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Justin R. Pica
Uniform Practice Policy Advisor
Municipal Securities Rulemaking Board
1900 Duke Street
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Dear Mr. Pica:

It was President Kennedy who said, "Our task is not to fix the blame for the past but to fix the course for the future." Fixing the course for the future is the position the Municipal Services Rulemaking Board (MSRB) is in at its upcoming July meeting in the floating rate securities market and in particular auction rate securities (ARS). Clear, decisive and substantive action is needed to restore investor confidence and allow liquidity to return to this market. If the MSRB acts in an ambiguous or indecisive way, it will only add to the damage to investor and issuer confidence that has occurred. If the MSRB responds with excessive requirements that purport to be "full disclosure" but that lead to further confusion and obfuscation, the damage will worsen and an important opportunity will have been missed.

Some have suggested that the MSRB should simply permit the demise of the ARS market that is shrinking, a market that has been declared "dead" by some of those who have created it. This will just burden issuers who struck a fully disclosed bargain with investors with additional costs and expenses to restructure and refinance - without ever addressing the problems that have been uncovered by the crisis. Neither taxpayers nor the customers of colleges, universities, and hospitals should be burdened with higher costs even if they decide to transition away from this market. And investors should not be forced to languish in illiquidity when there are practical steps that could be taken to improve the process.

Rather, the MSRB should take actions that level the playing field and allow auctions to be true auctions and not managed bidding systems. Markets should be allowed to work based on transparency and competition. There is nothing wrong with an auction if it is an auction. The private reality must match the public face of the use of the term "auction". An "auction" has a meaning and what the MSRB should do is ensure that the meaning of an auction is its reality as well. This is the essence of integrity and confidence in markets and the mission of the MSRB.

Through the MSRB's leadership if one can establish a transparent fair and competitive system with full disclosure, then market participants can make the decision as whether this is a cost-effective financing alternative for issuers and investors. Investors coming together in a true investor auction can determine the appropriate liquidity premium (increase in the interest rate compared to a benchmark) for that auction. No one should try to impose a solution on the market. In the absence of this leadership, a bad situation will be made only worse and the damage to integrity and confidence will be profound. There is no one size fits all solution and to suggest one is a disservice to the clients both issuers and investors we serve.

Let us focus on two key items for the MSRB: 1) Transparency to Restore Investor Confidence and 2) Liquidity

Transparency to Restore Investor Confidence

First, the MSRB should require fundamental economic transparency in all auctions.

Give simple and understandable information to let investors judge their liquidity risks and make their own decisions as to whether to participate in an auction. If they do participate, let them determine how much they want to be compensated within the terms of the structure to absorb the liquidity risks of each auction. The single most common complaint has been, it appears from published reports and anecdotal evidence, that no one knew what the liquidity was in the auctions. Were there 4 investors or 400? Did the broker step in some times or all the time?

But to be effective, transparency needs to be *simple, accessible and understandable*.[1] Using the EMMA platform, it should be easy to devise a simple matrix of key data on each auction that allows investors to know and understand the liquidity issues.

We suggest that the model for transparency should be the straightforward and clear disclosure found in the US Treasury auctions. It is what investors require from the Department of the Treasury to promote investor confidence. The Treasury Department conducts Dutch auctions using the same mechanism as in ARS.

The process is two step. First there is an announcement of the auction and then an announcement of the auction results. Each auction has a press release and web access for the results.

The auction results are summarized with some specific details so that market participants can evaluate the "success" of the auction. Success is defined not just by raising the amount required --- that's only part of the story.

The Treasury Department releases the following information on each auction compared to the information available in corporate and municipal auctions:

Information Released	US Treasury	Corporate/Municipal Auctions ARS[2]
Winning Yield	✓	✓
Amount of Competitive Bids[3]	✓	
Amount of Competitive Bids Accepted	✓	
Amount of Non-Competitive Bids[4]	✓	
Amount of Non-Competitive Bids Accepted	✓	
Amount of Bids at the Winning Yield	✓	
Median Yield	✓	
Lowest Yield	✓	
Amount of Competitive Tenders at or below Median Yield	✓	
Amount of Tenders at Lowest Yield	✓	
Bid to Cover Ratio	✓	

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[1] One state issuer experimented with releasing all the data that was provided by an auction agent to the issuer. This amounted to a confusing situation known among market participants as a "data dump" which is not the essence of good disclosure.
[2] Released to investor not to market
[3] Competitive Bids are bids that specify a rate similar to a Hold at or Buy at rate in ARS.
[4] Non-Competitive Bids are bids that do not specify a rate only an amount and indicates the investor is willing to accept whatever the winning rate of the auction is similar to a Hold Order in ARS.

In giving this transparency one needs to require the terminology to be used be consistent. Some auction agents interchange the use of "shares" and "bonds". Some talk about bids by numbers which are then defined by bond or share denominations as opposed to the dollar amounts. This confusion needs to be eliminated. The transparency proposed should be by the dollar amount bid by *unique* investors.

The one addition to the US Treasury model is that is necessary is the separation of the broker-dealer's amount bid for its own account from other investors.

The role of the broker-dealer as a market maker bidding in the auction is completely legitimate and should be accepted by all market participants as the broker's complete discretionary option, not a requirement. Their discretion to bid or not to bid and how they wish to use their capital is solely their business. If this is to continue as a pure secondary market activity, the principle that a broker's participation in the auction is completely at their discretion, must be preserved and protected. These are not remarketings or underwritings and the distinction must be clear.

The MSRB should consider adding the key term of a "bid to cover ratio" which has been missing from previous discussions as opposed to "failed" or "successful" auctions, terms that give limited and possibly misleading connotations. This one statistic, for example, can give great insight into the liquidity of any auction. This ratio represents the amount of bonds that were bid (either competitively or noncompetitively (hold orders)) for the amount of securities in the particular series otherwise known as "coverage". A bid to cover ratio of 0.8 clearly indicates an auction that did not succeed in clearing the entire issue. A bid to cover ratio of 1.1, shows marginal coverage but all securities placed. A bid to cover ratio of 2.3 would show robust demand. Indeed, this is how the market interprets data presented in other auctions like the Treasury Department. When this one statistic is combined with other simple and understandable disclosures such as the low, high and median rate bid, a more complete understanding of the auction is made available for investors to consider and to price this information in when evaluating subsequent auctions or secondary market activity.

Finally, how this information is presented is as important as the information itself. Much of what discussed above, is already required for those issuers bidding in their own auctions in accordance with the safe harbor guidance by the SEC released in March. Yet, how this information has been released to the market has been in an awkward and a less than useful format. The MSRB should show leadership in providing the basic electronic, accessible information without providing so much information that it becomes useless to investors. The experience of one state issuer showed the uselessness of a "data dump" in multiple pages and links of confusing data and terminology.

Liquidity

The essence of liquidity is competition with minimal barriers to that competition. The liquidity crisis for many auction issuers is based not on credit but lack of confidence as noted above. It is made worse because of an inability by other investors to access the securities directly, even if they are not customers of the designated broker-dealer.

Unfortunately, a large part of the municipal auction securities market has auctions with only a single broker-dealer or market maker permitted in the auction. This severely limits the number of investors bidding in the auction. If the Treasury Department required all bids in their auctions to go through a single broker-dealer, most would question whether that was really an "auction" by what we all consider that term to mean.

Besides limiting the number of investors competing for the securities, this sole broker-dealer system creates confusion with variable rate demand bonds (VRDBs) that reprice through a remarketing agreement. The two are substantively different but have been merged in common practice. A broker's legal responsibilities and relationships are different in a broker-dealer agreement compared to a remarketing agent agreement. To blur the use of the word "remarketing" to apply to both remarketings *and* auctions creates confusion and expectations among investors which only complicate the functioning of the market.

As further support for this confusion, the role of the auction agent versus the broker-dealer has routinely been confused. Reference to the broker-dealer as "running the auction" or "managing the auction" are inappropriate from the structure of the security though the practice may have deviated from the structure. Hence, there is created misunderstanding and consternation among issuers and investors.

These distinctions do matter, and while they may be technical in a discussion among members of our profession, the confusion it presents to issuers and investors is real and should not be denied.

To think innovatively as to how to address this problem, we might consider what the common market practice is for "competitive bidding in an auction". Generally speaking, market participants would agree that three independent bidding channels would create a "competitive" pricing. This would be similar to the IRS safe harbor for determining fair value and to how competitive "auctions" for new issues are thought of. Liquidity means investors competing for investments. Anything that limits competition limits liquidity and therefore the more barriers that are eliminated, the better potential liquidity for investors.

Consequently, the MSRB might consider limiting the use of the word "auction" to describe situations that clearly meet investor perception, expectation and definition of an "auction". Only those securities that have at least three independent broker-dealers and market makers should be considered "auctions." (We would strongly prefer that as many broker-dealers be allowed to bid in as many auctions as possible.) This means that the MSRB should encourage broker-dealers to give up the proprietary model of approach to ARS, which confuses the role of a broker-dealer in an auction with the completely different and independent role of a remarketing agent in variable rate demand obligations.

Clearly, broker-dealers do not control how many other broker-dealers are in an auction. That is the issuer's decision. Nevertheless, the broker has a great deal of influence with issuers. And the MSRB could encourage the dramatic expansion of auction distribution channels to assist in the liquidity crisis for investors in auction rate securities. This would benefit issuers and investors.

Conclusion

The market is looking for leadership now, not further litigation. The MSRB could help provide that leadership and help fix the course for the future. The MSRB has the opportunity and we hope it will use it to make markets work effectively and efficiently.

Thank you for your consideration of this material and for your concern in this matter. It is unfortunate that we could not discuss these matters last Fall when we first contacted you. Please do not hesitate to call us with questions or requests for clarifications now.

Best regards,

JFichera

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