November 16, 2004

Mr. Keith Rake
Deputy Assistant Commissioner
Bureau of Public Debt
U.S. Department of the Treasury
P.O. Box 396
Parkersburg, WV 26106-0396

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Dear Mr. Rake:

On behalf of the nearly 16,000 members of the Government Finance Officers Association (GFOA), I would like to submit these comments in connection with the September 30th Notice of Proposed Rulemaking in the Federal Register regarding State and Local Government Securities (SLGS).

The GFOA has had a long standing relationship with officials from the Bureau of Public Debt and the Treasury Department regarding the SLGS Program. Indeed, during the last major overhaul of the SLGS Program in 1996, the GFOA and other marketplace participants were consulted throughout the restructuring of the Program to ensure that the changes were appropriate to the municipal finance community and the Issuers who place SLGS subscriptions. We hope that during this current review of the Program our input as well as that of our colleagues throughout the public finance sector, will be considered and a partnership will exist to improve the SLGS Program. We welcome the opportunity to submit this letter.

Earlier this year, representatives of the GFOA met with staff from the Bureau of Public Debt (BPD) regarding possible changes to the Program. Despite the success of the Program to provide a legally sound means for municipal bond Issuers to invest their proceeds and meet Congressionally mandated arbitrage rebate requirements, and assist the federal government with its financing needs, we recognized at the meeting the importance of addressing the administrative burdens and certain flaws within the Program. We were, however, surprised upon reading the proposed rulemaking change of the significant alterations proposed, which go beyond the confines of our earlier discussion. These proposed changes substantially undermine the improvements that were made in 1996. The 1996 changes resulted in an easy-to-use and efficient SLGS Program, a goal that we continue to support. However, if Treasury is not careful, these proposed changes will impair the efficiency of the municipal bond marketplace where the capital is used to pay for essential infrastructure projects and ensure the continued development of communities, large and small, across America.

An important mission of the SLGS Program is to promote Issuer accessibility to the SLGS market for municipal bond refundings and eliminate the possibility of arbitrage rebate and yield burning violations that the IRS found were prevalent prior to the 1996 changes. Since 1996, the SLGS Program has been a tremendous success, used by a vast majority of the Issuers in the refunding marketplace, and has helped ease the burdens for Issuers and the IRS pertaining to yield burning investigations. While we concur with the need to address administrative problems experienced by the Bureau of Public Debt, we believe that the proposed changes could bring back extensive problems that were eradicated after 1996, and return the refunding marketplace into a tangled web of complicated arbitrage and yield burning compliance rules, cause greater transaction costs, and instill a new set of administrative problems that all parties will experience – including the Bureau of Public Debt and Treasury.

The nature of the proposed changes should receive proper vetting through the procedures of a major rule change. The significant changes at almost every level of the Program under this proposal, and the significant costs to local and state governments associated with this proposal, should not be underestimated. The inability to cancel subscriptions, alone, will bring significantly greater costs to Issuers, and may cause Treasury to lose upwards of $80 million a year through additional borrowing costs. There is no quantitative analysis in the proposal explaining why the proposed changes have been suggested. Thus, we believe that the proposed regulations are in excess of the guidelines for "significant regulatory action," and that formal hearings and discussions need to be completed prior to enacting the proposed changes to the Program.

Support for Changes

We support the notion of using SLGSafe, exclusively, to alleviate the unwieldy problems associated with fax transmittals for SLGS subscriptions. The use of a web-based system, following a proper introductory period, and having a safeguard mechanism in place when the electronic system is not working, has our support. However, there must also be an accommodation to assist those Issuers who currently have subscriptions, but are not in the SLGSafe system. Most importantly, we believe that the significant change to move to a web-based system will alleviate most of the concerns and address the administrative issues that BPD has regarding the SLGS Program. This will help determine if the use of SLGSafe provides the remedy necessary to address BPD's concerns before placing additional constraints on the SLGS Program that could be detrimental to the users of SLGS.

Additionally, we support the need to address the abuses found regarding subscriptions being made by parties other than Issuers, without a "real" transaction attached to the subscription. However, we believe that the proposed changes do not accurately reflect the procedures relating to bond transactions, and should be revised to address the fact that many transactions do not have "official authorization" at the time of the subscription, yet subscribers are able to have a "reasonable expectation" that the bonds will be issued. This minor, yet important, change to the certification proposal should ease the Treasury's concerns including the "shopping" of subscriptions, and allow the natural course of events of a transaction's timeline to be unaffected.

As suggested, setting the SLGS rates in the morning, rather than the evening prior, is agreeable. However, we believe the timing should be earlier than 10:00 am EST to assist those Issuers who need to determine their subscriptions prior to that hour. We would also advise Treasury to carefully review the internal administrative protocols that will be necessary to allow the rate setting to occur in the morning and be clear that it does not present additional administrative burdens on BPD – something that this proposal seeks to eliminate.

Areas of Concern

We believe that by mandating the use of SLGSafe, providing some type of certification for each subscription described above, and setting the interest rates in the morning, BPD will have the tools necessary to address their administrative and cash management concerns regarding the current SLGS Program. Thus, these three fundamental changes to the Program should be enacted prior to adopting any other changes to the Program that are embedded in the proposal.

Penalty for Canceling a Subscription

As reported in the press and anecdotally by Treasury staff, there is concern regarding the canceling and resubscribing of SLGS by Issuers who seek a better yield on their investment proceeds. There are already finite constraints on Issuers, and the use of their investment proceeds. Adding another layer of restrictions on Issuers, who are trying to satisfy the complicated arbitrage rules to prevent yield burning, is unnecessary and goes against the spirit of the 1996 changes. When this issue was considered in 1996, it was determined that restrictions should not be placed on the ability of Issuers to cancel and resubscribe. As noted earlier, implementation of this proposal could increase Issuer's costs tremendously, and will also cost the Treasury millions as Issuers are forced to purchase open market securities rather than SLGS. This would reduce the attractiveness of the SLGS market for Issuers, cause Issuers to purchase open market securities to a much greater degree, and create another set of potential yield burning problems for the Treasury and IRS as experienced prior to 1996.

We strongly disagree with the belief that SLGS are a "cost free" option available to Issuers. It can be clearly demonstrated that there is a 5 basis point savings by Treasury when an Issuer subscribes to SLGS rather than purchasing open market securities. This discount, enjoyed by Treasury each time SLGS are purchased or redeemed prior to their maturity, is in effect a 'fee' placed on Issuers for the opportunity to purchase SLGS. These calculations should be seriously reviewed by Treasury as this point refutes the notion that SLGS are a "cost free" option for Issuers. In other words, any "free option" is more than outweighed by the interest savings to Treasury from SLGS.

It is unfair to place restrictions on Issuers who can seek a better yield by canceling and resubscribing to SLGS. If it is true that the canceling/resubscribing is an administrative burden placed on BPD, even after the mandatory use of SLGSafe is in place, then we suggest reviewing the merits of providing Issuers with the best rate within their 60 day subscription, which eliminates the need for Issuers to cancel and resubscribe.

To address the concerns regarding "cash management" obstacles that the BPD faces when Issuers subscribe/resubscribe, we do not view the proposal as providing any great difference on this matter, since Issuers will delay filing subscriptions until the last minute, causing the same type of cash management concerns that BPD has indicated exist.

Trading Day Hours

The idea of having the SLGS trading day open from 10:00 a.m. – 6:00 p.m. EST is not reflective of marketplace practices and is especially discriminatory to Issuers outside of the Eastern time zone. There are many moving parts to a transaction including the involvement of many parties outside of the Issuer's control. Having an unrealistic time frame placed on the trading day, again, will push Issuers away from using SLGS and into open markets. Consideration of all time zones, and a review of the current subscription practices should be carefully reviewed before determining the hours available to purchase SLGS. Since the markets are closed after 6 p.m., we fail to see the merits in closing the window at that time. By implementing the use of SLGSafe, the administrative concern of a mountain of faxes on the floor the next morning, should be alleviated, and keeping the window open, via SLGSafe, will provide Issuers the needed flexibility to place their subscription at the appropriate time for their transaction.

Again, we would like to emphasize that the use of SLGSafe and the morning setting of interest rates should assist with the BPD's administrative concerns regarding this matter.

Delivery Date

For many reasons, an Issuer may need to change its SLGS delivery date. This is mostly due, again, to factors outside the Issuer's control. The inability to change the delivery date does not consider the multitude of issues that may arise during the formation and implementation of a transaction. Eliminating the flexibility currently inherent in the Program will again force Issuers into the open market and cause many unnecessary problems. We believe that Issuers should continue to benefit from being able to change the delivery date for up to 7 days. Once again, we believe that a vast majority of the cash management concerns cited in the proposed regulations will be addressed by the use of SLGSafe, and the certification of a transaction. Thus, eliminating the ability to change the delivery date is too restrictive on Issuers and should not be implemented.

Investment of Other Funds

To comply with the very complicated and arcane arbitrage rules, Issuers are currently able to invest monies other than the gross proceeds of tax-exempt bonds in SLGS. For an unexplained reason, the proposal suggests that this option be eliminated. We believe this is an unnecessary action by Treasury. Issuers should be able to retain the ability to use other funds to purchase SLGS.

Investment of Funds at a Higher Yield

The Proposal eliminates the ability for Issuers to reinvest funds at a yield higher than which they had been originally invested, and calls for certification that the new investment is not capturing this greater yield. Again, this provision seems unnecessary and overreaching. There are countless regulations that address arbitrage rules for tax-exempt bonds, and provide for careful calculation and adherence to these rules. This provision seems to push arbitrage regulations even farther, in a manner that is both counterintuitive to helping Issuers with the complicated arbitrage rebate rules and second, imposing new restrictions on a section of regulations that are not directly part of the SLGS Program – forcing Issuers into negative arbitrage situations. We believe that setting the SLGS rate in the morning, will address the administrative concerns that Treasury has with this issue.

Changes in Subscription Amounts

We object to eliminating the option for Issuers to change their subscription amount either by 10% of the subscription amount or $10 million, and only allowing the 10% of the subscription amount to be altered. This reduces the flexibility needed when structuring escrow accounts, unfairly impacts smaller Issuers, and will push Issuers into open markets rather than use the SLGS Program.

Additional Changes

One item that was not addressed in the proposal, yet is significant to the Issuer community, is the closing of the SLGS window as the Treasury reaches the debt limit. We suggest that when Treasury is looking for solutions to avoid reaching the debt limit that it first look at other options rather than close the SLGS window. Second, and most importantly, a set rule should be in place that will provide adequate notification to the Issuer community and the marketplace when the window will be closing. While obviously it is difficult to determine exactly when the debt limit level will reach a critical level, it is unfair for Treasury to give a one hour's notice of the closing, as was done last month, and expect the entire marketplace to adhere to such a significant shift, without a sufficient amount of time given so that Issuers with pending transactions may act more quickly and place a subscription, or adjust to the closing of the window.

Conclusion

SLGS are a vital tool used by local and state governments to manage their investments and comply with arbitrage regulations. It is crucial that the success and viability of the SLGS Program continues in the future, in order to meet the needs of the Issuer community – the public sector - and curtail unnecessary IRS yield burning enforcement actions.

We understand the desire for the Bureau of Public Debt to make administrative changes to the SLGS Program and support the ideas of the exclusive use of SLGSafe, providing some type of certification, and setting the interest rate in the morning. We strongly encourage BPD to incorporate these changes into the Program prior to making any other changes that will cause the SLGS Program to be less appealing to the Issuer community.

Some of the ideas within the proposed changes would significantly reduce the flexibility and attractiveness of the Program, most specifically: eliminating the ability to cancel a subscription without penalty, establishing unworkable trading day hours, eliminating the ability to change the delivery date, excluding the investment of other funds into SLGS, restricting the ability for Issuers to reinvest funds at a higher yield than they were originally invested, and reducing the flexibility to change the subscription amount. We do not believe that these changes are warranted, nor should they be adopted.

As proposed, these changes to the Program are severe enough to warrant "significant regulatory action" and should be treated as such with public hearings, providing additional time for comments, and, as in 1996, establishing a close working relationship with Issuers and others in the marketplace to ensure the viability of the SLGS Program.

We would very much like to meet with BPD and other Treasury officials to discuss our concerns and find viable solutions to the problems noted in the proposed changes.

Thank you for your consideration of our comments, and we look forward to working with you in the near future.

Sincerely,

Susan Gaffney
Director, Federal Liaison Center

cc: Greg Jenner, Assistant Secretary for Tax Policy (nominated), U.S. Department of the Treasury