NABL Weekly Wrap – June 10, 2011

IDEA OF THE WEEK

Congress Flirts with Default

An idea that has simply been unthinkable is seeping into the mainstream of the 112th Congress: that it might be acceptable for the United States to default on its debt. Since 1962, Congress has increased the debt limit 74 times. Congress has never refused to raise the debt limit, which has increased from $5.94 trillion in 2000 to the present level of $14.29.

Raising the debt limit has only become a partisan game in the last 15 years. During the Clinton administration, then House Speaker Newt Gingrich (R-GA) took the U.S.to the brink of default in 1996. Similar to today's standoff,in 1996 young Republican Members of the House sought spending concessions from a first-term President. The 1996 stand off ended with Gingrich agreeing to an increase in the debt ceiling in exchange for budget concessions. Democrats—including then Senator Obama—later resisted raising the debt limit during the Administration of President George W. Bush, when it was increased a total of five times in eight years. President Obama later said he regretted his vote.

The history of the debt limit has its roots in legal doctrine that will sound familiar to bond lawyers. Prior to WWI, Treasury had to obtain the permission of Congress each time it wanted to issue different types of debt instruments. In 1917 the Second Liberty Bond Act, P.L. 65-43, 40 Stat. 288, 31 U.S.C. § 3101 was passed to finance WWI which gave the Treasury Department the authority to issue bonds without obtaining congressional approval for each issue. But to maintain some degree of oversight, Congress limited the aggregate amount of debit outstanding. But this limit is unique, as no other developed country has a debt limit separate from its sovereign budget process.

Both Moody's and Standard & Poor's have issued warnings in recent weeks about the disturbing consequences for the U.S. failing to raise the debt limit (See below, Moody's Warns U.S. Debt Could be Downgraded). Federal Reserve Chairman Ben Bernanke has also stated that the dangers associated with default are real, and there is a near consensus among academic economists that failure to raise the limit would permanently damage the U.S. economy and reverberate around the world. However, in recent weeks, House Budget Chair Paul Ryan (R-WI) and Senate Budget Chair Jeff Sessions (R-AL) have both denied that failure to raise the limit,for a short time,would result in economic disaster. Presidential candidate Tim Pawlenty, the former Governor of Minnesota, has said the same.

What exactly would happen if the debt limit is not raised? First the federal government would have to decide whether to prioritize principal and interest payments on outstanding debt over funds for maintaining the basic programs and functions of the federal government. It is likely that payroll and payments to vendors and to social security recipients would be delayed. However, the results in terms of job losses from sudden cuts in public spending are very hard for economists to predict. Some in Congress are determined to find out.

LEGISLATIVE

A Bank to Re-Build America?
By Shontae Denise Gray, NABL Governmental Affairs Summer Associate
On Wednesday, June 8, 2011, The Atlantic sponsored a conference on the *Kerry-Hutchison Building and Upgrading Infrastructure for Long-Term Development Act* (Build Act) in the Senate Dirksen Building. The conference focused on what a National Infrastructure Bank would mean for America, how the bank would work, and why Senators John Kerry (D-MA) and Kay Bailey Hutchison (R-TX) believe an infrastructure bank would create jobs to help American business and labor.

The Build Act seeks to upgrade and expand U.S. roads, bridges, trains, and airports by facilitating investment in economically practical infrastructure projects through the creation of a National Infrastructure Bank. The bank would provide loans and loan guarantees for infrastructure projects through the American Infrastructure Financing Authority (AIFA). AIFA will be government-owned, but will operate independently under the leadership of a Board of Directors. In order to be eligible for loans or loan guarantees a project would have to be at least $100 million in size and have a clear public benefit while meeting economic, technical and environmental standards. Qualified projects include transportation infrastructure, water infrastructure, and energy infrastructure. Projects of regional and national significance, such as those eligible under this act, would require those seeking the loans to hire people to complete the ventures, creating numerous job opportunities for Americans.

During the conference, a five member panel spoke on what they believed to be the strengths and weaknesses of the Build Act, followed by a keynote address from Senator Kerry. Senator Kerry believes that, “infrastructure is the core of [American] economy,” however, he states that there are other significant non-economic consequences for allowing American infrastructure development to remain stagnant, including allowing America to lose its competitive advantage in infrastructure technology. Senator Kerry expressed his disappointment with the fact that technology, which at one time other nations would have had to acquire from the US, the US must now acquire from them. He feels that the Build Act is the first step in nearing a solution to this problem.

REGULATORY

IRS Names 10 New Members to the Advisory Committee on Tax Exempt and Government Entities
On June 7, 2011, the Internal Revenue Service released IR-2011-62, which announced the selection of ten new members to the Advisory Committee on Tax Exempt and Government Entities (ACT). The new member for Government Entities, Tax Exempt Bonds is Sue Painter, Chief Investment Office and System Director, Providence Health & Services. Continuing members in Tax Exempt Bonds are David Cholst, Chapman and Cutler LLP, and George Magnatta, Saul Ewing LLP, both of whom are NABL members. ACT members serve two year terms.

IR-2011-62 is available here. http://www.irs.gov/newsroom/article/0,,id=240130,00.html

NABL Submits Comments on Related Party Acquisitions of Build America Bonds
On June 6, 2011, the National Association of Bond Lawyers submitted comments on related party acquisitions of Build America Bonds to the Internal Revenue Service and the Department of the Treasury.

The comments were prepared by the Tax Law Committee under the leadership of Michela Daliana, Hawkins Delafield & Wood LLP.

The NABL comments are available on the NABL web site library under Comment Letters/Position Statements here.
http://www.nabl.org/uploads/cms/documents/NABLRelatedPartyAcquisitionsBABs.pdf

NABL Submits 2011-2012 Priority Guidance List
On June 1, 2011, the National Association of Bond Lawyers submitted recommendations for inclusion in the 2011-2012 Guidance Priority List in response to IRS Notice 2011-39.

The recommendations were compiled by a NABL task force headed by the Chair of the NABL Tax Law Committee Michela Daliana, Hawkins Delafield & Wood LLP. NABL has submitted suggestions to the IRS each year, in response to its request for public input in developing its internal list of priority topics.

The NABL 2011-2012 Priority Guidance List is available on the NABL web site library under Comment Letters/Position Statements here.
http://www.nabl.org/uploads/cms/documents/PriorityGuidance2011final.pdf

IRS Seeks Public Comments on Redesigned Form 990
On June 2, 2011, the Internal Revenue Service (IRS) released Announcement 2011-36, which invites public comments on transitional issues regarding the extensively redesigned Form 990, Return of Organization Exempt from Income Tax. The IRS continues to refine the form in response to questions and comments from the public. Comments are due in writing by August 1, 2011.

Announcement 2011-36 is available here. http://www.irs.gov/pub/irs-drop/a-11-36.pdf

OTHER NEWS FROM WASHINGTON

Moody's Warns U.S. Debt Could be Downgraded
On June 2, 2011, Moody's Investors Service issued an Announcement that the credit rating of the United States could be downgraded due to lingering uncertainty regarding Congress' intentions with regard to the looming deadline to increase the U.S. debt limit. If the debt limit is not raised, the Department of the Treasury anticipates that the U.S. could default as soon as August 2. The status of current discussions does not appear to be promising. Republicans have said they will not vote to increase the limit without also attaining measures to decrease the federal deficit without any tax increases. The Democrats have already agreed to roughly $150

billion in spending cuts, but outside experts say that $4 trillion in deficit reduction is necessary to stabilize U.S. debt over a 10-year span. Although the August 2 date is imminent, many traders and market participants continue to doubt that members of Congress will risk a default.

Congressional and Administration sources are reporting that Republicans and Democrats are likely to agree to reduce farm subsidies, require federal workers to contribute more to their pension plans, cap annual spending, sell excess federal property, reduce Medicare fraud and over payment, and auction broadcast spectrum licenses. Democrats have stated that they will not consider cuts to health benefits, the largest federal budget outlay, until Republicans consider tax increases.

Although negotiations have been very slow moving, Treasury Secretary Timothy Geithner has stated that he is optimistic a consensus will be met before the August 2 deadline, recently saying he is "confident two things are going to happen this summer. We're going to avoid a default crisis, and we're going to reach agreement on a long-term fiscal plan." The Moody's Announcement allows that if the debt limit is raised for even a short time to allow negotiations to continue, it may postpone downgrading the U.S. rating from Aaa to Aa. Under this type of scenario, Moody's delay would be contingent upon negotiations appearing likely to achieve substantive change in the debt trajectory. The next negotiating session is scheduled for June 9.

Moody's Announcement can be found here: http://www.moodys.com/research/Moodys-Updates-on-Rating-Implications-of-US-Debt-Limit-Long?lang=en&cy=global&docid=PR_220066

Bond Dealers of America Releases Guidelines for Secondary Market Disclosure

The Bond Dealers of America (BDA) has released guidelines to its members, who are primarily dealers, regarding compliance with disclosure requirements in the secondary market.
These guidelines are in response to FINRA's Notice 10-41,which included a "checklist."

An Executive Summary of these guidelines, titled *Guidelines Regarding Disclosures, Suitability and Pricing of Municipal Securities Transactions in the Secondary Market* is available here.
http://www.bdamerica.org/wp-content/uploads/2011/06/Secondary-Market-Disclosure-Executive-Summary-2011-06-03.pdf