
Letter To the Editor: Why Muni Debt Managers Reject OAS Methodologies.

Re: "Kalotay cites higher muni costs, need for MA training due to advance refunding halt," The Bond Buyer, July 16:

As a 30-year public finance practitioner who has the privilege of working with some of the largest and most sophisticated issuers in the country, I have an answer for Mr. Kalotay as to why, referring to option-adjusted-spread (OAS) methodologies, "municipal debt managers have largely disregarded it, in favor of questionable seat-of-the-pants methods."

Firstly, finance is not physics. Newton's second law of motion has held up since the late 17th century because it is imposed on us by the realities of nature. Finance, however, is pure convention. It is a science/art that is organic and constantly evolving. It is the responsibility of debt managers to constantly seek superior decision making methodologies, not lock themselves into a generation old methodology that was never designed to address their programmatic realities.

Secondly, it is not correct to say that debt managers have largely disregarded OAS methodologies. Rather than disregarding OAS methodologies, my experience is that a large majority of sophisticated issuers have evaluated and rejected them in favor of more organic and integral methodologies.

The black box gang has always mistaken complexity for sophistication in the realm of financial modeling and it is both denigrating and arrogant to characterize non-OAS methodologies currently utilized by debt managers as "questionable seat-of-the-pants methods."

They are, in fact, methodologies developed by earnest and sophisticated public finance professionals over the course of the generation that has passed since the advent of OAS methodologies who are not willing to cede complex decision making processes to antiquated black box models that do not in any meaningful way capture the broad range of programmatic considerations inhered in modern municipal debt programs. (How could they? They were developed for a completely different purpose.)

As the article states, Mr. Kalotay is a fixed-income expert and of that there is no doubt. I both acknowledge and applaud his significant contributions in this area. But the reality is that the fixed-income analytics he espouses, which are at best of dubious value for their intended security analysis purposes, as proven during the calamitous financial crises, have even less value for public finance debt managers. Rather than weld himself to OAS methodologies, I encourage Mr. Kalotay to channel his unique intellect and insights into the development of new methodologies that are more relevant to the realities faced by modern public finance debt managers.

Frank Lloyd Wright, the great architect, wrote that "five lines where three are enough is always stupidity." That is the lesson I recommend the MSRB impose on municipal advisors as our profession continues its efforts to improve public finance decision making through the development of more organic and integral decision making processes.

Sincerely,

Laurence H. Wadler

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