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CC: "Nathaniel Singer" <nsinger@swapfinancial.com>
Date: 6/1/2009 8:36 AM
Subject: RE: Comments on Interest Rate Agreement Guidelines
Attachments: 20090501BondGuidelines PS Redline.pdf

Attached please find our comments on the proposed swap guidelines. We applaud your much-needed efforts, and hope this bears fruit. We note in our comments some areas that clearly need to be cleaned up in order for the guidelines to be useful.

Highlights of our comments include:

. We think changes should be made to reduce the administrative burden that would be placed on issuers. The key changes appear to be: (a) to allow a single trusted firm to serve as swap advisor on both an on-going and transaction basis; and (b) to allow greater flexibility for the issuer to allow only two officials to handle all policy-related matters, rather than the three (or four) that the guidelines appear to dictate. Regarding (a) above, it is our experience that having two firms tends to provide a lack of continuity and a degree of confusion, in a subject area that is already of great complexity.

. No reporting burden should be placed on conduit issuers. Most of them have little or no role in swaps. While they issue the related bonds, the swaps are entered into directly between the borrower and the swap provider. Often the conduit issuer is only minimally involved in the process, and may not be aware of it.

. Certain activity involving swaps - such as terminations in the event the swap provider's credit is downgraded, or refunding-related transactions - are very time-sensitive. There should be a provision allowing a "fast track" or "emergency" waiver of the 15-day delay built into the guidelines, if merited by circumstances.

. The \$50 million size minimum is too large. There should be allowance for smaller size, for a variety of reasons (if the swap is a smaller component of a larger financing; if the swap is an amendment to an existing financing; or if the jurisdiction can otherwise demonstrate that the swap is suitable for it). We would recommend a \$25 million minimum size, and still include the above exceptions.

. The standards for savings (100 for synthetic fixed, 200 basis points for synthetic floating) are very unrealistic. For synthetic fixed, we would recommend a threshold based on NPV savings as compared to conventional bonds, and that the threshold be something on the order of 2% to 3% added savings. This is the policy in use among those jurisdictions that have robust swap policies.

. For synthetic floating, it is important to recognize that floating rate exposure created by a swap is in several important respects less risky than conventional floating rate bonds. Conventional floaters have proved to have significant risks in the current crisis, including put risk, bank facility rollover risk, and term-out risk. Synthetic floating rate structures have none of these risks, but do have counterparty credit risk. There is a little good justification for requiring a 200 bps savings for the use of a product that could actually reduce risk. (And 200 bps is a level of savings that has never been achieved under any market conditions, and is likely to never be achieved, so the guidelines would prevent Tennessee entities from using a valuable tool that jurisdictions throughout the United States have used successfully.

. A similar problem arises with the proposed five-year limitation on swap contracts. This provision would effectively prevent Tennessee entities from accessing the swap market for savings in 99 out of 100 cases. The greatest savings generated by swap historically has been in maturities ranging from 15 to 30 years. Moreover, if the issuer is using the swap

properly - as a hedge - the maturity of the hedge should match the maturity of the hedged item. The hedged item is a municipal bond issue, and the normal maturity for municipal bonds is 30 years.

. The guidelines are proper in prohibiting speculative transactions, but the examples given are not good ones. In some cases, the types of transactions listed a "speculative" can, in fact, be very much hedging transactions. We should discuss this issue in more detail if you would like. Nailing down what is in fact speculative is a complex thing.

. We believe the guidelines would expose issuers to too great risk by allowing a swap counterparty to cure a credit problem by posting collateral. Collateral posting is, at best, an intermediate step to lessen credit risk. No issuer should be exposed to a very weak counterparty (i.e. in the triple-B rating range) simply because that counterparty is posting collateral.

. Finally, mark-to-market calculations for collateral purposes should be daily, not weekly, to provide adequate protection.

Our firm works solely for issuers, and solely on swaps. We are on the issuer's side all matters, and maintain a very strict conflicts policy. Please see our website, www.swapfinancial.com, for more details. We would be delighted to discuss our thoughts on the guidelines and our suggestions to improve them at your convenience.

Thanks,

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