'Swaps'/Gambling Slams School Districts

by Marcia Merry Baker

Sept. 3—Millions of dollars continue to flow from beleaguered school districts to megabanks—JPMorgan Chase, Wells Fargo, Deutsche Bank, Royal Bank of Canada (RBC), et al.—under rigged gambling practices of interest rate swaps, otherwise formally called "qualified interest rate management agreements." These, and related swindles, were legalized in many states after the 1999 repeal of the 1933 Glass-Steagall law, separating commercial banks from speculative banks' betting activities. The reinstatement of this law is the necessary emergency measure to open the way for restoring economic function and creating the future of the nation, in particular, to make way for real education and hope among our children, their parents, and teachers. There is no alternative recourse, and no "local" solution.

U.S. school systems, along with local and state government services of all kinds, have been increasingly undermined, as the national economy was eroded over the last 50 years of deindustrialization and globalization. Deliberately making it worse for schools, was the onslaught against U.S. education in the name of "reform," by the Bill Gates philanthropo-fascist wing of Wall Street/London interests, as part of undermining the nation-state system itself. This so-called reform crowd pushes every kind of destructive measure, from outsourcing education—charter schools—to busting pay, morale, and tenure of teachers and staff, and of course, promoting computer-brain curricula.

Then, on top of this crisis, over the last decade, came a wave of blatant looting of the resources of schools, by the Wall Street/London networks of banks, financial advisors, corrupt officials and flunkies, to induce local school boards to enter into sucker-agreements, for such contrivances as variable interest-rate loans, interest-rate swaps, CDOs (collateralized debt obligations, tied to crap), and the like. Meanwhile, interest rates themselves were rigged on the Libor, ISDAFix Index, Forex, and by other means.

The big-name financial players include all the usual suspects: JPMorgan Chase, Goldman Sachs, Royal Bank of Scotland, UBS, Royal Bank of Canada, and more. They are all still in the game, raking it in off schools. Plus, school districts are buckling under the pressure of lawsuits, legal fees, and blood-sucking swaps termination fees.

Of the approximately 12,000 school districts nationwide, thousands have been looted in this way.

On Aug. 28, LaMar Lemmons III, President of Detroit Board of Education, issued a statement denouncing the Wall Street operations, and calling on Congress to immediately reinstate Glass Steagall (see preceding article). He presents details of the devastation to the Detroit area schools in recent years.

The following are a few headline updates on the same destructive process at other locations, beginning with the model story of swaps-looting, as experienced by a central Pennsylvania school district, coerced to pay $10 million to the Royal Bank of Canada.

The gory particulars of this one instance—there are many similar ones cross-country—show exactly what JPMorgan Chase chairman Jamie Dimon was lauding as successful Canadian banking, in an interview against Glass-Steagall Aug. 7 with the daily *Oklahoman*, in Oklahoma City. Stating his opposition to U.S. Senate bill S. 1282 to restore Glass-Steagall, Dimon lied, "Our [problematic] issues have nothing to do with Glass-Steagall in America, and a lot of the rest of the world didn't have Glass-Steagall and didn't have problems, like Canada. . . ."

Here is how the Royal Bank of Canada screwed a school district in Pennsylvania—a Jamie Dimon success story.

Pennsylvania: State College Swaps Model

In Centre County, Pa., the State College Area School District (serving the town where Penn State University is located), started classes this Fall for 6,900 students, under a January 2013 court settlement order to continue to pay multi-millions in blood money to the RBC over

YouTube

In Chicago, the Board of Education rubber-stamped a vastly reduced school budget, shutting 48 schools and firing more than 3,000 teachers and staff. Here, citizens protest the cuts on the 50th anniversary of the March on Washington, Aug. 28.

a 2006 interest-rate-swaps deal, for a school never built, for a loan never taken. First, some brief background, then the State College particulars.

In 2003, the Pennsylvania legislature, knuckling under to the Wall Street thug-lobby, passed a law, which allowed municipalities and other local entities to enter into interest-rate swaps and other innovative sucker deals with banks—U.S. and foreign—which, in turn, under the 1999 Federal repeal of Glass-Steagall, could conduct such bilking freely.

By September 2012, 108 school districts (22% of all Pennsylvania districts), along with 105 local governments, including the capital, Harrisburg, and Philadelphia) carried $17.5 billion in public debt, tied to swaps, through 800 structured deals.

In 2006, the State College Area School District signed an interest-rate swap transaction with the RBC, for a fixed rate of 3.884% on a sum of about $58 million, associated with a loan, projected to be made in 2007, when the district planned to finalize its borrowing for that amount and break ground on a new school. RBC was to pay the district a floating rate in the swap.

When in 2007, the District re-evaluated going ahead with the project to build a new school—given that bids had come in over budget, etc.—the termination price to get out of the swap was $168,000 as of June that year. The school district continued its re-evaluation process.

In October 2007, the termination fee on the swap reached nearly $2 million, because of interest-rate fluctuations. The school district had kept the swap, while it was deciding on whether to go ahead on the new school or not. In late 2007, the school board cancelled the building project altogether, and, rather than the district paying the multi-million dollar termination fee, the swap deal was converted to a higher rate, but on a lowered debt figure (since there was no actual loan), and continued for three years.

By February 2010, the swap termination fee had soared to $5.5 million.

By Summer 2010, the termination fee hit $10-11 million.

In August 2010, the School District sued Royal Bank of Canada, claiming that the swap was illegal, because it wasn't tied to an actual debt: The school

loan was never taken out, for which the swap was supposed to be interest-rate insurance. "How can we make interest payments on debt that doesn't exist? It's a naked swap. That's not even allowed under state law," said an attorney for the school district, Louis Moffa.

RBC countered that the original swap deal was tied to "anticipated" debt, so it must be honored. Moreover, the bank argued that it had taken out new hedging obligations, and they must be honored! That is, in order to "hedge" on the swap deal, the bank entered into contracts with other parties, so the Bank was obligated to pay the other parties—and implicitly, daren't lose money—so, the local school district must be held to its swaps contract, no matter what.

In May 2011, the school district refused to make a payment of $978,285 to the Royal Bank of Canada. The bank then filed suit against the school district to recover the full $10.3 million termination fee. The school district contested.

In October 2011, a Federal judge ruled in favor of the bank, saying that the swap was valid. The school district contested.

At this point, more than 700 such swaps deals had been entered into in the state, according to Pennsylvania Auditor General Jack Wagner, who has repeatedly denounced swaps as nothing more than "a gamble with taxpayer money."

In particular, RBC, as of 2011, was the biggest municipal-bond underwriter in Pennsylvania (according to Reuters), and also was a leading swaps wheeler-dealer in the state, with at least 88 contracts, including in Harrisburg, which went into bankruptcy/state receivership in 2011.

In January 2013, the school district finally submitted to settling the legal fight, rather than racking up more legal fees, and agreed to pay the nearly $10 million demanded by RBC on the naked swap. In March, the district wired $6 million to the bank, which funds came from the general operating budget of schools, as well as separate balances.

The State College Area School District is to pay out the remaining termination fee amount of $3 million to RBC, over the next five years, with sums due each March, beginning with a payment of $800,000 in 2014, and $550,000 annually for the next four years.

One more bankster feature of the saga: In 2006, the original advice to the school district, to be "smart" and take out an interest-rate swap, came from one Lou Verdelli, who at the time worked for Public Financial Management, Inc. (PFM), from which, in 2007, he left to go to work directly for Royal Bank of Canada.

Other Swindles

Bethlehem: In 2007, in order to get out of two of its 13 swap agreements, the Bethlehem Area School District had to pay $10 million in termination fees.

Philadelphia: On Aug. 16, of this year the city announced its agreement to lend the Philadelphia School District, which otherwise lacked the resources, $50 million, so schools could be opened on time for the Fall semester. For this coming year, the school district, serving 136,000 students, had a deficit of some $304 million, in which debt service figures prominently, at $280 million. In June, the school district laid off 3,783 staff (including teachers, assistant principals, and others).

The city's agreement to provide $50 million, meets part of an emergency package asked for by the school district, which seeks $120 million from the state, and millions in "give-backs" of wage reductions from teachers and staff.

School district leaders are undertaking to rehire laid off workers, but the entire education program is in crisis. Gov. Tom Corbett (R), offering at first only $45 million of a hoped-for $120 million, demands deep concessions from school employees. The teachers are supposed to agree to a 10% reduction in pay, as their contribution to the "solution."

The City of Philadelphia itself filed suit on July 26 against nine of the mega-banks for their looting of city resources through swaps derivatives and manipulation of the Libor interest rate.

Harrisburg: Besides the capital city being in state financial receivership since 2011—in which swaps-looting by the Royal Bank of Canada figured—the Harrisburg School District is likewise in official financial distress. On Aug. 26, school board approved various of the latest measures involved in operating the schools with lack of resources. It ratified a $6.4 million loan (interest-free) from a state-administered fund for school districts in "financial recovery." This involves approving a new chief financial officer to cut costs, while meantime, the metro-Harrisburg area's economy erodes.

The school district's two labor unions, over the

Summer, agreed to a 5% pay cut; and a 5% hike in what they pay for health insurance.

Midwest Districts Hit

Wisconsin: Five Wisconsin school districts in 2006 entered into loans, investments, and complex derivatives deals, which subsequently blew up, causing the districts to lose nearly $40 million, plunging them deeper into the hole on their health-care funds and other obligations, for which purposes, in 2005, they were suckered into dodgy transactions in the first place. The districts are Kenosha Unified, Waukesha, West Allis/West Milwaukee, Kimberly, and White Fish Bay.

The principal players, all of which made millions in the course of various transactions, in the game against the districts, involve Depfa Bank plc of Ireland and RBC, among others, including a Midwest brokerage house. In short, Depfa Bank loaned $163 million to the districts, which put in their own $37 million, to invest $200 million in AA-minus securities, which were supposed to yield more to the school districts than the interest costs the districts had incurred to pay for the loans. The idea of the school districts is that this net revenue stream would go into the schools' health-care funds and other obligations.

The Royal Bank of Canada provided investment product and collateral for the Depfa loans, in the form of a cooked-up "synthetic" CDO, which was based on 100 corporate bonds, whose selection as underlying portfolios was made by RBC, reportedly involving selections by UBS and ACA Management.

The end result was that the securities tanked; the CDO blew out. The school districts lost the $37 million they had put into the investment; they "gained" only in the sense that they do not have to repay Depfa the borrowed $163 million, because of a clause in the loan making it a "non-recourse" instrument, spelling out that if the securities bought with the loan failed, the school districts did not have to pay that part.

On Aug. 10, the Securities and Exchange Commission filed suit against the St. Louis-based brokerage firm Stifel Financial, which advised the school districts to do all this. The SEC is charging Stifel with peddling overly risky securities deals to unsophisticated investors.

However, the SEC is conspicuously *not* going after any of the mega-banks for perpetrating this whole pattern of rip-offs of localities. Stifel has filed its own lawsuit against RBC, charging that it concocted the synthetic CDO involved, in such a way as to profit off it—making some $6.4 million for RBC—when it went bad.

Chicago: On Aug. 28, the Chicago Board of Education rubber-stamped a significantly reduced school budget, for the drastically downsized Chicago Public Schools. Board members are appointees of Mayor Rahm Emanuel, former advisor to Obama, and advocate of London/Bill Gates-style education "reform." Over the Summer, 48 elementary schools were closed; more than 3,000 teachers and school staff were fired. The newly passed budget of $5.6 billion for the Chicago schools slashes $68 million from classroom spending. A protest rally of 500 demonstrated outside the school board session.

The City of Chicago was paying annually some $66.9 million in interest-rate swaps deals as of 2010. Chicago Public Schools was paying out, as of 2010, an annual amount in the range of $35.7 million in swaps deals.

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—*Lyndon LaRouche, Feb. 11, 2013*

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