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Public Hearing Statement for 3/3/2010- HB 1905

In 2009, Mark Love, constituent of the 176th Legislative District and resident of the Pocono Mountain School District took the liberty of forwarding me an article published on July 16, 2009 from the Pocono Record entitled, "Pocono Mountain School District loses $3.1 Million after credit rating fell." Incorporated into the story regarding the School District's fallen credit rating, was a discussion of the harsh consequences from the termination of a very complex financial deals identified as interest-rate swap agreements.

The original establishment of interest-rate swaps in Pennsylvania can be attributed to passage of Act 23 of 2003. The passage of Act 23 amended state law to explicitly permit local governments to enter into these agreements with financial institutions. At the point of enactment, interest rate swaps may have been an attractive investment instrument due to the low interest rates on variable-rate bonds and notes, as compared to fixed-rate bonds and notes. These variable-rate bonds and notes allowed local governments to take advantage of the lower rates while, *in theory*, providing a hedge against large increases in said rates.

However, as a result of the global collapse of the banking industry in September of 2008, interest rates on variable rate bonds and notes skyrocketed and many local governmental entities are now "***on the hook***" for making payments to financial institutions. Complicating matters even further are the fees and termination costs associated with the contracts local governmental entities consummated with the various financial institutions.

Much has recently been made in press and at the local government level regarding the usage of swaps. This is due to the fact that local governments are engaging in and gambling with taxpayer funds when entering into these agreements. While favorable economic conditions may lead to strong returns, when conditions deteriorate, local governments, in many cases, are left to shoulder large losses and administrative/cancellation costs that all end up being funded by taxpayer dollars. This scenario regarding the loss of millions of taxpayer dollars could have been avoided, in part, if local governments would have utilized traditional investment plans, as opposed to exotic investment techniques.

Keeping taxpayer dollars in mind, I have introduced HB 1905 intended to ban future usage of swaps by Pennsylvania local governments. By limiting the ability local governments have regarding the usage of exotic investment tactics, the General Assembly would set in place guidelines that protect local taxpayer funds.

Mario M. Scavello

Mario M. Scavello
State Representative
176th Legislative District