

NABL Weekly Wrap Print-friendly Version – Feb 12, 2010

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IDEA OF THE WEEK:

Action on Municipal Securities Moves to the Senate

Two separate legislative efforts in the Senate could potentially affect municipal securities.

On February 11, 2010, Senate Banking Committee Chairman Chris Dodd (D-CT) announced that he would move forward with a financial services sector regulatory reform bill with a relatively junior Republican Member of his Committee, Senator Robert Corker (R-TN), conceding that he and the Committee's Ranking Republican Member, Senator Richard Shelby (R-AL), have reached an "impasse" in efforts to create a bipartisan bill. Committee staff have indicated that Senator Dodd's revised bill is likely to include several provisions related to municipal securities, most of which first surfaced in a widely circulated discussion draft of the "Restoring American Financial Stability Act of 2009" (the "Discussion Draft"). These include language that would alter the membership of the Municipal Securities Rulemaking Board (MSRB) to require that the majority of board members be "public" members, unaffiliated with the securities industry. Another provision would confer enforcement and examination authority on the MSRB for the first time. The Discussion Draft also included a highly controversial definition of "eligible contract participants" (ECPs), persons and entities legally entitled to enter into Over the Counter (OTC) derivative contracts. State and local governmental entities with less than \$50 million in investments, excluding bond proceeds, were excluded from the ECP list and are likely to remain so according to staff.

Several of the most controversial provisions of the Discussion Draft that Chairman Dodd released in November are said to still be in play, including provisions to consolidate the federal financial regulatory agencies, and the controversial Obama Administration proposal to create a new federal financial services product regulatory agency.

On a separate track, the Senate Leadership is working with the White House to move a Jobs bill. Senate Majority Leader Harry Reid (D-NV) had hoped to take up the "Hiring Incentives to Reduce Unemployment Act," (the "Jobs bill") universally referred to as the Senate "Jobs bill," Monday. But the so-called "Snowpocalypse" that closed the federal government for an unprecedented four days this week has slowed progress.

The [draft 362-page bill](#), which was widely circulated in Washington on Monday and formally released by the Senate Finance Committee on February 11, 2010, includes language that would essentially allow issuers to issue certain energy and school bonds in BABs form, i.e., as federally subsidized interest bearing instruments. These include: Qualified School Construction Bonds (QSCBs), Qualified Zone Academy Bonds (QZABs), Qualified Energy Conservation Bonds (QECBs) and Clean Renewable Energy Bonds (CREBs).

The bill also includes provisions that would extend the Section 1602 low-income housing tax credit (LIHTC) cash grant exchange program that was created by the ARRA; extend the new markets tax credit (NMTC) program; and retroactively extend deadlines for Gulf Opportunity (GO) Zone provisions that expired in 2009.

The Jobs bill would extend transportation programs that were authorized by the Safe, Accountable, Flexible, Efficient Transportation Equity Act: a Legacy for Users, or SAFETEA-LU, until Dec. 31, 2010; would provide funding for the highway trust fund by repaying “foregone interest” that it has been legally unable to earn on its revenues; and would give the fund \$14.7 billion for highways and \$4.8 billion for mass transit, and would restore the fund’s ability to earn interest.

In addition to the snow delays, the recent election of a Republican Senator, Scott Brown, to replace Democratic Senator Ted Kennedy of Massachusetts, adds even greater uncertainty to the mix, as Democrats no longer have a 60 vote filibuster-proof majority. It is therefore difficult to handicap the odds of either of these Senate bills passing this year. With regard to the Jobs bill, more ominously, the Leadership of both the House and Senate have expressed concerns that the job creation piece of the Jobs bill is too weak.

REGULATORY

NABL Releases Member Advisory Evaluating the Case for Extending Temporary Changes to Section 265 of the Internal Revenue Code

On February 3, 2010, the National Association of Bond Lawyers (NABL) released a [Member Advisory](#), Extending ARRA Relief for Debt Issuance of Small Government Entities and 501(c)(3) Organizations, which evaluates the case for extending certain temporary changes made to Section 265 of the Internal Revenue Code in the American Recovery and Reinvestment Act of 2009. NABL believes that these provisions, which increased the \$10 million "Bank Qualified" (BQ) limit to \$30 million and permitted banks to hold a 2% de minimis amount of tax-exempt bonds outside the general proportionate interest expense disallowance rule, have been highly beneficial to local governmental units and to nonprofits.

The Advisory was prepared in response to requests from NABL members and other municipal securities market participants, and is part of ongoing outreach regarding the ARRA and related issues.

FROM THE ADMINISTRATION

White House Seeks Permanent Extension of the Build America Bonds Program at a Reduced Subsidy Level

The Obama Administration has called upon Congress to make the Build America Bonds (BABs) program permanent in its FY 2011 Budget proposal and for extending the program to nonprofit Section 501(c)(3) issuers. Additionally, the Administration proposes to extend the BABs program to include refundings and working capital. The current BABs program expires on December 31, 2010. However, the Budget also calls

for reducing the subsidy from 35% to 28% beginning Jan. 1, 2011. The goal is to make BABs “revenue neutral” with respect to tax exempt bonds, a goal that many market participants believe will undermine the nascent BABs market.

The Administration's FY 2011 Budget Provides \$4.4 Billion for Community Development; Reforms FHA Mortgage Insurance

The Obama Administration has proposed providing \$4.4 billion for the Community Development Fund in its FY 2011 proposed Budget. The lion’s share, \$3.99 billion, would be allocated to Community Development Block Grant (CDBG) program, but \$150 million worth of funds would be allocated to the new “Catalytic Competition Investment Grant Program.” Unlike CDBG, the Catalytic Competition Program will allow consortia of non-governmental entities, together with government entities, to develop plans targeting communities experiencing significant economic distress.

The Administration’s Budget also calls for reforms to single family mortgages insured by the Federal Housing Administration (FHA). The changes include raising the minimum credit score for high risk borrowers and restructuring insurance premiums in an attempt to replenish the FHA’s depleted capital reserves. The Administration’s Budget also proposes \$338 million for FHA to allocate to housing and foreclosure counseling services.

Obama Administration Looks to Address Size and Powers of Nation’s Big Banks

On Thursday, January 21, 2010, President Obama proposed a new set of regulatory rules for the nation’s largest banks. The new rules would prohibit banks from conducting “proprietary trades,” or trades made by the bank with its own funds and for its own accounts instead of customers. The intent is to ensure that the federal safety net--- deposit insurance and other protections for depositors---does not indirectly subsidize trading. The President also intends to introduce rules to limit the size of large banks, limiting the ability of the largest banks to grow in size, and possibly forcing some large banks to shrink through divestment.

These new proposals come on the heels of the President’s call a week earlier to impose a new tax on the 50 largest banks in order to aid the recoupment of the \$120 billion spent on the Troubled Asset Relief Program (TARP) by the federal government in 2009.

Obama Calls for Creation of Bipartisan Deficit Taskforce

Recognizing that partisan politics will inevitably prevent Congress from addressing the federal budget deficit effectively, President Obama has called for the creation of a bipartisan budget taskforce to tackle mounting budget deficits, projected at \$1.35 trillion for 2010. President Obama will most likely create the taskforce by executive order after the Senate narrowly defeated a bill to create the taskforce on January 26, 2010.

The taskforce, if created by executive order, would lack authority to force Congress to act on its recommendations and several Republicans have already said they will refuse

to participate in its proceedings. The taskforce will likely be given broad authority to recommend changes in the tax code and entitlement programs such as Social Security and Medicare.

LEGISLATIVE

Frank leading the Charge to Dismantle Fannie Mae and Freddie Mac

In a recent hearing, House Financial Services Committee Chairman Barney Frank (D-MA) stated his intention to move forward with a proposal for “abolishing Fannie Mae and Freddie Mac in their present form and coming up with a new whole system of housing finance.” Chairman Frank announced that he would hold hearings on the two housing GSEs during the week of March 4, 2009.

Neither the House Financial Services Committee nor the White House has published any proposals or guidance on the future of Fannie and Freddie. The Department of Housing and Urban Development (HUD) made a commitment last summer to release plans for the housing GSEs around the time of the release of the FY 2011 federal budget, but has so far remained silent. HUD Secretary Shaun Donovan recently said that “we continue to be on track to release a statement in the very near future,” but no exact date has been given.

Some analysts think that any legislation that overhauls Fannie Mae and Freddie Mac will have to wait until at least 2011. With lawmakers already debating a much broader overhaul of financial services regulations, inclusion of controversial plans for Fannie Mae and Freddie Mac in the broader bill is widely perceived as likely to derail the current efforts.

Separately, on February 2, 2010, Federal Housing Finance Agency (FHFA) Acting Director Edward J. DeMarco sent [a letter](#) about Fannie Mae’s and Freddie Mac’s conservatorship to the leadership of both the House Financial Services Committee and the Senate Banking Committee. The letter addressed FHFA’s plans for the GSEs’ business activities while in conservatorship, including loan modifications and mitigating credit losses, retained portfolio, new products and affordable housing mission.

House Lawmakers Push for Revamp of Transportation Funding System

A new working group spearheaded by Rep. Heath Shuler (D- NC) and Rep. Jeff Flake (R-AZ) is working on proposals to completely revamp the highway trust fund system and how it apportions money to the various states. Presently, states pay fuel taxes into the federal highway trust fund and the fund is divided amongst the states following a formula that takes into account numerous factors such as population, amount of miles of highway in the states, average distance traveled on highways, and many others. Under the current system, certain densely populated states pay in more money to the trust than they receive, while other more sparsely populated states receive more than they pay.

Proposed alternatives to the current system include a mandatory 96% return on state contributions to the highway trust fund or allowing a state to opt out of the current system altogether, provided they agree to minimum levels of highway spending and meet certain performance measures. Observers note that the outlook for reforming of the transportation funding system is more likely in 2010 than other years, since a new multi-year transportation bill to replace the SAFETEA-LU is currently in the works but has yet to actually be enacted.

Bernanke Reconfirmed as Federal Reserve Chairman

On Thursday, January 28, 2010, Federal Reserve Chairman Ben Bernanke was reconfirmed as Chairman of the Federal Reserve by the United States Senate by a vote of 70-30. Bernanke retained his position at the Fed, but 30 “no” votes is almost double the previous high of 16 that Paul Volcker received in 1983, which demonstrates the pressure the Chairman will be under during his new term.

There are currently two additional open seats on the Board of Governors of the Federal Reserve. The Administration is said to be close to nominating candidates to fill those slots.

House and Senate Vote to Raise Debt Ceiling While President Pushes for Spending Freeze

On Friday, January 29, 2010, the United States Senate voted 60 to 39 to raise the federal deficit ceiling from \$12.4 trillion to \$14.3 trillion, an increase of \$1.9 trillion. Without the increase the Department of Treasury said the federal government would have hit the former debt ceiling by the end of February. Together with the increase, however, the Senate also instituted a “pay as you go” rule which requires all new mandatory spending to be offset equally with new revenue or cuts elsewhere in the budget.

The House passed similar debt ceiling legislation on Thursday February 4, 2010, by a vote of 271 to 212, largely along party lines as well. The House also passed the “pay as you go” rule 233 to 187.

President Obama has called for a three year spending freeze on government spending on discretionary programs outside of entitlements, defense, and education, reducing the deficit by approximately \$250 billion. The freeze would keep discretionary government spending at current levels for three years but would not begin until next year.

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