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Introductory Remarks of Steven I. Turner
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I would like to thank the Commission and its staff for inviting me to participate on this panel.

My name is Steven Turner and I am a partner in the law firm of Hawkins Delafield & Wood LLP. The views expressed by me here are mine and don't necessarily reflect those of my firm.

The areas in which I and my law firm practice are limited principally to public finance and related activities. Our clients include States, municipalities and special districts and authorities, as well as underwriters. Hawkins celebrated its 150th anniversary in 2004.

Over the years, we have participated in numerous transactions involving interest rate swaps, principally as bond counsel. Most often, the swaps have been entered into in connection with variable rate debt, to synthetically convert variable rate exposure to a more predictable and manageable fixed rate by means of a variable-to-fixed swap contract.

Issuing variable rate debt, together with a variable-to-fixed rate swap, is intended to provide a lower fixed cost of borrowing than fixed interest rate debt, even after taking into account ancillary costs such as remarketing fees. Issuers enjoy the lower interest rates, and underwriters earn both the underwriting fee and continuing remarketing fees. In theory, these swaps are advantageous for both parties.

But there are risks. Although we are not financial advisors or municipal advisors, as bond counsel we want to make sure that the public officials who are considering and approving the swaps are aware of the known risks of the transaction. Risks that are common to variable-to-fixed swaps include counterparty credit risk (such as default by the counterparty), interest rate risk (such as the variable rate paid by the counterparty not being sufficient to cover the issuer's variable rate debt), and termination risk (including as a result of a material change in the credit of the issuer or swap insurer). In my experience, the nature of such risks was carefully explained to issuers, both orally and in writing, and, more important, were understood by them.

However, no one foresaw the dramatic impact of the mortgage credit crisis and associated financial market turmoil on these swap instruments. Once the underlying swap insurers lost their triple-A (or even lower) credit ratings, many issuers were required to post collateral or face termination. Because of the dramatic drop in interest rates, the fixed interest rate stream being received by the swap counterparty was very valuable and therefore it was very expensive to terminate and at the same time it was difficult to post collateral.

In addition to the termination risks associated with insurer downgrades, issuers found that they had bargained away their right to most economically take advantage of declining long-term fixed interest rates to refund variable rate debt because the benefits of the refunding were outweighed by the termination costs of the swap contract. Nonetheless, at great cost, many issuers refunded their variable rate debt and terminated swaps just to be rid of these transactions.

These dramatic market events -- "black swan events" if you will -- created significant costs and risks to many issuers that either were not foreseen or were thought to be so unlikely that they were not viewed by issuers and others as a realistic concern.

Swaps as hedging instruments still may be a useful public finance tool if prudently used in situations that are appropriate to the fiscal status of the public body. But in light of the financial crisis and its material financial impact on issuers that had executed swap contracts, going forward – at least in the near term – many public officials will not be willing or able to justify, as a prudent public financing practice, executing a swap contract to save 10, 15, or 25 basis points in light of the possible material adverse impact of another "black swan" event. For various reasons, including stories of significant termination fees being paid by public issuers to commercial and investment banks and the loss of all triple-A municipal bond insurers, we are simply not seeing new interest rate swap contracts being done to create synthetic fixed rate financings.

We've all heard the highly publicized allegations of abuses in the swap process which have cast doubt on whether particular transactions in fact have been prudent and appropriate. Although undoubtedly the Commission will find instances of abuse, we suspect that they occurred without the knowledge of the issuer community and most other public finance professionals, and are not representative of the open and transparent processes that were used more generally.

For those who are still considering swaps in the face of all this, we applaud and encourage the efforts of the Commission and its staff to try to ensure that they are entered into with due appreciation of their risks as well as benefits, are fairly priced and otherwise are prudent and appropriate.

Thank you.