Detroit to pay millions to banks that swindled city

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US Bankruptcy Judge Steven Rhodes approved a settlement Thursday handing $85 million to the banks that swindled the city of Detroit out of hundreds of millions of dollars in an interest rate swap deal. UBS Bank and Bank of America will receive a flat sum to unwind the agreements entered into by the city in 2005-06.

The agreement was the third attempt by the banks to extract millions of dollars from the city from financial arrangements negotiated by the administration of former Detroit Mayor Kwame Kilpatrick. Judge Rhodes rejected two earlier proposals involving higher payouts, evidently concerned that they were too nakedly one-sided.

The judge called the deal an example of "the very spirit of negotiation and compromise." In reality the agreement represents the continued looting of Detroit by financial institutions that enticed the city into complex and highly risky deals in violation of state statutes. Both Judge Rhodes and Detroit Emergency Manager Kevyn Orr have acknowledged that the two banks likely broke the law when they negotiated the swaps, which were a bet that interest rates would rise, when in fact they fell to nearly zero following the financial crisis of 2008.

In 2009 the city of Detroit pledged its casino tax revenue as collateral for the swaps. Judge Rhodes said this likely violated provisions of the Michigan Gaming Act, which stipulates that casino revenue must be used for "socially beneficial" purposes.

The swaps also violated Michigan's Revised Municipal Finance Act of 2001, which was enacted to protect cities from predatory deals. An attorney representing insurer Ambac Assurance testified during the bankruptcy hearings that "This deal should have the swap counterparties (i.e. the banks) paying the city, not the city paying the swap counterparties."

Despite this, Judge Rhodes called the deal "entirely reasonable," claiming a lawsuit against the banks would be too long and costly. With the agreement UBS and Bank of America have agreed to vote in favor of the restructuring plan advanced by Orr. Rhodes said the deal sets the stage for a potential "cram down," in which a restructuring plan can be imposed on creditors.

The agreement to pay the banks follows the announcement of a deal Tuesday to pay major creditors 74 cents on the dollar for debts owed by the city. This represents a huge increase over earlier proposals, some of which were as low as 15 cents on the dollar. Among the creditors affected are wealthy bond insurers such as Assured Guaranty Ltd, Ambac Assurance Corp and National Public Finance Guaranty Corp (NPFG). In the wake of the deal bondholders, including major banks that hold Detroit debt are being told they will continue to receive "timely payment of principle in interest" in full.

Kevin Brown, a spokesman for New York-based NPFG told Bloomberg News that bondholders "are going to get every nickel that they were originally entitled to."

By way of contrast, Detroit pensioners face a staggering cut of 50 percent or more when cuts to dental, health and vision insurance and the elimination of cost of living raises are taken into account. Such a reduction in income will drive thousands into poverty and destitution at the same time that the banks responsible for plundering the cities resources are paid off.

The settlements with the banks are meant to apply additional pressure on pensioners, who are being told that unless they accept the proposed cuts, even more drastic terms can be imposed. Under the rules of municipal bankruptcy law, if one class of creditors votes to approve the city's plan the court can then impose the terms on everyone else.

In a warning to pensioners Rhodes declared, "the message is now is the time to negotiate, not on the eve of the confirmation hearing in July, nor even in June or May, but now."

If retirees approve the plan they will face pension cuts of 26 percent for general retirees and six percent for police and fire. If retirees reject the proposal the cuts would rise to 34 and 14 percent, respectively. In addition, retirees are facing massive cuts to city paid health benefits including the elimination of dental and vision coverage.

The city of Detroit is seeking to recover $300 - $400 million in supposedly excess payments made to retirees under the Annuity Savings plan. How much individual retirees will lose is unknown, but details will be spelled out when ballots are sent out to vote on the plan of adjustment around May 1.

The proposal is contingent on the full payment by all parties signing on to the so-called Grand Bargain involving the state of Michigan, wealthy private foundations and the Detroit Institute of Arts (DIA). To this date the Michigan legislature has not voted approval of the money pledged by the administration of Republican Governor Rick Snyder as part of the agreement.

Orr is also proposing that city pension funds be managed by a five-person board, with two additional non-voting members. The plan requires that union representatives be excluded from the board.

The threat to exclude the unions from the management of the pension boards is meant to put pressure on the leaders of the American Federation of State, County and Municipal Employees (AFSCME) and other unions to drop their opposition to Orr's proposed plan of adjustment. For their part the unions are more than willing to sign off on pension cuts as long as their control of the multi-billion dollar retiree investment funds remains intact.

At the same timeg the unions are supporting a reactionary scheme promoted by wealthy creditors to force the city to sell off artwork from the Detroit Institute of Arts. The creditors say they have lined up a group of investors who have made bids on portions of the museum's priceless collection.

The payoff to Bank of America and UBS highlights the thoroughly undemocratic character of the bankruptcy proceedings. The banks can violate the law with impunity while pensions are slashed in violation of the state constitution and the art at the DIA is held to ransom.