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PRESENTATION TO

Securities and Exchange Commission

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CITADEL

The Role of Convertibles in the Capital Markets

The Convertible Market has been a Key Source of New Capital

- The convertible market is a primary source of capital for growth companies and undercapitalized sectors seeking to raise new capital
  - Software
  - Biotech
  - Semiconductor
  - Financial

- Through August the market was on pace for $100bn of new issuance in 2008
  - Financial institutions used the convertible market to raise over $40bn of new equity capital this year
    - Bank of America $7 billion
    - Wachovia $4 billion
    - Citigroup $3 billion
  - Banks extended bridge loans designed to be refinanced with new convertible offerings through the remainder of the year

Convertible Bond Investors

How do Convertible Bond Investors Manage Risk?

- Approximately two-thirds of the investors in the $350bn convertible market pursue a relative value strategy

- Relative value investors seek to identify value discrepancies between convertible securities and underlying equities

- Relative value investors sell the common stock of the issuer to isolate values identified and manage and mitigate risk; not to express a bearish equity view of the issuer

- In fact, most convertible investors have considerable net long exposure to the underlying equity
  - i.e., many fewer shares are sold short as a hedge than shares into which the security is ultimately convertible

The Regulatory Environment

Regulatory Uncertainty Has Greatly Impacted the Convertible Market

- The scope of covered securities expands daily and now includes companies in the health care, industrial, and consumer discretionary sectors

- Little to no advance notice is given when new names are added to the list
  - Market participants are forced to quickly react to the latest series of restricted companies
  - The stability and predictability of the market has been replaced with instability and uncertainty

- Due to short-sale restrictions, convertibles in the financial sector have dramatically underperformed convertibles of other sectors
  - The direct and immediate impact on convertible pricing has been more severe than the impact from any other event over the past 20 years

Current State of the Convertible Market

Since the Adoption of the SEC's Emergency Orders, the Convertible Market has Ceased to Function

- Uncertainty in the marketplace has shut down the primary market and greatly reduced liquidity in the aftermarket
  - Last new convertible issue in the U.S. was over two weeks ago – a typical week will see approximately four new issues
  - Volume of bonds traded in the secondary market has declined over 50% since September 19
- Relative value investors that cannot manage or mitigate the risks of their holdings are unwilling to purchase new issues from companies that are seeking to raise capital
  - Uncertainty in the regulatory environment has made investors afraid to commit capital - nobody is sure what will happen next
  - Even if companies were able to raise capital, the cost of that capital will come at a markedly higher cost if relative value investors cannot manage their risk

Pending Bond Conversions will be a Problem for Issuers

Some Convertibles are Trading at Levels that Give the Holder an Incentive to Convert and Force the Issuer to Pay Cash

- The inability to short stock against convertible securities has created pricing anomalies
- Some convertibles are trading at levels below conversion value, giving holders of such convertibles an incentive to convert
- Pressure to quickly de-lever further exacerbates this incentive, especially in the absence of a market outlet
- In some cases, in lieu of delivering shares, issuers are contractually obligated to deliver cash equal to the conversion value of the security
- The same companies that tapped the convertible market for financing will not have an alternative to raise new capital to satisfy the conversion
- What happens to companies that cannot raise new capital and are forced to pay cash to the holders of their convertible securities due to unexpected early conversion?

How Can we Prudently Open the Convertible Market?

Adopting an Exemption Consistent with FSA's will Open the Convertible Market and Preserve the Goals of the Emergency Order

- The FSA order allows the holder of a convertible security to short the delta equivalent of underlying shares
  - The holder of the security can short up to the delta equivalent of long shares represented by the convertible
  - The holder of the security cannot take a 'net economic short position' where the number of short shares is greater than the delta equivalent of long shares represented by the convertible
- As the delta of the convertible instrument changes a market participant can adjust its hedge by selling short, or purchasing, underlying shares
- The number of shares that can be sold short is capped at the number of shares the convertible holder would receive at conversion

SEC Exemption

The SEC can Similarly Address the Issues Facing the Convertible Market

- We suggest the following language for an exemption
  - IT IS ORDERED that, pursuant to our Section 12(k)(2) powers, the requirements of this Order shall not apply to any short sale effected as part of a bona fide hedging strategy directly related to convertible bonds, convertible preferred securities, warrants, and similar company issued derivative securities.

- An exemption that allows only short sales that do not increase a net short economic exposure will fall well short of what is needed to restart the convertible securities markets
  - The largest investors in convertible securities are large diversified firms that will have numerous other net short economic exposures that would prevent convertible securities hedging and thus would prevent holding convertible securities