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Re: Suspension of Issuance of State and Local Government Securities

Gentlemen and Ms. Tsilas:

The National Association of Bond Lawyers ("NABL") respectfully submits the attached memorandum containing suggestions for changes to the extraordinary measures taken by the Bureau of Fiscal Service ("BFS") of the Department of the Treasury ("Treasury") when Treasury determines that debt of the United States subject to the statutory debt limit is approaching that limit. Among the extraordinary measures taken under present procedures is the suspension of acceptance of new subscriptions for the purchase of Treasury Securities – State and Local Government Series ("SLGS"), including investments for zero coupon SLGS as may be required by certain defeasance escrows.

As described in the attached memorandum, the suspension of acceptance of new subscriptions imposes costs on issuers of tax-exempt debt, particularly smaller issuers. We believe that it might be possible to modify the current procedures so as to mitigate or eliminate the costs to issuers while at the same time meeting the needs of the Treasury as it manages the public debt.

NABL was incorporated in 1979 to provide a forum for the exchange of ideas as to law and practice relating to state and municipal bonds and to provide advice and comment with respect to legislation, regulations, rulings and other actions affecting state and municipal obligations. NABL has approximately 2700 members.

The attached memorandum was prepared by an ad hoc committee whose members are listed in Exhibit A. The memorandum was reviewed and approved by NABL's Board of Directors. If you have any questions, please contact William Daly, NABL's Director of Governmental Affairs, at 202-503-3302 or bdaly@nabl.org.

Sincerely,

Allen K. Robertson

Allen K. Robertson

Proposal Concerning Issuance of State and Local Government Securities When Approaching the Debt Limit

I. Background.

United States Treasury Securities – State and Local Government Series ("SLGS") were created at Congressional request in 1972 to help states and local governments comply with tax rules that restrict the yield on the investment of proceeds of tax-exempt (and now certain other tax-advantaged) state or local bonds. Over the years, the SLGS program has been refined and revised to make it the preferred investment vehicle for proceeds of tax-exempt bonds. In certain transactions (most importantly, yield restricted defeasance escrows), the tax regulations effectively require states and local governments to follow procedures to assure that investments other than SLGS are purchased for fair market value. The most commonly used of these procedures is the bidding of open market securities (usually open market Treasury securities). Such bidding generally must follow certain detailed rules (the "Bidding Process"), including the receipt of at least three bona fide bids. Many local governments dislike the Bidding Process because it is expensive, complicated, and leaves a residual concern that the agent hired to follow the Bidding Process will not adhere to the applicable tax rules. Because of this, many issuers of tax-exempt bonds avoid such bidding procedures when possible. The simplest way to avoid these concerns is through the use of SLGS as the investment of choice. When available, SLGS are purchased through an online subscription process (called "SLGSAFE"). Generally, SLGS subscriptions must be submitted five calendar days before delivery (for subscriptions of $10,000,000 or less) or seven calendar days before delivery (for subscriptions of more than $10,000,000). The subscriber specifies the maturity date and the interest rate for the SLGS to be purchased. Interest rates may not exceed the published maximum rates. The maximum rates are designed to be slightly below market rate for comparable open market Treasury securities.

In addition to purchasing SLGS in connection with the issuance of advance refunding bonds and other yield restricted defeasance escrows, many bond documents call for agent banks to purchase SLGS on scheduled reinvestment dates over possibly multi-year periods. Most commonly, such future scheduled SLGS purchases are at a 0% yield and are for terms of 6 months or less. (They are often referred to as "0% SLGS Rolls.") These 0% SLGS Rolls are scheduled to avoid leaving bond proceeds uninvested and to provide certainty to the local government about the investment return on the investment portfolio. Leaving such amounts uninvested may in some cases cause the escrow yield to exceed the bond yield in violation of the arbitrage restrictions.

SLGS are also, less frequently, used by state and local governments for investment of proceeds of tax-exempt bonds that are not subject to the yield restriction rules of refunding escrows. For example, they can be and sometimes are used in project funds, debt service funds and reserve funds. In those cases, SLGS are used because of their convenience, their safety and their simplicity. This is especially true of the variable rate SLGS program.

II. Rationale for Current Procedures Related to Suspension of SLGS Sales.

When Treasury determines that following normal procedures might cause the statutory debt limit to be exceeded, among the extraordinary measures taken is the suspension of acceptance of SLGS subscriptions. Because Treasury holds weekly auctions for open market securities, it could adjust open market Treasury sales to account for SLGS. However, some time is needed to make such adjustments. The five- or seven-day SLGS subscription period may be insufficient to give adequate time to make the adjustments. Additionally it is possible for states and very large local governments to subscribe for large quantities of SLGS (say $1,000,000,000 or more), which could make adjustments difficult, even with advance notice.

Suspension of all SLGS subscriptions eliminates these difficulties for the Bureau of Fiscal Service, but at a cost to state and local governments. The Bureau of Fiscal Service is able to honor even large subscriptions submitted before the suspension for issuance after the submission, because it has had sufficient advance notice.

III. Problems Created by Complete Suspension of SLGS.

While SLGS benefit all states and local governments, certain local governments are harmed more than others when sales of SLGS are suspended. Because of a lack of bidder interest, it is extremely difficult, expensive and sometimes impossible to conduct a qualifying Bidding Process for small amounts of Treasury securities, and especially for short-term securities. Nonetheless, some local governments must buy Treasury portfolios extending only one or two years (or at times less than one year) or must buy Treasury portfolios that, from the point of view of bidders, are of a small amount (e.g., less than one million dollars to a few million dollars). The process itself is cumbersome and often deviates from normal market processes. For example, while open markets normally trade for T+1 delivery (i.e. delivery versus payment on the next business day after the trade), the Bidding Process typically calls for at least one or two weeks between the trade and settlement date. A bidder must provide a firm bid that is held open for at least 10 minutes. A bidder needs to sign and fax in a certification that it agrees to certain terms of the bidding and that it has not collaborated with other bidders. All of these special situations make it expensive and difficult for Treasury dealers to participate in the bidding process. When a large amount of Treasuries are bid (say $100,000,000 or more), the bidders may make enough profit on a successful trade to make bidding on the portfolio worth the trouble. However, most securities dealers will pass on an opportunity to bid on small or short-term portfolios because there is little or no potential to make a reasonable profit given the deviation from normal Treasury purchase processes. The result is that many smaller issuers of tax-exempt bonds have difficulty completing transactions without SLGS. Additionally, professionals who conduct Treasury bidding charge for their services. Even on the smallest portfolios, bidding fees are often at least $2,000 to $3,000. At times when bids are received, the effective yield of the securities to the investor may be below 0% (i.e. the cost of the security plus the bidding fees is greater than the sum of the receipts of principal and interest to be received on the security.) The result has been unfortunate for many issuers. Funds have been left uninvested or transactions have failed, all because of the inability to purchase SLGS.

When, as is common, escrow documents require SLGS to be purchased on a specified (e.g., 0% SLGS Rolls) date in order to accomplish yield compliance in respect of a defeasance escrow investment portfolio but the prospective purchaser finds that it cannot complete the subscription, confusion ensues. While many bond documents provide alternatives and proposed tax regulations and an IRS revenue procedure provide a detailed road map for such alternate procedures, these alternatives are cumbersome and require several separate actions that benefit no one (except perhaps those that are able to charge fees for their services). 0% SLGS Rolls are predictable significantly in advance (often years in advance) of the purchase dates.

IV. 2013 SLGS Forum.

On August 8, 2013, in Louisville, Kentucky, the Bureau of Fiscal Service held a "SLGS Forum" to discuss with potential users of SLGS various aspects of the program. At this Forum, bankers, lawyers and issuers discussed the SLGS program with personnel from the Bureau of Fiscal Service. During this discussion there seemed to be a consensus among the attendees that some extraordinary measure short of the complete suspension of all SLGS subscriptions (a) would be very beneficial to local governments, and (b) would not prevent the Bureau from making appropriate adjustments to avoid exceeding the statutory debt limit.

V. Proposal.

As a result of the discussions at the SLGS Forum, NABL is providing to the Treasury the following proposals as alternatives to the current practice of suspending SLGS subscriptions entirely when the debt is approaching the statutory limit. We believe that the proposals would meet both the needs of the Treasury when the debt is approaching its limit and the needs of issuers, particularly smaller issuers.

1. Only suspend subscriptions for larger SLGS purchases. Since purchasers of smaller quantities of SLGS have the most difficulty with alternate investments, suspensions of SLGS subscriptions over some limit would solve the problems for many local government units. We propose using a $10,000,000[1] cutoff.

2. If necessary, consider an increase of the advance subscription period when extraordinary measures are in effect. While the current five-day subscription period is useful, small issuers could in extraordinary times adjust to a longer subscription period of, say, 10 days.[2] Such issuers would prefer to have SLGS available with a longer waiting period than not to have them at all.

3. If necessary, limit SLGS terms to a relatively short period. Short-term Treasuries are the most difficult to bid as an alternative to SLGS. If during such periods subscriptions were only allowed for SLGS with maturities of

[1] $10,000,000 is the regulatory cut off for the ability to provide five days advance notice to SLGS purchases. More importantly, we understand that it is difficult to interest Treasury dealers in a Bidding Process for securities in an amount under $10,000,000.

[2] Obviously, states and local governments would like this period to be kept as short as possible, but we understand that a longer period would make it easier to adjust Treasury auctions in response to subscriptions for SLGS.

seven[3] years or shorter, the Bureau of Fiscal Service might find it feasible to adjust Treasury auctions to account for SLGS.

4. Allow subscriptions for 0%[4] SLGS during periods of extraordinary measures. Because of the difficulties related to alternative investments, many local governments would buy SLGS with a 0% yield if they were available (and higher yielding SLGS were not available). This would also solve most 0% SLGS Roll problems.

We do not see the above list as disjointed alternatives. While allowing subscriptions of $10,000,000 or less in times of extraordinary measures would, perhaps, be the most useful and effective measure, we could envision a system where even $10,000,000 or smaller subscriptions required a 10-day subscription period during such times. Perhaps subscriptions of over $10,000,000 could be allowed during such times if the SLGS terms were relatively short (five years or less), the subscription periods were long enough or the interest rates were 0%.

We encourage you to consider this proposal and believe that any relief from the complete suspension of new subscriptions for SLGS would generally be well-received among states and local governments.

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[3] Most SLGS have initial maturities of 10 years or less. Shorter investments are harder to bid out. Shorter SLGS would also be easier to swap out of a scheduled Treasury auction without seriously affecting the debt structure of the United States. Even a one-year rule would be beneficial in that it would allow most 0% SLGS Rolls.

[4] When the United States issues 0% SLGS, it is borrowing money for free. This is the most efficient borrowing for the United States.

Exhibit A

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