SIFMA

Securities Industry and
Financial Markets Association

February 6, 2009

The Honorable Timothy Geithner
Secretary
Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Secretary Geithner:

The Securities Industry and Financial Markets Association (SIFMA)[1] applauds the bold steps the Treasury Department has taken to put our financial markets back on track. We understand the severity of the credit crisis is such that there are many competing demands, but we respectfully urge you to consider taking action to help restore liquidity and functioning in the municipal and auction securities markets. Historically, state and local governments have looked to the municipal bond market to help fund roads, public school construction and improvements to public infrastructure, among other projects. Auction rate securities had been an attractive source of funding for state and local governments, student loan financing authorities, and closed-end funds since 1984.

As you know, beginning in 2008, as the credit markets tightened, investor demand for investment options supported by monoline insurers and third-party credit enhancers halted. Because of the critical role insurers and third-party credit enhancers play in the municipal bond and auction rate securities markets, demand for these securities declined sharply. The resulting lack of liquidity in these markets has made it difficult for state and local issuers to meet the financing needs of their communities, threatened the viability of small regional broker-dealer firms, and left individual investors holding onto illiquid securities. We wish to work with you to stabilize these critical markets at this difficult time in our economy.

I. Municipal Issuers

The municipal bond market is experiencing a significantly low level of liquidity. State and local issuers are facing a critical need for reliable long-term credit enhancement, making it difficult to bring issues to market. The municipal securities market is also facing a serious dislocation between supply and demand. Municipalities are finding that even full faith and credit general obligation bonds cannot find investors. In some instances, due to the lack of availability of liquidity facilities for short-term money market fund eligible debt, cities and states have been forced to replace their variable rate municipal securities with more expensive, long-term, fixed-rate debt. This change in the supply of municipal bonds drives up rates on long-term munis, hurting municipal bond issuers

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. More information may be found on our website: http://www.sifma.org.

and raising costs for taxpayers. In other cases, municipal issuers have simply been unable to find buyers in the short- and long-term markets for their debt issues. Examples of state and local issuers who have recently faced difficulties in the municipal market include:

- The Port Authority of New York and New Jersey failed to receive any bids on its $300 million auction of taxable three year notes in December.
- The Michigan Municipal Bond Authority abandoned plans to issue $200 million in revenue bonds to help fund the state's clean water revolving fund, opting instead to issue $150 million in shorter-term notes. This was the first time in the program's ten-year history that the state will issue notes instead of bonds.
- The Commonwealth of Pennsylvania limited a $600 million competitive general obligation sale due to market conditions. Pennsylvania tends to sell debt twice a year, but may be forced to borrow more frequently in smaller quantities.
- The State of California also reduced a $523 million bond issuance by half and has had difficulty renewing liquidity facilities and maintaining the long-term ratings necessary to ensure its short-term debt is eligible to be purchased by money market funds.

As these examples illustrate, the deteriorating conditions in the credit markets generally have spread into the municipal market, severely limiting the capital available to build roads, bridges, schools and other necessary infrastructure. We are forwarding the following options to federal policymakers in hopes of restoring liquidity, adequately addressing the need for reliable long-term credit enhancement, and resolving the serious dislocation between supply and demand in the municipal bond market.

- Develop a federal liquidity facility to write or guarantee letters of credit and standby bond purchase agreements for state and local governmental issuers of debt.
- Develop a federally-supported monoline insurer or reinsurer.
- Modify restrictions on pension fund investments in in-state tax-exempt bonds.
- Appoint a contact at the Treasury Department to monitor the economic functioning of the municipal securities market.

II. Regional Broker-Dealers

Historically, auction rate securities, which include auction rate bonds (ARBs) and auction rate preferred securities (ARPS), have provided an attractive cost of financing for state and local governments, student loan financing authorities and closed-end mutual funds. ARS were considered highly-rated investments because they are backed by state and local governments' taxing authority, revenues from student loan financing authorities, 501c3s, and the assets of closed-end mutual funds, making them attractive to retail and institutional investors. But as the credit crisis spread into other markets, demand for ARS halted, resulting in "failed" auctions and leaving investors unable to sell their ARS. Today most ARS auctions continue to fail and many thousands of investors are holding securities which offer no liquidity and cannot be sold. As a result, many state and local issuers, including state student loan financing authorities, have faced steep increases in their cost of capital. Some state and local government ARS issuers have been able to refund or restructure their outstanding ARS, but others have not, resulting in difficulty for state and local issuers to meet the financing needs of their communities.

The failed auctions have also threatened the viability of small and regional broker-dealer firms. These small and regional firms are often a source of necessary financing for projects in their local communities. Some broker-dealers have purchased the auction rate securities from their clients, but this often just transfers illiquidity problems to the dealers who are facing their own liquidity and balance sheet issues. Other broker-dealers are facing capital limitations as a result of the continuing credit crunch. If these firms are required to reimburse investors for the auction rate securities, many would be forced to go out of business, resulting in lost jobs and revenues in some of our already struggling communities.

It is essential that we restore liquidity in the auction rate securities market to help state and local issuers, retail and institutional investors and small and regional firms. We respectfully request you consider:

- Using authority under the Troubled Asset Relief Program (TARP) to purchase auction rate securities.
- Developing a federal liquidity facility to write standby letters of credit for ARPS.
- Developing a temporary federal government guarantee program for ARPS, similar to the Treasury's Temporary Guarantee Program for Money Market Funds.
- Developing a lending facility to repurchase auction rate securities.

We look forward to working with the administration, the Congress and the municipal securities community, as we all work to return to a vibrant and healthy municipal securities market and restore liquidity to the auction rate securities market. Please do not hesitate to call Scott DeFife, Senior Managing Director, Government Affairs, at 202.962.7330 with any questions or if we can be of assistance in this area.

Sincerely,

T. Timothy Ryan, Jr.
President and CEO