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***By Electronic Delivery***

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Jeffrey Van Hove
Acting Tax Legislative Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

RE: Auction Rate Preferred Stock—
Extension of Notice 2008-55

Dear Jeff:

The ICI[1] and its members appreciate the time that you, John and Mike spent with us discussing the continuing credit market crisis for auction rate preferred stock ("ARPS") and the industry's request that the relief provided by Notices 2008-55 and 2010-3 (collectively, the "Notice") be extended. As we emphasized, while the credit markets generally are recovering, the auction market for ARPS issued by closed-end funds remains in widespread failure; the outstanding ARPS remain illiquid.[2] Recovery of the auction market for these ARPS is not possible.

The industry needs additional time to utilize fully the relief provided by the Notice. The relief, as we discussed, is fully consistent with sound tax principles. Having answered this very narrow debt/equity question and expressly limited the Notice to ARPS issued by closed-end funds, we submit that any Treasury Department concerns about extending the duration of this guidance are outweighed by the substantial benefits that an extension would provide to the remaining ARPS holders, to the common shareholders of these funds, and to the municipal bond markets more generally.

This letter describes: (1) the progress that closed-end funds have made in replacing their ARPS outstanding on February 12, 2008; (2) the closed-end funds' ability to issue variable rate

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.05 trillion and serve over 90 million shareholders.

[2] Almost half (approximately $8 billion) of the outstanding ARPS issued by closed-end funds holding municipal bonds are held by individuals and by businesses that purchased ARPS for cash management purposes. Privately-negotiated secondary market sales of ARPS are completed only rarely and often at substantial discounts.

demand preferred ("VRDP") stock supported by liquidity facilities described in the Notice and the limitations on the Notice's use; (3) the closed-end funds' expectations for securing liquidity facilities if the Notice is extended; and (4) the potential consequences if the Notice is not extended. We would be pleased to provide any additional information that you request.

Progress Made by Closed-End Funds in Redeeming ARPS

Of the nearly $64 billion of closed-end fund ARPS outstanding when the auction markets collapsed early in 2008, over $40 billion has been redeemed. Progress has been greatest among the closed-end funds holding taxable securities ("taxable funds"); only $5.6 billion of ARPS issued by taxable funds (less than 20% of the ARPS issued by taxable funds outstanding on February 12, 2008) remain outstanding.[3]

Redemption progress has been much slower for APRS issued by closed-end funds holding municipal bonds ("municipal funds").[4] Only approximately 40 percent of the municipal fund ARPS outstanding as of February 12, 2008 (about $12.5 billion of the $30.55 billion) has been redeemed.[5] Stated another way, over three quarters of the remaining $23.7 billion of all outstanding ARPS issued by taxable funds and municipal funds combined ($18.1 billion) was issued by municipal funds.

[3] Most of the ARPS refinancing by taxable funds has been accomplished through new debt (issued at taxable rates). A significant portion of this debt was issued pursuant to SEC exemptive orders enabling funds temporarily to issue debt in excess of the 300% asset coverage requirements imposed by the Investment Company Act of 1940. While the ARPS crisis is more acute for municipal funds, we believe that extension of the Notice also might provide an opportunity for taxable funds to issue VRDP as a more permanent method of financial leverage.

[4] Municipal funds cannot issue taxable debt economically because the bonds in their portfolios are issued in the tax-exempt market. All securities issued by these funds must receive equity treatment for federal income tax purposes so that investors receive exempt-interest dividends that, under Code sections 852(b)(5) and 103, are exempt from regular federal income tax.

[5] Tender option bonds – the instrument used first by municipal funds to replace ARPS – are not an option to refinance all of the remaining ARPS. Most of the closed-end fund industry's securities that could be placed in TOBs, as we discussed last year, already have been so placed.

Preferred shares with a fixed term (such as five years) are expected to be a viable option for replacing a portion of outstanding ARPS in the current interest rate environment. But due to, among other things, (1) potential limits on the demand for short- and intermediate-term securities, (2) uncertainties regarding the cost of replacing this temporary financing when the term ends (*e.g.,* in five years), and (3) the impact of the reissuance costs of term securities that replace permanent financing, there may be limits on the ability of this option to replace outstanding ARPS.

Closed-End Funds' Use of the Notice and its Limitations

$2.5 billion of VRDP has been issued by 12 municipal funds pursuant to the Notice. This VRDP has not experienced a single remarketing failure or "put" to the liquidity provider.[6] By every measure, the VRDP issued has been a success.

Several factors, however, have limited the Notice's use by municipal funds. First, the credit crisis (and accompanying economic environment) have made it very difficult for municipal funds to find banks willing and able to act as liquidity providers.[7] Second, the credit analysis, due diligence, and document preparation necessary with any new product, such as VRDP, have prevented closed-end funds from moving quickly. Finally, in the current, historically-low interest rate environment, maximum rates payable to ARPS holders are significantly lower than the yields on the longer-term municipal bonds in the fund's portfolio. If short-term interest rates move even part way closer to their historic norms, however, the economic benefit to the common shareholders of continued ARPS-financed leverage could turn negative.

Progress Expected From Notice Extension

The industry expects substantial use of the Notice if it is extended. Not only are more banks expressing interest in providing liquidity, but more money market fund complexes are approving VRDP for investment.[8] Financing opportunities are encouraging. One major closed-end fund complex reports that it is working with three major financial institutions that have not served previously as VRDP liquidity providers with the potential to provide liquidity support for VRDP ranging from $2 billion to $2.5 billion. Other major closed-end fund sponsors estimate that $5 billion to $10 billion of liquidity support could be established over the next year.

The Notice is necessary for VRDP to remain a viable option for refinancing ARPS. Experience has shown, and current markets confirm, that banks will demand a six-month put right as a precondition for agreeing to serve as a liquidity provider.

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[6] Moreover, while the original placements of VRDP required a significant yield premium to then-existing levels of the SIFMA Municipal Swap Index (the principal benchmark for tax-exempt money market investing), the weekly remarketing process since has reduced that premium substantially.

[7] Uncertainty regarding bank capital requirements, which also made banks cautious in committing capital, was resolved only recently by the Basel III Accord.

[8] Six major money market fund complexes, representing over 50% of the buying capacity in the tax-exempt money market fund marketplace, have approved VRDP for investment. We expect market participation to increase as money market funds gain more experience with VRDP.

Potential Consequences If Notice Is Not Extended

Widespread deleveraging, and possibly even liquidation, of ARPS-issuing funds could occur if the Notice is not in effect when interest rates rise to a level at which the ARPS become uneconomic financing for the funds. In order to deleverage, closed-end funds could be forced to sell billions of dollars of municipal bonds; these sales could occur in a constrained time period and perhaps in a difficult market. Consequently, deleveraging could be disruptive to the municipal bond market, impacting adversely both investors (due to declining bond prices) and municipal bond issuers (due to increased interest rates and thus borrowing costs). The sharper the interest rate increase and the faster the deleveraging, the greater the potential municipal market impact.

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We urge the Treasury Department to extend the Notice. The relief, as we discussed, is fully consistent with sound tax principles. Moreover, not only has the recovery occurring in the credit markets generally taken longer than expected, but the general recovery does not address the auction market for ARPS. These auctions, which some initially thought might restart after several months, remain in widespread failure, leaving such ARPS holders without liquidity. Finally, few viable alternatives to VRDP exist for municipal funds. The continuing ability to issue VRDP pursuant to this Notice is a key solution to the ongoing ARPS crisis.

A multiple-year extension, we submit, is warranted.[9] Unlike other guidance issued by Treasury in response to the recent market developments, the Notice was issued with the expectation that it would have some "permanence." Specifically, the Notice contemplated that any liquidity facility put into place by December 31, 2010 could remain outstanding indefinitely. Moreover, the Notice contemplated that any liquidity facility put in place by that time could be replaced by new liquidity facility arrangements entered into thereafter. The Notice provides temporary guidance only in the sense that there is a cut-off date by which a liquidity facility must be entered into by a fund for the first time.

While a one-year extension will provide closed-end funds with additional time to enter into initial liquidity facilities under the Notice, the current interest rate environment may prevent funds' full utilization of the Notice. Nevertheless, even a one-year extension will benefit greatly existing ARPS holders. Closed-end funds' common shareholders, the municipal bond markets, and municipal bond issuers also will benefit.

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[9] Industry participants remain concerned, as they were last year, that another one-year extension is not sufficient. *See, e.g.,* page 5 of the ICI's September 28, 2009 letter to John Cross Requesting Notice 2008-55 Extension ("Because of the uncertainties regarding how quickly the credit markets will recover, extending the guidance for only one year virtually guarantees that the industry will request another extension next year.").

We appreciate the careful consideration that the Treasury Department already has given to this request. Please let me know if we can provide you with any additional information. We look forward to continuing our discussions with you and your colleagues.

Sincerely,

*/s/ Keith Lawson*

Keith Lawson
Senior Counsel – Tax Law

cc: John Cross
Michael Novey