

---

**Transcript: Field Hearing On The State Of The Municipal Securities  
Market: Morning Session Panels I & II**

**Panel I Speakers: William Collins, Scotia Capital; Joseph Deane, Western Asset Management; Thomas Doe, Municipal Market Advisors; Alan Greco, Ramirez and Company; Sean McCarthy, Assured Guaranty**

**Panel II Speakers: Hal Whittman, individual investor; Helen Kirkpatrick, individual investor; Don Niewiaroski, individual investor; Jim Lebenthal, Co-Founder Lebenthal And Company**

*This transcript has not been edited for content.*

**Elisse Walter:** Today's event is one of a series of field hearings across the nation that we launched earlier this fall in order to learn about the current state of the municipal securities market, to hear from interested parties and to gather ideas for potential improvements in this area. We held our first hearing in San Francisco and found it to be extremely helpful. We learned a lot about the topics covered at that hearing: disclosure, ratings, significant liabilities such as pensions, other post-employment benefits and derivatives, internal controls and the investor experience. We anticipate holding additional hearings in Florida, Texas, Alabama and Illinois. Each field hearing will include participants from the local region and will focus on some of the issues we are examining. At those hearings we may revisit some of today's topics and those we addressed in San Francisco but we will also cover many others such as investor education, conduit borrowers, offering participants, professionals and market intermediaries, sales practices, distressed communities, small issuers, 529 Plans and pricing and quotation issues.

With respect to this last topic, pricing and quotation, I was very pleased to learn that this will be an area of particular focus in a study of the market and market structure that the MSRB is initiating. I imagine you'll hear a bit more about that study during the Self-Regulation panel this afternoon but I wanted to make special note of it as this topic is one in which I take a personal interest. I'm delighted that the MSRB has decided to review these important issues as it seeks opportunities to improve the quality of the municipal securities market for the benefit of investors. At the conclusion of all the hearings, the Commission staff will prepare a report concerning what we've learned, including their recommendations for further action that we should pursue. These may include recommendations for changes in legislation, regulations and industry practice. These hearings will be instrumental in informing those recommendations.

I was very pleased that our Chairman Mary Schapiro, asked me to lead this series of hearings as I have long had an interest in strengthening investor protection mechanisms, applicable in this important market. Although I and my colleagues at the Commission have thought about municipal securities issues for a long time, I look forward to deepening and broadening my knowledge base as I learn through this tour, this learning tour, re-examining my opinions and developing new ideas and I know that my fellow Commissioners feel the same.

Let me introduce you to my colleagues who either are or will be sitting with me at the table during the day. We are fortunate to be joined this morning by Chairman Schapiro. We all owe

her a debt of gratitude for placing municipal securities high on the Commission's priority list and instituting this series of field hearings, which she announced last spring. We are also fortunate to have nearly all the Commissioners with us sometime during the day today. To my right is my fellow Commissioner, Luis Aguilar. Troy Paredes will be joining us as well later in the day. Commissioner Kathy Casey is in New York today co-chairing the CPSS Iosco Steering Group meeting but would have loved to have been here.

Next to Commissioner Aguilar is Lori Schock, the Director of the Office of Investor Education and Advocacy and also joining us during the day today will be Robert Cook, the Director of the Division of Trading and Markets and Jim Kroeker the Commission's chief accountant.

Not everyone at this table will be here for the full hearing but some of my colleagues will be with me during each of the panel discussions. Our role will be to listen, learn and engage with the panelists by asking questions. In addition to welcoming you, I remind you on behalf of myself and all other Commission participants of the Commission's standard disclaimer: that is that our remarks today represent our own views or at least maybe our own views and not necessarily those of the Commission, other Commissioners or members of the staff and with that, I hope I saved you from having to hear that repeated throughout the day.

As the chairman has noted in the past, to grapple with the complex issues presented by the municipal securities market, we need to harness the ideas of a wide range of people who have experienced this market from many different perspectives, which is exactly why we're here today. We've assembled a diverse group of panelists for each of five panels, covering topics ranging from market stability and liquidity to the investor experience to self-regulation to accounting and, finally, to Build America Bonds.

Today's panel panels will be made up of state and local government officials, municipal securities investors and academic and experienced municipal market professionals representing the broker-dealer, municipal advisor, muni-analyst, institutional investor, bond insurer and auditor perspectives. Thank you all for so generously agreeing to participate. We are sure to have interesting and informative discussions on these important topics.

The moderators of today's panels are two staff members well known to most of you: Amy Starr, Senior Special Counsel for Capital Markets, Office of Chief Counsel, Division of Corporation Finance who is on the stage right now and Martha Haines, Chief of the Office of Municipal Securities in the Division of Trading and Markets. My appreciation goes as well to Kayla Gillan, Chairman Schapiro's Deputy Chief of Staff who is leading this effort for the Commission staff. My councils, Alicia Goldin and Lesli Sheppard, who have been indispensable to this effort and Rachel Hurnyak from Chairman Schapiro's office who has handled the logistics for this hearing and has done a phenomenal job of keeping us all organized.

I would also like to welcome and introduce our fellow regulators who are joining us today, either right now or a little bit later in the day. For the Municipal Securities Rulemaking Board we have Alan Polsky, a member of the MSRB's board and Lynnette Hotchkiss, who will be participating in our self-regulation panel this afternoon, Hal Johnson and Ernie Lanza.

From FINRA we will have Tom Selman, who will also be participating in the self-regulation panel, Angela Goelzer, Matt Shimkus, Mac Northam and Cindy Friedlander. The MSRB and FINRA, as you well know, play critical roles in regulating professionals who operate in the municipal market and their assistance has been invaluable.

Also attending today's hearing are colleagues from the Government Accountability Office, Karen Tremba, Robert Pollard, Lisa Reynolds, and Stephanie Yonkman, and the GAO, as you know, has been tasked with studying various aspects of the municipal securities market under the Dodd Frank Act. And among those participating as panelists are several highly knowledgeable federal,

state and local officials; John Cross, Associate Tax Legislative Council of the Department of the Treasury, Nancy Kopp, Treasurer of the State of Maryland and Tim Firestine, Chief Administrative Officer of Montgomery County Maryland.

We have an exciting agenda for today, packed with interesting and timely topics. The format of today's field hearing will entail five panels, covering issues relating to market stability and liquidity, the investor experience, self-regulation accounting and BABs. As moderators, Amy and Martha will introduce their topics and panelists. Each panelist will then make brief opening remarks. Following the opening remarks the panelists will be asked questions by the moderator and those of us at this table.

We will look forward to each panel helping us to understand better the particular concerns of different market participants, highlight key areas for improvement and provide some concrete ideas for moving forward. I hope that this will be a comfortable, candid and enlightening discussion and I encourage the panelists to engage in a dialogue with the rest of you, with each other, in addition to addressing our questions.

A few housekeeping items before we begin; first, we'd like to ask the panelists, moderators and other questioners to please stand your name plate vertically when you would like to speak and if that doesn't work, wave. Second, there will be a lunch break from 12 p.m. to 1p.m. We would ask those of you attending in person to bear in mind the security checkpoint in our lobby and plan to budget at least 10 minutes upon your return from lunch for that process.

Our last panel of the day will conclude at five. This hearing is being Webcast and an archived version will be available on our Website. Additionally, a written transcript of today's event will be made available on the Commission's website, as was the case for the San Francisco hearing. We will also post any written statements provided by the panelists.

Finally, we encourage investors and all other interested parties to submit comments related to the field hearing topics and any other topics related to the municipal securities market to assist the Commission staff in determining whether to recommend changes. Comments may be submitted by using the comment form on the SEC website or sending an e-mail to [munifieldhearings@SEC.gov](mailto:munifieldhearings@SEC.gov).

Again, we're so pleased you're all here today or watching via Webcast and hope this will prove to be a really excellent learning experience for all. I'll now turn it over to Amy Starr who will introduce our first panel.

**Amy Starr:** Thank you Commissioner Walter. The first panel of today's field hearing, Market Stability and Liquidity, will explore issues relating to the liquidity of the market for municipal securities, including the factors affecting liquidity and the role of liquidity providers. It will examine the key risks for the market for municipal securities, the stability of the market and the roles of market participants as they affect the market, including dealers, issuers and investors.

Our panelists this morning are William Collins, Managing Director of Scotia Capital. Mr. Collins is in the public finance group of the Bank of Nova Scotia which provides credit and liquidity facilities to support municipal debt, as well as providing direct lending. Our next panelist is Joseph Deane, Portfolio Manager for the Exempt Fixed Income at Western Asset Management. Thomas Doe is founder and CEO of Municipal Market Advisors, an independent research and strategy firm serving participants in the fixed income industry. Alan Greco is the Managing Director for Underwriting and Trading for Ramirez and Company, a full-service securities firm and Sean McCarthy is the Chief Operating Officer of Assured Guaranty, which provides financial guaranty insurance in the municipal market. We've decided that we are going to be doing everything alphabetically so I'm going to start down at the other end of my panel here. Mr. Collins, would you be willing to open up with us?

**William Collins:** Sure, well, thank you Commissioners for inviting me here to speak today. I'm told I have five minutes of comments to make and then we can have an open discussion. So, you're going to have to sit through five minutes of my written comments. I'll just warn you about that now.

But let me give you a little background of my business and where I think it's going. My name is Bill Collins. I run the public finance group at the Bank of Nova Scotia. Our primary business is providing credit and liquidity facilities for a variety of short-term, tax-exempt debt sold in the U.S. municipal marketplace. The Bank of Nova Scotia has been engaged in the municipal credit enhancement business since 1994 and currently we provide enhancement facilities to 52 borrowers across 24 states and territories.

The U.S. municipal credit enhancement business is largely the result of a significant growth in both the issuance of floating rate debt by governments and enterprises, as well as the increase in assets and tax-exempt money market funds over the past 25 years. From 1985 to 2007 tax-exempt money market fund assets grew from 36 billion to over 400 billion. Expansion of the product to more issuers and the growth in the long dated, tax-exempt interest rate swaps drove demand further over the past 15 years. Annual issuance of variable rate debt increased from approximately 14 billion in 1990 to over 62 billion by 2005.

Banks in the credit enhancement business also saw their business grow during this time period as low capital requirements under the Basel I regime compensated for the low margins achieved in the business. In the 1980s and early 1990s letters of credit from banks were the preferred form of enhancement. Letters of credit accomplish two tasks: first, they provided a guarantee for the payment of principal and interest on the debt and, second, they offered liquidity support for bonds that were tendered, not remarketed. As monoline bond insurance became more prevalent in the municipal marketplace credit enhancement on variable rate debt became a bifurcated product. Now monoline insurers assume the credit risk and banks continue to provide the liquidity support. The so-called insured liquidity product was popular for banks as it provided two layers of security: one of the underlying municipal borrower and another from the guarantee of the AAA insurer. Indeed, insured liquidity facilities became commonplace over the past decade.

In late 2007 the option rate security market began to freeze up as credit concerns on monolines penetrated the marketplace. Apprehension about monoline credit quality migrated to the insured variable-rate demand marketplace as well. The primary concern for money market funds was the ability of the bank to terminate its liquidity facility in the event of an insurer downgrade. Fearing the loss of liquidity, funds began to tender these securities, necessitating bank advances. A considerable effort was made by enhancement banks during 2008 and 2009 to restructure these insured backstops to stand alone liquidity facilities and letters of credit.

Further exacerbating the problem was the downward pressure on bank credit quality as the recession took hold. A large number of European and U.S. regional banks lost their high grade ratings, effectively sidelining them from the municipal enhancement business.

Finally, a large number of municipal borrowers had locked in lower fixed interest rates by undertaking long-term, tax-exempt, interest rate swaps in their variable rate debt. As interest rates fell during this time period, these issuers incurred negative marks in these swaps, making them prohibitively expensive to refinance. During the 2009/2010 period, expensive liquidity from capital constrained banks and the inability to refinance swapped debt led to a reduction in the issuance of variable rate debt. The lack of bank activity and the reduction in variable rate debt has been somewhat mitigated by the fact that tax-exempt money market fund assets have been declining since 2008, largely the result of lower yields offered in the short term marketplace.

Some stabilization occurred during 2010 as several larger U.S. institutions became more active in the market. However, the municipal credit enhancement debt market still lacks depth and of the 30 to 35 major institutions that comprise the normal universe of municipal credit enhancement banks, less than one half could be considered active players in the current marketplace. Nonetheless, I expect increased activity by banks in the market in 2011, as more institutions return.

Complicating the return to stability by banks in the credit enhancement sector are the new capital regulations being developed currently. One of the effects of the downturn was a series of proposals from the Bank for International Settlements, designed to prevent a future crisis like the one which occurred during 2008. The so-called Basel III rules contain a number of provisions which are likely to increase the costs of providing credit and liquidity facilities going forward. It is too early to determine the actual impact of these proposed rules as they are still in the process of being developed and agreed to by the G20 countries.

Based on my experience in the municipal credit enhancement business, I would like to make a few observations about municipal variable rate debt and the money market fund industry. First, unlike the auction rate securities market, the SEC rule 2a-7 regulated tax-exempt money market fund sector which purchases municipal debt with third party liquidity support performed exceptionally well during the downturn. What had been contemplated in theory actually worked in reality. When money market funds tendered debt, notice went out to the banks and the banks funded as required. The backstop structure to ensure money market funds were made whole did the job they were designed to do.

Second, the draws under bank facilities were not due to a flight from tax-exempt money market funds or from a deterioration in municipal credit quality but rather, a technical issue related to bank agreements. Therefore, the fundamental low risk nature of the municipal market remains intact.

Third, with nearly a 30-year history, the variable rate demand bond has proved its worth. A win-win product for the industry, variable rate debt has saved governments and enterprises billions in interest costs over its life while providing money market funds with a valuable cash-like instrument. Those governments that employ a prudent mix of variable rate debt in their overall borrowing structures have been richly rewarded over the past 25 years. The bottom line is this product is a real champion for the municipal industry.

It will take some time for banks to work through the new capital requirements for credit and liquidity facilities and even more time for the short term municipal marketplace to return to normal. However, given the value of the products to U.S., state, and local governments, I am optimistic that the variable-rate marketplace will continue to provide as much value in the future as it has in the past. Thank you.

**Amy Starr:** Thank you Bill. Next we have Joe Dean. Joe.

**Joseph Deane:** Good morning. I'm suffering from the same thing you are Mary. I want to thank both of you for inviting me here today. Normally on a panel like this my preferred position is I love batting cleanup but I'll hit second and move the guy to third.

I've been in the business for 40 years, myself, and if you take a look at the track record of our, really basically flagship fund, it was the number one fund in terms of performance for the decade of the 1990s. You turn around in a completely different environment. It was also the number one municipal fund for the decade of the 2000s. We're very much a believer in total return, not just creating yield and I think that over a long period of time our clients have been extremely well served by that idea. And when Amy first called me up and said "we'd like you to talk about

the markets, what's been going on," I always look at it from the viewpoint of a money-management operation. And from our perspective, what you had was -- from 2002 or three, really post September 11, you had a significant buildup in the amount of leverage that was being created throughout the system. Municipal's were really no different. You know, you had the single strategy municipal hedge fund. You had regular, you know, open end mutual funds that were using tender option bond programs to build up leverage within a non-levered fund and, you know, everything was great and hunky-dory as long as everybody was a buyer and then what really happened was when you finally got to 2008 what you went through in an individual basis was probably not even a down market in bonds. I'll get into that in a second but what you really had was the greatest delevering trade in the history of the United States financial markets, municipals included and I can promise you one thing, we can go up, we can go down but I can guarantee you, probably for the rest of your careers, you'll never see another 2008.

Because I think that some of the very, very highly levered players, specifically the hedge fund side of the business, really, for all intents and purposes, doesn't exist anymore and I think as you take any market environment and as you delever it, you're actually making it stronger, better, more capable of taking a punch. But there is still a reasonable amount of leverage left in the system simply through tender option bonds that are in funds. From our own standpoint, over the years, we've never used it. It's a product that we've never touched. It hasn't hurt us, obviously, over the years. But I do think that that's something that the Commission probably should take a peek into and decide what appropriate levels are and that's really more in your venue than mine. But when you have the number one fund in the industry and you've never used the product at all, I think it says something about the product.

In terms of what's gone on in munis, and I know the guys are going to get into a bunch of different topics, all of which you know, you were mentioning before, but from our perspective, I think if you take a look at the liquidity which is really what you're trying to talk about in the business, it's really a two-pronged thing.

Number one, if you go back to 2008, we lost a number of players in our marketplace. You lost Bear Stearns. You lost Lehman Brothers. UBS closed their institutional department. Merrill and B of A merged and basically they closed B of A's department. So there were a number of liquidity providers in our business that were no longer really viable and in the business and at the same time, fortunately, I guess from our point of view, the funds have been getting larger and larger and larger and what you want to make sure is that liquidity providers can be big enough to provide liquidity to sensible investors and that really should be the long-term goal.

But there's absolutely no question today that there are fewer people involved in that process than there were, let's say, five, eight, nine or 10 years ago. And it has altered the way we manage money. I think if you take a look across the board the way we do things, we're probably higher grade. We're probably more conservative and a little bit lower key and probably today versus where we would have been five or 10 or 12 years ago, we keep more cash on the books. So, if we have a mantra that we use every day at Western it's simply this, "Liquidity is king." We always want to have it. Every day we walk into the office we're going to have a bid. You may like it. You may not like it. You may actually hate it but you may need it and I want to make sure that we are in a position to be able to provide that. In 2008 when you really went through, probably the closest thing in my career to a train wreck, I mean, we weren't looking for liquidity. We had huge defensive positions built up and we were a provider of liquidity to the industry and that's really sort of our long-term goal.

So, I think you can talk about credit. You can talk about balance sheets. You can talk about pension liabilities but when you get into major moves in a marketplace in a relatively short period of time, it is rarely a long-term problem that will create it. It is usually a tremendous amount of pressure in a very short timeframe that moves markets and I think, in my opinion, that pressure too many times in our business has been the leverage factor in the business.

Thank you.

**Amy Starr:** Thank you very much. Our next panelist, Tom Doe. Tom.

**Thomas Doe:** Thank you. It's a pleasure to be here this morning. I have several slides that we'll take a look at. I'll try to explain and describe a little bit of the market conditions and our observations regarding this topic, price stability and liquidity.

I have a daughter who is an art history major and she introduced me to the art auction process and the Christie's auction process that a notable entity describes their -- the purpose of the auction is to create the illusion of liquidity and when I thought of that I thought, "well, isn't that what the competitive AAA, high grade, bond sale represents or, in fact, the bids wanted process that occurs in the secondary market, especially around high grade names?" So, similar to the art world, that where a Monet, or a Picasso, or a no name is transacted and provides an aggressive and high price that then can be applied to lesser-known works, so too, the municipal market has come into the common practice of using the best names, the highest-quality credits in the marketplace and using that to extrapolate evaluations across lower credits and, sometimes, creating a misleading process or information.

Because our thought is, is that the evaluation or the prices that investors have is the daily and consistent form of information that our industry communicates to its investors and the importance that that evaluation and the processes behind that that comes up with that number that appears on an investor statement is absolutely critical to the integrity of our market.

So, there are three points that I want to share with you is one that I've already made is that the high grade market, again, AAA, because of bond insurance and its proliferation prior to 2008 where we had more than 60 percent of the market was AAA insured, provide a commoditization of the market and is a fairly easy evaluation.

We've now come to a process where we also have fewer people, fewer firms providing secondary liquidity for bonds and that concentration of capital, the fewer players providing liquidity, results in an imbalance and creates a risk to the marketplace and, again, to the price discovery process. It limits it. It also makes, allows investors fewer opportunities to get a bid for their bonds.

And the third point regarding regulation, and I had the pleasure of serving on the MSRB from 2003 to 2005, is with all the resources of the real-time transaction reporting is that there's the opportunity of really digging into the data to understand who's providing liquidity and when and using creative tools, much like Bill James in examining baseball statistics and players, is to be able to look at, creatively, who's providing liquidity, who's active and when and what purposes they are providing that liquidity.

So, let me show you a couple of graphs very quickly to illustrate, make a couple of points about our market. The first line reflects municipal issuance and my point is, in 2000 municipal issuance was around 200 billion a year. Very quickly by 2003 we were up to 400 billion a year and we were averaging on a 12 month rolling basis 400 billion. And the marketplace grew. Issuers got to the market because it was well banked and there was a high demand from the leverage players that Joe alluded to.

Here in the last two years, in 2008 with the help of Build America Bonds, we've had -- the industry has been able to maintain a 400 billion pace: the tax exempt portion of that issuance dropping back toward the levels of 2001, again, around -- just under 300 billion.

The next slide is a table reflecting the relationship between AAA benchmarks again, these high -- the representation of levels of that AAA, Geo state name that has a great deal of pricing influence and both ourselves and another firm, Municipal Market Data, provide a benchmark

widely used and what the point is, is that we discovered that there's a high degree of correlation between the daily movement of the basis point change, of a one single piece of data, and the evaluation matrices of investment grade securities. The correlation, using the Barclays Investment-Grade Index, 1100 names, a third of which are high grade, AAA: two thirds of which are AA, representing 50 states is 0.99. You always have to be careful with statistics but correlation does -- this level, number 1.0 would be perfect, 0.99 suggests that there's a potential existence of causal relations.

Again, if someone is able to provide price discovery or move the market by simply trading a Picasso in the municipal marketplace and change the prices of all securities, that becomes very important for investor risk, investor information. Again, the evaluation being the daily communication of the industry to the investor. Recently, as Joe alluded to, we had a sharp rise in yields that was extraordinary. Again, it was a creation. This graph here, the red line representing as the sharp increase of secondary selling. The gray area representing a decline -- the declining price. And what was interesting here is that starting at Labor Day is that we saw an increase in secondary selling. And what I would suggest as a regulator at the SEC or MSRB is being very cognizant and researching again being Bill James-like and being aware of the changing context of the market that can put investors at risk when they're trying to get a price for their bonds or a bid.

Next slide represents, again in this November period the daily par that was traded among different aspects, different transactions, again drawn from the MSRB data. What was of note was there -- is when liquidity is provided and liquidity increased considerably when yields were at their highest in November, which means that, like any good business or market maker or anyone who's in the profit and loss business is you provide your capital when the market is in the greatest distress and can create the most opportunity for profit. And the municipal dealer community was extraordinarily active, their activity jumping 700 percent when yields were at their highest, yet all the participants were somewhat restrained the five days prior to that peak.

And lastly, slide -- is that -- well we talk about 2008 and we talk about the adversity of that period -- is that these columns -- the columns here represent where there were sharp spikes in yields in the municipal industry. Using the Bond Buyer 20 GO index [spelled phonetically], you can look back starting in 1933 around the period of time the Arkansas GO defaulted and the New York City crisis in early 1970s, the mutual fund withdrawals and redemptions of the 80s and 1994. And of course, in the fall here of November where we also again, not leveraged, but individual investors exiting the municipal bond funds because of fears resulted in high spikes in yield.

So my final remarks are in the charges that I would like to have us think about -- is one is, the investors need to understand that the municipal market has, let's just say instead of illiquidity, let's say it's inconsistent liquidity. And that can, while there may be a bid, that bid may be -- may deviate greatly from the expectations of the evaluation that appears on their statement. And finally, in order to have adequate price discovery and better evaluations, it's absolutely critical that issuer information is complete and timely to reduce those incorrect conclusions regarding price volatility and default risk. Because once again, we don't want to have volatility be misinterpreted as a credit risk and have the media take that volatility and draw incorrect conclusions that can create poor investor decisions. Thank you.

**Amy Starr:** Thank you very much, Tom. Next we have Alan Greco, Alan --

**Alan Greco:** Good morning, Chairman Schapiro, Commissioner Walter and members of the committee. I appreciate the opportunity to appear before you today to provide my perspective of a municipal bond market, particularly on market stability and liquidity. Given my years of experience as a market maker in municipal bonds, I believe today I can help explain certain

reasons why at times there are volatility in a liquid environment and municipal market. I am also happy to answer any questions following my remarks.

I did put today, together a PowerPoint and this will basically be about my having traded in municipal markets over 20 years. And I think I've been very successful at it. And my first topic is anticipate [spelled phonetically] liquid market. This is in no particular order. The first one is supply in the tax exempt market. The technicals are basically the fundamentals where you have a small universe of buyers. When you can have a week where you have \$6-\$7 billion dollars in deals that can be taken pretty well by the market. But once you get to a number of say 10 billion or so, to me that's a warning sign and that's a possibility that there is too much supply in the market and there may be an issue with the market.

Second is the depth of accounts. What's going on with Joe Deane? What's he doing? Is he buying or selling? What are insurance companies doing? Are they buying or selling? And a big part of that is the bid wanted in the secondary market. At times bid wanted in the illiquid market jump, you know, 10 fold in a normal market. Also, interest rate trends -- obviously, at times, municipal bonds track treasuries. And if the treasuries are rising, there's a very good possibility that the muni-market rates are going to be increasing. Another important factor is absolute levels. At times when municipal yields are very low, they are competing for other products out there in the security business. So you'll have investors chase other type of products. Retail is very big in our business. And retail, depending on what's going on with retail, if they're involved or not, if they're putting money in the equity money market, if they're saying rates are too low, if there's a credit issue, you have to pay a very good attention to the retail situation.

What I also do is look at my inventory, what my turnover is in regards to taking on positions in the secondary market. If I'm sitting with bonds for a week or so, I'm not seeing the activity with the flow of the account. That's another mark where I got to figure out what I need to do. That's probably if it's sitting too long I need to exit those bonds and try to get my position down. Also, we have an account base. A smaller base now is the ARBs [spelled phonetically] where at times when treasuries are very close to percentages of yield, it's the same as tax exempts, they'll be putting on trades. So if you were looking at the normal trade of a tenured AAA tax exempt bond with about 90 percent of the treasury tenure, that can be attractive at times. When it gets to 80 percent or so, you got to be very careful. You may have as many sellers on that particular side of the account base.

Seasonal -- seasonal is very important in regards to municipal bonds. You have March where there is a pretty big issuance for the month of March. And then you have April in which you have tax season, where you'll have sellers at times. So those two months and October are very important. October is probably the peakest [spelled phonetically] month when it comes to issuance of -- in a muni-market, you have probably the lowest investment coupon there. Those two aspects normally will have an inverse affect on the market.

The last sell off of this I'll touch really briefly. It started in November 5. You had rising U.S. treasury yields and that was a response to the QE2 where the market sold off in the long run, especially the longer end. Supply, as I said before, you had 54 billion in new issue volume in October was the second biggest month since October of '03. And redemptions, you had a two week period of redemptions from mutual bonds of approximately five billion. And when that happened, the just became sellers and it just fed on themselves with the market going down. And the uncertainty of BABs -- this will be a topic that'll be discussed later. When we had BABs - - that started in April of '09 -- that kind of put a floor on the long end of the tax exempt market.

And now headline news, which is becoming very important. You're seeing that take place. You read it all over, what's going on with certain municipalities in states with budgetary problems and unfunded pension funds. And if you just take a look at this little chart here, it showed the

tenure from November 5 to November 17. The market backed up 55 basis points. And the third year AAA backed up 72 basis points. But after that, what Tom said, there is a buy in opportunity. In four days, the long AAA market immunities rally 31 basis points.

I've been using these methods for many years, trading strategies for illiquid markets. Basically, have a lower overall inventory level. Get your position down. There is no hedge to protect the cash market of municipal bonds. There have been certain products that haven't been efficient. So the best thing to do in an illiquid market, as a market maker is try to get your position down. And if you're involved, trade with high grades, AAA states, AAA towns, AA utilities and try to see what the wholesale retailer's looking to do -- if they find the time to come back into the market. Also, I think what you have to do as a trade-in desk with your traders. Management and traders set decisions what's purchased will liquidate in your inventory. And I find this very true, number four. If you need to get out of bonds, your first bid is probably the best bid. [laughs] Joe would understand that. It is, in my experience, that when you see that first bid and you believe you're in a liquid market -- you know you're in a liquid market -- you need to sell. And what Joe said, have a bid signed. And there's opportunities out there also. When the market's oversold [spelled phonetically] -- you believe it's oversold -- that's when you're supposed to put your capital of your firm to work.

Going forward, I think, is quite important. It was mentioned by everyone here. Don't be over levered. Quite important. Work down your inventory as a market maker. You can't get down immunities one or two days. You need to liquidate it over a time frame. Call it a week or week and a half. Rely on quality research, which is so important now with the monolines not being around that many. You really have to look at the underlying credit, credit which is quite important. And be prepared for headline risk if anything pops up in the media in regards to budgetary problems, pension liabilities or a hospital having issues. Having dialogue with issuers and investors -- you know, the middle of the month of October there were probably just under 700 million bonds pulled from new deals. This was the bankers and the traders having discussions with the issuers and telling them, "This is not the appropriate time to bring your deals. Manage their expectations."

I don't think this will ever happen, but continue to search for a viable hedge. If someone came up with an idea where there is some very high correlation with the muni cash, that can help out tremendously on the market maker's side. Use capital efficiently. Work account bonds, don't always have a bid side out there. See what the account basis do in work situations. And B, which I really take to heart, you know, treat the firm's capital like your own money. It's your money. There are people out there who may not agree with that but I take it to heart that I have the capital of the firm's money and it's going to be mine. And I'm going to try the best what I can do is protect that capital base and try to make some money. In the dealer community, work closely with the MSRB, has been invented. It's been wonderful. We need to work on a couple more things with the MSRB. Thank you.

**Amy Starr:** Thank you very much, Alan. We're now going to turn to our last panelist for his opening remarks, Sean McCarthy [spelled phonetically]. Sean --

**Sean McCarthy:** Chairman Schapiro, Commissioner Walter, Commissioner Aguilar, Commissioner Paredes, Ms. Starr, and others present today, on behalf of a short guarantee-limited, the holding company for bond insurers, assured guarantee municipal court or AGM, and municipal only insurer and AGC, a diversified insurer, an municipal and structured financings, we appreciate this opportunity to express our views to the Commission and its staff. And thank you for inviting us to participate in this field hearing on such an important topic. In the time afforded me, I'd like to explain the role our companies play in the U.S. municipal market and its positive impact on market stability and liquidity. I would also like to express our views on regulation that would strengthen the municipal market.

As monoline bond insurers, we are in the business of guaranteeing bonds and related products only. We do not provide other types of insurance products such as property, casualty, life or health insurance. AGM and AGC, which are the highest rated bond insurers in the market today carrying the double plus from standard of course, and a double-A three from Moody's [spelled phonetically].

The industry's basic guarantee insurance policy insures that if the issuer of insured bonds fails, to make a scheduled payment of principal and interest, the bond insurer will make the scheduled payment when due. This unconditional, irrevocable guarantee to the bondholder is in place regardless of the reason for failure to pay, including fraud. The guarantee brings differences between the needs of investors and debt issuers and offers significant benefits to both sides. For issuers, the primary benefit of the guarantee is the credit enhancement of the bond. We provide the highly rated, second source of payment of principle and interest, which helps issuers to achieve significant finance-cost savings. The rating agencies recognize the value of the guarantee and will rate the bond the higher of the insurer's rating or the rating of the uninsured bond. Additionally, by backing our credit assessment with our capital, we provide issuers with a broad market distribution. This is particularly valuable to smaller and lesser known issuers who could not access the market without our guarantee.

For investors, we provide significant benefits that go beyond the guarantee. These include credit analysis, structural terms, ongoing surveillance and remediation where possible. These are the - of all the issues that we insure. Our credit underwriting and ratings homogenize the underlying credits we insure, which in turn creates significant market liquidity in the market. Retail investors particularly benefit from this standardization.

Another way to think about our role in the market is that we act as the super bondholder, not only because we insure the bonds, but because we step into the shoes of the investor to identify issues before they grow into problems that could result in a default and work with issuers to address these financial difficulties. Year to date, we've insured approximately 1,600 issues across \$25 billion of new issue volume, or approximately 89 percent of the transactions that we've done have a par size of less than 30 million. So we really are focused on helping smaller issuers access the market. This equates to 14 percent of all new issued transactions of 30 million or less. And again, it would be nearly impossible or much more difficult for issuers to come to this market without that guarantee.

Additionally, we're a prime source of credit enhancement available in today's municipal market. During the first nine months of 2010, only 130 municipal issues were supported by bank's letters of credit, which equates to 1.9 percent market penetration. We think it's an important product itself, but we also think that the role of the guarantor has been extremely important for a very large number of issuers.

Before closing, I'd like to address two regulatory matters. First, both the SEC and the CFTC are considering the breadth and definition of what a swap is or a derivative under the Dodd-Frank Wall Street Reform Consumer Protection Act. We believe there are good legal and policy reasons to not treat state regulated insurance policies including financial guarantee policies as swaps. It would be inappropriate and unnecessary to interfere with the benefits we provide to the municipal market by treating financial guarantee policies as swaps. Additionally, property and casualty insurance, including monoline financial guarantee insurance, is a fully regulated activity. We therefore, urge the SEC and CFTC to insure in their upcoming regulations that insurance policies including financial guarantee insurance policies are not regulated as swaps under the Dodd-Frank Act.

Secondly, we have closely observed that the continuing changes in rating agency standards and the lack of transparency and consistency in determining ratings have contributed to the instability in the market. We therefore propose, in implementing the Dodd-Frank Act, the SEC

consider new rules for rating the rating agencies that would facilitate a more transparent and consistent business environment for issuers and investors and ensure that the same assumptions and stress standards are applied consistently in evaluating all the entities they rate. Importantly, this would attract new entrance to the financial guarantee industry by creating a stable and predictable rating environment that would allow new entrance to have a road map to build a company, permit investors, both fixed income and equity, to analyze the health of companies in the industry, and finally, increase the availability of affordable capital at a time when liquidity concerns remain paramount for municipalities throughout the country. Thank you very much.

**Amy Starr:** Thank you all panelists. Now we're going to turn for questions. Commissioner Walter, did you have any questions you want to start with?

**Elisse Walter:** Sure, let me lead off, and I want to thank you all again. Thank you. Your opening statements already shed some light on some things. I guess where I'd like to start -- we heard in our San Francisco hearing from the retail investor point of view about the difficulties there are if you're holding a municipal bond. And contrary to popular opinion, people actually do want to sell them from time to time and want to sell. Can one of you, perhaps Alan or Joe, give us an outline of the actual bid wanted process, how it actually works and perhaps how it's affected depending on the supply, demand balance in the market place?

**Alan Greco:** Sure, I would love to. I've been trading institutionally the last 15, 18 years, but I've been involved with retail at times. A client would normally call up their retail broker, wanted to maybe liquidate for some reason, you know, to sell some municipal bonds. What you can do is the retail broker will call the trading desk or a liaison desk who speaks with the trading desk and ask them for a bid for on the bonds. If -- what I've done when I was trading retail, if the broker or the client was not happy with the bid, you can put the bid out for competitive bid in the retail market. You can put it on the broker's broker wire and that will be open up to all different dealers to bid on and competitively, and that should get the best bid for that security for that particular day.

**Elisse Walter:** Alan, can you back up a second? You said, "If the broker or the client wasn't happy with the initial bid, you would put it out." What information would they turn to to determine whether they were happy or not?

**Alan Greco:** Well depending on the day, if the market's down, you know, the evaluation on their monthly statements -- they look at their monthly statements. They are seeing where maybe other bonds have traded prior, you know, a week or so ago. So they might say -- or they might be really unaware what exactly the bond is worth. You know, I think the bonds are worth par and but the real market value is at 98. So -- and also, you know, if you go around to sell other brokerage firms if you have multiple accounts you can speak to two different brokers and get two different bids. But then, you know, what I said, put it on the broker's broker wire and you can get, you know, 10 different bids from 10 different dealer desks. And that should be the best bid for that day.

**Elisse Walter:** Joe, anything to add?

**Joseph Deane:** Well this is not as -- not exactly my area of expertise because we're basically institutional buyers and our ability to sell bonds is going to be vastly different than an individual investor. I think one of the problems that you have is the fact that when people take a look at their statements, okay -- and I think this is where if you're in a very, very calm market environment, I think the difference between where you're evaluation is going to be and where the bond will potentially be portrayed in the secondary market is not going to be significantly different. You'll probably have a lot of happy investors. I think the problem comes is whether the market is moving rapidly. And the pricing services usually price on what they call a matrix.

So they're going to move it depending on the speed they think that the market is going. They're going to be moving that matrix. But that matrix will not represent where the real market is. And I think that's where sometimes you'll get a discrepancy to where people, you know, think their bonds should trade and where the real market is. If it's a calm market place, there probably won't be a problem. If the market is moving at great speed, like it was a couple of weeks ago, you're going to get huge discrepancies but they're real. And I think the bid side that you get is probably much more reflective of where the market place is and your evaluation is.

**Thomas Doe:** Can I jump in here for just a moment?

**Elisse Walter:** Please do.

**Thomas Doe:** Just coming back to the events of the past, in November -- on November 11, Veteran's Day, markets are closed and standard employers downgraded the tobacco sector. Fifty percent of those bonds down to junk status. The next day bonds that were affected by that, the Ohio Buckeye Tobacco loans were transacted at yields 80 basis points higher than the evaluations that morning. The result of that and the impact of that were those funds were disproportionately allocated to the tobacco sector, taking risk to enhance their performance because the securities had higher yields. And, you know, let's be blunt, they were held in the leading fund in the end of third quarter, which happened to be the Rochester Group that used that as their strategy. The shock to the investors was to see the number one performing fund lose their entire returns in the process of five days for the year.

And after 2008, we had numerous phone calls from investors who were concerned about the fluctuation, not just of their individual bond holdings prices or their evaluations, not prices, their evaluation services is but also the fluctuation of the net asset value of the funds that were involved in. And not being able to understand that volatility and understanding the risk that the portfolio manager was taking in order to enhance performance.

So I think one of the key points here is that when we had illiquid market conditions that can occur for a number of different reasons. There may be a bid, but again, come back to my statement is the discrepancy between where there is liquidity -- of where someone will offer a bid in order to make -- again, that bid is based on being able to make a profit and also to reduce the risk that they have from providing and owning that bond because they're putting capital at risk and where that bond is evaluated on their statement is critically important. And I think that's, you know, where some focus -- again, my point of high grade market providing that information to investors as to -- or to the market place itself how much the market has changed on any given day and to extrapolate across, and across all evaluations it is a very important facet that, you know, needs to be examined.

**Elisse Walter:** Today, a retail investor can take advantage of the transactional information that's in EMMA. But there really isn't much if you're truly a retail investor that you can determine other than that. Do you think there's further information that should be publicly available a propos of, I think, Lynnette's going to talk about later in terms of the MSRB study? Or are there options that should be considered about making other aspects of the market more transparent?

**Sean McCarthy:** Well, some things in technology is bringing greater transparency to the market as a whole. So if you think about platforms such as the muni center, what they're doing is putting up 25,000 line items of individual bonds of prices and a bid wanted list that's really more broadly accessible. So that process is bringing greater price discovery to the table. Well, that's different than, you know, back ground credit information, which is, I think, the other part of the question for the retail investor -- is, how do I know the credit worthiness of the underlying security, especially since the municipal sector there are 30,000 individual credits. That's very

challenging to understand that. So two parts to it. I do think though that technology -- and I'd be interested to see what Alan or Joe think about it -- is really starting to address greater transparency for the municipal bond itself.

**Joseph Deane:** I think there's a two part answer to that. I think number one, if you listen to what all of us are saying here, one thing becomes very, very apparent. I mean, if you're, you know, a good solid institutional investor today, you have to have your own independent research staff so that you can take a good hard look at the credits that you're buying. You may listen to Moody's or S&P, there may be insurance. But at the end of the day, it really is going to come down to a call on our research staff. And I think that is something that the individual investor, I think has been tending towards the fund arena because they really don't have access to any great degree of research. And that's one of the things that we provide.

You know, Tom brings up a good point. I mean, when we went through the little mini crushing, you know a few weeks ago, there were a couple of parts to it. I mean, number one, you did have the announcement, you know, on November, 11 about tobacco bonds. By the way, we don't own any. So I mean that's not, you know -- I can be agnostic on the subject because we have no exposure to it at all. But you also had the final announcement from Bernanke and QE2, which I always thought was an ocean liner. Turns out it's a program from the Fed. But I think what had happened was -- it's almost like the old theory. You know, you buy the rumor. You sell the fact. Well, once he announced that, "Gee, we're going to do something," -- but there was no real announcement as to what it was going to be. I mean, people started speculating that, you know, it was going to be the second coming. I mean, they were talking about a trillion, trillion and five, two trillion, 11 trillion. And then he comes out and he announces a huge program, 600 billion dollars. And everybody goes, "Huh? What?" And there was disappointment.

So you had the tobacco announcement, then the treasury market, which had driven itself way, way up in anticipation of nirvana. Got a great program presented to it, and sold off like crazy. Then on top of that, there was the -- the not guarantee that BABs would be renewed. And there were so many people who had waited and waited. You know, let's just call it what it is, greed. They thought that rates were going to keep going lower and lower and lower and they didn't bring their deals to market. Then all of a sudden, you had these two things occur and everybody said at the same time, "Holy cow, I've got to get my deal whether it was tax exempt or a BAB, into the market before year end." So you had this title wave of deals. There was the instability that Tom mentioned and some of the NAVs of some of these funds -- they got redemptions.

So what you had was this perfect little storm of you had cash flows leaving the mutual fund arena. You had the new issue market place exploding where three weeks before that, I mean, anybody could have brought a billion dollar deal to market. I mean, it would have been like ink going on the water. It would have been absorbed. Nobody would have even felt that it was in the market place because things were so thin. So it's the timing of it. I don't think, in spite of what you read in the press, this is not a credit issue. As you said before, it is truly an issue of liquidity. I mean, the credit issue may come down the pike. It may or it may not. But I think what we're looking at here and talking about is an event that was a liquidity event and not a credit event. And I think those were the things that pushed the buttons to make it happen.

**Thomas Doe:** And I think one of the challenges with the municipal, for the individual investor are twofold. One is, how do you resolve that here's a security that's being presented to you, sold to you, or through a fund or individually as being very safe from a credit perspective. And yet, there's not consistent liquidity. How can that be right? That's the disconnect. It makes it very difficult then for investors to understand what exactly that they're owning.

The second thing is that even though we have all the transaction information -- and I hope perhaps this will be where the MSRB is going -- is trying to organizing that for the individual

investors so it has meaning, would be a tremendously positive step. Because, just because you have a line of transactions, we all know here on the panel that because of the eclectic nature of the market place and the different sizes of the transactions influence the prices that are provided to them in order to provide liquidity or offer liquidity -- is that it makes it very difficult to then identify what is a fair price or how close can that price be to the evaluation on the statement. So if there's a way -- and maybe this is where the MSRB is going -- is being able to organize that so that it does provide a more palatable form of understanding from all this information. Because remember, you know, Oscar Wilde, right, who defined a cynic as, you know, "knowing the price of everything and the value of nothing." You know, and I think that's what we're, you know -- that's one of the things we have in our market place. We can price a lot of things. We can have offerings on -- meaning we know what something is for sale. But we really don't know what the actual value and appropriate price is.

**Joseph Deane:** You know, you bring up a good point. And I think the desire of the Commission has always been to get as much information out there as rapidly as you can with the small investor in mind. But keep in mind one thing too. It's a two-edged sword. You know, when I go out in the market place -- and you know, like the other day I sold somebody a block of 100 million bonds. Okay -- within 15 minutes, everybody in the market place, whether they have a commitment of capital or no commitment of capital whatsoever to the industry will be able to have access to that information. If you're putting up \$100 million of your capital to make a market for someone on a secondary market, it's really difficult for people to put that kind of capital up knowing that they only have a 15 minute head start and that everybody else in the industry will know precisely what went on in that trade within a few minutes. It makes it very, very difficult on some of the people that are the real, true capital providers in this business. Because the ability to, you know, put your money up and then have some quiet time to be able to work that, especially since you've put your money up. It's the other side of that coin. It's not always just one side. There's two sides to that story.

**Sean McCarthy:** And, you know, I think that also and if you look at sort of the history of -- Tom alluded to the fact that historically the credit enhancement and its variety of forms really had penetrated the market up to about 60 percent at one stage. And why is that the case? Well, ultimately really what happens, you know, at insured is that we marry every credit that we guarantee. So it's not only that you're making a credit assessment and that you're going to surveil it on an ongoing basis, but you're putting your capital up against that. So to the extent that there is a payment default, you are actually going to make that payment to the investor. Now from a retail stand point, whether, you know, sort of Joe's firm has an excellent research department themselves and when they decide to sell bonds, sometimes they'll route them and sometimes they won't to sell them ultimately into the hands of a retail investor, which is really the ultimate execution, whether it's by fund or by individual bond. And so we really think that that kind of protection is what's enabled lots and lots of credits to get market access.

**Amy Starr:** I have a question. We're -- part of what we're talking about here is liquidity. And as I hear the discussions, we have different -- there could be different meanings of liquidity. We have liquidity providers and liquidity providers. So you have people who are willing to buy and sell in the market and you have people who are willing to provide credit enhancement. Can you talk a bit about how people are viewing liquidity and the different roles and characteristics it may have depending on the market players? Anyone jump in please.

**William Collins:** Well, if you're asking about bank liquidity -- you know, we're in this period and I think we've been in this period for several years of low bank liquidity. And I've been in the municipal business for 23 years and 21 out of those 23, I've been in the credit enhancement business on the bank side. And I've seen periods of high liquidity and low liquidity. It's, you know -- they go in waves. And what is unusual about this -- the present liquidity situation is previously, probably in the 1990s, if you saw banks shy away from our business, it was usually related to a particular country and they had a specific set of problems in that country. So if they

had a set of banks that were involved in the municipal liquidity business, you know, if they exited, it wasn't a problem because there were other countries with strong banks that would fill in.

This particular downturn -- yeah, this particular downturn has affected a significant number of banks around the world. And it basically shows you, we are moving to a global economy where problems can affect -- can move across borders quite quickly. So, you know, in our business we're in this period of low liquidity really due to the fact that a significant number of institutions have been sidelined due to capital concerns. And that's not unique to any particular country. And I think it's a question of just working out of those problems and rebuilding capital and that's something that has to occur around the world.

**Alan Greco:** On the market maker's side, providing liquidity is twofold. You have accounts looking to, you know, sell municipals for any different reason. And they either come to your firms saying, "I want to move these bonds." You can either work the situation or give the account a bid. I want to own these bonds at X price. So the market maker's involved every day with that. They're providing liquidity, trying to purchase securities or crossing securities to the account base.

Also on the investment banking side, there's a times that you're providing liquidity on the new issue. In regards to both negotiated competitive deals, when a municipality wants to sell a competitive deal, they will put it up for sale at a particular date and time. And then you put the firm's capital to work. Or you believe that you can give them the lowest interest cost plus be able to have a return on that. And also on the negotiated side on the investment back. At certain times, municipalities need to raise capital and they need to do so in a certain amount of time. And if until illiquid time, there might not be enough buys on the institutional side. So the firm -- the underwriting desk needs to put up the capital to get the deal done and you're going at risk with the faulty balance of the deal that it's unsold at that time.

**Amy Starr:** Anybody else?

**Joseph Deane:** I might add one quick thing. It goes along the lines a little bit of what Tom was talking about before. I mean one of the things that we've watched over the years because we have a tendency to be very, very active in the longer end of the muni curve; especially with as steep as the curve is today we think that's where most of the value is anyway.

I don't know about you folks but I've got two boys that are 19 and 21 and I've always had one mantra that I've shared with them. "Nothing good happens after midnight." That's been very, very true over the years. I've observed that in the long end of the muni curve, nothing good happens under five percent. I think that as the Muni business starts to drive things, which it did a few months ago comfortably below you know, where you're trading bonds at a 450, 420 or 410 we were a pretty large seller into that market place.

One of the reasons I think why all of a sudden you know the spike in liquidity that you were talking about before, you know I mean it doesn't take a genius to figure out you went from a 410 to a 570 in you know basically four days.

At a 570 I like it. At a 410 you can have it. I think that over a period of years our industry in the long end of the curve -- not short -- but in the long end of the curve has had very, very little success below five percent. I think that's one of the things that we monitor very, very closely in our funds.

**Amy Starr:** Go ahead.

**Thomas Doe:** Again, just coming back I think one of the interesting aspects of some of the research that perhaps the MSRB is working on or that the SEC could also be involved in is I've really become fascinated in when people -- again, when people provide liquidity and because we have such limited price discovery, again because it's a relatively, again, liquid.

Is that we will provide price discovery and then that price discovery being that information that influences evaluations can be extraordinary powerful. When I've talked with people in the equity markets about some of the activities that occur in municipals regarding that where the transaction is done, a competitive bid is submitted and a deal is won. That transaction, then, like my Picasso painting is that that price then can be extrapolated broadly. That can influence the value of one's holdings whether it's a large portfolio.

But when I've talked with people in the equity markets they said, "Oh, isn't it great, the strategies that are in the equities markets have now found their way to municipal bonds." This is particularly true when we have leverage investors and the proprietary trading desks that were so dominant between 2002 and 2008.

What I think becomes fascinating, again, we have all the transactions, we know who is buying and selling. The regulators have that information. Being able to monitor that can be very helpful in understanding what is influencing evaluations and who is influencing evaluations that may put other investors at risk.

So this information while can be detrimental it can be sometimes inhibitive to some liquidity process is extraordinarily helpful from a regulator and understanding the context of the environment when we're talking again about liquidity being an investor trying to sell a bond in the secondary market and trying to get a price that is reasonably close to their expectations which then becomes critically important to the integrity of the market.

**Amy Starr:** Lori I think you had a question.

**Lori Schock:** My office deals with retail investors every day and I understand that municipal bonds are held primarily by retail investors. In fact they hold about two-thirds of the market. So you talk about head lying risk but I think there is also some serious risk regarding the state and local government's ability to pay their debts.

What do you suggest you know if you could be in our shoes for a day, what would strengthen the markets in this area and make it more stable?

**William Collins:** I'm going to respond to that one as a bank because that is a concern of banks. That's a concern I address every day. You know many of the banks around the world read The Wall Street Journal, some even read The New York Times. [laughs] You know the number of articles about problematic state and local governments in the U.S. has risen to a crescendo.

I do a fair amount of work every day sending rebuttal e-mails to management about articles that are written in the newspapers. There is a concern when they see a high number of articles being written, it does raise a red flag. I talk to my colleagues at other banks and they're in the same position. There is a concern about state and local governments.

We can give them historical data. We can give them the benefit of our experience. We can see through some of the misstatements that are made in the press. But the increase in volume of these articles will cause concern and it's important for us because we're going to be in a new environment where we're assessing not only credit risk but were going to have to assess liquidity risk. These new regulations will you know, there'll be a credit charge and a liquidity charge too. So we're adding something in the mix here.

The last thing I want to do is have to struggle on the credit side. I thought that was an argument I had made. But you know there is a good deal of concern over state and local governments and that's something that maybe that will dissipate quite quickly given the recovery. I look at those Rockefeller Institute numbers on revenue growth for states and I'm seeing a good trend. But I can send that data up to management every day, there's still a concern about governments and it's largely due to the press that we've received.

**Sean McCarthy:** I also think it's important when you look from a retail stand point that there's a number of participants in the market that try to disseminate the valuation on credit strength. So the rating agencies have historically and continue to play a very important role in terms of individuals and institutions either marking their portfolios or in what their determination is in terms of whether they buy a security.

Institutions like ourselves and like the banks and bills, are taking a credit risk themselves so they're making assessment, putting capital at risk, putting a guarantee on it which again, ultimately helps investors feel secure about the investment that they're making. If you step back and think, okay there needs to be more transparency kind of ability on who is making these assessments about the credits. That's one thing. That's the process and dissemination of information.

The second part to the question is what's happening to the municipalities themselves? That's a completely different assessment which really runs to the overall economy, its health and also sort of the way we look at it is for the last 30 years everybody's really looked at the ability of municipalities to pay back their obligations. And now take that into affect but you're also looking at the willingness to pay back. So is there political risk attached to these municipal credits that wasn't there or probably always was there but it wasn't something that people particularly looked at and now I think they do.

**Joseph Deane:** I think the way we approached it which is you know obviously a little different than the way a retail investor would. Probably six or seven years ago we began to really severely limit the amount of GO credits that we have in our funds because we saw -- you know and it was always in print that an ant couldn't read on page 400. But we really did start to look through the balance sheets of some of these state and local governments and realized that there were liabilities that were off balance sheet that we're building. And yet they were still viewed as what the premier credits.

As you take a look at you know Managed Muni which is our flagship fund. That entire fund is only 1.2 or 1.3 percent in GO bonds of any kind. We prefer Revenue Bonds, Government Escrow Pre-Refunded Bonds, things like that. But we have a very, very low exposure and it wasn't by accident it was really through research and early on. This is not something that we came to you know, two months ago that we read about in the papers. That's what you pay us for and that was our conclusion.

**Elisse Walter:** I believe that Tom back in his opening talked about the fact that with respect to price discovery, particularly in the kind of market place we have today it's critical that issuer information be complete and timely.

Does the market place evaluation of that issue, the completeness and timeliness affect the liquidity of bonds today?

**Thomas Doe:** I think there's no question that the weaker the information is that's disclosed by the issuer entity the more troublesome or less accurate the evaluation is apt to be. I think right now though if we're -- the evaluation process is really because the market place is so unwieldy, it is very labor intensive. The information because it's coming from public entities is you have

such an inconsistency of what the resources they have in order to provide not only provide it completely but also provide it in a timely manner.

This speaks to the question that you're asking. How does an individual investor navigate this market place? The problem is and we just began providing credit because we're an independent firm, providing credit surveillance to institutions. And one of our clients we were looking at represents 30 community banks and we were looking at the holdings. There were about 300 different line items. About 20 percent were non-rated.

Then we started looking at those non-rated securities and looking at how timely their financial information or how untimely. Some of it was two years old. So this becomes the question may be is what level do you have -- does someone really -- does an issuer deserve access to the capital markets? Is everyone entitled to access to the capital markets?

If you can't provide information in a timely manner maybe you should be denied access. Maybe it's not right for you.

**Elisse Walter:** Is there a secondary market issue as well? I mean if you were to take one of those issuers with quite stale information and go through the bid wanted process are you likely to get fewer people willing to buy? Does it have that kind of a direct impact?

**Alan Greco:** I'll answer that. Absolutely. At times when we see bid wanted's throughout the day with so many different institutional accounts and at times there are some non-rated municipal bonds that are out for bid competitively and I would go over to my research person and say, could we get some information on this credit? At times you can't even get a phone call back in enough time to bid the bond. That is a serious issue where you do not have that information for that time, for that bid wanted; you're not going to get many bids on that bond. You'll be lucky if you get any bids.

So that's a very serious situation where getting the information out to the public with these issuers -- especially the smaller issuers is very important.

**Elisse Walter:** And does that vary depending on whether the issuer's are frequent issuer's or not? I mean if you're going to come back to market I would imagine there's more incentive to keep your financial information current. Is there -- can you think of a way for those less frequent issuer's for us to provide an incentive short of a requirement of a certain standard of time line?

**Thomas Doe:** We talk about this a lot in our firm and one of the -- can you think outside the box? Rather than -- take the premise that it's an industry, that it's valuable for us to have product. In other words to have issuers issue debt. If then we also want to make as a given that it's in the best interest of the issuers to have access to the capital markets because they'll get lower financing costs for important enterprises.

So if we agree on those two things; industry interest being good for the issuer and ultimately us as U.S. citizens is that then maybe what we ought to be doing is when we see -- again, through now with [unintelligible] we're able to see when there's a problem. We can see when someone's behind. When we can see when somebody has problems, when there's a Credit Impairment Notice that, maybe there's a way -- and I don't know how you do it within the regulatory construct but is there a way that there can be support given to public entities who need help?

And we can see they need help because they're unable to provide the accurate financial information. Some of it may just be a resource issue or they don't know. Could there be almost a -- if you will -- consulting arm or some type of aid to say, look at, we can -- there are advisory boards as part of the MSRB that involve issuers that involve investors as well as the

representatives themselves is kind of how do we use this information in a positive way to help these people out rather than to just simply penalize them? Market will do that, will look at the higher interest rate.

Maybe again, if those two premises, especially if we believe that issuers of all sizes should have access to the markets then maybe we as an industry with the resources that we have should try to help those that don't have.

**Elisse Walter:** Is there empirical evidence out there that the market does punish people for failure to have timely and complete information? You mentioned higher interest rate. I mean is there something we can point to to show that in a scientific sort of way? Are you aware of studies that have been done?

**Joseph Deane:** I don't think it's a scientific sort of thing. You know it really is the discipline that the market puts on you. If you're a lower rated credit -- just human nature -- I mean we're going to be much more on top of you. Most of the broker/dealers you know, Alan's company, before they're going to put their capital up they're going to want to know what your numbers are.

Obviously even if you're a somewhat lower rated credit, if you're a somewhat prolific issuer you have an enormous incentive to keep up, let us know what your numbers are. Where the rubber kind of meets the road a little bit is the somewhat lower rated credit, smaller guy -- Sean like you we're talking about where they're not going to be issuing debt very frequently. If they're having budget problems, they're cutting back time you know, do they have a strong incentive to -- if they're not coming back to market for a long time, to give you the timely information?

**Sean McCarthy:** And some of the things if you think about you know sort of relatively straight forward issues that can be standardized. Well let's focus on the ratings. Joe just referred to the ratings for example. If there was a guarantee that if you had a rating that it was update once a year or once every other year -- part of the contract of having a rating is that the information underlying the rating is really that's what it is. It's an assessment of the credit worthiness of the municipality. If people knew that that was being done that would be helpful.

I think part of the reason why the credit enhancement world developed to the extent that it did, was because they do that. They you know for example at our company we have 80 people that all they do is look at the underlying credits for transactions that we've already guaranteed to make sure we get the timely information. If we don't we call up the Treasurer and say, "Hey, we need to get this piece of information from you, we're doing a review."

We go all the way down to the small school district to do that. That information is how we make our credit assessment. Why? Because we're putting our capital at risk. So two things that you can see that would help the market; one is databases where the requirement for providing your financial information for municipalities would easily be put in place and standardized. The MSRB could play a critical role in that.

The other is the rating agencies in terms of what their covenant is by having a rating outstanding on a triple-B small municipality in Texas. By giving the rating initially are they promising that they're going to update it once a year or just when the person comes to market?

As Joe said, it's self-selecting. If you are the state of New York or the state of California; a big issuer, you are going to keep your financials up to date. You're coming to the market all the time and people are going to understand that. It's the smaller issuers that have this difficulty because there aren't guidelines for what would happen.

**Amy Starr:** Bill, I saw that you wanted to say something but I've got a related question.

**William Collins:** This is near and dear to my heart. I mean my department is a special case within our institution. We perform annual reviews every year of every name we lend to in the bank. Compared to the corporate side they have a certain amount of time that they have to complete an annual review after the end of the fiscal year.

Well public finance is a special case because governments can't get their financial statements out in that period of time. So we have a longer period to do an annual review and it's still problematic. We have compliance systems and these are databases. Once we execute an agreement with a borrower we input all that covenant information and all those reporting requirements into our compliance database and the regulators, our regulators are all over us about keeping the compliance database up to date and make sure we're checking it and make sure we're getting that information.

So this is a clear problem for us. In my 23 years I have determined the better the issuer the better the information; the weaker the issuer the more likely you're not going to get information.

**Amy Starr:** I have a related question.

**Joseph Deane:** I do too.

**Amy Starr:** You mentioned that Basel III is going to require you and require banks to look at the underlying credit. Do you have a sense on how that may affect the role of banks as liquidity providers in the muni market particularly relating to entities that may not be providing the information?

**William Collins:** I should go back on your statement. We have always looked at the underlying credit in public finance. The monoline insurance business when it was at its peak it penetrated so much of the market place we couldn't avoid it at that point. We would always look to the underlying government or enterprise when we were evaluating the credit simply because of the numbers involved.

But will it affect -- it will affect our price and it will affect our credit charge. Credit charges are getting very -- let's say immediate and very exacting. Under Basel II we are taking the advanced internal ratings based approach. Meaning our institution is evaluating the risk of the business and the individual credits within that business and we apply capital based on that risk.

The new Basel accords will probably add a liquidity charge to that as well. So there will be two risks to look at. But getting timely information and the accuracy of that information is very helpful for us in pricing facility and applying capital against that.

**Joseph Deane:** The question I had really is for Bill and Sean. When you guys go out and you give a guarantee on debt, within the agreement that you have with the local municipality, I mean is there anything in the documents that state that they have to give you timely -- but I mean like a real hard and fast rule?

**Sean McCarthy:** Yes.

**Joseph Deane:** Or is it sort of like well you know --

**Sean McCarthy:** We ask for a particular -- it depends on who the creditor is. We always require timely reporting of the financial position. So that's one of the things and more importantly having a requirement is one thing. Making sure you follow up to get the information is the other and that's why it's labor intensive.

**Elisse Walter:** Do you have trouble getting that covenant? Do you ever?

**Sean McCarthy:** Generally when people are issuing into the market they're willing to say that they're going to give you the information. First for you to actually do the credit assessment, put the guarantee in place on the initial transaction. You've done a full vetting of the particular credit itself so you've gotten the information current at the time you do it.

The question is making sure you get it on an ongoing basis. That's why one of the things I said earlier was you know sort of the role as the super bondholder -- when we're on top of the entire risk as sort of an umbrella if there are covenant violations which Bill eluded to, we spend a lot of time listing municipalities, particularly in this environment making sure that you know they're meeting their covenants or if they're not looking into why and helping them try to address how the credit should be strengthened.

So there are, number one, surprises and number two, how we can make changes to the transaction in order to make the issuer secure. All that under the umbrella -- what I mean by the umbrella is that if they make a mistake and they make a default, if they run out of money, we just pay that and then go back and mitigate the loss later. It's different than any other kind of insurance in that you pay first and then you go figure out how to get your money back. It's very different. It's timely payment. That's the critical lynch pin behind the process.

**William Collins:** Everything is stipulated and when we close an agreement we have formal reporting requirements right down to the number of days after the end of the fiscal year or after the end of the quarter. Any covenants that we have built in, we have reporting requirements for those covenants.

Sean is exactly right. A lot of the problems that we fix you don't see. If they trip a covenant we'll go in, we'll work with that borrower. We may grant them a waiver. We may reset the covenant. But we will fix the underlying problems generally. So that investors, they just see that they're getting the principal in interest or if a money market fund tenders they'll get their money. A lot of the work we do is behind the scenes.

**Elisse Walter:** A slightly different question. Has there been a trend line in the market place about the extent to which you or others are willing to rely in whole or in part on ratings as opposed to your own research?

**Sean McCarthy:** We absolutely do our own credit and Joe said the same thing before, it's a, I wouldn't say vicious cycle but we make our own credit assessments. We are rated ourselves and the point that I was making before is that we really want to make sure that whatever the rules are for ratings that they're very transparent and consistently applied.

It is a fact though that if ratings migration for example -- several of the ratings agencies upgraded a tremendous number of municipalities over the last year and a half which wasn't consistent with what's happening economically. So it's confusing so there was sort of a wholesale upgrade and now there's kind of a retail downgrade one credit at a time.

So, there in fact a very big influence in the industry. I think the important part is try to get people to look to what the underlying analysis is. So for example with the NAIC they've taken references to rating requirements out of their standards and come up with another standard for which they are making investment guidelines consistent that have more to do with the actually fiscal health of the security versus an absolute you know category.

**Elisse Walter:** Let me focus you on one aspect of my question which is, is there a difference today from in the past about the extent to which people rely on or value ratings?

**William Collins:** Let me add to that. From a bank perspective under Basel II if you're taking this internal ratings based approach banks do not rely on rating agencies in terms of determining capital. We made a significant investment in developing a system with criteria for all sectors and I was involved in that as well. To enable us to go through and rate an individual credit ourselves.

At the end of that criteria you can input the ratings as the rating agencies have them and then you can look and you can reconcile. You have a chance to actually go through and offer an explanation of why you might rate better or you might rate worse than the rating agency.

The bottom line is we don't need rating agency ratings anymore to determine the credit quality of a borrower

**Thomas Doe:** But unfortunately the individual investor does and so if you look at that there are -- I look at the industry and there are really five key players. There are three rating agencies. There are two evaluation services. Those provide simple information for the individual investor which what, represents 75 percent either through the institutional proxy or individual bond holding, 65 percent -- by providing really the capital for issuers to get to the market.

So the reliance on essentially five institutions for providing information that's digestible because it's simple. A number appears on my statement each day. I look at some letters that tell me very simply whether this is safe or not safe and I've deferred that responsibility to these entities. And so the degree in which there's confidence lost either in the evaluation or in the credit rating so that starts to undermine the functioning of the market which comes back to liquidity price discovery. And then as you were saying about we'll what's the bid for a bond that doesn't have adequate financial information?

**Sean McCarthy:** And the ratings are -- when ratings were migrated up the credits didn't change overnight but the prices did on the bonds which indicates how important they were in that particular role. Right or wrong -- Joe makes his -- Joe what do you think? You make your own credit determinations.

**Joseph Deane:** Yeah we do. Sean brings up a good point. When they went to this global rating system I can think of one very large state in the western half of the United States that got significantly upgraded then was instantly put on credit watch with negative implications. [laughs] What does that tell you?

You know at the end of the day it's our research team against theirs. I'll take our research team every time, that's why we have them. But I think for the individual investor -- Tom brings up a good point. You don't have these people. You can have them. You can buy my fund and they will take care of it but aside from that if you're doing individual bonds right now I don't think it's ever been more important to have some research capability.

The other thing that you don't have right now which has been a really part and parcel with our industry for many man years. The normal yield curve in the United States is relatively flat from 30 days to 30 weeks to 30 months to 30 years its usually 100, 150 basis points.

Right now the yield curve of the United States looks like the Eiger Sanction because you've got basically you've got the Federal Reserve Board keeping short term rates at zero and longer rates are determined by the market place, supply, demand, economic factors and it's incredibly steep. So you know, going back to Sean's point before, for many, many years you could just go buy a AAA and AAA insured bond. You could buy it in almost any maturity. You could come in the curve and not take too much risk; you weren't giving up much income strain.

Where today you have really two fundamental decisions that you have to make if you're going to buy a bond, you have to make a credit decision and number two you have to make a curve decision, how far out you want to go, how much risk you want to take. And those were decisions that probably up until 2008 were almost moot points. It's a huge change in the industry.

**Elisse Walter:** Well, thank you. I think I'll let Allen have the last word and it's time for us to wrap up.

**Alan Greco:** Thank you. Research is very important where I am at my firm two parts. First of all working on the institutional trading desk, you don't want to have a situation where you buy a block of bonds and you do not have all the information. You need quality research, you know, you have to have a research staff or person that is ahead of the curve where they can make a judgment if this is a good credit or a bad credit. That's one aspect. The second aspect is how at my firm we are more proactive with the retail side in regards to research. If our research staff feels that there is something negative going to happen or there's negative news or you work it proactively. You contact your retail people and say, "This is what we think about this credit." And going forward you make a determination if you want to buy or sell. So it's kind of two fold in my firm.

**Elisse Walter:** Thank you all so much, this has been extraordinarily helpful. We're going to take a five minute break and come back for our Investor Impact Panel.

**[break]**

## Transcript: Field Hearing On The State Of The Municipal Securities Market: Morning Session Panel II

**Elisse Walter:** I think we are ready to get started, Martha.

**Martha Haines:** Thank you. Panel two of today's field hearing will focus on investor impact in the municipal securities market. The investor base for municipal securities, particularly the tax exempt municipal securities is both institutional and individual. But individuals are estimated to hold about 68 percent of municipal bonds, either directly or through mutual funds or closed end funds and money market funds. Traditionally individual investors in municipal securities have tended more to be buy and hold investors, although today there is significant secondary market trading by individuals as well as by institutional investors.

Today's panel is composed of three individual investors, Hal Whittman, Helen Kirkpatrick and Don Niewiaroski, who will share their personal experiences as investors in munis and their thoughts about the information that they find important in making investment decisions and any recommendations that they might have for changes.

And we're also pleased to have with us Jim Lebenthal, who's the co founder of Lebenthal and Company, a broker dealer who has long been a participant in the market. And I will ask Jim to discuss his views regarding the adequacy of both primary and secondary market disclosure in today's marketplace for municipal securities. And to reflect on how that has changed over the years and how that might be further improved. We're going to start with approximately five minute presentations by each of our panelists. And I wanted to tell you when we come to questions, if you put your -- if you want an answer or get attention just put your tent like this or raise your hand if you want to. But that's often the easiest way to let them know if you're willing to answer. Mr. Whittman, would you like to start?

**Harold Whittman:** I'd be happy to [inaudible].

**Martha Haines:** You need to push --

**Elisse Walter:** Dr. Whittman just push the button on your mike, down at the bottom in the front. There you go.

**Harold Whittman:** Hal Whittman is my name and I'm a member of the American Association of Individual Investors. I'm probably here as an investor advocate. And I'm very pleased to be here and feel honored to have been invited to participate in the forum for you. Financial security finds itself in the top echelon of priorities in the eye of the investor. In the effort to maintain a current standard of living commensurate with the wants and desires and needs, there is a constant concern to develop a means of a constant stream of income in the years of retirement or in the event of a financial crisis. These factors are the motivation for saving and investing discipline. Among the myriad of investment vehicles, municipal bonds have become one of the attractive choices. For many years they were considered dull investments that produced little other than current income.

There are long or short-term debt security in the investments that add an element of stability in the asset allocation structure of portfolios and are often called fixed income investments. They provide current income and the opportunity for capital gains, have a low correlation to stocks, can be purchased in primary or secondary markets and many have exceptional tax advantages. Municipal bonds which have tax exempt status are not indicated in tax deferred plans or savings programs. They're subject to five major risks.

All investments have risks, interest rate risks, purchasing power risks, business risks, liquidity risks and call risks. They have demonstrated in the past a very low default rate of less than .01 percent. There are many variations of municipal bonds available including insured entities. They're subject to complex legal regulations that serve to protect the public and are rated for levels of risk by rating agencies that include Standard and Poor's, Moodys and Fitch's. They evaluate the financial soundness of issuers, their ability to repay date and constantly update the information and profiles of all the bond issuers on a periodic basis. When purchasing bonds, it is important for investors to become educated on the various advantages and disadvantages of the different bond entities prior to inserting them into their investment portfolios to see if they meet the strategies and goals that they had previously predetermined. Thank you.

**Martha Haines:** Sorry, Ms. Kirkpatrick, would you like to go next?

**Helen Kirkpatrick:** Yes. Good morning and thank you madam for inviting me and my colleagues here. My name is Helen Kirkpatrick. I currently serve on the Board of Directors of the Washington chapter of the American Association of Individual Investors, an organization serving 150 thousand members across the country. My remarks, however are my own and do not represent the position of the Association.

Since we are here today to discuss bonds as an investment vehicle, I will begin by pointing out that the most recent national survey of AAI members reveals that their bonds and bond allocations are at 21.8 percent, in other words the survey indicates that members are devoting almost 22 percent of their investments to bonds. This is the 10<sup>th</sup> time in 11 months that fixed income allocations have exceeded 20 percent. The historic average is 15 percent. So that more or less tells you that because of the situation in the economy and interest rates and so on, people are really looking for better income opportunities.

Many bond investors appear to be most interested in muni bonds for retirement income. Many rely on high quality, broadly diversified municipal funds, funds that receive high ratings from Morningstar in particular. This is because most investors and that includes me also, have difficulty judging the safety of individual bonds, never more so than now when bond insurers are leaving the market, forcing investors to attempt to determine the credit quality of the municipalities issuing bonds. Compounding the problem, it is my understanding that the three biggest ratings firms, that is Moody's, Fitch and Standard and Poor's recently aligned their rating scales for municipals with that of other types of bonds for simplicity's sake. The next effect of this change was to upgrade many municipals according to a recent article in The Washington Post. Subsequently the percentage of municipal bonds rated AA or better at Fitch, rose from 52 percent to 82 percent, obviously such great inflation dilutes the value of ratings. The problem of finding high quality municipals is further hindered because many states and local governments are deep in debt and collecting less revenue due to current economic downturns. Therefore bond investors face the challenge of cash-strapped state governments trying to issue bonds and at the same time issuing Build America Bonds, a federal government issue. This leaves the average bond investor seeing stars, not safety. I personally would like to see an uncomplicated rating system and what I call, the parental approach to promoters of all investing vehicles. That is clear regulations that spell out exactly simple rules or directives with the caveat that any change or attempt to skirt the rules is strictly forbidden. For film buffs, I'd like to close this statement by saying that I recommend the movie, "Inside Job" currently playing in theaters around the country. And for lovers of books on finance, I recommended Michael Lewis' "The Big Short" which chronicles the history and players in our subprime crisis. Thank you.

**Martha Haines:** Thank you very much. Mr. Niewiaroski.

**Don Niewiaroski:** Hi, good morning everybody. Thank you to the Commission for inviting us. I come to you via Denver, although I live in Silver Spring, Maryland. I'll let you wonder about that. I'm a very small investor, not a member of any AAIA or any other LSMFT. So I come to

you municipal bonds late in my life starting with September, 2008 when my financial advisor, whom I've known since 1983 and I decided that the market had tanked, so we got out, wholesale. And since then I've been going into municipal bonds. The other factor affecting my investments is my age.

I retired eight years ago from the U.S. Treasury Department which I do not miss although I enjoyed my 33 years there. I rely on my financial advisor heavily and I've known him since 1983. So the language in many municipal bond offerings doesn't usually reach my eyesight because I rely on him wholesale. Once in a while we'll get into details. There even sometimes he'll even send me a prospectus. So the one thing that I could add to this panel's recommendations is the language in these documents is very turgid and goes on and on, and it just brings my eyelids to close. So whatever could be done about that would be very, very helpful to the individual investor. And with that, I'll close and I'm available for questions.

**Martha Haines:** Thank you, Mr. Lebenthal.

**James Lebenthal:** Thank you. I am truly happy for this opportunity to share with my fellow panelist, typical Lebenthal clients and with the SEC, my feelings about the use of information and education and full disclosure as a sales tool and probably as the best investor protection there is. Now I joined the municipal bond business late in life at the age of 35 after a career as a journalist and a TV producer and all those wonderful, glamorous jobs because there was a family business in the bonds -- municipal bonds waiting for me. And I thought I was the one who discovered the municipal bond information gap and got up on radio and TV and did commercials trying to close it. And even explained yield to maturity, the yield curve, prior lean, spreads, in 30 and 60 second radio and TV commercials. And to put the details of this, what I call the most un-understood investment in America within the reach and comprehension of the average individual investor. And I must say that doing so put my firm really on the map and made municipal bonds a household word in New York City.

In this day and age of so many unknowables, the economy, the ever growing complexity of municipal bond structures and with the predominance of the individual investor in municipal bonds now being the mainstay of the market. And my number that I get from adding up all the direct ownership and mutual fund and other instruments, I get an even larger than 68 percent number, it's 71 percent with about 36 percent mutual funds and the other 35 percent, direct ownership of the bonds. I'm going to be very positive in what I think the SEC should do and what I think individual investors can do to protect themselves in this day and age of the Internet. What a fantastic instrument it is to an 82 year-old-man, who used to have to look everything up in obscure text books. Today with the MSRB real time price data right there at your finger tips, with official statements and I'm not here to disparage official statements. They are a treasure trove if you've got to know and if you want to know of the "whys" and the "why nots" of investing in that particular municipal bond with official statements also available through EMMA. And I will say that there are a couple of layers that you have to go through just as you do as you have to buy a pair of shoe laces on the Internet, you do have to sign off on an agreement. And I must read one of those one day. I do read official statements because I have a need to know and they are the source of my information to clients.

But I find that the temptation to follow a disclosure statement, a negative disclosure statement in an official statement, to follow it with, "Yes, but," is terribly misleading to self and to the investor. And I hope I'm not in violation when I skip from page five of a summary to probably page 282 in Appendix B page one to find an explanation somehow buried for the clash that exists today between the Constitution of a state and the laws of practicality in providing the needs that people need to demand of government. And today those constitutionally derived, general obligation bonds are but 36 percent of new issues coming to market. And so you have these appropriation bonds which are an inviolate obligation of the rental to be paid or the fee to be paid, subject to appropriation, and the bonds not being a debt of the state. No way, no how, the

state liable for payment thereon, these conflicts cannot be resolved in plain English or brevity and I respect that.

So I am a fan of what you're saying Helen, and I would like to get the Constitutions of the 50 states amended so that the GO can now -- or the powers of asset backed bonds and appropriation bonds which so far have not defaulted. Correction, in the very beginning there was a default of the New York State Dormitory Authority that led to the New York City crisis and which resulted in the New York City crisis being resolved. Dr. Faustus would have loved to have known where interest rates are going. Are the cities and states for whom the full impact of the recession has not hit, because that's where the jobs and the factories and the people and the taxpayers and the revenue are. And it hasn't hit yet because the last tire that hits the road are the communities. Are they going to live up to that one-half of one percent permanent loss statistic in the Depression that we all traffic in.

When I say we all, I am talking about all of those who have read George Hempel's book on the post war quality of state and local debt. Only there's another number in there and I don't hesitate to mention it, 15 percent of the debt that was outstanding during the Depression was tainted by some of its interest or principal being late. I -- can I say that is going to happen again? No, but I must when I talk to somebody about a municipal bond acknowledge the past history and the truth about defaults. You cannot have the sun shine in every community of America without the rain occasionally falling. And how much it will, I don't know. But those are the questions that investors want to know that I can't answer other than past. And I won't even say it is or isn't prologue.

**Elisse Walter:** What about information about the particular issue that you want to either, the types of issues that you want to buy or if you have a particular bond that you want to sell, do you feel that you have access and I open the floor to all of you, do you feel that you have access to the information that you need to make that decision in an informed way?

**Harold Wittman:** Part of the problem that's involved here is credibility. All of us that are involved in the purchase of bonds or any type of equity or investment article has to depend upon the credibility of the source of the information. And many times transparency of this information is a little confusing and clouded. As an example, ratings that are used by Fitch and all the rest of the rating agencies, you can get split ratings, Moody's and Poor's will say one thing, Moody's will say another, therefore there is some conflict of interest as to whom is looking at what and what information is important. And it's difficult for the average investor to begin to trust the credibility of the sources of information, that's a major problem.

**Elisse Walter:** Do you want to get information directly from the town or the city, the municipality that's issued the securities? Do you look to that or what information do you look for when you're making that decision?

**Harold Wittman:** I'm looking at their history of how do you pay the debt that you've encouraged. It's a very important item to understand. But there are other variations that influence that affect ratings don't necessarily involve themselves in. Many of the ratings are paid for by issuers in their execution of rating them. And so there might be a little bit of biasness involved, not intentionally but because of the nature of the transaction that takes place.

**Elisse Walter:** To the extent Dr. that you want to know about the past history of payment, can you get that information? Do you know where to go to get it?

**Harold Wittman:** Well technically speaking, you always go to the government offices to find out the people that are involved in the accounting series to understand how their repayment of debt has occurred or has taken place. Now, I am not an accountant so I rely on other people to do that. But because of some much conflictatory [spelled phonetically] statements and some of

it immersed in language that is not understood by the average investor, it's difficult for us to understand what they're saying.

**Elisse Walter:** Thank you, anyone else?

**James Lebenthal:** I would like to offer the suggestion to investors that with the availability of official statements and if a municipality has defaulted and very few have in our lifetime other than the famous ones, my New York City, only we called it a moratorium, The Washington Public Power Supply System and you have several communities now and the availability of material events. The information is there, it is there. I was going to talk French. There was a movie called, "Nous Sommes Tous des Assassins", meaning we're all assassins. We are all at fault in not availing ourselves of the information that is there. And if you are offered a bond and there is not an official statement within what you call a reasonable period of time and I would say within the last year or even if it's within the last two years because some of these bonds don't come to market more than once or twice in a decade. If you don't find the information available, you can say thank you very much, not interested because there are thousands of alternatives of comparable coupon maturity and quality. You can and I think we investors and I'm going to treat myself as a principal in a firm, as an investor, because we are committing our money to that bond. I think we brokers who probably never have cracked an official statement, I think nous sommes tous des at fault.

**Elisse Walter:** What about in the secondary market with respect to bonds that are already outstanding?

**James Lebenthal:** I'm talking about the secondary market. And it is so that if it's Broken Bone, Nevada and I make up names, Horse Cough, Arizona, you're probably not going to find an official or current official statement. Your broker must in analyzing you and in knowing the customer, know better than to show you a bond that you have no way of knowing about and he or she may not be up on either. There is some much selectivity out there, my point is that with the Internet all of this information, plus the offering itself from outfits like, The Muni Center, which has billions of live offerings every day from brokers all over the country that information is available and if it isn't eschew the bond. I've never used the word but it's quite appropriate.

**Elisse Walter:** Robert.

**Robert Cook:** I was just wondering if in your view it would follow from that, that it would useful for investors to have disclosures about those bonds where that information isn't available. So in other words, you don't have to go through the task of figuring out that they're delinquent filler or that they or whatever it is but that there'd be some flag on the bond that would alert you to the lack of either full information or timely information.

**James Lebenthal:** I think that is a fresh, at least for me and a wonderful idea and it may be already one of the, I don't know, is it one of the 11 material events, the unavailability of current information. It ought to be.

**Helen Kirkpatrick:** I would just like to add, [laughs] because I've been in the bond market since 1985 and it's gotten more and more complicated. When you go into a store to buy a steak, you see it's USDA inspected. Why can't the SEC simply either give its okay to bond issues or say no? I mean, it becomes so complicated for the customer. It's bad enough when you want to get an airline ticket today; you have to go on the Internet for everything. But why and I'm agreeing with Jim, I'm not disagreeing that his point is, that it takes a lot of research and you can find it eventually. But come on folks, [laughs] I find it offensive that these bond merchants and some are able to make it so complicated that the average person just gives up. I've ended up myself as a result of all this, of fortunately I have found a very reliable bond

person whom I trust and rely on. But the average person has a lot of trouble trying to figure out what, what on earth am I trying to buy here? It looks like a pile of spaghetti.

**Harold Wittman:** I might add to this the average [unintelligible] they tell me is written for the eighth grade level reader. If it were not for that purpose they could never sell the newspaper, outside of editorials that give you more sophisticated opinions and information. I've always wondered why so many documents and so many sources of interest come out with language that's impossible for the average person to understand.

**Helen Kirkpatrick:** Right.

**Harold Wittman:** That is all the time constantly. There is another small issue involved too. And no offense to anybody or to violate anybody's sensitivities but most brokers are merely marketers. And they are not qualified enough really to tell the client exactly what he's doing. I would take issue; in fact I was in a panel with the SEC several years ago dealing with the fact that brokers should have RIAs [spelled phonetically] for example, Registered Investment Advisors, with some background and knowledge of what they're dealing with. Not just spilling out what their particular company wants them to spill out. They should also identify the client that they're dealing with, is he the type of person that needs this type of product. Most of these issues are never addressed.

**Elisse Walter:** But when you deal with which ever advisor you use to buy these products, do you have a robust conversation about what they've identified for you and what factors are important?

**Harold Wittman:** Are that directing to me? Absolutely as a matter of fact, I probably offend several brokers because if you've become too much of an educated consumer, they are not interested.

**Elisse Walter:** What types of things do you want to know about?

**Harold Wittman:** I want to know the liquidity of the bond; I want to know about the issuer, the bond is political arena and its stance. I want to understand what their debt repayment history is and has been. I want to know how long that bond has been out there. I want to know how often it has been re rated by the Moody -- by the ratings services that are out there. They're very critical. Factors like that are ignored by most people. A bond as we all know here, is supposed to be -- the profile of that bond is re rated periodically at certain times to see if the debtor is still able to perform as he should.

**Elisse Walter:** Rest of you, do you agree with that? Leberthal?

**Helen Kirkpatrick:** Oh me?

**Elisse Walter:** Yes, do you agree?

**Helen Kirkpatrick:** Oh yes, no, but I absolutely agree. You know the day of razzle dazzle should be promptly ended, and I would make it as simple and make the rules as simple as possible.

**Elisse Walter:** I guess one of the things that perhaps we should, we should explain is that under current law the SEC does not set disclosure requirements for municipal bonds. Those are set at a local level. And one of the things that we are exploring here, at least we do have some control through the broker dealers who sell the bonds but we do not control the disclosure requirements, either in the initial offering or the disclosure that comes out of the offering. And

one of the things I would ask you is whether you would favor more uniform standards that would cut across places all across the country?

**James Lebenthal:** I'm at risk of being, no I wouldn't be disbarred from my industry, I would be patted on the back. My answer is a qualified, yes. I think the Tower Amendment which has separated the federal government from regulating the state's in this capacity has served its purpose and the time has come now that you have a half trillion or \$440 billion so far this year of municipal bonds to market. I think we have a national market and a national need for uniformity and that the issuers themselves should comply with a law of practicality and be required to meet basic standards for disclosure.

**Elisse Walter:** Sounds good to me.

**Lori Schock:** When you've purchased your municipal bonds, do you purchase them with intent of holding them to maturity? Or do you trade them in the secondary market? Can you just tell me a little bit about your experience with that?

**Harold Wittman:** Well speaking for myself, most of the times when I buy municipal bonds, I buy, I ladder them. I ladder them based on the call feature. I do not ladder them on their maturities because I think the call factor is more important than the maturity value. And as a result that helps to reduce the risk of avoiding interest rates and the other risks that are involved in the bonds. It makes good sense to me to do that sort of thing, so I do. And also I diversify, I think it's important to diversify between revenue bonds and general obligation bonds to have the correct mix whenever possible to enhance the stability of your asset allocation.

**Elisse Walter:** Do you, Dr. Whitman, sell them after you buy them? Or do you buy them with the intent to hold them until they're called or mature? And does that change?

**Harold Wittman:** As a general rule, I buy them for the long term to hold them subject to call features that are involved. But because I use a laddering system of the call feature, I still protect myself. I am forced to sell the bond if they're called, if not I just stay with it. I think cyclically interest rates go up and down like a sign curve. And if you can stand out there long enough eventually, hopefully it just averages out.

**Helen Kirkpatrick:** The bond purchases that I made myself have all been subject to calls. So I didn't have any control over that. I didn't necessarily lose any money but I lost the bond which I was happy with. That's what you face with the call feature of course. And I've been lucky to find a bond man who I have a great deal of confidence in which was not the case for a long time. So he has followed the practice of laddering and everything that implies with a great deal of safety, as much as one can and very conservative. So --

**Harold Wittman:** I may add something else, I usually don't use many mutual funds or bond funds themselves, though the advantage to a bond fund is its reinvestment capability to repurchase bonds free and to do that [unintelligible] involved if one is so involved. One of the issues that I do have and it seems to be an important one is that a lot of the people dealing with bonds and selling them are not really qualified to do it. They really are not; they are not informed well enough. They are not trained well enough and I understand that many of the brokerage firms would prefer not to go to the expense of training people, having registered investment advisors, people who take the effort to deal with the individual's concern. And that can become a major issue. You're dealing with most brokers, no offense meant or sensitivities be involved, they're marketers.

**Female speaker:** Right.

**Harold Wittman:** All they do is sell the product of a particular brokerage house. And municipal bonds are never, seldom told to an investor unless the investor asks because the spread on municipal bonds is very small. It doesn't, it does not equate to what an equity pays in commissions. So one has to go out of their way to tell the broker to investigate the municipal bond and if you do in most cases, they are not prepared to answer you.

**Elisse Walter:** Do you have preferences in terms of the types of municipal bonds that you hold, whether they're general obligation bonds or revenue bonds where repayment comes from particular revenue stream? And if you do, why?

**Helen Kirkpatrick:** Well I've always favored general revenue bonds given that the state has the ability to tax and raise money. The problem that we run into right now is the current economy when the states themselves are in debt so they don't feel very comfortable about trying to raise money. So you do run into that problem with general obligation bonds. Revenue bonds, my experience, I've had good experience and very bad experience. So you know --

**Lori Schock:** Can you share with us the bad experience?

**Helen Kirkpatrick:** Pardon?

**Lori Schock:** Will you share with us what the bad experience was?

**Helen Kirkpatrick:** Oh, with revenue bonds, yes, depending on other than the state to be backing the bond and --

**Lori Schock:** Did it default or where they late on payments? What was your experience with that?

**Helen Kirkpatrick:** Beginning with late on payments and then finally default, yes.

**James Lebenthal:** Could I return to the question that you asked Harold?

**Harold Wittman:** Yeah.

**James Lebenthal:** No, I'm going to ask, I'm going to answer Commissioner Walter's question. What do you look for, what do you want to know when you buy a bond. And you might not be able to rattle all of those off but I'll tell you what I want to know when I hold one of those 300 page official statements in my hand. And it makes searching for that information all the more fun. Simple thing, what's the money for? If it's for deficit financing, I walk away because why should I dilute the ability of the issuer to pay on its good bonds. I look for the source of repayment. Where's the money coming from to pay my interest and principal? I look for how many times does that source of revenue that it is committed to paying the bonds, how many times does it cover debt service? I look for something that previous panelists called willingness to pay, I strengthen it, I call it the sincerity of commitment to pay, which is more words to say willingness to pay. Meaning where does the bondholder stand in line for getting paid, first, second, third, last? Who is the ultimate obligor? Is it the state or is it an agency of the state? And what is the obligation of the state to that agency? That's good stuff and if you read a couple of hundred official statements, you'll know exactly where to find it.

I look for entrapment of revenues in the event that there is a shortfall in the revenue stream. What provision and there is bond out there and I please everybody forgive me if I'm in my selling mode, I say this with all humility and admiration for the wit of man to discover what we have in New York State called the Personal Income Tax Bonds. Which are not GOs in which the personal income tax had to be appropriated annual every year by the legislature. And who knows in a Tea Party environment what legislatures may or may not one day do. But the

entrapment provisions on this personal income tax which is a source of revenue bonds are such that those revenues, those personal income taxes cannot be used for any other purposes if they aren't used first to pay debt service. And those bonds are rated higher than the state's GOs. I look for obviously how is the community, the state doing financially? And that's only about that much and I'm not talking about lines, I'm talking about thickness, it's there.

And you look for one shots, now we at the state level are obliged to balance our books. We can't do what the federal government can do. And do the states and the communities we're looking at, how do they -- is it with one shots do they sell the convention hall? Do they sell the turnpike; get rid of it in order to use the money for one purpose or another? Those are the juicy tidbits that can make reading the official statement meaningful and wouldn't you know that after that you might then say I think I'll buy the bond or no thanks, it's not for me.

**Elisse Walter:** Thank you. State and local governments generally issue their annual financial statements six to 12 months, sometimes longer, after the end of the year to which they apply. Do you have an opinion as to whether the value of that information has diminished by the time it's issued? Should they be forced to produce it more frequently? How do you evaluate information that much after the fact?

**James Lebenthal:** Commissioner, you asked me that question.

**Elisse Walter:** All, any --

**James Lebenthal:** I'm going to let my fellows answer first and then I'll do my thing.

**Harold Wittman:** Well basically most investors probably revalue [unintelligible] on a basis of every three months and their GP accuracy of the events that are occurring. I wanted to add a special thing about ratings if I may.

**Elisse Walter:** Okay.

**Harold Wittman:** Okay. I'm using some information quoted by Bob Pugh from Insight, he owns his own company. He did some work for Prince William County in Virginia and the conclusion that the facts that the ratings by the bonds were not accurate at all because they didn't do enough due diligence in an effort to find out what was really happening. And his conclusions as an example were, "continuity of management from a senior management staff that has a track record of many years of mismanagement and failure to prevent bid rigging and other scandals is not in the interest of municipal bond investors."

Now statements like that are pretty sad. I'm not saying that they occur all over the country, I don't even say that they occur very often. But it's an example that sometimes maybe a little bit of oversight on ratings agencies would be in order. I realize that they are involved in a best effort to do what they can, but as long as they are being paid by issuers, there's a possibility that some information may be a little askance.

**Elisse Walter:** Other comments about that or about the time limits of financial information?

**James Lebenthal:** It is wonderfully gratifying when you read an official statement of a New York State, the New York State as an issuer or it's agencies because and especially with New York City, the crisis put New York City under the gun back in 1975 and ever since there is a four year, forward looking financial statement or financial plan that is re evaluated every three months, every quarter. And so you do get fresh information from certain official statements that have that obligation to have a financial plan and re-analyze it every quarter and make adjustments to that plan projecting deficits and hardships out into the future.

It's gratifying because you just read that story, maybe only a month ago in The New York Times or what have you and hear it is in an official statement. That's a wonderful feeling when you get the currency of the situation in an official statement. There is again a way that the investor can protect herself or his self and that is by sticking to new issues where you do get reasonably fresh information that may even have been covered one way or the other in the newspapers and that has the ring of familiarity when you see it in an OS. And then you do have the satisfaction of knowing that you're getting it at the original issue price.

**Harold Wittman:** May I add to that?

**Elisse Walter:** Certainly.

**Harold Wittman:** Okay. If I may, that's an excellent idea. The problem is that the fresh issue has to be re-evaluated on a quarterly basis to see if it's maintained its credibility.

**James Lebenthal:** I, you know, I'm feeling defensive.

**Harold Wittman:** Don't feel defensive, please. No, no.

**James Lebenthal:** -- to that --

**Harold Wittman:** All I'm saying is that the rating systems usually renew the profiles of various issuers on a periodic basis. And what we're discussing here is the probability, should it be re-evaluated more frequently or less frequently or are the municipalities or the issuer of the bond, should be required to forward new information where their current debt capability repayment schedule quarterly or more or less often.

**James Lebenthal:** I think it would be over sweeping of me to say that again, that you can deal or you can invest only in those issues which are large enough and frequent enough that the information, to the extent that it is updatable is available. I think if you're at -- if you were a seller of municipal bonds in my industry, I would give you one piece of advice to the new salesman. And that is, if it's knowable, make sure the customer knows it.

**Helen Kirkpatrick:** Knows it.

**James Lebenthal:** And if it isn't knowable, don't pretend and that's the hardest part.

**Lori Schock:** All right, Donald you've had a long standing relationship with your investment advisor. Can you tell me how you feel about the price mark up you probably pay with your transactions for the transparency? Do you know how much you're paying to buy these municipal bonds?

**Don Niewiaroski:** Absolutely not, I have no idea. But because I trust this guy since 1983, why should I care. I know that he has a financial relationship as a financial advisor with a reputable, large investment banking/bank. So I know that he's been vetted by them. Having said that, he and I do discuss in some detail options on different possibilities that he's offering or is not offering but willing to suggest to me. And we discuss that. He even sometimes at my request or his offer sends me information. So I put an awful lot of trust in his judgment. There's no way as I very small investor can understand fully the complexities of municipal issuers. All I can do is go on their record, whether or not it's going to be tax beneficial to me meaning I'm a resident of the State of Maryland, so I buy Maryland bonds. Fortunately Maryland has a AAA rating.

**Lori Schock:** Okay.

**Don Niewiaroski:** That's not true of all states or municipalities. Maryland has a very conservative system of government and even though there may not be a Republican living at all or voting at all in Maryland, as once someone said to me.

[laughter]

I do trust them and their track record is no defaults. Their track record is excellent. So it's the tax free aspect of a Maryland bond is very, very important to my wife and I because we're using this as a provider of additional income on which I have to pay no federal or state taxes. Not that I'm avoiding them but I mean the law allows it. I'm not running off to the Cayman Islands or Switzerland and hiding my bucks there. So the trust of this financial advisor is exceedingly important.

**Lori Schock:** Right.

**Don Niewiaroski:** And if there's one thing that I can leave with everybody, one thought, it is that trust is absolutely essential. Now let me make a comment which I draw from the previous panel. One of the speakers mentioned how difficult it is for small municipalities, states to issue municipal bonds because this is a very large undertaking of information. My question to the and I echo the question that was put forward by the previous panel, should there be any form of assistance provided to the infrequent and relatively small issuers of municipal bonds, be they state, local, what have you? I suspect that out there in municipal bond land there are some entities that face this problem and the question then is, should they be going to the municipal bond market or should they be going to another market to finance their whatever projects or their GOs, they're trying to do. That to me is an important question. If I were sitting in little old Cumberland, Maryland as the financial guru, what would I do? How would I get help? So that's my question. [laughs]

**Elisse Walter:** Thank you very much. Do any of you have anything else you would like to say in closing before we adjourn? I want to thank all of you so much for being with us today. This has been very useful to us and we are going to adjourn and reconvene at one o'clock for the self regulation panel. Thank you so much.

**Helen Kirkpatrick:** Thank you for inviting us.

[end of transcript]