
22 in the City increased from 23.8 percent
23 to 24 -- to more than 28 percent, and
24 child poverty increased to 39 percent.

25 As you know, thousands of City

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2 residents have faced foreclosure, and
3 actually the number of foreclosures has
4 increased in the first half of this year.
5 And you also know that City taxpayers
6 have paid a price for this recession,
7 including a doubling of the City's sales
8 tax rate in order to make up for the lost
9 revenue.

10 The toll of this recession on
11 individuals and families is extremely
12 large. The rates of long-term
13 unemployment are very high, and we have a
14 whole generation of students who have
15 graduated from college with record high
16 debt who do not have very bright
17 prospects of obtaining employment that's
18 commensurate with their education. We
19 have paid dearly for this recession.

20 And the point I want to make
21 and I think others want to make is that
22 there is blame to be assigned for all of
23 this and that the actions of the large
24 financial institutions, including the
25 very ones who were involved in these

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2 swaps agreements here in the City of
3 Philadelphia, played a role in
4 precipitating what has been a
5 catastrophic event for Philadelphians and
6 indeed for all Americans.

7 Again, as I wanted to point out
8 to you that there has been a deliberate
9 systematic attempt by the financial
10 services industry to de-regulate the
11 industry in order to bring more local
12 governments into using these types of
13 derivatives, and you have seen frankly
14 the result. In Pennsylvania, Act 23 of
15 2003 expressly authorized local
16 governments and school districts to enter
17 into these swaps agreements, and then the
18 race was on. And between 2003 and 2009,
19 local governments entered into 628
20 separate swaps agreements.

21 You heard Auditor General Jack
22 Wagner talk about the investigation that
23 was done in Bethlehem. That was the
24 first look, detailed look, at the impact
25 of swaps agreements on school district or

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2 municipal finances, and at that very
3 moment, in 2009, the Auditor General
4 characterized swaps as highly risky and
5 impenetrably complex transactions that
6 quite simply amount to gambling with
7 public money, and he reiterated those
8 comments today.

9 Now, again, we would agree that
10 in theory the municipal derivatives
11 should have provided some benefit to
12 local governments, and you've heard in
13 excruciating detail about that, so I
14 won't go into it anymore. But the
15 reality was in fact very different, and
16 it is unclear whether the risks were
17 really made clear to local government
18 entities here but also across the state
19 and across the nation. And a different
20 Auditor before the Auditor General has, I
21 think, made a comment that is quite
22 telling saying that swaps derivatives and
23 other complex financial instruments are
24 typically understood only by the people
25 who sell them.

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2 So I think as you heard the
3 testimony today, a very important
4 question is who has the wherewithal to
5 make the determination that these
6 agreements are in the best interest of
7 the taxpayer? I think the City of
8 Philadelphia should be commended for
9 entering into a swaps policy, setting
10 ground rules for the use of these
11 instruments, but I think that doesn't go
12 far enough.

13 So look at exactly what the
14 cost has been for local governments of
15 these swaps agreements. According to
16 Bloomberg, taxpayers have paid more than
17 \$4 billion to banks just between January
18 2008 and November 2010 to get out of
19 swaps agreements, and like many other
20 local governments, the City and School
21 District made the decision to terminate
22 the swaps that were costly and at that
23 point had highly unfavorable terms.

24 I think the point that we want
25 to make is to Councilman Kenney's point,

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2 has the City of Philadelphia really done
3 all that it can do to help recover some
4 of the costs and to turn the balance of
5 payments back towards the City's favor
6 and towards the taxpayers' favor? And we
7 would simply argue that that should
8 occur.

9 A report, which you have in
10 front of you, identified and we think was
11 very important to begin to raise
12 awareness about this problem, the fact
13 that the City and School District from
14 our calculations had lost about \$331
15 million in net interest payments and
16 cancelling fees and that the City could
17 lose, using a very static analysis, more
18 than \$240 million in additional net
19 interest payments, depending on how
20 interest rates move forward through the
21 life of the swaps, the existing swaps
22 agreements.

23 We identify again what the
24 swaps agreements were for the City and
25 the School District. I do want to point

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2 out to you that our analysis did not look
3 at a comparison between the cost of a
4 fixed -- the comparison of whether the
5 School District or the City had entered
6 into fixed rate agreements versus the
7 variable rate agreements with the swaps
8 that they did, but even then, as the
9 Auditor General pointed out, the cost to
10 the School District would be about \$35
11 million, and you've certainly heard the
12 Treasurer's cost analysis, which
13 ranged -- again, created additional
14 costs. And, again, this all happened in
15 a time when the City could least afford
16 it.

17 So let me make two points and
18 then I know you have to get on. I think
19 the first is that we would argue that at
20 a time of financial crisis, the
21 Department of Treasury had taken this
22 very unpopular step of providing taxpayer
23 dollars to help insure the financial
24 solvency of the financial institutions.
25 We, certainly our organization and most

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2 organizations, would argue that that was
3 an absolutely necessary step. However,
4 there is nobody who is taking that step
5 to help compensate the taxpayers, and we
6 believe that good corporate citizens
7 should take the step to begin to redress
8 some of the imbalance in terms of
9 taxpayer dollars.

10 We would argue, therefore, that
11 the City needs to do two things. The
12 first would be that you should use your
13 power to try and renegotiate some of the
14 termination fees or to get a better rate
15 on some of these agreements that exist.
16 And we think it's very important that the
17 City take the opportunity to try to lower
18 its costs and, in fact, change some of
19 the imbalance that exists in its current
20 payments with respect to the swaps
21 agreements.

22 So in the best of
23 circumstances, these swaps are risky
24 business. During normal economic
25 downturns when interest rates are low,

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2 they can become very costly. I think we
3 have seen that here. I think one
4 question that has been posed is whether
5 or not municipalities or local
6 governments should continue to use these
7 instruments, and I think the answer is we
8 have to look at what the history has
9 been, and you have to answer the question
10 has this worked out to the benefit of
11 City taxpayers or has it not. And doing
12 so I think will answer the question of
13 how to proceed moving forward.

14 So I want to thank you for the
15 opportunity to testify today. I'm happy
16 to answer any questions.

17 COUNCILMAN GREENLEE: Thank
18 you.

19 Councilwoman Bass.

20 COUNCILWOMAN BASS: Hi, Sharon.
21 How are you?

22 MS. WARD: Hello, Councilwoman.

23 COUNCILWOMAN BASS: Forgive me,
24 I'm suffering with a cold.

25 Just a couple of quick

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2 questions for you. And, number one, I
3 want to thank you for your report. I
4 look forward to getting a chance to read
5 it later. I know that you're always very
6 thorough in what you provide. But in
7 thinking about this issue, there was
8 recently a piece, just this past Sunday,
9 on 60 Minutes about Goldman Sachs and
10 about some of the sort of funny business
11 in terms of investments and kind of
12 luring investors into products that they
13 knew were not good products, that they
14 knew were complex and really too complex
15 for those investors to really understand
16 what it was that they were actually
17 purchasing, all in the interest of
18 profit.

19 And so as we think about pieces
20 like that and other information that we
21 have, I just wanted to say that this is
22 very disconcerting. It's good that we
23 have policies that protect us here in the
24 City of Philadelphia. We obviously could
25 have more, but beyond that, we need the

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2 protection of the Commonwealth. We need
3 for our state to do much more to look out
4 for its citizens and for municipal
5 authorities such as Philadelphia and many
6 others that have been mentioned today.

7 So as we talk about the
8 imbalance, about taxpayer support to
9 financial institutions that were
10 considered to be too big to fail, but at
11 the same time, the support to individuals
12 has not been nearly as aggressive or as
13 supportive. And so there's just a lot of
14 work to be done, and I just wanted to
15 thank you for the report that you
16 provided. I know that it's great
17 information and I look forward to reading
18 it. So thank you, Sharon.

19 COUNCILMAN GREENLEE: Thank
20 you.

21 No other questions?

22 (No response.)

23 COUNCILMAN GREENLEE: Thank you
24 very much.

25 MS. WARD: Thank you.

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2 COUNCILMAN GREENLEE:

3 Appreciate it.

4 Next witness, please.

5 THE CLERK: Michael Krauss.

6 (Witness approached witness
7 table.)

8 COUNCILMAN GREENLEE: Good
9 afternoon. Please identify yourself for
10 the record and proceed.

11 MR. KRAUSS: Mike Krauss,
12 Mr. Chairman.

13 Mr. Chairman, Councilman
14 Kenney, thank you all for taking this
15 work up. It is indeed important work,
16 and it's to your credit that you're doing
17 it.

18 I'm a Director of the
19 nationally recognized Public Banking
20 Institute and Chair of the Pennsylvania
21 Project. We are non-profit, non-partisan
22 public policy organizations, and we're
23 engaged in campaigns of public education
24 to achieve public banks in the United
25 States. But we're here today to

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2 challenge you, to challenge you to fight
3 for the people of this city and to just
4 say no to the too-big-to-fail banks that
5 failed --

6 (Applause.)

7 MR. KRAUSS: -- that failed and
8 that are gouging this city and its people
9 for hundreds of millions of dollars in
10 the interest rate swap swindle that is
11 the subject of this hearing. And I say
12 "swindle" because really to think that
13 Goldman Sachs and J.P. Morgan sold
14 products in which they had a 50/50 chance
15 of taking big losses simply
16 (unintelligible). I say "swindle"
17 because people are going to jail now
18 because interest rates were fixed. I say
19 "swindle" because we know the LIBOR rates
20 were fixed. The rates in which your
21 losses were calculated were all fixed.
22 It's a swindle.

23 This at a time when the long
24 recession caused by these same banks that
25 sold the swaps has resulted in

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2 unemployment, home foreclosures, lost
3 revenue, and budget cuts that are having
4 catastrophic effects in this city.
5 Everybody knows what's going on and
6 should be quite properly angry.

7 But what everybody needs to
8 know is that these causes, these losses
9 could have and should have been avoided
10 altogether. Swaps were never necessary
11 to hedge against interest rate
12 fluctuations. For almost 100 years, that
13 insurance was provided by responsible
14 municipal finance managers who employed
15 the technique referred to as "laddering."

16 As Pam Martens, a widely read
17 critic, has explained, To hedge risk, an
18 insurer simply has bonds maturing along a
19 short, intermediate, and long-term yield
20 curve. If rates rise, they are hedged
21 with the intermediate and long-term
22 bonds. If rates fall, the short-term
23 munis will mature and can be rolled over
24 into the lower interest rate environment.

25 Further, she says, Municipal

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2 insurers are further protected by being
3 able to establish call dates of typically
4 five years, seven years, or ten years
5 when they issue long-term bonds. They
6 pay moms and pops and seniors across
7 America, who buy these muni bonds, a
8 small premium of usually 10 to 20 per
9 thousand face amount and call in the
10 bonds if the interest rate environment
11 becomes more attractive for issuance of
12 new bonds.

13 Philadelphia paid a lot of
14 money to advisors and bankers who made
15 long presentations, about 39 pages, about
16 how good swaps would be. They were a
17 disaster. We just explained in two
18 minutes why they were never necessary,
19 and we did it for free.

20 The Auditor General agrees, he
21 wants the act of the legislature that
22 allow these swaps to be rescinded.
23 That's for the future, but what are the
24 damages done? What is the relief and
25 where will it come from?

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2 A handful of banks crashed the
3 economy, virtually the same banks that
4 sold the swaps. They were rescued. But
5 the long recession they caused has
6 collapsed municipal tax revenues, putting
7 enormous pressure on budgets. The state
8 cut spending, and the cuts grew even more
9 severe.

10 Now these same banks that
11 caused the crash are demanding payment on
12 their one-sided interest rate deals or
13 huge fees to exit the swaps.

14 This isn't adding insult to
15 injury. It is adding yet more injury to
16 already injured people of this city.

17 In a March 15th article in
18 Counterpunch, entitled "An Inside Glimpse
19 into the Nefarious Operation of Goldman
20 Sachs: A Toxic System," Darwin
21 Bond-Graham writes, "Virtually all
22 interest rate swaps between local and
23 state governments and the largest banks
24 have turned into perverse contracts
25 whereby cities, counties, school

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2 districts, water agencies, airports,
3 transit authorities, and hospitals pay
4 millions yearly to the few elite banks
5 that run the global system, for nothing
6 meaningful in return."

7 This is an outrage, and it must
8 be ended.

9 Earlier this month, we
10 testified in support of the Responsible
11 Banking Review ordinance and suggested
12 that important as it is to review how the
13 banks conduct their business, it is vital
14 for the City to review how it conduct its
15 banking and look for new models to
16 replace those that have failed. We
17 advocate a public bank. A public bank
18 keeps the taxes of the City certainly in
19 the City for economic development.

20 But today, right now, the City
21 needs a champion to stand up for its
22 people against the abuses of a handful of
23 Wall Street banks. We hope the City
24 Council will be that champion and do what
25 is now being done in Baltimore, New

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2 Haven, Oakland, and a growing list of
3 cities nationwide that are taking the
4 looted money back.

5 We urge Council to do what is
6 required to form a task force of the
7 District Attorney, Treasurer, Controller,
8 acquire whatever additional forensic
9 accounting expertise is needed, identify
10 the cost to the people in the
11 manipulation of the LIBOR rate, the
12 rigging of the bond market, the interest
13 rate swap swindle, and seek to recover
14 that money from the banks involved.

15 Further, while the Auditor
16 General has called for a negotiation to
17 reach an equitable resolution between the
18 banks and the municipalities, which these
19 banks and other agencies from which these
20 banks are extracting huge payments and
21 fees, we urge Council to give serious
22 consideration to a strategic default on
23 these swaps -- just say no -- and suspend
24 any and all payments until there is a
25 settlement to the City's satisfaction.

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2 Remember --

3 (Applause.)

4 MR. KRAUSS: -- the banks have
5 no money at risk. They invested not one
6 nickel in the swaps and have nothing to
7 lose, just billions to be made by gouging
8 the people whose lives they've already
9 burdened with lost jobs, lost homes, lost
10 futures, deteriorating education, slashed
11 vital service, and deteriorating
12 neighborhoods.

13 We think the time for talking
14 needs to be over. We all know the damage
15 done and who was responsible. They need
16 to be made to pay up. This Council needs
17 to make them.

18 And we need new models for
19 municipal banking and finance, nothing
20 short of a revolution in the way public
21 funds are managed.

22 What better place for that
23 revolution to begin than right here in
24 Philly where the First American
25 Revolution was declared.

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2 Come on, Philly. Fight. Take
3 the money back.

4 Thank you.

5 (Applause.)

6 COUNCILMAN GREENLEE: Thank you
7 for your testimony.

8 MR. KRAUSS: You're welcome,
9 sir.

10 COUNCILMAN GREENLEE: Our next
11 witness.

12 THE CLERK: Is there a
13 representative from the Philadelphia
14 Coalition Advocating for Public Schools?

15 (Witness approached witness
16 table.)

17 COUNCILMAN GREENLEE: Good
18 afternoon.

19 MS. WALLACE: Good afternoon.

20 COUNCILMAN GREENLEE: Please
21 identify yourself and proceed.

22 MS. WALLACE: I'm Carmen
23 Wallace. I'm speaking on the behalf of
24 Dawn Hawkins. She's sick right now.

25 Good afternoon, Councilmen and

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2 Councilwomen. This is the letter that
3 she sent.

4 She said, Hello. My name is
5 Dawn Hawkins. I am a parent of two
6 children, one who has graduated from
7 college and one who is a 7th grade
8 student at LP Elementary at 31st and
9 Ridge in North Philadelphia. There is no
10 question my son will go to college as
11 well, but I am very concerned that
12 depleted resources in our public schools
13 is making the path more and more
14 challenging. My son's school does not
15 have a library or a computer room. We
16 share a school nurse with three other
17 schools, so she comes out to our school
18 only once a week.

19 I am so concerned about the
20 bleeding of money away from our public
21 schools that I joined with Action United
22 and, through them, have become part of a
23 larger group called a Philadelphia
24 Coalition Advocating for Public Schools,
25 or PCAPS.

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2 We believe that the School
3 Reform Commission's plan to close dozens
4 of public schools is exactly the wrong
5 prescription at this time when we need
6 more investment in our schools, not less.
7 My son's school with students from K to 8
8 grade is very crowded. Most classes have
9 30 to 35 students. We have 6th, 7th, and
10 8th graders on one floor. You have big
11 kids picking on little kids.

12 Thank goodness for the public
13 library about seven blocks from our
14 house, where my son can get help with his
15 algebra on coolmath.com and for a
16 positive after-school program with the
17 Franklin Institute to teach engineering,
18 math, and science. We also have students
19 from Temple and other schools come to
20 help students study.

21 These are all great -- this is
22 all great help, but it's like bailing
23 water from a sinking boat because our
24 schools keep seeing their funding go down
25 and the only solution the SRC has is to

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2 close more schools. The District closed
3 FitzSimons, Rhodes High Middle School is
4 in our area and sent all the children to
5 Strawberry Mansion High. That created a
6 very crowded and dangerous situation.

7 When I heard that the
8 Philadelphia School District pays \$63
9 million to buy its way out of some
10 complicated financial deals that were
11 peddled by the big banks, I almost threw
12 up. These banks crashed our economy,
13 asked us to bail them out, and now
14 they're taking money out of our already
15 broken school district.

16 What could that \$63 million
17 have done for my child's school? Maybe
18 he could have a functioning library or
19 smaller class sizes. Maybe I would have
20 sent my child to school and had a nurse
21 to respond if he had an asthma attack
22 four days a week, and no computer room
23 for him to learn skills he will need in
24 the future.

25 The School District of

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2 Philadelphia says it will save \$33
3 million by closing up to 64 schools in
4 the next year. Maybe our neighborhoods
5 and our children will not have to be
6 sacrificed if these banks hadn't run off
7 with almost twice the amount.

8 I understand that the District
9 still has several swaps which are
10 potentially even more risky than the ones
11 they paid 63 million to get out of. How
12 can we put our children in this kind of
13 situation?

14 Our organization is calling on
15 the banks that took \$63 million to repay
16 it. My children need the same kind of
17 education that those bankers' children
18 get. Bankers are making record profits
19 while school budgets are cut to the bone.
20 We're calling on the City and the School
21 District to sever our ties with any bank
22 that won't refund this money. It's only
23 right.

24 COUNCILMAN GREENLEE: Thank
25 you, ma'am.

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2 (Applause.)

3 COUNCILMAN GREENLEE: Thank you
4 very much.

5 Ms. Marconi, our next witness.

6 THE CLERK: Anne Gemmell.

7 (Witness approached witness
8 table.)

9 COUNCILMAN GREENLEE: Good
10 afternoon. Please identify yourself. We
11 have a copy of your testimony.

12 MS. GEMMELL: Okay. I'm going
13 to get a little bit off the script, if
14 it's okay, because I know some things
15 have already been said.

16 COUNCILMAN GREENLEE: Right.

17 MS. GEMMELL: My name is Anne
18 Gemmell. I'm the Political Director at
19 Fight for Philly. Fight for Philly is a
20 non-profit organization that's been
21 organizing in Philadelphia's struggling
22 neighborhoods since spring of 2011, and
23 we work on things that generally beat the
24 drum about Wall Street's culpability for
25 the condition of our economy. So it's

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2 natural for us last January when we
3 learned of the Pennsylvania Budget and
4 Policy Center's paper to build a public
5 campaign about it. So we've been taking
6 action on that, as well as focused on
7 corporate tax fairness during the state
8 budget battles and advocating for things
9 like an increase in the federal minimum
10 wage for workers, along with other
11 fight-for-fair-economy cities.

12 Locally, as I said, we started
13 this campaign in January of 2011 and
14 started talking to Council folks about
15 it, and I want to thank Councilman Kenney
16 for listening and showing the people that
17 we've been organizing, that democracy
18 does work, that when you learn about
19 something and you have questions about it
20 and you take it to your elected official,
21 that they respond. And that we're able
22 to have this public hearing I feel like
23 is a huge victory and demonstrates to so
24 many Philadelphians that may be dismayed
25 by our process, dismayed by government

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2 generally that this is what democracy can
3 look like when you engage. So I thank
4 you for that.

5 Like so many other people have
6 said already what swaps are, I don't --
7 I'm not a financial expert, but I'm not a
8 dumb person either, and after 40 slides
9 of two PowerPoints from the advisors that
10 have built cottage industries on advising
11 to purchase swaps and a City Treasurer
12 that wasn't sure how they felt about it,
13 I still don't understand the swaps any
14 better. So I think that in itself is
15 sort of self-evident, but I want to state
16 it for the record, is that I've been
17 listening. I've been trying to really
18 listen, and I don't have a better
19 understanding even after everything
20 that's been said.

21 Some of the squiggly lines from
22 the boxes and the bond insurance going
23 here to there really reminded me of the
24 inside job, which with the squiggly lines
25 and boxes and taking insurance on this

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2 deal and taking insurance on that deal,
3 that's what led to our mortgage crisis.
4 That's exactly the kind of behaviors that
5 crashed the economy in the first place.

6 Councilman Green, you asked a
7 good question about bond insurance, did
8 the losses to the bond insurance count.
9 That's separate from the swaps. Well,
10 sure, if you forget the whole forest of
11 the problem, which is we bought insurance
12 and it was meaningless. That's kind of
13 the point that Fight for Philly is trying
14 to make, is that we're dealing -- if
15 everything was level and all the actors
16 were transparent and everything was above
17 board, sure, maybe swaps aren't so bad,
18 but that's not the case. We know that's
19 not the case. We have so much evidence
20 that that's not how big banks behave,
21 that it's hardly even news. People pick
22 up the paper, another federal
23 investigation, another settlement, Wells
24 Fargo, predatory lending, \$70 million
25 settlement. It's not even news, barely

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2 even news anymore.

3 So we're dealing in a system
4 that we don't understand, a system that's
5 created which feels like it's created to
6 prey upon regular people, from the
7 checking account level where it's \$7 fees
8 suddenly one month and the next month you
9 have to storm into a bank lobby and sit
10 down to get banks to relinquish their
11 checking account fees.

12 So the point is is that we
13 should have a system where if you buy
14 insurance, it means something. But we
15 don't have that system, so that changes
16 the evaluation of whether or not public
17 money should be involved with swaps.
18 Fight for Philly says no, that we don't
19 think it should be involved in swaps.

20 So that's the thing. I think
21 that we may not be smart enough to
22 understand complicated derivatives. We
23 still don't know who makes money on these
24 deals. I can't find that out. I read
25 this stuff all the time. Nobody is

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2 required to say how much money they make
3 on these deals. I think that's a huge
4 telling problem. But I do know the
5 difference between scarce public dollars
6 and plentiful private funds in the
7 financial world. If you're a private
8 hedge fund investor, go for it, get
9 involved with swaps. But if you're a
10 city like Philadelphia where a property
11 taxpayer like me is looking at a 300
12 percent increase in her property tax
13 values, as her local public school,
14 highly successful, neighborhood public
15 school, is being asked to reduce the
16 number of per-pupil dollars every single
17 year since the meltdown, this is
18 difficult. This is difficult.

19 So, again, I want to thank
20 Councilman and all the Councilpeople that
21 came to this hearing and asked good
22 questions. Thank you for listening and
23 understanding what people see from the
24 ground: Schools closing. Remember, Paul
25 Vallas, pushed out of town for an \$80

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2 million deficit. It makes the
3 conversation -- it makes that look silly,
4 \$80 million. Oh, what's that big deal?
5 Now the District -- which where's the
6 District? All we have is a PowerPoint
7 for the District. We're looking at a
8 \$300 or \$400 million deficit.

9 COUNCILMAN GREENLEE: Let me
10 interrupt for a second. Just for the
11 record, they were invited. I assume --
12 let me just ask the question. Is there
13 anyone here from the School District?

14 (No response.)

15 COUNCILMAN GREENLEE: So for
16 the record, they were invited. But
17 please proceed.

18 MS. GEMMELL: I know they were
19 invited, because their PowerPoint was on
20 the table and they submitted testimony,
21 but we also need public entities to be
22 able to sit in a chair and answer
23 questions.

24 So my point is again that if we
25 can't understand it, public money

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2 shouldn't be involved in it, and Fight
3 for Philly, we are going to continue. We
4 want to work in coalition with innovative
5 and creative ideas like the Public
6 Banking Institute, which would have
7 seemed like pie in the sky maybe a decade
8 ago, but now I think we really need to
9 evaluate those sorts of options. We're
10 going to work in coalition with folks
11 that are upset about school closings and
12 keep reminding folks that how we got into
13 this position in the first place was the
14 banks, and once we recognize that and
15 never forget it, it will be much easier
16 for our champions in elected office to
17 say, Look, banks, all the folks that want
18 to underwrite airport bonds or underwrite
19 any other, water, sewer -- all these
20 water main breaks, how are we going to
21 pay for that? Bonds. Who is going to
22 underwrite that? The big banks that got
23 us in this in the first place.

24 So we need to recognize that
25 2008 was a game changer for our swaps

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2 deals and the way we look at financial
3 business moving forward. In a pre-crash
4 environment, swaps were risky enough, but
5 after the crash, large global banks, many
6 of whom are under investigation for
7 manipulating LIBOR, should reset the
8 current swap deals to reflect the
9 post-2008 historical shift in interest
10 rates.

11 We have to be able to count on
12 something, and they could help restore
13 the faith in our financial system by
14 resetting municipalities, districts. And
15 this could be an act of Congress. You
16 could call on it in the form of a
17 resolution. That would be amazing.

18 Furthermore, large bailed-out
19 banks should refund any swap cancellation
20 fees collected since the crash in 2008.

21 When the Nutter
22 Administration -- let me just say,
23 there's no bad guys here that testified.
24 I mean, the Nutter Administration has
25 done everything to get our finances in

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2 better shape. The School District, the
3 people who are there now, are probably
4 looking back into the files and finding
5 the same thing, Oh, we don't know. We
6 don't know what happened. There's no
7 record. It's probably the same problem.

8 There's no finger-pointing at
9 this point, except above and beyond to
10 Wall Street, but we still have to deal
11 with them. And I think that we're in a
12 moment politically where we can set the
13 terms of those dealings a little bit more
14 than we ever had in the past.

15 So to my point and concluding,
16 barring good-faith renegotiations from
17 large global banks, Philadelphia leaders,
18 yourself included, Mayor Nutter, any
19 future mayors, Philadelphia leaders need
20 to protect all of our public funds, not
21 only from derivative deals but also more
22 generally from these banks that are too
23 big to trust.

24 It's not hard to figure out.
25 There are four major banks who have the

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2 vast majority of the derivative deals on
3 their books. And I don't have evidence.
4 I'm not a financial expert, but something
5 tells me that we have another mortgage
6 crisis on our hands with these
7 derivatives. Nobody understands them.
8 They're being labeled this way and that.
9 How do we know they're not the next
10 crash? We don't know. We don't know.
11 And I don't see any evidence of big banks
12 reforming themselves. I don't think
13 Dodd-Franks is as effective as it could
14 be, and their games continue on. It's in
15 the headlines every day.

16 So in conclusion, we look
17 forward to working with elected leaders,
18 coalition partners, and we'll continue to
19 work on this and explore and support
20 folks that are willing to go out and talk
21 about creative solutions for our
22 financial needs and with the ultimate
23 goal of protecting very scarce public
24 dollars.

25 Thank you.

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2 COUNCILMAN GREENLEE: Thank you
3 very much.

4 (Applause.)

5 COUNCILMAN GREENLEE: Thank you
6 for your testimony.

7 That concludes our witness
8 list. As was pointed out today, there's
9 a lot of things to discuss here, a lot of
10 things to take in. It's a complicated
11 matter. I'm sure there will be more
12 going on here.

13 So to wit, this hearing of the
14 Committee on Rules on Resolution 120147
15 is recessed to the call of the Chair.

16 Thank you.

17 (Committee on Rules recessed at
18 12:55 a.m.)

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CERTIFICATE

I HEREBY CERTIFY that the proceedings, evidence and objections are contained fully and accurately in the stenographic notes taken by me upon the foregoing matter on October 23, 2012, and that this is a true and correct transcript of same.

MICHELE L. MURPHY
RPR-Notary Public

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