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Saber Partners Renews Call for Transparency in Auction Rate Securities Markets

(New York, New York March 9, 2010) Saber Partners, LLC, a leading expert in auction rate securities and the financial markets, called for “across-the-board” information transparency in the distressed auction rate securities (“ARS”) market. Specifically, Saber renewed its call for the Municipal Services Rulemaking Board (“MSRB”), the regulator of the municipal market, to complete the implementation of a promised comprehensive electronic ARS disclosure system. ARS are long-term debt or preferred securities, whose interest rates are adjusted at regular intervals in organized secondary market auctions. According to Bloomberg, two years after an enormous liquidity shock in February 2008, more than \$100 billion in illiquid ARS remain outstanding – over 70% of which are municipal securities. The MSRB was slow to react to this crisis, and continues to respond in a piecemeal, overly-bureaucratic fashion. If the MSRB will not take all the actions necessary, with a sense of urgency, someone else should.

Saber also encourages the SEC to apply this same type of system to the auction rate securities of closed-end bond funds and asset-backed securities that are sold through the same brokers.

An opaque market inhibits liquidity. Greater transparency about the auctions would address some of the investor confidence issues created by the 2008 crisis. It would encourage secondary market trading through other broker-dealers and perhaps through other innovative private sector initiatives. This could provide a foundation for the full modernization of municipal securities trading.

More Disclosure Addresses Confidence and Liquidity

The SEC and other regulators have found that ARS were often inappropriately sold as short-term instruments and as alternatives to cash. Unless the auctions match sellers and buyers at a fixed price of 100, within the interest rate range specified under the unique terms and structure of each ARS security, many current ARS holders cannot easily sell their investments except at a significant loss. Certain ARS may be suitable investments for some investors. However, potential buyers cannot make those evaluations because they can’t easily find reliable information about the auctions.

Information about ARS market risks, and the widely differing liquidity risk profiles of specific ARS securities, was not and is still not adequately disclosed to most investors. Reading the prospectus or supplemental broker practices alone are insufficient. Many auctions failed in February 2008, and many continue to fail. Market opacity has disadvantaged new broker-dealers from entering the market and hindered new private sector initiatives that could broaden liquidity. Some new investors appear to have entered the market simply to take advantage of that opacity through predatory bidding. “If the auctions are ever going to succeed for the distressed ARS securities again, the auctions need more bidding, and more bidding at something approximating fair market value. To get more bidding, investors need more, and reliable, information about ARS and the liquidity of the auctions. Transparency is only one part, but a critical part of the solution.” said Joseph S. Fichera, Saber’s Senior Managing Director and Chief Executive Officer.

Slow Regulatory Action in a Continuing Crisis

“The MSRB did not act when the SEC first signaled concerns about the ARS markets in 2004, or when the SEC did so again in 2006. In late 2007, as many market professionals – but not investors – knew liquidity risks were

increasing in certain segments of the ARS markets, the MSRB began to ‘discuss’ studying transparency. In 2008, after the upheaval, and in response to a Saber Partners, LLC proposal based on the U.S. Treasury auction model, they promised transparency. In 2009, they gave participants minimal information, implementing only part of that proposal. It’s 2010, and we still do not have a fully transparent system. Most other regulators – the SEC, the Internal Revenue Service, and State securities regulators – have moved swiftly, within their authority, and within months of the 2008 crisis, to address investor concerns. Why does the MSRB still lag the ‘market?’” asked Fichera. Saber’s proposal to the MSRB is available at: http://saberpartners.com/oped/saber_letter_msrb.html

“The Treasury Department conducts the same type of auctions, with full transparency to maintain market integrity and allow investors adequate discovery of the price, yield and liquidity (bid to cover ratios) of each auction. The Treasury model is what many investors understand by the term ‘auction,’” Fichera said.

Responsible Regulatory Action Is Within Reach

The US Treasury model is known and well-understood. Implementing it for auction rate securities is clearly feasible. The technology exists. And the expenses are not unreasonable, particularly given the costs that a lack of transparency has imposed on issuers and investors. If the MSRB does not have adequate funds, perhaps it could ask members for a contribution of just 1 of the 15-25 basis points per annum that they continue to receive for ARS auctions (even failed ones). This would generate \$10 million per year, based on ARS currently outstanding, an amount sufficient to develop and maintain a system.

“It’s not a question of if this can get done but when. This is a crisis for brokers, investors and issuers. The MSRB needs to stop its “promising and deferring” action, and take concrete steps to provide a transparent system and level playing field so that informed market participants can make good decisions.”

“The MSRB may hope that the ARS problem will just go away, but ‘hope’ can’t be a regulatory strategy. It should not let the crisis continue and expect the market to contract to zero. That predication was made 2 years ago. The MSRB should help make markets work. It’s 2 years later, and \$100 billion is still outstanding. That’s a lot of investor, taxpayer and ratepayer money.”

Joseph Fichera has been an expert on auction rate securities since the development of the product in 1984 and an advocate of transparent efficient pricing mechanisms. See <http://saberpartners.com/management/bio-fichera.html> He won an *Institutional Investor* "Deal of the Year" Award for restoring liquidity to one of the first ARS to have successive failed auctions and then succeed. He has served as an expert advisor on the subject to the Securities & Exchange Commission (2004-2006), the Secretary of the Commonwealth of Massachusetts (2009-2010) and the Executive Director of the Dormitory Authority of the State of New York, the third-largest tax-exempt bond issuer in the country at the height of the crisis (2008).

Saber Partners, LLC, is a New York-based financial advisory firm. It provides independent analysis and strategic advice to private and public sector entities, including state and federal regulators.

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