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MUNICIPAL SECURITIES FULL DISCLOSURE ACT OF 1976

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

S. 2969

TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO REQUIRE THE PREPARATION OF ANNUAL REPORTS AND DISTRIBUTION STATEMENTS BY ISSUERS OF MUNICIPAL SECURITIES, AND FOR OTHER PURPOSES

S. 2574

TO AMEND THE SECURITIES ACT OF 1933 TO PROVIDE FOR THE REGISTRATION OF SECURITIES ISSUED BY STATE AND LOCAL GOVERNMENTS

FEBRUARY 24, 25, AND 26, 1976

Printed for the use of the
Committee on Banking, Housing and Urban Affairs

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U.S. GOVERNMENT PRINTING OFFICE

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CONTENTS

	Page
S. 2969	5
S. 2574	3

LIST OF WITNESSES

TUESDAY, FEBRUARY 24

Thomas F. Eagleton, U.S. Senator from the State of Missouri	14
Roderick M. Hills, Chairman, Securities and Exchange Commission	18
Edwin H. Yeo, III, Under Secretary of the Treasury for Monetary Affairs; accompanied by Robert Gerard, Deputy Assistant Secretary for Financial Resources Policy	30
Harvey Kapnick, chairman and chief executive, Arthur Andersen & Co.; accompanied by Mario V. Marabelli, and Charles A. Bowsher	42

WEDNESDAY, FEBRUARY 25

Brenton W. Harries, president, Standard & Poor's Corp.; and Jackson Phillips, executive vice president, Moody's Investor Services, Inc	109
Richard F. Kezer, president, Dealer Bank Association; accompanied by Henry T. Rathbun, Wilmer, Cutler, & Pickering	123
Wallace O. Sellers, Merrill, Lynch, Pierce, Fenner, & Smith, Inc., chairman, Public Finance Council; David G. Taylor, Continental Illinois National Bank & Trust Co. of Chicago, vice chairman, Public Finance Council; Gedale B. Horowitz, Salomon Bros., co-chairman, Municipal Federal Legislation Committee, Public Finance Council; and Arthur Fleischer, Jr., Fried, Frank, Harris, Shriver, & Jacobson; for the Public Finance Council of the Securities Industry Association	135

THURSDAY, FEBRUARY 26

Richard Carver, Mayor, Peoria, Ill.; on behalf of the National League of Cities and the U.S. Conference of Mayors	155
Jim Flaherty, chairman, Allegheny County Board of Commissioners for the National Association of Counties, accompanied by Aliceann Fritschler, deputy director for federal affairs	166
Gilman C. Gunn, III, senior municipal bond analyst for the Chubb Corp., accompanied by Robert G. Nordling, vice president	203
S. Grady Fullerton, Harris County Auditor, Harris County, Tex.; member of executive board and former president, Municipal Finance Officers Association, William J. Reynolds, director of finance, Greenwich, Conn.; vice chairman Government Debt Administration Committee, Municipal Finance Officers Association, accompanied by John Peterson	209
Donald Robinson, Hawkins, Delafield & Wood, New York City	231
Richard B. Smith, Davis, Polk, & Wardwell, New York City	236
Donald R. Hodgman, O'Melveny and Meyers, Los Angeles, Calif	241
Ronald W. Forbes, associate professor of finance, State University of New York	251
Robert W. Doty, professor of law, Creighton Law School	307
Evelyn Y. Davis, editor, "Highlights and Lowlights"	328

ADDITIONAL STATEMENTS AND DATA

Allegheny County Bonds:	
Customary 4-page prospectus	171
Full disclosure prospectus	175
American Bankers Association, statement for the record	331

	Page
Arthur Anderson & Co.:	
Letter from Charles W. Boand, Wilson & McIlvaine	58
Letter from Wilmer, Cutler & Pickering	64
Reprint of study titled "Sound Financial Reporting in the Public Sector:"	
Overall summary	75
Observations concerning current U.S. Government accounting and financial reporting	76
Questions related to governmental financial reporting	77
Illustrative consolidated financial statements—U.S. Government	78
Consolidated balance sheet	79
Consolidated statement of revenues and expenses	81
Consolidated statement of changes in cash and cash equivalents	82
Notes to consolidated financial statements	83
Certain economic questions related to consolidated financial statements	93
Conclusions and recommendations for U.S. Government	96
Appendix:	
1. Financial highlights	98
2. Government expenditures and gross national product	99
3. History of accounting in the U.S. Government	100
4. Accounting and reporting questions raised by illustrative consolidated financial statements	102
5. Excerpts from section 3 of Securities Act of 1933	103
Congressional Record, reprint of remarks of Senator Williams on introduction of S. 2969	66
Daily Bond Buyer:	
Article by Robert W. Doty titled "The Case for Self-Regulation in Tax-Exempt Bond Financing"	322
Excerpt from Calendar of Sealed Bid Opening	208
Grant, William R., vice chairman, Smith, Barney, Harris, Upman & Co., letter and attachments received	336
Harris County, Tex., resolution of the Commissioner's Court	230
Mitchell, Thomas F., comments received in letter to the subcommittee	348
Municipal Finance Officers Association:	
Current reporting and disclosure staff work paper	361
Disclosure guidelines for offerings of securities by State and local governments	289
Resolution of executive board	213
Municipal Securities Rulemaking Board, statement received for the record	386
Municipal Advisory Council of Texas, letter enclosing descriptive leaflet	356
Municipal Issuers Service Corp., letter from John R. Butler	379
North Carolina Local Government Commission, letter and accompanying notice and blank proposals received from Harlan E. Boyles, secretary	408
Pell, Haven N. B., letter enclosing no-action letter submitted to Securities and Exchange Commission	500
Rathbun, Henry T., memorandum on constitutionality of a Federal statute providing for civil damage actions in Federal courts against issuers of municipal securities and their officials	511

CHARTS AND TABLES

Electorate of Allegheny County, Pa	191
Municipal Finance Study Group, tables and charts accompanying prepared statement:	
Average annual interest rates on long-term municipal and corporate bonds rated by Moody's	273
Number of institutions with full-time municipal credit analysts	272
Size distribution of general obligation bonds in survey of official statements	270
Summary measures of new issue volume in municipal and corporate securities markets, 1970–75	269
Summary of reporting practices in survey of official statements	271
New issue market yields on Aaa and Bbb rated general obligation bonds	148
Size distribution of municipal bond issues	149
Tax exempt/taxable yield ratio	148
Total costs of flotation	320

MUNICIPAL SECURITIES FULL DISCLOSURE ACT OF 1976

TUESDAY, FEBRUARY 24, 1976

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room 5302, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr. (chairman of the subcommittee) presiding.

Present: Senators Williams and Tower.

Senator WILLIAMS. These hearings of the Subcommittee on Securities will come to order.

This morning the Subcommittee begins three days of hearings on legislation to upgrade the quality and uniformity of financial and other information concerning State and local issuers of municipal securities—S. 2574, introduced by Senator Eagleton, and S. 2969, introduced last week by Senator Tower and myself.

A year ago there was little reason to reexamine the status of issuers of municipal bonds under the Federal securities laws or the application of its concepts to State and local borrowers. The antifraud provisions alone seemed adequate to achieve the necessary disciplines in the offering of municipal securities.

The situation is far different today. The past year has seen turmoil and uncertainty in our municipal securities market. Mr. Lennox Moak, the Philadelphia Director of Finance, vice president of the Municipal Finance Officers Association, and a respected authority on municipal finance, accurately described these conditions in testifying on the plight of New York City:

> Increasingly, it seems that the confidence in municipal bonds has disappeared. My analysis of this indicates that this is due to several factors. The first is there is no universal accepted accounting procedure for State and local governments so that one does not know when he reads an accounting statement precisely what it really means.
>
> Second, there are no broadly accepted set of opinions for disclosure of information concerning financial conditions and in many cases, especially general obligations bond issues are sold with no disclosure whatever to potential purchasers. This is not true in the case of revenue bond issuers. Yet even there, it depends on the combined interests of the parties concerned in the transaction.

On the second point, he elaborated by adding:

> There are no requirements for an effective flow of continuing information during the life of the bond issue. Nor is there any uniform system for its organization and circulation. Nor is there any central point from which existing information can be secured.

I agree with this excellent analysis of the problem as well as the solutions proposed:

> The establishment of well-defined alternative systems of accounting which would be acceptable for application by State and local governments . . . and establishment of standards for disclosure incident to the creation and servicing of the debt of state and local governments.

These recommendations are the very foundations of S. 2969.

A congressional reexamination of the longstanding exemption of municipal issuers from the Federal securities laws is necessary to facilitate informed investment decisions, promote responsible municipal fiscal practices. and to maintain confidence in the efficiency and integrity of the marketplace.

The objectives of our review are threefold:

First, more information about issuers' financial condition and other essential information must be made available. Also, it must be timely, accurate, and compiled on a uniform basis. Unless this is done, there will be less investor participation, lower ratings, and underwriter antipathy—meaning less total borrowing and at higher interest rates.

Second, the lack of uniform and nationwide municipal accounting standards and practices must be remedied and the current hodgepodge of current practices and customs must be replaced by more generally accepted procedures. The benefits derived from such procedures currently exist in some States. In these instances, credit ratings have improved and sound fiscal management and standardized municipal accounting and reporting have resulted in lower borrowing costs to the taxpayer.

Third, municipal issuers must compete for the savers' dollars more effectively to meet projected future capital needs. To promote confidence and stimulate demand, individual investors will be called upon to participate to a greater extent in the primary market. The protections and safeguards of the securities laws must be available to them. This means that some of the disclosure standards investors are accustomed to in the corporate sector will have to be adapted to fit the unique nature of Government borrowers.

There are several possible ways in which these goals can be achieved.

State government could impose such requirements. This has been the pattern since municipalities were first exempt from the securities laws 43 years ago. Unfortunately, this approach has not proved successful. With few exceptions, progress toward improved disclosure and uniform accounting practices has been unsatisfactory, notwithstanding the efforts of the Municipal Finance Officers Association.

[Copies of the bills being considered follow:]

94TH CONGRESS
1ST SESSION

S. 2574

IN THE SENATE OF THE UNITED STATES

OCTOBER 28, 1975

Mr. EAGLETON introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs

A BILL

To amend the Securities Act of 1933 to provide for the registration of securities issued by State and local governments.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 3(a)(2) of the Securities Act of 1933 is amended—

(1) by striking out "or any territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or territory or by any public instrumentality of one or more States or territories,"; and

(2) by striking out "or any security which is an industrial development bond" and all that follows

through the semicolon following "does not apply to such security".

(b) Section 3 of such Act is amended by adding at the end thereof the following new subsection:

"(d) The Commission may from time to time by its rules and regulations and subject to such terms and conditions as may be prescribed therein add to the securities exempted as provided in this section any class of securities issued by a State of the United States or by any political subdivision of a State or by any territory of the United States or political subdivision of a territory or by any public instrumentality of one or more States or territories if it finds, having regard to the purposes of this title, that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors.".

(c) Section 15B(d)(1) of the Securities Exchange Act of 1934 is amended by striking out "Neither the Commission nor the Board is" and inserting in lieu thereof "The Board is not".

94TH CONGRESS
2D SESSION

S. 2969

IN THE SENATE OF THE UNITED STATES

FEBRUARY 17, 1976

Mr. WILLIAMS (for himself and Mr. TOWER) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing and Urban Affairs

A BILL

To amend the Securities Exchange Act of 1934 to require the preparation of annual reports and distribution statements by issuers of municipal securities, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Municipal Securities Full Disclosure Act of 1976".

SEC. 2. (a) Section 3 (a) (12) of the Securities Exchange Act of 1934 is amended by inserting "13A," immediately after the phrase "for the purposes of sections".

(b) Section 3 (a) (10) of such Act is amended by inserting "guarantee of," immediately after "receipt for,".

(c) Section 12 (h) of such Act is amended by inserting "13A," immediately after "section 13,".

(d) Section 15B (d) (1) of such Act is amended by striking out "Neither the Commission nor the Board is" and inserting in lieu thereof "The Board is not", and by striking out "with the Commission or the Board" and inserting in lieu thereof "with the Board".

(e) Such Act is further amended by inserting after section 13 the following new section:

"MUNICIPAL SECURITIES DISCLOSURE

"SEC. 13A. (a) (1) Any issuer of municipal securities which has outstanding during any portion of a fiscal year an aggregate principal amount of municipal securities exceeding $50,000,000 shall prepare for such fiscal year an annual report and reports of events of default in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or for the protection of investors.

"(2) The annual report required by paragraph (1) shall contain the following information, if applicable:

"(A) An identification and description of the issuer of the securities outstanding;

"(B) A description of any legal limitation on the incurrence of indebtedness by the issuer or the taxing authority of the issuer;

"(C) A description of the issuer's debt structure, including information with respect to amounts of authorized and outstanding funded debt; estimated amount of short term debt, character of amortization provisions of funded debt, sinking fund requirements, security for debt, nature and extent of guaranteed debt, and debt service requirements;

"(D) A description of the nature and extent of other material contingent liabilities or commitments of the issuer;

"(E) If any payment of principal or interest on any security of the issuer or any predecessor thereof has been defaulted on, or has been postponed or delayed, within the past twenty years, a description of the date, amounts and circumstances of such event and of the terms of any succeeding arrangements thereof;

"(F) A description of the issuer's tax authority and structure over the past five years including the nature of taxes levied, tax rates, property (real and personal) valuation and assessment procedures, amounts of property valuations and assessments, amounts of tax levies, amounts of tax collections and delinquent tax procedures and experience;

"(G) A description of the issuer's major taxpayers;

"(H) A description of the principal governmental

and other services provided or performed by the issuer, the extent to which similar or differing services are performed by other governmental entities which serve the same geographic area and any major changes in such services in the last ten years;

"(I) A description of the nature and extent of Federal or other assistance programs available to the issuer; and

"(J) Financial statements of the issuer in such detail and form and for such periods beginning not earlier than the fifth previous fiscal year as the Commission may prescribe, which statements for any fiscal year commencing on or after December 31, 1978, shall be audited and reported on by an independent public or certified accountant in such manner as the Commission may prescribe.

"(3) The reports of events of default referred to in paragraph (1) shall contain such of the information required by paragraph (2) as the Commission may by rule or regulation prescribe.

"(4) The reports required by paragraph (1) shall, in addition, contain such other similar and specific information as the Commission may by rule or regulation prescribe as being necessary or appropriate in the public interest or for the protection of investors,

"(b) (1) Except as provided in subsection (c), any issuer that offers or sells an issue of municipal securities, the aggregate principal amount of which exceeds $5,000,000, to or through a municipal securities broker, municipal securities dealer, or bank acting as agent, shall, prior to such offer or sale, prepare a distribution statement in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or for the protection of investors.

"(2) The distribution statement required by paragraph (1) shall contain such of the information pertaining to the issuer required by subsection (a) (2) as the Commission may by rule or regulation prescribe, and the following:

"(A) A description of the offering, including amount to be offered, price, plan of distribution, and underwriting arrangements and compensation;

"(B) A description of the security to be offered, including provisions as to security, events of default, payment of principal and interest, sinking fund, redemption, debt reserve funds, priority, legality and authorization for issue and rights of security holders to bring suit against issuers;

"(C) A description of any project or enterprise of the issuer to be financed from the proceeds of revenue or special assessment securities, and any engineering or

financial feasibility reports or studies on the construction and operations of the project or enterprise;

"(D) A description of the intended use of the proceeds of the offering;

"(E) A statement of counsel's opinion as to the legality of the issuance of the securities to be offered;

"(F) A statement of the availability of the reports required by this section; and

"(G) Such other similar and specific information as the Commission may by rules or regulations require as necessary or appropriate in the public interest or for the protection of investors;

except that, prior to any sale, the information specified in subparagraphs (A), (B), and (E) may be set forth in preliminary form.

"(c) The provisions of subsection (b) shall not apply to an issuer solely by reason of an offer or sale of municipal securities—

"(1) the disclosure with respect to which has been approved, after hearing, as adequate for the protection of investors by a State governmental authority (other than the issuer) expressly authorized by law to grant such approval, or

"(2) which would meet the criteria set forth in sections 3(a)(9), 3(a)(10), 4(1), 4(2), 4(3), or

4(4) of the Securities Act of 1933 if such offer or sale were not within the scope of section 3(a)(2) thereof.

"(d) The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, change the minimum amounts set forth in subsections (a)(1) and (b)(1) if, giving due regard to such factors as general economic conditions, costs involved, and the nature of the distribution system for municipal securities, such change is deemed to be appropriate in the public interest.

"(e) The Commission may prescribe, in regard to reports and distribution statements made pursuant to this section, the form or forms in which the required information, including the financial statements, shall be set forth, and the accounting methods to be followed in the preparation of financial statements.

"(f)(1) The issuer shall make the reports required by subsection (a)(1) of this section available upon request to security holders at the issuer's expense and to others at their expense and shall give appropriate public notice of such availability.

"(2) The issuer shall make the distribution statement required by subsection (b)(1) of this section available to municipal securities brokers, municipal securities dealers, and banks acting as agent for delivery to prospective purchasers

in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(3) The reports and distribution statements required by this section shall also be maintained by the issuer at a designated location for examination by the public in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Commission may also contract to establish a central repository which shall receive and maintain such reports, and may require the contractor to adhere to such rules and regulations as the Commission may prescribe in furtherance of the purposes of this section. Each person subject to the requirements of this section shall, upon the establishment of any such repository, thereafter file copies of reports and distribution statements required to be prepared by this section with the repository in accordance with such rules and regulations as the Commission finds are necessary or appropriate in the public interest.

"(g) In no event shall any underwriter of an issue of municipal securities (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable

in, or as a consequence of, any suit for damages in excess of the total price at which the issue was sold by it to the public.".

SEC. 3. The amendments made by section 2 take effect on January 1, 1977.

69-141 O - 76 - 2

On the other hand, the investment banking community could impose these requirements as a condition for the purchase of municipal securities. This has been happening in several instances during recent months but there are several drawbacks. For one thing, financial information is usually not reviewed or verified by independent public or certified accountants. Furthermore, the 1975 Securities Act Amendments expressly limits the authority of the SEC, the Municipal Securities Rulemaking Board and underwriters from requiring detailed disclosures from municipal issuers. The Board, for example, can only require dealers to supply information to investors which is generally available from a source other than the issuer.

The final approach of empowering the Federal Government to impose disclosure requirements is embodied in the bills now pending before our subcommittee, although there are substantial differences between them. Senator Eagleton's bill would subject municipal issuers to the full sweep of the registration provisions of the Securities Act of 1933.

In contrast, my bill would require the preparation of annual reports and distribution statements, specify their contents, and limit the SEC's responsibility and authority to administering the reporting requirements. In this way, bondholders and prospective investors would be fully informed of the precise nature and terms of the bonds being offered, as well as various other relevant matters concerning the issuer. But, the bill does not contemplate or permit direct regulation of municipal issuers through registration, waiting periods or through the filing of sale documents with the SEC.

In addition, only municipalities of significant size would have to comply with the annual report and distribution statement requirements of the bill. At the reporting levels in the bill, it is estimated that only 6 percent of the approximately 78,000 municipal issuers would have to prepare annual reports. It is more difficult to estimate the impact of the distribution statement requirements, especially since the bill expressly exempts offers or sales approved by an authorized State authority—a pattern which the bill would encourage.

Local governments must be able to borrow at reasonable costs. How best to achieve this result is the subject matter of our hearings and of the legislation before us today. I am confident, however, that as a result of our deliberations, accounting and disclosure standards acceptable to investors and the various governmental, trade, and professional groups involved in the municipal securities markets can and will be developed.

Senator WILLIAMS. We have a substantial list of witnesses for opening testimony and appropriately begin with the sponsor of one of the bills before us, Senator Thomas Eagleton of Missouri. So we welcome you, Senator Eagleton.

STATEMENT OF THOMAS F. EAGLETON, U.S. SENATOR FROM THE STATE OF MISSOURI

Senator EAGLETON. Thank you, Mr. Chairman.

I sincerely appreciate your invitation to be the first witness in these hearings on regulation of municipal securities. I commend you and

your colleagues on the committee for acting so promptly to call hearings after the initial discussion on my bill, S. 2574, late last year.

At the time I introduced my bill last fall, we were in the throes of the New York City crisis. I sat in this very hearing room as the full committee listened to witness after witness describe the city's condition and the impending day of reckoning. One fact, brought out time and again, was that lack of sound financial reporting was a major cause of the crisis.

The circumstances which led to the passage of the emergency aid bill did not come about overnight. Problems had begun germinating as long as 10 or 15 years ago. Public officials, the banks, the bond rating services, the union leaders—many had some knowledge long ago that all was not well with New York City. But they all went along, perpetuating the public story of fiscal soundness, until the house of cards collapsed.

Mr. Chairman, I know that I need not belabor the point before this subcommittee. The conclusion, I believe is unmistakable: There is an urgent need for legislation to open up and clean up the books of our cities and States. Only then can we assess the magnitude of the problems and develop measures to resolve them in an orderly and deliberate manner, well in advance of a major crisis. I see such legislation as a protection not only for investors, but also for public officials, State and local government workers, city residents—for all of us.

As you know, I introduced my bill on October 28, 1975, and offered it as an amendment to the New York City aid bill on December 5. This amendment, by the way, was withdrawn because of the urgency of the bill. This legislation would require the registration of tax-exempt bonds with the Securities and Exchange Commission, and subject these issuers to substantially the same accounting and disclosure requirements now required only of corporations.

This is something we can do now to curtail the artful accounting and management practices which have either destroyed, or soon will destroy, the creditworthiness of some of our large cities and even some of our states. A corporation seeking to issue new stock or bonds must meet a rigid set of requirements for accuracy and consistency in its reporting of financial data. The security itself, the terms of repayment, the use of the proceeds, and the company's operations must be described in the offering statement. Certified financial statements, earnings statements, and balance sheets for the previous 5 years must be submitted, after approval by an independent public accountant.

State and local governments are subject to much less stringent requirements when they seek to place a bond offering. There are no reporting or certification requirements at all. A municipality may tell a prospective buyer as much or as little as it chooses.

Mr. Chairman, I believe that requiring SEC registration would bring about the necessary changes. The many well-run States and communities could more easily demonstrate their soundness and the deservedness of their high credit ratings and low interest rates. At the same time, any bond issuer which was manipulating figures to show a balanced budget would be exposed. Good issues could be more easily differentiated from bad issues, and fiscally responsible units of

government might then see their prudence rewarded by lower interest rates and more competitive bidding.

A few other points regarding my bill are worthy of mention. Registration with the SEC could impose a burden on small units of local government issuing small amounts of bonds. These issues are typically placed privately, often entirely within the state. My bill follows existing procedure in permitting the SEC to exempt these types of issuers.

Further, I think it is recognized that most units of government do not keep their books according to generally accepted accounting principles. From what I know about audits currently underway in New York City, Washington, and elsewhere, it could be years before many cities are able to meet these standards. My bill, as offered in December, recognizes this fact, and also the fact that the SEC staff would have to be augmented, by delaying the implementation date.

Mr. Chairman, I think my bill is fair to all concerned and represents good public policy. It would not prevent future defaults, just as the acts of 1933 and 1934 have not prevented corporate bankruptcies. But at least investors and bankers and bond rating services and taxpayers and the U.S. Congress would know what sort of financial situation a State or municipality was in before default became even a remote possibility.

I would also like to take advantage of your offer to comment on the disclosure bill introduced by you and the ranking minority member of the committee, Senator Tower, last week.

Mr. Chairman, we are clearly seeking the same goals in our two bills. The difference, as I see it, is largely one of approach: I sought a simple, clearcut piece of legislation that I thought could easily find support in Congress, leaving the detailed rulemaking authority to the SEC; you and Senator Tower have opted for codifying the various requirements.

Many of the points in your bill—annual financial statements, auditing by independent public accountants, descriptive offering statements, exemptions for small issuers—I have suggested myself and would, of course, support. Your bill does not require prefiling with the SEC. I do think a strong role for the SEC is required, and I would encourage the Subcommittee not to weaken the controls too much if you think full registration in advance may be too stringent.

In short, I am encouraged by the bill you have introduced and the hearings that are now taking place. I am prepared to help the subcommittee in any way I can to see that these important first steps are carried through to their conclusion.

Finally, Mr. Chairman, let me say with my usual refreshing modesty, your bill is very good. It's almost as good as mine.

Senator WILLIAMS. We appreciate your statement and not only your interest but your leadership in filling this gap in the framework of securities legislation within which the SEC operates. I look back to the end of last year when we had the New York City crisis question before us. I know that you attended those hearings when the witnesses came in and described with some drama the needs of New York City. You and I responded and supported the measure that offered relief to the city at that time.

Looking ahead to testimony the Subcommittee will receive during these three days of hearings, I see that some of the witnesses that were here pleading the cause for New York and for our support, federal support, will be here in opposition to our legislation, yours and Senator Tower's and mine.

You probably haven't seen the statements that we do have filed that will be following your testimony, but do you have any comments on that general description—witnesses who want Federal support for cities in times of crisis but who are now opposed to bringing municipal issuers under fair standards of disclosure and financial statements, certified financial statements?

Senator EAGLETON. If municipal officials do testify here and say they are opposed to the concept—they can quibble about the contents of our bills—I think they are very shortsighted and unenlightened indeed. Let me put it another way. In my state, Mr. Chairman, Kansas City has, as a matter of charter, routine annual statements by a CPA. It's been in the charter of Kansas City for many years. Jackson County, which is the county that surrounds Kansas City, where President Truman was the presiding judge of the Jackson County court, dating back to his day, there was an annual audit by the CPA for Jackson County. In St. Louis County, Mo., the largest county in our State with 1,100,000 people, it's a matter of their charter: an annual certified audit. Sadly, the city that needs it most in my State, St. Louis, Mo., the oldest city, the city beset with the greatest problems, does not have it and is going through the pains now of an audit, and they know not where that will lead.

So for the well-run cities, the modern cities, the progressive cities, this is a matter of standard routine with them. If you went to the mayor of Kansas City he would fight you very bitterly if you tried to change the annual audit. Yet the old cities, especially in the Northeast and in the North Central region, the New York cities, the Detroits, the Clevelands—those are the cities that need it the most and I guess will come before this committee and fight it the hardest.

Maybe that's human nature. Maybe no one wants somebody looking over their shoulder. But when you come to the federal government for billions of dollars and pledge to the federal government that within 3 years you're going to have it all straightened out in New York City—that's poppycock. They won't have this thing straightened out in 3 years. You could have all the eight largest CPA firms—Arthur Andersen has been the leader in this field and we have retained them for the District of Columbia—they could be up there two years and make only a slight dent in the books and records crisis. We will never get a handle on these municipal problems unless we have accurate records and unless we can accurately predict what income is going to be, what expenses are going to be. You can't run a business without doing it on that basis. You can't run New York City or Washington, D.C. that way.

Senator WILLIAMS. If you had known that the Municipal Finance Officers Association and the brokerage house underwriters, or at least some of them, would oppose these requirements that we're putting in our bills, would that have affected your judgment on the New York City decision?

Senator EAGLETON. Again, I'd be surprised. I should think the stock brokers of America, in trying to sell worthwhile securities, securities that have a sound basis, would like to have the backing of some CPA figures—some statements that said, look, this bond that I'm recommending that you buy for your accounts or for these widows and orphans, we're going to put all the trust funds of the New York City school teachers in these issues. I think they ought to be the first to say we want these to be gilt-edged securities; we want to show our clients that these are worthy investments. They should not be the people fighting the bill. They should have been here two years ago leading the charge, but you know, wisdom comes late to many.

Senator WILLIAMS. Thank you very much, Senator.

Senator EAGLETON. Thank you, Mr. Chairman.

Senator WILLIAMS. Chairman Roderick Hills, Chairman of the Securities and Exchange Commission, is our next witness. We appreciate all you have meant to the development of this legislation, and we welcome you here this morning.

STATEMENT OF RODERICK M. HILLS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. HILLS. I might say that the Commission regards S. 2969 as an appropriate framework in which the Commission can be most effective in dealing with the problem that the subcommittee is dealing with. I have filed with the subcommittee a copy of my statement and with your permission I will excerpt from the statement some comments that we think are important.

Senator Eagleton and others have commented upon the need to protect investors. That obviously is a primary requisite and a primary objective of all of the laws administered by the SEC. If I may concentrate a bit on what seems to us to be a second objective, namely, to assist the issuers and underwriters of municipal securities in meeting their legal responsibilities under the federal securities laws. It seems to us that the second point may not have had sufficient attention in the recent discussion about the needs for disclosure requirements for municipal issuers.

As the Senator knows, the Securities and Exchange Commission now has the responsibility to enforce the antifraud provisions of the 1933 and 1934 acts. That means that if negligent or deliberate misrepresentations of fact are used in marketing municipal securities, we have the obligation to seek enforcement of these provisions of the 1933 and 1934 acts. It means, as the Senator knows, that on occasion we have to launch a major investigation of such alleged activities. It seems to us that not only our own litigation at the SEC, but the private litigation that will necessarily be engendered of the type we now see in the State of New York, can only add to the problems that we have seen growing presently in the industry. There has been to date little litigation but there seems now to be the prospect of considerable litigation which will further define the obligations of the parties, the issuers and the underwriters in this area.

The point which I make is that the bill in its present form does not expand the enforcement responsibility of the Commission and indeed

it does not expand the ultimate liability of either the issuers or the underwriters. It attempts merely to provide a standard to clarify that responsibility and a standard by which the SEC can better deal with the issue.

The proposed legislation of Senator Eagleton has to be viewed in light of the longstanding exemptions that have existed for municipal securities. Those exemptions, whatever their justification was in the past, come into a new view today, where the circumstances convince us that the use of municipal securities, the trading of municipal securities, and the reliance upon municipal securities is far more widespread in our society than it was 10, 20 or 30 years ago.

As a result, there is not only the greater likelihood of lawsuits, but there is a greater likelihood of inappropriate reliance upon the veracity of the information that people have with respect to those securities.

Because of municipal trading market problems that have occurred in recent years, the Securities Act Amendments of 1975 were passed in order to provide the Commission and the Municipal Securities Rulemaking Board with expanded authority to develop rules that would govern that market and govern the role of underwriters therein. But improvement of municipal issuer information was not one of the main objectives of the 1975 Amendments. In recent months and certainly in 1975, serious questions have arisen concerning the accuracy of the financial information that is being provided. It is in response to that problem that this proposed legislation is most fitted.

The failure of issuers to provide data of a consistent and understandable nature to underwriters and investors is necessarily going to cause a kind of confusion that is undesirable in a field of this size. There have been already, and no doubt there will be more, attempts by underwriters and by issuers to secure more information for people that wish to trade and wish to buy these securities. The fact is that we can, I think, properly guess that there will be a certain competition for disclosure, that around the country various underwriters, various rating services will seek to promote more and more kinds of disclosure, a kind of competition that will not necessarily aid the issuers, a kind of competition that is not necessary for protection of investors. Giving us authority to create standards that will make for a more uniform financial presentation, we think, will eliminate this potential competition; it will eliminate the confusion that exists to a degree already, and the confusion that can only be compounded as judicial decisions evolve.

It's important to note that S. 2969 does not embody any amendment to the Securities Act of 1933. As a consequence, municipal securities under S. 2969 would continue to be exempt from the registration requirements of the Securities Act. S. 2969 would amend only the Securities Exchange Act of 1934 by adding a new section 13A, which would provide disclosure requirements for municipal securities as defined in section 3(a)(29) of the Exchange Act.

The disclosure requirements of 13A, as proposed, are considerably more limited in scope than the analogous requirements in the Securities Act.

It's also important to point out that the information required by this legislation would not be filed with or automatically reviewed by

the Commission. We would have the authority to assist in the creation of a repository to insure that the information would be available for the Congress and the SEC to determine whether or not other methods were necessary to deal with the problem and would be available to underwriters and other people dealing in this industry so that they would have a better understanding of what is happening.

We note that the bill would require an issuer with more than $50 million in municipal securities outstanding to file certain reports and in any case in which an issuance of more than $5 million of municipal securities is contemplated there would be a distribution statement required.

We have analyzed the exemption from the distribution statement requirement which defers to State regulators and we think it is a useful one. We should point out to the subcommittee that the exemption, in its present form, relies very heavily upon the good faith which we expect on the part of States to determine that the purposes of the disclosure provisions of the proposed legislation have been met. Whether or not some additional requirement should be included to the effect that the disclosure approved by a State must be similar to that which this bill would require, is a matter for the Congress to decide. From our standpoint, we do wish to encourage the excellent type of State regulation that we see developing in many States, the kind of local regulation that Senator Eagleton referred to. It's important, I think, particularly to focus on the differences between the authority of the SEC to require additional disclosure under the 1933 act and under proposed 13A of the 1934 act. In sections 7 and 10 of the 1933 act, the Securities and Exchange Commission has a broad authority to require such additional disclosure as it may deem necessary or appropriate of issuers which are subject to the registration requirements of that act. The proposed bill, on the other hand, would give us limited authority to require additional similar and specific information of municipal issuers. The bill would essentially require the type of general information that is required by Schedule B of the 1933 act. The type of information which would be required derives from the different nature of a municipality. The bill would require disclosure of those things that relate more to revenue and expense and cash flow than those things that would deal with detailed operations.

It is important to emphasize the point again that this legislation does not expand the existing liability of municipal issuers. It merely assists in clarifying the extent of their obligation to disclose information.

There are some matters which we should point out which these hearings should direct themselves to from time to time—whether or not the initial threshold amounts of $50 million and $5 million are appropriate are matters on which we presently have no opinion. Our empirical data in this area is scanty. These strike us as reasonable initial limits but it may very well be that these hearings will develop data that suggests some other threshold limitations are appropriate.

Second, the committee may wish to consider issues relating to the scope of underwriter liability. This bill contains a limitation in section 13A(g) which is borrowed from a similar provision in section 11 of the Securities Act. Municipal securities underwriters and their

counsel may wish to comment upon that limitation and they may wish to make additional suggestions, but the point, of course, is that this limitation should be helpful in bringing underwriters back into the field in this period of uncertainty.

Finally, and underlining in part the previous point, is the need for these hearings to explore the extent to which sovereign immunity is, under current law and should be under the proposed legislation, available to issuers of municipal securities. This bill does not treat that.

Mr. Chairman, as I said at the outset, the proposed legislation seems to us to be a responsible framework under which the Securities and Exchange Commission can best act. Its purposes are, of course, to protect investors, but equally the purposes of the proposed bill in our judgment would provide necessary and helpful information to underwriters and issuers, and would help eliminate confusion that we see developing in the field.

Senator WILLIAMS. Do you deal with analysis of the other approach, the filing and registration with the SEC by the issuer, Senator Eagleton's approach?

Mr. HILLS. Yes, I think it's fair to say that the load on the Securities and Exchange Commission in reviewing registration statements will change even in the corporate field in the future. I'm not prepared today to say exactly how it will change, but it will change. The requirement that a registration statement for municipal securities be received and commented upon by the SEC would create two problems. First, the massive obligation is one we simply could not meet. Even if the Congress were to greatly expand our budget, it would be years before we had a staff trained in those matters. The types of problems that have arisen in the past with respect to municipal securities do not suggest to us that that type of approach is appropriate.

Second, creation of standards for disclosure, given the longstanding capacity of the Enforcement Division of the SEC, seems to us to give us the necessary handle to protect the public interest. But to require us to comment on statement after statement involving so very many different kinds of municipalities, so many different kinds of political and economic problems, would impose a burden of great dimensions not only on the SEC but upon the industry generally. We at this time see no reason to put that burden either on the Commission or on the industry.

Senator WILLIAMS. A lot of discussion and thought still has to go into the enforcement of the standards here. This is rather a thicket of law. Earlier in your statement you mentioned the greater likelihood of lawsuits in the present atmosphere. We might be able to start there to just run through effective enforcement of new standards that would be imposed without the SEC being the recipient or depository of registration statements.

Mr. HILLS. Well, the SEC, of course, would have under the proposed bill initial capacity to determine whether or not the disclosure requirements were complied with. If the requirements were complied with honestly and the facts were displayed fully and fairly, the Commission could more quickly devote its energies to other matters. Thus, the proposed bill would give us an easier threshold of decision. Second, it obviously brings home to issuers and people dealing with issuers their responsibility under the existing law. It would provide,

it seems to us, a better road map for enforcement activities. It would not change the enforcement responsibilities of the Commission in the sense that our ultimate responsibility is to enforce the provisions of the existing acts, but it would provide a road map to tell issuers what is the type of thing they should be doing. Therefore, it seems to us to greatly aid in the resolution of the thicket that we're talking about.

There's been very little litigation, as the Senator knows, in this field. The SEC has had only a handful of cases dealing with these matters. Today there are in New York alone a number of cases involving municipalities, city officials, municipal officials, underwriters, issuers of all kinds. The uncertainty concerning the information which is required is, in the absence of legislation, necessarily going to evolve through litigation rather than through SEC rulemaking, which as a matter of good administrative law seems to us always to be the better approach.

Senator WILLIAMS. Are issuers right now liable for civil damages if there is inaccurate information disseminated in connection with an issue of bonds?

Mr. HILLS. Well, there is controversy, as the Senator knows, as to what sovereign immunity means in this field. It is the judgment of the Commission that there is liability by municipalities in the context of an SEC enforcement action. The issue is not, of course, just inaccurate information. It has to do with whether or not the people should have known or did know; the degree of culpability, the degree of inaccuracy, must always be measured. Those are all matters about which there is uncertainty. Obviously, if some city official has every good reason in the world to believe that he did what he was supposed to do, it makes the question of liability more difficult; but as a matter of ultimate legal principle, it is the position of the Commission that sovereign immunity does not protect municipal issuers or their officials from liability in an SEC enforcement action.

Senator WILLIAMS. Counsel shows me a case that suggests that they are. The test here is whether the officials conduct was so aggravated as to place him beyond the scope of his official capacity. In other words, this recognizes evidently sovereign immunity except in an extreme situation. It recognizes the principle of sovereign immunity, not necessarily whether it's a constitutional standard or not, but it recognizes a different standard.

Now as to the underwriter, what is his liability now and is the underwriter able to escape liability if he can prove due diligence in attempting to arrive at all the relevant facts? That's the test on the corporate side, isn't it?

Mr. HILLS. That is the test on the corporate side. This bill certainly does not expand the liability of the underwriter. If anything, it limits it in amount to his involvement in the underwriting. The test is comparable to the corporate side. There's no reason why it shouldn't be, and there is a responsibility, in our judgment, for the underwriter to use due diligence now in this area. The question of what due diligence should produce, however, is the area of confusion.

Senator WILLIAMS. Well, due diligence is exculpatory for the underwriter. That puts an additional burden, I would think, back at the issuer.

Mr. HILLS. This bill would require the issuer to provide a certain financial presentation. The underwriter still has an obligation, as any underwriter does in connection with selling in any kind of security, an obligation to do what he should do to make certain the information is accurate. If he secures the information from an issuer and knows or should know that the information is inaccurate, he's still responsible.

Senator WILLIAMS. In this legislation we do not clarify or in any way further define present liability that resides with the issuer and I'm wondering whether some clarification might not be a good idea here.

Mr. HILLS. The Commission's view on that point is it's a matter for the Congress rather than the Commission to decide to what extent sovereign immunity should protect municipalities and people dealing in this type of exempt securities, and it is quite true that the proposed bill does not clarify the issue of sovereign immunity. As we say, it is the opinion of the Commission's general counsel, and I think of many respected outside counsel, that sovereign immunity does not protect the issuer from liability in an SEC enforcement action; but the question of whether there is further civil liability is a matter this subcommittee may very well wish to examine.

Senator WILLIAMS. Senator Tower, do you have anything?

Senator TOWER. I'm sorry, Mr. Hills, that I got here late. I didn't get to hear your testimony. It's my understanding, however, that your point of view of S. 2574 is it would be an enormous administrative burden that you're not prepared to carry at the moment. Is that correct?

Mr. HILLS. Senator, it would indeed be an enormous administrative burden. Obviously, if we thought that that burden was necessary to protect the public interest or investors, we would come before the Congress and seek an appropriation to enable us to bear the burden.

It's our present judgment that the problem created in the municipal securities area does not justify accepting such responsibility at this time. We can properly protect the public and provide standards which will eliminate a great deal of the confusion in the industry by the approach set forth in S. 2574.

Senator TOWER. What is your view of how the adoption of the bill that Senator Williams and I have introduced, S. 2969, would affect the sovereignty of State and local governments?

Mr. HILLS. It does not, in our judgment, affect it at all. It helps clarify the responsibility of local and State government. In our judgment, the proposed legislation does not expand or contract the ultimate responsibility of State and local government under the 1933 and 1934 Acts. It provides a framework for the performance of their responsibilities, for the exercise of their duties in this area.

Senator TOWER. If S. 2969 had been in effect earlier, how, in your view, would this have affected New York City's financial situation?

Mr. HILLS. Assuming that it was in effect and assuming, as we, of course, would, that the parties in the various types of New York securities transactions that are now a problem had fully complied, I suppose two observations could be made depending upon what time in history the bill was in effect. If it had been in effect in the recent

history, it probably would not have been possible for the municipalities to secure assistance in their underwritings or find investors to purchase them. Had the bill been in effect a number of years ago, it would have imposed a form of fiscal management that hopefully would have maintained the city and the other entities involved now in a sounder financial structure.

Senator TOWER. Perhaps fewer investors would be stuffing their portfolios with that inflated New York City paper.

Mr. HILLS. I think that's a fair guess.

Senator TOWER. Not quite so many of them would be left holding the bag. S. 2969 provides for an exemption for securities issued by any municipality where the State has approved such issuance. Should we do more to encourage States to regulate issuers within their jurisdiction?

Mr. HILLS. Well, I believe this bill certainly does encourage them. There may be other measures than can be taken to encourage them. This bill provides in its present form a rather broad grant of authority to the States. If a State, after hearing, decides that the disclosure is adequate to protect its investors then the State retains the jurisdiction as to the offering of municipal securities. I pointed out in my testimony that the present bill does not require that the States find affirmatively that the type of disclosure being used by a municipality within their jurisdiction is of the kind that the proposed S. 2969 requires. That may be something that the subcommittee may wish to consider, but in the bill's present form, there is a broad deferral to any State that takes on itself the obligation after hearing to decide that disclosure is adequate to protect the interest of investors. I'm not sure how a broader deferral could be better.

Senator TOWER. On page 4 of your testimony you said:

> Investors and underwriters are now alert to the inadequacies of the past disclosure practices and appear to be more demanding of adequate information.

Now if this is true, why do we need this bill? Wouldn't the marketplace demand it?

Mr. HILLS. Well, as the Senator knows, I personally am a great supporter of competition and there's no doubt that competition in disclosure policies will cause more disclosure, but I'm afraid that it's very likely that the competition for disclosure will cause greater confusion as to what is adequate disclosure and no entity is better qualified than the SEC to speak to all municipalities at once and prescribe the form of financial presentation that should be a reasonable approach for these entities. In other words, I don't see what is to be gained by promoting competition for this kind of disclosure for people, investors particularly, who have no real idea as to what kind of information they should be seeing. So for purposes of developing comparable information from municipalities, there seems to us to be a good and sufficient reason to provide a standard.

Senator TOWER. I still find it amusing that every time you and I get together we talk about disclosures of some sort.

Mr. HILLS. Or the lack of them.

Senator TOWER. Or the lack of. I assume your views on disclosure at this time are somewhat different than that.

Mr. HILLS. You might say it's more independent in my new job.

Senator TOWER. Thank you for your testimony. The chairman had to step out a minute, so if you will forebear a minute he would like to ask you some more questions.

Mr. HILLS. Surely.

Senator TOWER. While we are waiting for the chairman, let me run another one by you. Under the proposal in this bill, the SEC would have primary authority to issue rules and regulations on disclosure standards for issues of municipal securities. Would it be better to give sole authority to a board comprised of issuers of the municipal securities rather than the SEC?

Mr. HILLS. Senator, that's a policy judgment that's very hard for me to make. As I said earlier, the SEC in terms of its past experience has a fount of experience that's useful in doing this. Initially, I would say that there's every reason to believe that present SEC staff with the present Commission is as capable, if not more capable, than anybody else of doing it. Beyond that point, regardless of who should establish the rules and policies, it is the responsibility of the SEC to enforce the 1933 and 1934 Acts. Accordingly, it strikes me that there is some soundness in suggesting the SEC for this task; if it is going to enforce the law it will have to have some idea of what disclosure is required. Again, it seems to me, if we are trying to provide certain and fair rules, the bill's approach would generate less confusion. I should say this, that it has been the longstanding practice of our chief accountant, Mr. Burton, who's in the audience, and our staff, to provide financial presentation standards only after a careful consultation with the industry representatives. We have had a long and productive relationship with Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and from time-to-time with the Municipal Finance Officers Association. So any rules that develop would surely only be done after very careful securing of the views of the issuers through that framework.

Senator WILLIAMS. Thank you, Senator Tower. I just have a couple of remaining questions, Chairman Hills.

Basically, doesn't S. 2969 follow the ground that was broken way back in 1933 when we asked for and required additional disclosures very similar to those that were granted to the Commission under the Securities Act of 1933 as they pertain to the SEC's powers to require nonstatutory enumerated disclosures through rulemaking authority? We're going over the same ground, aren't we, in that degree?

Mr. HILLS. We are going over ground we have gone over before. As the Senator knows, the Commission has recently launched an effort to rethink the ground we have gone over for 41 years in our disclosure policies and both internally with the Commission staff and externally with a board of outstanding people we are going to rethink some of those things.

This bill has a limitation I might say on the type of disclosure and the type of rules that the Commission would be permitted to make. It's a bit ambiguous but I think nonetheless it's a real limitation. Under sections 7 and 10 of the 1933 Act, as I commented, the

Commission has rather broad authority to promulgate any additional rules that we think are necessary or appropriate. At the present time the Commission thinks that it's perfectly responsible to limit its authority somewhat more with respect to municipal issuers by saying that the Commission would only have the authority to require additional similar and specific information. Given the differences between a private profit making corporation and the structure of a city, that limitation, in our judgment, would not unduly interfere with the protection of investors.

As I say, it's a little bit difficult to say specifically where that would change the Commission's authority, but basically it would recognize that we would be trying to develop rules of disclosure dealing with revenue, expense, and cash flow of a city. We would not be involving ourselves so much in disclosure concerning management as we do in private industry, as we do in our present disclosure policies under the 1933 and 1934 Acts.

Senator WILLIAMS. I won't pursue it any further. I get the impression that more clarification is coming in terms of——

Mr. HILLS. Yes. This bill we think is a helpful framework to begin the dialog and our staff will be delighted to deal with any questions that the subcommittee or its staff may have.

Senator WILLIAMS. The Commission has embarked on an investigation of the New York City situation, as I understand it, and I think this can be described as unprecedented. Am I right on that?

Mr. HILLS. It is unprecedented in the sense that there never has been a city so large subject to the scrutiny of the Commission. There have been other investigations and in two cases that I recall the Commission has dealt with municipal issuers, although we have not before had an investigation of this scope.

Senator WILLIAMS. Can you state what the Commission's approach would be if evidence of wrongdoing were found in this investigation? The options, I would assume, are of consent decree or a lawsuit. What is the broad approach and possibilities that you are considering?

Mr. HILLS. Well, I should say categorically that I have no idea at this time that any actions will be brought, but one can hypothesize all kinds of things that might be discovered by investigation, and assuming a degree of culpability and degree of misrepresentation or a degree of fraudulent action, as to which I say again we have certainly not made any decisions nor has the investigation been completed or even progressed to a degree that I could speculate if it otherwise would be appropriate to, but there's no reason to think that the same kinds of considerations that the Commission has used in its enforcement with companies of private industry would not be followed.

In short, we would assume that the same types of approaches would be used—lawsuits, injunctive actions, administrative proceedings, consent decrees are all tools that the Commission has used in its enforcement proceedings and all those tools we assume to exist in this type of situation.

Senator WILLIAMS. And those various tools are available under the present authority of the SEC, but what we are doing through this legislation is really upgrading the quality of disclosure and to a

considerable extent protecting against situations you're faced with now in New York City.

Mr. HILLS. Not only protecting against it, Senator, but as a matter of good government it strikes us that it is not appropriate in matters of such significance as municipal securities to set disclosure policies by litigation and consent decrees.

Senator WILLIAMS. I haven't anything further. Thank you very much.

[Complete statement of Mr. Hills follows:]

STATEMENT OF RODERICK M. HILLS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Legislation providing disclosure requirements for municipal securities should have two principle objectives. First, to provide adequate information to investors to guide their investment decisions and to protect them against losses caused by inadequate or inaccurate information. Second, to assist the issuers and underwriters of municipal securities by eliminating possible confusion as to their legal responsibilities.

In current debates about the regulation of municipal securities the second point has not had sufficient attention. Presently, the Securities and Exchange Commission enforces the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 against issuers and underwriters of municipal securities. In addition, some question may be raised in private litigation as to the effect, if any, of sovereign immunity. There has to date been very little litigation involving such issuers and, as a result, there exists no well-established body of judicial precedent defining the obligations of these persons. We believe the establishment of specific disclosure requirements in the proposed legislation will provide some valuable guidance to issuers and underwriters in discharging their responsibilities under the federal securities laws, although the nature of the investigation necessary to avoid liability will remain undefined.

In short, S.2969 would not expand the enforcement responsibility of the Commission. Rather, by prescribing specific disclosure responsibility on the part of issuers of municipal securities, it may well enable the Commission to clarify the bases underlying its use of enforcement procedures in this area. In any event, in view of the Commission's general mission to prevent fraud in connec with the sale of securities, the limited expansion of its powers with respect to municipal disclosure is not out of keeping with its existing authority over private issuers.

The proposed legislation must also be viewed in the context of the long standing exemption from the registration and reporting requirements of the securities laws which have applied to municipal securities. The underlying basis for the adoption of these exemptions consisted of a desire for governmental comity and the absence of recurrent abuses. In addition, there has been a belief on the part of some that the typical purchaser of municipal securities is the sort of investor that does not need the protections of the federal securities laws—banks, insurance companies and other institutions. Over the years, the typical purchasers of municipal securities have been institutional investors with only limited individual participation. Further, the number of defaults on municipal securities has been very limited.

Towards the end of the 1960's, those patterns began to change significantly. As an escalating economy pushed more people into tax brackets which made the tax-free characteristic of municipal securities desirable, there occurred a great increase in public participation in the purchase of municipal securities. Unfortunately, this increase in public participation was accompanied by the development of questionable marketing practices in municipal security dealings and the unexpected occurrence of serious municipal issuer financial problems.

As a result of these problems in the trading of municipal securities, the Securities Acts Amendments of 1975 were enacted to create a new and com-

prehensive scheme of regulation of the trading markets in municipal securities and of municipal securities professionals.

The principle feature of these amendments was the creation of the Municipal Securities Rulemaking Board which has authority to prescribe rules governing trading in municipal securities, among its other responsibilities. Of course, if S.2969 is enacted into law, the Municipal Securities Rulemaking Board will be able to exercise its rulemaking authority as to underwriters in order to ensure effective use of the information prepared by municipal issuers.

The New York City financial dilemma and similar situations involving other municipal issuers, raises even new questions concerning municipal financing. These concerns are not only with the kind of fraudulent trading activity which spawned Congressional enactment of the 1975 Amendments, rather the questions now center on the accuracy of municipal financial statements and the extent to which municipal issuers are properly informing investors in both the primary and secondary markets with regard to their affairs.

Investors and underwriters are now alert to the inadequacies of the past disclosure practices and appear to be more demanding of adequate information. The failure of issuers to provide such data will impair their ability to secure the funds essential for community development.

It will, we believe, become increasingly apparent to municipal and other public officials that they seriously jeopardize their future financing opportunities if they resolutely resist efforts by underwriters, dealers and investors to gain greater insight and information.

To stimulate an appropriate reexamination of the long standing exemption of municipal issuers from the discosure requirements of the federal securities laws, Senator Thomas F. Eagleton recently introduced a bill that would subject municipal securities to the registration requirements of the Securities Act of 1933. That bill, S.2574, has properly focused attention on an important problem—the less than adequate information now available to those who invest and trade in municipal securities. The solution S.2574 suggests, however, creates a number of disadvantages which are not needed to achieve its basic objectives.

While we are not presently aware of the exact number of Securities Act filings that would be made by municipal issuers under S.2574, it is probable that there would be a great many more than the corporate filings now processed. Even if the Commission could obtain a much larger staff, it is unlikely that the threatened harm to investors justifies so drastic a proposal.

"The Municipal Securities Full Disclosure Act of 1976", S.2969, would provide a far more limited form of disclosure regulation for municipal securities—one that is more commensurate with the risks involved.

S.2969 does not, in contradistinction to S.2574, embody any amendment to the Securities Act of 1933. As a consequence, municipal securities would continue to be exempt from the registration requirements of the Securities Act.

S.2969 would amend the Securities Exchange Act of 1934 to add a new Section 13A which would provide disclosure requirements for "municipal securities" as defined in Section 3(a)(29) of the Exchange Act.

The disclosure requirements of Section 13A are different and considerably more limited in scope than the requirements of the Securities. Act and Exchange Act. In particular no information required of municipal issuers would be filed with or reviewed by the Commission

Section 13A would require an issuer with more than $50 million of municipal securities outstanding during any portion of a fiscal year to prepare for each fiscal year an annual report and reports of events of default (if such events of default occur).[1] The annual report would contain material financial and other information regarding the issuer, including financial statements audited and reported on by independent public or certified accountants. The reports

[1] It appears that defaults or payment problems involving municipal bonds have not been significant except in severe depression periods. Even in the Great Depression it has been estimated that only 15 percent of all outstanding municipal debt was directly or indirectly involved in some manner. Since World War II, the experience has been reasonably good. For instance, in the period from 1945 through 1969, it has been estimated that the number of actual defaults in this area was 431, of which 300 were considered of a technical or temporary nature. The total amount of these defaults is estimated at approximately $450 million—about .4% of the total amount of municipal debt outstanding at the end of the 25 year period.

of events of default would contain material information regarding any default

on, or postponement or delay of, principal or interest payments on the issuer's securities. The issuer would be required to make the annual report and reports of events of default available to the public upon request.

Section 13A would also require an issuer that offers or sells an issue of municipal securities exceeding $5 million to prepare a distribution statement prior to such offer or sale. The distribution statement would contain such of the information required in the annual report as the Commission prescribed and material information concerning the particular offering. The issuer would be required to make the distribution statement available to the underwriters of the security offering for delivery to prospective purchasers.

An exemption from the distribution statement requirements would be provided for municipal securities offerings that meet the criteria of certain specified exemptive provisions of the Securities Act, and offerings the disclosure for which are approved by a State governmental authority as adequate for the protection of investors. As contemplated by the Commission, this exemption would be available to offerings the disclosure for which, in the view of the State authority, is substantially similar to the disclosure required by Section 13A.

The items of information to be required in the annual report and distribution statement are set forth in Section 13A and the Commission would have only limited authority to require additional similar and specific information. Such information is similar to that called for by the Municipal Finance Officers Association's Proposed "Disclosure Guidelines for Offerings of Securities by State and Local Governments" and that which is required of foreign governmental entities under Schedule B of the Securities Act. The forms in which the required information is to be set forth, and the accounting methods to be followed in the preparation of financial statements, would be prescribed by the Commission to ensure the consistency, comparability, reliability and sufficiency of such data.

The disclosure requirements of Section 13A would not constitute an undue burden for municipal issuers of a responsible character. Most of the required information would be, or at least should be, presently available. It is our understanding that issuers that have their securities rated are required by the rating agencies to supply much of the information called for by Section 13A. In addition, some state law and conscientious underwriters demand that municipal issuers make available to the public material information comparable to that required by Section 13A. The Proposed Disclosure Guidelines of the Municipal Finance Officers Association call for information similar to that required by Section 13A. And, in cases where the disclosure requirements of Section 13A would impose a demonstrably unreasonable burden on a municipal issuer, the Commission would have authority under S.2969 to exempt such issuer from those disclosure requirements.

It is important to emphasize the point that this legislature does not expand the existing liability of municipal issuers. As I said eariler, the antifraud provisions of the Securities Act and Exchange Act presently apply to the purchase and sale of municipal securities. S.2969 contemplates their continued applicability. The effective date of S.2969 is January 1, 1977. Audited financial statements, however, would be required only for fiscal years commencing on or after December 31, 1978. The Commission believes that this time frame would afford issuers of municipal securities an adequate opportunity to "gear-up" for compliance with the new disclosure requirements of Section 13A.

Before closing, let me note that there are three areas where information obtained through these hearings will be helpful in refining S.2969. The first issue is whether establishing the threshold amounts of $50 million and $5 million in Section 13A is appropriate. The Commission does not now have any data indicative of the number of municipal issuers that would be subject to the disclosure requirements of Section 13A. Relevant empirical data developed through these hearings should enable the Committee to make any appropriate adjustments.

Secondly, the Committee may wish to consider issues relating to the scope of underwriter liability. Our bill contains one limitation in Section 13A(g) borrowed from a similar provision in Section 11 of the Securities Act. Municipal securities underwriters and their counsel will undoubtedly wish to comment not only on that limitation but also to make additional suggestions. We will be pleased to offer any assistance we can to the Committee and its staff

69-141 O - 76 - 3

in that regard. It is important that the provisions be both workable and appropriately protect public investors.

Finally, and underlying in part the previous item is the need for these hearings to consider the extent to which sovereign immunity is, under current law, and should be under the proposed legislation, available to issuers of municipal securities and their associated persons, and the effect of any such immunity on the duty of underwriters of any issue of municipal securities.

In conclusion, I would like to state it is the Commission's view that S.2969 represents a very effective and practicable solution to the serious information problems associated with contemporary municipal securities financing. Even though it is of course up to the Congress to determine whether or not legislation is needed, in our opinion S. 2969 will minimize regulatory costs and other burdens on both issuers and regulators while at the same time providing investors in municipal securities with consistent, comparable, reliable and sufficient information to make reasoned investment decisions.

Senator WILLIAMS. Our next witnesses are Edwin H. Yeo, III, Under Secretary for Monetary Affairs, and Robert Gerard, Deputy Assistant Secretary for Financial Resources Policy for the Department of the Treasury. Welcome, gentlemen. We look forward to your testimony.

STATEMENT OF EDWIN H. YEO, III, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS, ACCOMPANIED BY ROBERT GERARD, DEPUTY ASSISTANT SECRETARY FOR FINANCIAL RESOURCES POLICY

Mr. YEO. I have some short comments, Mr. Chairman.

Until last June, with one exception, no aspect of the municipal securities field was subject to Federal securities law. Apart from the reach of the antifraud provisions—section 17 of the 1933 act and section 10(b) of the 1934 act—there were no uniform national standards to govern and guide dealings in municipal securities.

I would like to say at the start that with that background the Treasury supports the concept, and with some qualifications which I will spell out, supports the Williams-Tower bill, S. 2969.

Under the leadership of the chairman, Congress moved last year to fill part of that void. The Securities Act Amendments of 1975 established a comprehensive mechanism to regulate transactions in municipal securities and the intermediaries which facilitate the process. Today we begin the infinitely more difficult and delicate—but equally important—I might even say personally perhaps of paramount importance—task of recognizing the critical need for current, accurate and comparable information about the fiscal and financial condition of State and local governments.

Forty-three years ago, when municipal securities were exempted from the securities laws, Congress could not have foreseen the importance of the municipal market of today. Approximately $30 billion of tax-exempt bonds were issued in 1975. Another $30 billion was borrowed short-term. Perhaps a more significant change than growth in the size of the market was the revelation that municipal securities were not riskless. Investors learned in 1975 that theoretical access to the ad valorem taxing power was not an absolute guarantee of timely repayment.

Clearly the times have changed for States and municipalties as well as for other economic sectors. States and municipalties now perform far more diverse services than four decades ago, or even 10 years ago. They employ a much more diverse set of taxes. Their financings are far more complicated. All of these changes accentuate the need of investors and underwriters and dealers—I might say taxpayers as well—for reliable, current and comparable information on the fiscal and financial condition of State and local governments.

A major defect in the flow of information now available is that the data are not easily, if at all, comparable. The growth of State and municipal activities, the diversity of taxes and the complexity of financing have spawned a variety of methods of reporting. Accounting procedures differ widely. As a result, verification and interpretation of State and local fiscal and financial data is extremely difficult.

The importance of providing reliable information is enhanced by the fact that the nature of investors in the municipal market has changed. Historically, investors have been sophisticated institutions —banks and fire and casualty companies—which had both the resources and the expertise to develop and evaluate information on their own. Today, however, individuals are playing an increasingly important role in the municipal market.

Under existing practices, there are in effect three mechanisms which tend to safeguard an investor's investment in municipal securities.

First, there is the fact that many States, either by statute or by constitutional provision, prohibit conduct which would undermine a political subdivision's ability to meet financial obligations. Such limitations generally include the requirement of a balanced budget and limitations on such items as outstanding long-term debt, short-term debt outstanding at the end of the fiscal year, tax rates and expenditures, among others.

Legal limitations provide poor financial standards because they are arbitrarily applied to all municipalities in the jurisdiction and often do not allow for judgment in financial planning. Also, such limitations often are legally established in constitutions, charters and statute books. As time passes, they often become obsolete and are very hard to amend. Finally, as we learned in the case of New York City, legal prohibitions are not necessarily enforced strictly. I might add that it requires accurate information to enforce them.

A second source of potential protection is the antifraud provisions of the Federal securities laws. But these safeguards alone are deficient in two respects. First, they are retrospective only. They cannot help investors to prevent unwise investments, but can only provide a basis for recouping losses after (and if) fraud is proved. Moreover, they do not provide a basis for helping investors choose among competing investments; they only prohibit certain extreme unlawful conduct.

A third possibility is the rating process. But, since the rating services must rely on the insufficient and noncomparable data provided to them, they can at best only make general estimates of

creditworthiness. There is a fundamental fallacy in trying to base ratings on less than full disclosure. There is no substitute for reliable, up-to-date, comparable information. To put it another way, reliable, up-to-date information would complement rather than conflict with the rating process.

In short, there is no mechanism to insure that investment decisions in municipal securities are made with clarity and confidence. Prudent decisions cannot be made when investors are forced to compare apples and oranges, and often old ones at that. An efficient market requires access to comparable, verified, and reasonably current information.

The fundamental goal of disclosure legislation must be to assure that the maximum amount of relevant information is readily available, with a minimum amount of Federal intervention and a minimum of cost. Disclosure rules and regulations should enhance the market, not interfere with the market mechanism for municipal issues. Most important, in order to insure that municipal investors are able to make a concise comparative analysis of the finances of different issuers, disclosure legislation must standardize the presentation of the information being disclosed.

It is the importance of standardization which requires that a disclosure program be administered at the Federal level. We have examined carefully the voluntary disclosure approach. As the committee knows, it has been argued that since investors and underwriters are demanding more information, if the free market were left to its own devices, the information would be provided by those issuers which needed market access. We concluded, however, that precisely to assure that the free markt mechanism will function smoothly with respect to municipal issues, it is necessary to insist upon mandatory disclosure of financial information by issuers entering the market. It is only by mandatory disclosure that adequate, uniform, usable information can be assured, and that its flow to the investing public can be guaranteed.

In designing a disclosure system, we must keep in mind that the policy tradeoffs here may differ from those employed under existing law and procedures. The governing principle in the corporate area is spare no expense to give the investor every last ounce of protection. In the municipal area, where such expenses must be directly paid by taxpayers, I do not think we can or should make a similar choice.

I'd like to talk a little bit about the scope. There are many municipalities which do not enter the capital markets frequently or to a heavy degree, and thus present lesser concerns to the investing public or to the proper functioning of our Nation's capital markets. There are many municipal issues which have a relatively limited market. So that mandatory disclosure does not result in overkill, we favor the setting of threshold limits below which disclosure would not be required.

Once the issuers which should disclose have been identified, the information required of them should be carefully specified and relatively comprehensive. Some flexibility, of course, is required, but State and local governments, we believe, are entitled to have Congress decide the kind of information it is required to disclose.

Based on the above principles, we oppose S. 2574 and H.R. 11044. By eliminating the 1933 and 1934 act exemptions for municipal securities, these bills would require that municipal securities undergo the same disclosure, filing and clearance and registration procedures as corporate securities. Such an approach would impose burdens and costs which outweigh the benefits derived.

We are in general agreement with S. 2969, cosponsored by the chairman and Senator Tower. S. 2969 is not a regulatory bill. It would not require filing, registration or presale clearance of issues. Instead, it is strictly designed to insure that information—reports and distribution statements—be prepared and made readily available to the public.

Let me stress this fundamental difference between the Solarz and Eagleton bills, and S. 2969, even at the risk of belaboring the point. The Solarz and Eagleton bills are regulatory measures. They would intimately involve the SEC in the issuance process, as it is in the corporate area. The Williams-Tower bill does not contemplate such involvement, providing only that informational reports and statements be prepared and made readily available.

Responsibility, in the final analysis, is more a matter of accountability than motive. And, in turn, accountability requires good information. If comparable, reliable, up-to-date information were made available through disclosure guidelines, in-depth scrutiny by investors and the electorate would be facilitated.

The mechanism for public scrutiny of municipal issues already exists. It lies in the marketplace and the election process. What is required is only to put it to work, and this, in turn, requires only assuring the flow of information. Reliable, comparable current data would preempt the need for presale registration and clearance.

I concur with the essential substance of S. 2969. The bill provides for the preparation of annual reports including audited financial statements by issuers of municipal securities with more than $50 million outstanding. It provides also that distribution statements be prepared prior to public offer or sale of $5 million or more of securities. And it requires that such reports and statements be reliable and comparable, as well as readily available to underwriters, dealers, and investors. Finally, it encourages State oversight by providing for exemptions from the distribution statement requirement where a State authority has approved the offer or sale of the issue.

The advantages of the Williams-Tower bill's approach are numerous. The 1934 act's reporting requirements are less burdensome than those under the 1933 act and will result in less burden to reporting entities. Ongoing information about the basic financial health of a city affords an excellent means of evaluating its creditworthiness and its potential for meeting debt service on bond issues into the future. To the extent new issue information is needed, the distribution statement which the Williams-Tower bill would require will provide all the relevant data. Thus, the Williams-Tower bill strikes an appropriate balance: requiring disclosure of as much information as is necessary to allow the market to function properly, without burdening our States and cities and their taxpayers with requirements that impose unnecessary costs.

In my view, the bill as currently drafted requires improvement in two areas. First, I am concerned about the authority conferred upon the Commission by subsection (d) of section 13A. To the extent this provision reflects the authors' belief that, in light of inflation, it may be appropriate at some future date to allow the Commission to adjust upward the minimum filing requirements, such intent could be more clearly expressed by substituting the word "increase" for the word "change" on line 5.

If, on the other hand, the provision contemplates a possible downward adjustment of the minimum limits, I believe the provision constitutes an inappropriate delegation of authority to the Commission. It is important to keep in mind that this legislation contemplates a degree of federal involvement in the affairs of sovereign political units. Accordingly, it is our strong belief that any change which materially increases the scope of the legislation, or the burden on entities initially subject to the legislation, must receive the review and approval of the Congress in the form of new legislation.

This leads directly to our second area of concern. While we recognize the necessity for a slight degree of rulemaking authority in the Commission to implement the statutory directives, we think the legislation, as currently drafted, goes much too far. As I indicated earlier, while the protection of investors is, and must be, a consideration, it is not in my view a consideration of such paramount importance as might be the case on the corporate side. The grant of discretion to the Commission to expand the type of information required should be carefully circumscribed and should recognize expressly the different competing considerations which exist in the municipal securities area.

After all of us have had the benefit of the hearing process, we expect to work closely with the Commission and the staff of this subcommittee to develop language to deal with the concerns set forth above. At the same time, we will also present additional minor technical amendments which we feel will improve the legislation.

All in all, S. 2969 presents a desirable framework for satisfying the important objectives of more and more useful information about municipal credits. We believe such legislation is urgently needed and we will cooperate with the Committee and the Congress in an attempt to achieve its expeditious passage.

Senator WILLIAMS. Thank you very much, Mr. Secretary.

You have analyzed the situation in the States as to State requirements in terms of financial statements and disclosure requirements. Are there any States that you would consider models that might be useful to other States where there is a lack of state demands upon municipal issuers?

Mr. YEO. I think that there are several States. One would be North Carolina. I have the impression based on conversations with authorities in other States that the North Carolina experience has been watched carefully and is likely to be duplicated in other States.

Senator WILLIAMS. Certainly the legislation that Senator Tower and I have introduced is designed to bring forth that State effort.

Mr. YEO. I certainly think that it would have that effect. I think it also would have another effect which is very important, and that is

the development of consistent data. If we have 50 States following the North Carolina approach, that still doesn't get the job done because we could have theoretically 50 different sets of criteria and this is where we agree wholeheartedly with the thrust of S. 2939 which would provide a framework within which States could move in the direction of the North Carolina experience.

Senator WILLIAMS. With this question I'm wondering whether it might be in conflict with something you said at the conclusion of your prepared statement and I wonder whether it would be desirable to establish definite criteria in the bill which a State would have to meet before it would be exempt from the operations of the bill as we propose it. I gather that you have some limited reservations over the grants of authority to the SEC in the bill. Is that right?

Mr. YEO. Yes, that's right.

Senator WILLIAMS. Well, now this question goes to even a greater degree to Commission authority and the establishment of definite criteria. This is confused by the fact that, in your view, there could be 50 states, all with good State law, and yet, all would be different. That would be a confusing factor to the investing public. I would think it would be. How do we resolve all this?

Mr. YEO. Our suggestion would be to establish the criteria through the legislation with the Commission in a position of applying that criteria but in a circumscribed way. The basic distinction that we are trying to make is that we don't think that disclosure should lead us to a situation comparable to that that exists for corporate securities.

Mr. GERARD. Mr. Chairman, let me try to elaborate a little bit further. The bill draws a distinction between the annual reporting requirement on the one hand, and the distribution statement requirement on the other hand. The possibility of an exemption for a State procedure applies only to the distribution statement requirement. It seems to me that that reflects a judgment by the draftsmen that we have really got two interrelated but independent sets of considerations. First is the market and the functioning of the market through time. To ensure the efficient functioning of the market you want to have comparable current and reliable information on issuers of substantial amounts in the market, that is issuers with $50 million or more. The bill also recognizes there may be a situation—and I suspect it would be a relatively rare one—where you've got somebody coming to market with more than $5 million in a new issue but not yet in the market generally in a large enough degree to come under the annual report requirement.

In those cases, I think there's a judgment here and it's a sound one, that investors—with whom you're essentially concerned about in this separate distribution statement requirement—ought to be satisfied with the judgment of appropriate state authority in terms of making an investment decision with respect to that security. So that the concern about the potential discretion of the SEC I don't think is quite so strong in the latter case.

I think again, given the principles of intergovernmental comity which surround this entire issue, that the legislation ought to make clear what in the way of State certification or what procedures are

required. I think, again, the Commission's ability in effect to grant or deny the exemptions by making the judgment as to whether the procedures in effect in a particular state are or are not adequate ought to be spelled out with a good deal of clarity in the legislation.

Again, the essential distinction is between the reporting requirement which is market oriented in a sense, and the new issue requirement which is investor oriented in a sense.

Senator WILLIAMS. You have suggested that during this hearing process, which is a refinement of the ideas that are in the legislation, you will be in communication with the SEC?

Mr. YEO. Yes, sir.

Senator WILLIAMS. I'm wondering whether this is a subject matter that might come up in those discussions and whether your ideas might not be discussed and perhaps result in specific legislative language and ideas for us to consider.

Mr. YEO. We'd like to do that very much and with the perspective of the hearings that are underway. We are most anxious to participate in that process.

Senator WILLIAMS. Was last year a record year in municipal offerings?

Mr. YEO. Yes, sir.

Senator WILLIAMS. How would you describe the investor climate for municipal securities right now?

Mr. YEO. I think that they could be characterized by three major elements. No. 1, the market is clearly functioning and handling a large amount of securities. As a whole, it is fulfilling its function. The second characteristic would be the development of sharp distinctions by investors among various credits. The technical manifestation of this is a widening in yield spreads between issues that are regarded as being very high in quality and those that are regarded by investors as being of slightly or substantially lower quality. We have called this a flight to quality and in its first manifestation in the second half of last year it was not a very distinctive phenomenon. By that, I mean investors tended to seize and devote their interest to issues of only the very highest quality in their view.

And the third characteristic of the market that is developing is that investors are becoming progressively more discriminating. The process of credit analysis, of making distinctions among issues, which is the essence of making this market mechanism work, is proceeding. In other words, from the initial fear that characterized the second half, we have moved from that to a more discriminating atmosphere. I personally think that this is a very healthy development and that it's healthy because it is the guts of an early warning system for credits that are getting into difficulty as these investors scrutinize each issue. If they discern changes in financial conditions those will be reflected promptly in the market rather than simply glossed over for a long period and then abruptly seized upon by investors. In colloquial terms, this would mean as this process develops that markets wouldn't close for issues overnight; that the door discernibly would start to move and that would give the issuers and others time in which to take corrective action.

That's why, Mr. Chairman, disclosure as embodied in your bill is so important.

Senator WILLIAMS. Would you say that the New York City experience hastened this meeting today? Would we have been here with this legislation without that dramatic episode in municipal finance?

Mr. YEO. I'd like to say that we would have, but I don't think we would have. I think we are here as a result of the impressions that it's made on all of us.

Senator WILLIAMS. So frequently that happens. It takes the near catastrophe to alert the public and the Congress, and the public through their Congress, to the need for action.

We were discussing—and I'm not sure you were here when Chairman Hills was testifying——

Mr. YEO. I was here for part of it.

Senator WILLIAMS. Toward the end of his testimony we dealt with the elements of enforcement and liability. Have you, from where you sit in your authority, thought in terms of issuer liability and underwriter liability and whether we need anything other than what we have in this legislation to affect the situation?

Mr. YEO. We are in the process of—we have been thinking a great deal about it, Mr. Chairman. We are in the process of continuing our analysis in that area. We are aware of the shortcomings of a system that imposes such burdens on the market mechanism that it can't function effectively and at which might loosely be called reasonable costs.

My own personal view is that an underwriter ought to be able to have shown that he took due diligence and that his liability ought not to extend so far that the cumulative effect of what we will have done will be to increase the distribution costs for municipal securities and the reason why I think that's very important is that it will not come out of the underwriter's pocket. It won't affect their profit. It will affect the interest costs of municipalities.

Perhaps my associate, Mr. Gerard, would add a little bit to that.

Mr. GERARD. As Under Secretary Yeo said, when we talk about liability in this area we are talking about costs. We are talking about the way in which an underwriter protects himself from liability in the subsequent damage action or at least the traditional way this is done is by spending a lot of money evaluating a credit irrespective of whether the issuer himself either by law or practice has had to incur some of the similar cost burdens.

So one of the areas that we are exploring, as Mr. Yeo mentioned, is the possibility of streamlining the process, so to speak, so that on the one hand the underwriter carries out his responsibility—and he clearly has a responsibility to his customers to insure that the product he's selling them is a reasonable product—but so that that responsibility can be satisfied with due regard to the overall cost burden which the issuer ultimately will bear.

To go back to something that we said in our testimony, I think in considering all this legislation we have to keep in mind that whatever the position—whatever the law may be— with respect to corporate securities, policy tradeoffs in this area are very different. We view this legislation as market oriented. Certainly protection of investors is a

key consideration, but whereas in the corporate area the way the law has developed, protection of investors is the keystone of the Federal securities law, here, we think a different set of policy balances may be appropriate.

Senator WILLIAMS. We don't codify the due diligence approach. That does apply on the private side and I'm wondering whether this is something that we should think through further and consider and maybe be part of this legislation. Do you think so?

Mr. YEO. We would like to have the opportunity to consider it further and perhaps work with the staff on an examination of it. For our own part, we think that there's definitely a responsibility on the part of the dealer and underwriter, but there has to be in our view a balance between that responsibility and something that produces costs that far, far outweigh the benefits. That's the judgment that I think we're talking about and we'd be very anxious to participate with the staff in considering it further.

Senator WILLIAMS. Now we're talking about costs. What is your judgment of what the costs will be for local governments to get their accounting and financial reporting on a sound basis? What kind of a burden are we talking about here?

Mr. YEO. I can't quantify it, Mr. Chairman. I think that any estimate that we would provide would be accurate only by accident, but I can say that I think in the present environment that it's probable that there would be a positive advantage as a result of the enactment of this bill in terms of costs. I think that this bill would provide the basis for informed investors, reassured investors, and a more efficient operation of what is already a great market, the municipal market.

My judgment is that this probably would not result in any over the long run incremental costs. The benefits would outweigh the explicit costs. That's a matter of judgment. I can't present you with figures that would give an analysis of cost.

Senator WILLIAMS. It would seem to me that it would certainly follow that investors would have a greater degree of confidence and it also would follow I think that there would be greater competition among underwriters for an opportunity to be in on an issue. Am I accurate in suggesting that might be one of the beneficial fallouts and therefore a net lowering of costs if there's competition among underwriters for the opportunities?

Mr. YEO. Well, I think that there could easily be more competition among underwriters. That would lower the costs to the degree that it contributed to a contraction in the underwriting spread. The big benefit embodied in this bill involves the broadening of the municipal market as a result of full consistent disclosure on a regular basis. To the degree the municipal market is broadened, to that degree, and inhibitions that exist as a result of recent experiences are reduced, to that degree, we could realize material savings in terms of interest costs.

In addition, this bill would facilitate the discrimination process, discrimination among credits. This is a constructive process and makes for a more efficient market system which in turn would lower costs.

[Complete statement of Mr. Yeo follows:]

STATEMENT OF EDWIN H. YEO, III, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

Mr. Chairman and members of this distinguished Subcommittee, I am pleased to appear before you to testify on legislative initiatives to require disclosure by States and municipalities of their fiscal and financial condition. The Treasury supports the concept, and, with qualifications which I will spell out later, supports the Williams–Tower Bill, S.2969.

THE CURRENT STATE OF MUNICIPAL DISCLOSURE AND ITS SHORTCOMINGS

Until last June, with one exception, no aspect of the municipal securities field was subject to Federal Securities law. Apart from the reach of the anti-fraud provisions—Section 17 of the 1933 Act and Section 10(b) of the 1934 Act—there were no uniform national standards to govern and guide dealings in municipal securities.

Under the leadership of the Chairman, Congress moved last year to fill part of that void. The Securities Act Amendments of 1975 established a comprehensive mechanism to regulate transactions in municipal securities and the intermediaries which facilitate the process. Today we begin the infinitely more difficult and delicate—but equally important—task of recognizing the critical need for current, accurate and comparable information about the fiscal and financial condition of State and local governments.

Forty three years ago, when municipal securities were exempted from the Securities laws, Congress could not have foreseen the importance of the municipal market of today. Approximately $30 billion of tax-exempt bonds were issued in 1975. Another $30 billion was borrowed short term. Perhaps a more significant change than growth in the size of the market was the revelation that municipal securities were not riskless. Investors learned in 1975 that theoretical access to the ad valorem taxing power was not an absolute guarantee of timely repayment.

Clearly the time have changed for States and municipalities as well as for other economic sectors. States and municipalities now perform far more diverse services than four decades ago, or even ten years ago. They employ a much more diverse set of taxes. Their financings are far more complicated. All of these changes accentuate the need of investors and underwriters and dealers for reliable, current and comparable information on the fiscal and financial condition of State and local governments.

A major defect in the flow of information now available is that the data are not easily, if at all, comparable. The growth of State and municipal activities, the diversity of taxes and the complexity of financing have spawned a variety of methods of reporting. Accounting procedures differ widely. As a result, verification and interpretation of State and local fiscal and financial data is extremely difficult.

The importance of providing reliable information is enhanced by the fact that the nature of investors in the municipal market has changed. Historically, investors have been sophisticated institutions—banks and fire and casualty companies—which had both the resources and the expertise to develop and evaluate information on their own. Today, however, individuals are playing an increasingly important role in the municipal market.

SAFEGUARDS CURRENTLY AVAILABLE

Under existing practices, there are in effect three mechanisms which tend to safeguard an investor's investment in municipal securities.

First, there is the fact that many State, either by statute or by constitutional provision, prohibit conduct which would undermine a political subdivision's ability to meet financial obligations. Such limitations generally include the requirement of a balanced budget and limitations on such items as outstanding long term debt, short term debt outstanding at the end of the fiscal year, tax rates and expenditures, among others.

Legal limitations provide poor financial standards because they are arbitrarily applied to all municipalities in the jurisdiction and often do not allow for judgment in financial planning. Also, such limitations often are legally established in Constitutions, charters and statute books. As time passes, they often become obsolete and are very hard to amend. Finally, as we learned

in the case of New York City, legal prohibitions are not necessarily enforced strictly.

A second source of potential protection is the anti-fraud provisions of the Federal Securities Laws. But these safeguards alone are deficient in two respects. First, they are retrospective only. They cannot help investors to prevent unwise investments, but can only provide a basis for recouping losses after (and if) fraud is proved. Moreover, they do not provide a basis for helping investors choose among competing investments; they only prohibit certain extreme unlawful conduct.

A third possibility is the rating process. But, since the rating services must rely on the insufficient and non-comparable data provided to them, they can at best only make general estimates of creditworthiness. There is a fundamental fallacy in trying to base ratings on less than full disclosure. There is no substitute for reliable, up-to-date, comparable information.

In short, there is no mechanism to insure that investment decisions in municipal securities are made with clarity and confidence. Prudent decisions cannot be made when investors are forced to compare apples and oranges, and often old ones at that. An efficient market requires access to comparable, vertified, and reasonably current information.

THE DESIRED NATURE AND SCOPE OF DISCLOSURE LEGISLATION

The fundamental goal of disclosure legislation must be to assure that the maximum amount of relevant information is readily available, with a minimum amount of Federal intervention and a minimum of cost. Disclosure rules and regulations should enhance the market, not interfere with the market mechanism for municipal issues. Most important, in order to ensure that municipal investors are able to make a concise comparative analysis of the finances of different issuers, disclosure legislation must standardize the presentation of the information being disclosed.

It is the importance of standardization which requires that a disclosure program be administered at the Federal level. We have examined carefully the voluntary disclosure approach. As the Committee knows, it has been argued that since investors and underwriters are demanding more information, if the free market were left to its own devices, the information would be provided by those issuers which needed market access. We concluded, however, that precisely to assure that the free market mechanism will function smoothly with respect to municipal issues, it is necessary to insist upon mandatory disclosure of financial information by issuers entering the market. It is only by mandatory disclosure that adequate, uinform, usable information can be assured, and that its flow to the investing public can be guaranteed.

In designing a disclosure system, we must keep in mind that the policy trade offs here may differ from those employed in the corporate area. It is not an overstatement to say that, under existing law and procedures, the governing principle in the corporate area is spare no expense to give the investor every last ounce of protection. In the municipal area, where such exepnses must be directly paid by taxpayers, I do not think we can or should make a similar choice.

SCOPE

There are many municipalities which do not enter the capital markets frequently or to a heavy degree, and thus present lesser concerns to the investing public or to the proper functioning of our nation's capital markets. There are many municipal issues which have a relatively limited market. So that mandatory disclosure does not result in overkill, we favor the setting of threshold limits below which disclosure would not be required.

Once the issuers which should disclose have been identified, the information required of them should be carefully specified and relatively comprehensive. Some flexibility, of course, is required, but State and local governments, we believe, are entitled to have Congress decide the kind of information it is required to disclosure.

Based on the above principles, we oppose S.2574 and H.R. 11044. By eliminating the 1933 and 1934 Act exemptions for municipal securities, these bills would require that municipal securities undergo the same disclosure, filing and clearance and registration procedures as corporate securities. Such an approach would impose burdens and costs which outweigh the benefits derived.

We are in general agreement with S.2969, cosponsored by the Chairman and Senator Tower. S.2969 is not a regulatory bill; it would not require filing, registration or presale clearance of issues. Instead, it is strictly designed to insure that information—reports and distribution statements—be prepared and made readily available to the public.

Let me stress this fundamental difference between the Solarz and Eagleton bills, and S.2969, even at the risk of belaboring the point. The Solarz and Eagleton bills are regulatory measures. They would intimately involve the SEC in the issuance process, as it is in the corporate area. The Williams-Tower bill does not contemplate such involvement, providing only that informational reports and statements be prepared and made readily available.

Responsibility, in the final analysis, is more a matter of accountability than motive. And, in turn, accountability requires good information. If comparable, reliable, up-to-date information were made available through disclosure guidelines, in depth scrutiny by investors and the electorate would be facilitated.

The mechanism for public scrutiny of municipal issues already exists. It li lies in the market place and the election process. What is required is only to put it to work, and this, in turn, requires only assuring the flow of information. Reliable, comparable current data would pre-empt the need for presale registration and clearance.

I concur with the essential substance of S.2969. The bill provides for the preparation of annual reports including audited financial statements by issuers of municipal securities with more than $50 million outstanding. It provides also that distribution statements be prepared prior to public offer or sale of $5 million or more of securities. And it requires that such reports and statements be reliable and comparable, as well as readily available to underwriters, dealers and investors. Finally, it encourages State oversight by providing for exemptions from the distribution statement requirement where a State authority has approved the offer or sale of the issue.

The advantages of the Williams-Tower bill's approach are numerous. The '34 Act's reporting requirements are less burdensome than those under the '33 Act and will result in less burden to reporting entities. Ongoing information about the basic financial health of a city affords an excellent means of evaluating its creditworthiness and its potential for meeting debt service on bond issues into the future. To the extent new issue information is needed, the distribution statement which the Williams-Tower bill would require will provide all the relevant data. Thus, the Williams-Tower bill strikes an appropriate balance: requiring disclosure of as much information as is necessary to allow the market to function properly, without burdening our States and cities with requirements that impose unnecessary costs.

In my view, the bill as currently drafted requires improvement in two areas. First, I am concerned about the authority conferred upon the Commission by subsection (d) of Section 13A. To the extent this provision reflects the authors' belief that, in light of inflation, it may be appropriate at some future date to allow the Commission to adjust upward the minimum filing requirements, such intent could be more clearly expressed by substituting the word "increase" for the word "change" on line 5.

If, on the other hand, the provision contemplates a possible downward adjustment of the minimum limits, I believe the provision constitutes an inappropriate delegation of authority to the Commission. It is important to keep in mind that this legislation contemplates a degree of Federal involvement in the affairs of sovereign political units. Accordingly, it is our strong belief that any change which materially increases the scope of the legislation, or the

burden on entities initially subject to the legislation, must receive the review and approval of the Congress in the form of new legislation.

This leads directly to our second area of concern. While we recognize the necessity for a slight degree of rule-making authority in the Commission to implement the statutory directives, we think the legislation, as currently drafted, goes much too far. As I indicated earlier, while the protection of investors is, and must be, a consideration, it is not in my view a consideration of such paramount importance as might be the case on the corporate side. The grant of discretion to the Commission to expand the type of information required must be carefully circumscribed and should recognize expressly the different competing consideration which exist in the municipal securities area.

After all of us have had the benefit of the hearing process, we expect to work closely with the Commission and the staff of this Subcommittee to develop language to deal with the concerns set forth above. At the same time we will also present additional minor technical amendments which we feel will improve the legislation.

All in all, S.2969 presents a desirable framework for satisfying the important objectives of more and more useful information about municipal credits. We believe such legislation is urgently needed and we will cooperate with the Committee and the Congress in an attempt to achieve its expeditious passage.

Senator WILLIAMS. Thank you very much, gentlemen, and we look forward to further discussions and communications on some of the particulars that were raised that were very helpful.

Mr. Harvey Kapnick, chairman Arthur Andersen & Co. We are very pleased to welcome you before our committee, Mr. Kapnick, together with and flanked by eminent counsel.

STATEMENT OF HARVEY KAPNICK, CHAIRMAN AND CHIEF EXECUTIVE, ARTHUR ANDERSEN & CO., ACCOMPANIED BY MARIO V. MIRABELLI AND CHARLES BOWSHER

Mr. KAPNICK. Thank you, Mr. Chairman.

My name is Harvey Kapnick. As you have indicated, I am chairman of Arthur Anderson & Co., an international firm of public accountants with offices in 35 different countries and approximately 14,000 personnel. I have with me Mr. Mario Mirabelli of the law firm of Mirabelli and Gould, our counsel in this regard; and Mr. Charles Bowsher, a partner of our firm.

Many of our clients file financial statements with the Securities and Exchange Commission under the Securities Acts, and we report on such financial statements in accordance with the acts and the applicable rules and regulations. Therefore, we have considerable experience and knowledge about the financial accounting and reporting of corporations and the financial data in prospectuses that go to investors in connection with the issuance of corporate securities.

Our firm has performed professional work for various departments of the Federal Government. As a public service, and at our own expense, we prepared in 1975 a booklet, "Sound Financial Reporting in the Public Sector—A Prerequisite to Fiscal Responsibility," which has created considerable interest and has been entered in the Congressional Record. Secretary of the Treasury Simon has announced that the Treasury plans to publish consolidated financial

statements on the accrual basis for the Federal Government as a whole for the fiscal year ending September 30, 1977.

During our fiscal year ended August 31, 1975, our firm performed professional work for: (1) 54 departments, agencies, authorities, and other entities of State governments in 25 States, and (2) 124 cities, districts, authorities, and other local governmental units in 25 States and the District of Columbia.

At the request of the Secretary of the Treasury, we prepared a special report in December 1975, regarding information relating to financial requirements under the New York City Seasonal Financing Act of 1975. We have also been recently engaged to survey the accounting and financial management practices of the District of Columbia. The purpose of this survey is to define and analyze existing problems and to develop a plan that would lead to the implementation of generally accepted accounting principles and an eventual auditors' opinion. The results of the survey are to be reported to the Senate Committee on The District of Columbia.

My purpose in testifying today is to present my views on the accounting and financial reporting of state and local government entities and their systems and controls, particularly as these matters relate to the issuance of securities by those entities. My comments are made for use by your committee and the Congress in considering the proposed legislation in the area of municipal securities. In my opinion, this issue is of utmost importance to all citizens of the United States. I am pleased that the Senate of the United States is considering legislation to protect citizens from abuses that have or could have occurred in this area.

I fully support the Municipal Securities Full Disclosure Act of 1976 (S. 2969) as it has been introduced in the Senate of the United States. There is an urgent need for legislation to give investors more adequate information, to place greater responsibility on the issuers for the information disseminated, to achieve more uniformity, and to establish better standards for information to be presented, all of which I believe will add more credibility to the market for municipal securities. This act's concept of requiring an annual report and a distribution statement for issuance of new securities under the prescribed conditions is, in my view, the minimum required at this time.

In addition, there is a need for uniform standards applicable to these documents from the standpoint of everyone concerned. The securities acts have been designed to protect investors. Investors in municipal securities need the same quality of information as investors in corporate securities. The concern of Congress and the public interest should be the same for both types of securities. Until recently, a clear case may not have existed for specific requirements covering municipal securities. However, with recent events casting serious doubts on whether certain governmental units can obtain the funds required for needed programs or for refinancing existing obligations, immediate action is required to assist such governmental units and to protect potential investors.

In my view, the program contemplated by the proposed bill would be greatly strengthened and enhanced in the view of investors, if the annual reports and distribution statements were to be filed with the Securities and Exchange Commission subsequent to their issuance. The SEC could then perform a monitoring function with respect to such documents, perhaps on a test basis. Such a function would enable the SEC to review compliance with the provisions of the bill, and the rules and regulations to be prescribed thereunder, in order to determine the general level of compliance and any changes in regulations or legislation that should be considered. To file the annual reports and distribution statements in a central repository only, with no review by the SEC, would seem to be missing an opportunity for monitoring by the SEC. Such a review would result in benefits far in excess of the costs. Also, an annual report by the SEC to the Congress concerning the results of this subsequent review would be beneficial in evaluating the success of this program.

I realize that the Securities Reform Act of 1975 contains a specific provision prohibiting any requirements for the issuer of municipal securities to file any documents with the SEC or the Municipal Securities Rulemaking Board prior to the offering of the securities. Nevertheless, a question continues to exist about whether registration of certain municipal securities under the Securities Act of 1933 would be in the public interest. The question of whether prior filing of documents is required will not be answered until experience is gained with the proposed program. This step could be omitted now, but this is one of the reasons that I suggest a monitoring function for the SEC to observe what is being done by the issuers of municipal securities and to make an annual report to the Congress reporting the results of that review. This subject is so important in my view that developments in this area should be considered by the Congress in a periodic and orderly manner for the next several years.

The cost of regulation to the issuers of municipal securities is undoubtedly of concern to many governmental entities and will represent an additional cost in many cases to be borne by taxpayers. However, the question is whether this cost is necessary to provide an orderly market for such securities and to protect the purchasers of municipal securities. This, of course, is a judgmental matter, but I believe that the public interest now must of necessity lean toward the investors. Also, the effects of the uncertainty that presently exists in the minds of investors with respect to municipal securities is difficult to judge, but it is certain to be of some significance to the ability of the market to absorb the securities as well as to the interest rates that must be paid. Any additional costs incurred as a result of the registration process and the greater disclosure requirements may be more than offset in the long run by lower interest costs resulting from greater investor confidence. In addition, another concern might be considered. In recent years, the interest rates of municipal securities have tended to increase faster than interest rates on longterm corporate bonds. Since our Federal tax system

exempts interest on municipal securities in computing individual or corporate taxable income, a tendency on the part of smaller corporate taxpayers (including banks) to invest in such securities without all the data required to protect earnings could have a serious impact on our entire society.

Since certain constitutional questions have been raised, we have obtained from two law firms an opinion that the Congress of the United States has the power under the Commerce Clause of the United States Constitution to subject issuers of municipal securities to requirements of registering such securities and to the reporting requirements comparable to those included in the Securities Act of 1933 and the Securities Exchange Act of 1934 in respect of other domestic issuers. These opinions, which also cover other related matters, are attached to my statement and I will not refer to them in this particular presentation.

The basic purpose of the securities acts has been to provide adequate information to investors. The original exemption for municipal securities was logical since they were not significant in amount. In 1933, the expenditures for State and local government approximated $7 billion. In 1976, such expenditures will exceed $200 billion, without including the Federal grants-in-aid to State and local governments, which have also grown in importance. The long-term municipal securities presently being sold each year are in the general magnitude of $25 billion to $30 billion. These securities are now much more important in relation to total securities being issued and outstanding. The interests of investors cannot be separated since all securities tend to compete for investor dollars.

There is a tendency to refer to municipal securities as a single classification, and this of course is inappropriate since a wide variety of types of securities are included. However, without the availability of adequate and extensive data, there can be a tendency on the part of investors to consider all securities as having the same risk. In fact, a general review of official statements from municipal securities leaves me with the impression that in many cases the greater the amount of risk the less information there is provided. This situation suggests a great need for legislation to achieve more uniformity and quality in the information given to investors.

Municipal securities today are an important component in the financial health of our national economy, particularly that of the commercial banks. During 1960 to 1975, outstanding municipal securities grew by $145 billion, 58 percent of which went to commercial banks, with many of them being smaller banks. Municipal securities owned by commercial banks have now reached a level somewhat equivalent to the U.S. Government securities owned.

Not only did the State and local government securities held increase from $4 billion in 1945 to $101 billion in 1975, but the percentage that such securities represented in relation to total assets increased from 2.93 percent to 12.36 percent during that same period.

69-141 O - 76 - 4

In addition, these securities were about twice the total capital for such banks at the end of 1975. Thus, in my opinion. liquidity and safety are essential. However, liquidity can only be achieved if others are willing to buy. Safety can only be evaluated if the investor has adequate information on which to base a decision.

Our political and economic systems are also being undermined by the lack of adequate and uniform information with respect to State and municipal securities. While knowledgeable investors should carry the burden of risk of loss on their investments, there is no excuse for investors not being given adequate data. If the data are inadequate, we all end up sharing in the responsibility when problems surface. State and municipal securities should be placed in the same position as that of corporations. Investors should be given the facts upon which to make their evaluation, and their decisions then become their own responsibility. Under such circumstances, society should not have to bail out the losers. The primary reason that New York City was not allowed to fail was not the impact on the man in the street, but its implication to the owners of the bonds—the banks, retirees, insurance companies, and others who would have taken the loss in the cancellation or restructuring of the debt. How could they be held accountable since they bought them under circumstances of trust in a system that is inadequate?

In many of our governmental units, there are today significant hidden future costs that have not been identified either to investors or taxpayers. One of the most significant of these is the unrecognized pension costs, but they also include other amounts for services rendered that have not been recognized and recorded. Sooner or later, these hidden costs must lead to crises when they become unmanageable by the community and can no longer be avoided.

Financial reporting and accounting standards and the accounting systems and controls of many State and local governmental units are deficient. Many State and local governmental entities either do not publish financial statements for investors or the public in general or the statements that they do publish are not very complete or informative. Neither the investor, the taxpayer, nor municipal management receive the kind of reporting that would be useful to them in the performance of their roles in our society. I believe that only through the kind of regulation proposed in this bill, and modified as I am suggesting, can we see an early correction to the situation.

Financial reporting is an essential part of holding public officials and employees responsible for the proper stewardship of the funds and for the trust that has been placed in them for the performance of their functions. Historically, there has been an excessive preoccupation with legal compliance permeating the entire field of governmental accounting. Legal compliance is important, of course, and there is no inconsistency between sound accounting and legal compliance.

There is considerable debate in accounting circles over whether the necessary upgrading of the accounting and reporting can be ac-

complished on a timely basis. I do not view this as an overwhelming task because the experience of the private sector should be helpful. To aid in this effort, our firm has commissioned the Center for the Management of Public and Nonprofit Enterprise in the Graduate School of Business of the University of Chicago to carry out a study of the standards of accounting and financial disclosure for State and local governments. This research is scheduled to commence during the spring of this year and to be concluded by October 1, 1976. This study will cover not only current practices, but also recommendations for what the practices can and should be. The findings of this study will be published and available to the SEC, the Congress, and other interested parties without cost.

In conclusion, I want to emphasize that as a general proposition I do not favor any more regulation by the Federal Government than is necessary. Further, I am well aware of the traditional prerogatives of the State and local governments with respect to the issuance of municipal securities. However, there is an urgent need for improvements with respect to financial and other data related to the issuances of of municipal securities; and, therefore, I believe that the Municipal Securities Full Disclosure Act of 1976 should be enacted.

In my opinion, the only way that sufficient progress can be made in a reasonable time is for a central authority with the necessary statutory power to take the lead with respect to the many thousands of issuing entities. The SEC is the only logical place for this responsibility. The welfare not only of investors but also of the citizens of the various governmental entities is importantly at stake. The ability of many of these entities to borrow adequate amounts for schools, police, fire, and other governmental services on a reasonable basis may also be at stake. Those from the States and cities who may oppose any type of Federal regulation and are in favor of a continuation of the do-it-yourself approach are actually performing a disservice to the citizens they represent.

The proposed bill, in my opinion, is a practical and minimum step at this time, and as indicated earlier, I fully support it. However, I do believe that a modification to provide for a monitoring function by the SEC and an annual report to the Congress would add a great deal in accomplishing the objectives and should be adopted. No area is more important for our elected leaders to be concerned than with the viability of our local communities where we reside and work and raise our families.

Mr. Chairman, I thank you for this opportunity to present my views.

Senator WILLIAMS. Thank you very much, Mr. Kapnick, and we certainly applaud you and your organization that has a name of such distinction and all that you are doing in a leadership role in trying to bring a new order out of what I would colloquially describe as chaos in municipal financing.

[Complete statement follows:]

STATEMENT BY HARVEY KAPNICK

My name is Harvey Kapnick. I am Chairman and Chief Executive of Arthur Andersen & Co., an international firm of public accountants. We have 49 offices in the United States and Puerto Rico and 57 offices in 34 other countries. We have approximately 14,000 personnel in our firm.

Many of our clients file financial statements with the Securities and Exchange Commission under the Securities Acts, and we report on such financial statements in accordance with the Acts and the applicable rules and regulations. Therefore, we have considerable experience and knowledge about the financial accounting and reporting of corporations and the financial data in prospectuses that go to investors in connection with the issuance of corporate securities.

Our firm has performed professional work for various departments of the Federal government. As a public service, and at our own expense, we prepared in 1975 a booklet, "Sound Financial Reporting in the Public Sector—A Prerequisite to Fiscal Responsibility," which has created considerable interest and has been entered in the Congressional Record. Secretary of the Treasury Simon has announced that the Treasury plans to publish consolidated financial statements on the accrual basis for the Federal government as a whole for the fiscal year ending September 30,1977.

During our fiscal year ended August 31, 1975, our firm performed professional work for: (1) 54 departments, agencies, authorities, and other entities of state governments in 25 states, and (2) 124 cities, districts, authorities, and other local governmental units in 25 states and the District of Columbia.

At the request of the Secretary of the Treasury, we prepared a special report in December, 1975, regarding information relating to financial requirements under the New York City Seasonal Financing Act of 1975. We have also been recently engaged to survey the accounting and financial management practices of the District of Columbia. The purpose of this survey is to define and analyze existing problems and to develop a plan that would lead to the implementation of generally accepted accounting principles and an eventual auditors' opinion. The results of the survey are to be reported to the Senate Committee on the District of Columbia.

My purpose in testifying today is to present my views on the accounting and financial reporting of state and local governmental entities and their systems and controls, particularly as these matters relate to the issuance of securities by those entities. My comments are made for use by your Committee and the Congress in considering the proposed legislation in the area of municipal securities. In my opinion, this issue is of utmost importance to all citizens of the United States. I am pleased that the Senate of the United States is considering legislation to protect citizens from abuses that have or could have occurred in this area.

Support for S. 2969

I fully support The Municipal Securities Full Disclosure Act of 1976 (S. 2969) as it has been introduced in the Senate of the United States.* There is an urgent need for legislation to give investors more adequate information, to place greater responsibility on the issuers for the information disseminated, to achieve more uniformity, and to establish better standards for information to be presented, all of which I believe will add more credibility to the market for municipal securities. This Act's concept of requiring an annual report and a distribution statement for issuance of new securities under the prescribed conditions is, in my view, the minimum required at this time.

In addition, there is a need for uniform standards applicable to these documents from the standpoint of everyone concerned. The Securities Acts have been designed to protect investors. Investors in municipal securities need the same quality of information as investors in corporate securities. The concern of the Congress and the public interest should be the same for both types of securities. Until recently, a clear case may not have existed for specific requirements covering municipal securities. However, with recent events casting serious doubts on whether certain governmental units can obtain the funds required for needed programs or for refinancing existing obligations, immediate action is required to assist such governmental units and to protect potential investors.

In my view, the program contemplated by the proposed bill would be greatly strengthened and enhanced in the view of investors, if the annual reports and distribution statements were to be filed with the Securities and Exchange Commission subsequent to their issuance. The SEC could then perform a monitoring function with respect to such documents, perhaps on a test basis. Such a function would enable the SEC to review compliance with the provisions of the bill, and the rules and regulations to be prescribed thereunder, in order to determine the general level of compliance and any changes in regulations or legislation that should be considered. To file the annual reports and distribution statements in a central repository only, with no review by the SEC, would seem to be missing an opportunity for monitoring by the SEC. Such a review would result in benefits far in excess of the costs. Also, an annual report by the SEC to the Congress concerning the results of this subsequent review would be beneficial in evaluating the success of this program.

I realize that the Securities Reform Act of 1975 contains a specific provision prohibiting any requirement for the issuer of municipal securities to file any documents with the SEC or the Municipal Securities Rulemaking Board prior to the offering of the securities. Nevertheless, a question continues to exist about whether registration of *certain* municipal securities under the Securities Act of 1933 would be in the public interest. The question of whether prior filing of documents is required will not be answered until experience is gained with the proposed program. This step could be omitted now, but this is one of the reasons that I suggest a monitoring function for the SEC to observe what is being done by the issuers of municipal securities and to make an annual report to the Congress reporting

* The proposed bill and the related comments by Senator Williams and Senator Tower are included herein as Appendix C.

the results of that review. This subject is so important in my view that developments in this area should be considered by the Congress in a periodic and orderly manner for the next several years.

The cost of regulation to the issuers of municipal securities is undoubtedly of concern to many governmental entities and will represent an additional cost in many cases to be borne by taxpayers. However, the question is whether this cost is necessary to provide an orderly market for such securities and to protect the purchasers of municipal securities. This, of course, is a judgmental matter, but I believe that the public interest now must of necessity lean toward the investors. Also, the effects of the uncertainty that presently exists in the minds of investors with respect to municipal securities is difficult to judge, but it is certain to be of some significance to the ability of the market to absorb the securities as well as to the interest rates that must be paid. Any additional costs incurred as a result of the registration process and the greater disclosure requirements may be more than offset in the long run by lower interest costs resulting from greater investor confidence. In addition, another concern might be considered. In recent years, the interest rates of municipal securities have tended to increase faster than interest rates on long-term corporate bonds. Since our Federal tax system exempts interest on municipal securities in computing individual or corporate taxable income, a tendency on the part of smaller corporate taxpayers (including banks) to invest in such securities without all the data required to protect earnings could have a serious impact on our entire society.

Since certain constitutional questions have been raised, we have obtained from Wilson & McIlvaine, general counsel of our firm, an opinion that the Congress of the United States has the power under the Commerce Clause of the United States Constitution to subject issuers of municipal securities to requirements of registering such securities and to the reporting requirements comparable to those included in the Securities Act of 1933 and the Securities Exchange Act of 1934 in respect of other domestic issuers. This opinion, which also covers other related matters, is attached as Appendix A. Another legal opinion by Wilmer, Cutler & Pickering also relating to the basis for Federal legislation in this area is attached as Appendix B.

My remaining comments set forth briefly my reasons for supporting the proposed legislation.

Nature and Importance of Municipal Securities

The basic purpose of the Securities Acts has been to provide adequate information to investors. The original exemption for municipal securities was logical since they were not significant in amount. In 1933, the expenditures for state and local government approximated $7 billion. In 1976, such expenditures will exceed $200 billion, without including the Federal grants-in-aid to state and local governments, which have also grown in importance. The long-term municipal securities presently being sold each year are in the general magnitude of $25 billion to $30 billion. These securities are now much more important in relation

to total securities being issued and outstanding. The interests of investors cannot be separated since all securities tend to compete for investor dollars.

There is a tendency to refer to municipal securities as a single classification, and this of course is inappropriate since a wide variety of types of securities are included. However, without the availability of adequate and extensive data, there can be a tendency on the part of investors to consider all securities as having the same risk. Essentially, there are four basic types of long-term municipal securities:

1. General obligation bonds that are backed by the full faith and credit of the governmental unit involved. These are normally retired from the general tax revenues and, if not, must be refinanced at their maturity through the sale of additional bonds.

2. Special tax bonds that are limited in security to a particular tax that will be used to retire them. An example of this would be highway bonds to be retired from gasoline taxes.

3. Revenue bonds that are secured only by the revenues that will come from the investment of the proceeds. An example would be industrial revenue bonds issued to build facilities for corporate users whose rentals then retire the bonds.

4. Recently created housing authority bonds that are issued by a state authority which has no taxing power and are not guaranteed by the state. These are secured, however, by rentals or mortgage payments from the housing and the credit of the Federal government; and thus, become Federally supported tax-exempt issues.

The balance of the municipals, in the short-term category, can be grouped into three other types:

1. Securities that are issued in anticipation of revenue receipts to be received in the near future and to be retired when the specific revenues are in hand.

2. Securities that are to cover emergencies such as floods or disasters which were not foreseen when the budget was prepared. These types of securities would normally be rolled over into long-term bonds, if they are significant.

3. Securities that are issued in anticipation of bond sales. These securities are used to economize on financing costs, but in our recent economic environment the inability to subsequently sell bonds has rendered these securities hazardous in certain cases. For example, one of the critical financial aspects of the New York City crisis was caused by the bond anticipation notes that it had begun to issue in 1962 under the Private Housing Finance law. These notes were to be replaced through the issuance of long-term bonds, but as of June 30, 1975, $1.57 billion of them were not converted. Thus, short-term notes are financing long-term needs, a practice that can be very risky.

Any attempt to analyze types of securities is further complicated by the great variety of issuers, which include states, cities, towns, school districts, and authorities, and the broad range of purposes, such as airport, road, sewer, building construction, housing development,

and industry and job generation. Each issue has its own unique informational and disclosure needs. In our review of the official statements covering recent security sales, the information supplied varied widely. One issuance of $200 million of notes for a State Authority was covered with a five-page circular that included almost no financial information. In contrast, a $4 million industrial revenue bond issue guaranteed by a large company was supported by a 44-page official statement that included audited financial statements of the company and extensive disclosures. A general review of official statements for municipal securities leaves me with the impression that in many cases the greater the amount and risk, the less information there is provided. This situation suggests a great need for legislation to achieve more uniformity and quality in the information given to investors.

Impact on Banking System

Municipal securities today are an important component in the financial health of our national economy, particularly that of the commercial banks. During 1960 to 1975, outstanding municipal securities grew by $145 billion, 58% of which went to commercial banks, with many of them being smaller banks. Municipal securities owned by commercial banks have now reached a level somewhat equivalent to the U. S. Government securities owned.

The following data taken from a report of the Board of Governors of the Federal Reserve System shows the great increase in state and local government securities held by commercial banks:

Year-End	State and Local Government Securities Held	Total Assets	Percent of Securities Held to Total Assets
	(Millions of Dollars)		
1945	$ 4,170	$142,408	2.93%
1955	12,898	185,025	6.97
1965	38,725	336,354	11.51
1970	69,637	490,664	14.19
1973	95,145	713,116	13.34
1974	100,345	784,616	12.79
1975	101,545	821,516	12.36

Not only did the state and local government securities held increase from $4 billion in 1945 to $101 billion in 1975, but the percentage that such securities represented in relation to total assets increased from 2.93% to 12.36% during that same period. In addition, these securities were about twice the total capital for such banks at the end of 1975. Thus, in my opinion, liquidity and safety are essential. However, liquidity can only be achieved if others are willing to buy. Safety can only be evaluated if the investor has adequate information on which to base a decision.

As a further example, the Board of Governors of the Federal Reserve System stated that as of January, 1976, 954 banks in most of the states had New York obligations (State

and State agencies and New York City) equivalent to 20% or more of their capital, and 236 of these banks had such obligations equivalent to 50% of their capital. The largest concentration outside New York was in the banks in Florida, where total holdings exceeded $226 million. Since earnings are important for all banks, large or small, the tax-free nature of municipal securities can improve earnings significantly, especially with the current interest rates. However, as interest goes up, so might risks. It is essential, therefore, that all banks have adequate information on which to base decisions.

The assurance of a sound market in municipal securities based on proper and adequate information—financial and otherwise—is necessary for the efficient functioning of our banking system.

Effect on Our Political System

Our political and economic systems are also being undermined by the lack of adequate and uniform information with respect to state and municipal securities. While knowledgeable investors should carry the burden of risk of loss on their investments, there is no excuse for investors not being given adequate data. If the data are inadequate, we all end up sharing in the responsibility when problems surface. State and municipal securities should be placed in the same position as that of corporations. Investors should be given the facts upon which to make their evaluation, and their decisions then become their own responsibility. Under such circumstances, society should not have to bail out the losers. The primary reason that New York City was not allowed to fail was not the impact on the man in the street, but its implication to the owners of the bonds—the banks, retirees, insurance companies, and others who would have taken the loss in the cancellation or restructuring of the debt. How could they be held accountable since they bought them under circumstances of trust in a system that is inadequate?

In many of our governmental units, there are today significant hidden future costs that have not been identified either to investors or taxpayers. One of the most significant of these is the unrecognized pension costs, but they also include other amounts for services rendered that have not been recognized and recorded. Sooner or later, these hidden costs must lead to crises when they become unmanageable by the community and can no longer be avoided. Citizens do have alternatives—i.e., the community in which they reside. These alternatives can create immense problems when hidden costs surface and taxes become excessive in one community in relation to others. A problem with our cities today is that citizens have moved out of the inner city to the suburbs and escaped a part of the responsibility for paying the hidden cost of services that were delivered when they were residents. It is a reasonable expectation now that New York City has to face its crisis that there will be an additional outflow of citizens to escape the financial burden. Therefore, our citizens need uniformity of financial disclosure to help them make their choices and to require that they and their political leadership pay for the cost of services when they receive them and not defer them to a later period or group who because of economic circumstances may not have

viable choices. Uniformity of accounting and adequate disclosure for all political entities may help avoid such problems.

Perhaps the biggest benefit from uniform financial disclosure would be its injection into the elective political process of our country. For the first time, effectiveness and efficiency of resource management might become an issue in political campaigns, thus providing citizens with a competitive choice in the selection of the leaders to administer their services and funds. This step could be an exciting new challenge to our political leaders.

Accounting and Reporting Problems

Financial reporting and accounting standards and the accounting systems and controls of many state and local governmental units are deficient. Many state and local governmental entities either do not publish financial statements for investors or the public in general, or the statements that they do publish are not very complete or informative. Neither the investor, the taxpayer, nor municipal management receive the kind of reporting that would be useful to them in the performance of their roles in our society. I believe that only through the kind of regulation proposed in this bill, and modified as I am suggesting, can we see an early correction to the situation.

Financial reporting is an essential part of holding public officials and employees responsible for the proper stewardship of the funds and for the trust that has been placed in them for the performance of their functions. Historically, there has been an excessive preoccupation with legal compliance permeating the entire field of governmental accounting. Legal compliance is important, of course, and there is no inconsistency between sound accounting and legal compliance. My point, however, is that the governmental entity should report in a rational and useful manner.

There are four critical areas of deficiency in accounting practices:

1. Financial statements consolidating the funds of a governmental entity are generally not presented.

2. Accrual accounting is not followed in many cases.

3. Recognized standards of accounting for pension costs are frequently not followed.

4. Depreciable property and the related depreciation are usually not recorded.

Consolidated Financial Statements. Some of the current accounting literature indicates that a consolidation of all the funds for a particular governmental unit may not be in accordance with generally accepted accounting principles. This position fails to recognize that the resources of a political community constitute a single fiscal capacity. The number of individual funds in a governmental entity may range from a few to in excess of 100. It is impossible to portray the overall financial health of the governmental entity—the political community—through a review of individual fund balances. How does the investor

know whether the resources of the community will support the services? How does the investor identify the risk in a security issue? How can the individual citizen make rational choices concerning where to live and when to move?

The subject of consolidation is a complex one, but I am convinced that it has not been dealt with properly in the past. Where there are interrelationships between the funds, and where direct and indirect guarantees or obligations with respect to debt exist between funds, only consolidation will give an understandable picture of what the situation really is. In some cases, financial statements both for individual funds and consolidated funds would be appropriate. A common-sense approach is needed to determine what financial information is the most useful and meaningful.

Accrual Accounting. The financial statements should portray how the current citizens are faring. Are they bearing their costs currently for the services rendered? Are these costs being deferred to the future or are the current citizens bearing a greater than equitable share of the cost? Only full accrual accounting will adequately answer these and other questions. Present governmental accounting relies either on a cash basis or a modified accrual basis of accounting. In the case of New York City, revenues were in most cases accrued but expenses were recorded on a cash basis.

The widely used modified accrual basis of accounting has been an approach whereby expenditures other than accrued interest on general long-term debt are recorded at the time liabilities are incurred, and revenues are recorded when received in cash. A significant point here is that under this common practice, expenditures are recorded when liabilities are incurred, not necessarily when services are rendered and costs incurred.

Some accountants apparently believe that state and local governmental units need not record such costs as vacation and sick leave at the time benefits are accumulated. This omission, which commonly exists, is just another of the many examples of costs not being recognized and currently reported in governmental financial statements.

Pension Plans. One of the major areas of deficiency in the financial affairs of many state and local governmental units relates to pension plans, which have been estimated to be about 80,000 in number and which involve many billions of dollars. These plans frequently are not adequately funded, are not based on appropriate actuarial assumptions, and are not accounted for in a proper manner. In addition, the real condition of the plans and the actual or potential liabilities involved usually are not properly disclosed in financial data published by the affected governmental unit. A proper recording of pension costs might well double the amounts presently being recorded.

The current area of your Committee's concern is the accounting for, and reporting of, costs and liabilities and the pertinent disclosure thereof as a part of financial reports of state and local governmental units. Although some exceptions exist among pension plans of state and local governmental units, considerable improvement in the accounting and financial

reporting is needed, because costs and liabilities frequently are not being accurately reflected and do not meet the standards presently being followed in the accounting for business enterprises. Recording these costs currently is extremely important to the public employees who must be assured that their pensions will be paid.

My comments would be incomplete, however, if I did not point out that deficiencies exist in many of these plans not only in the recording of realistic costs by the governmental unit, but also in funding. These are very serious, not only to the participants in the plans but also to the citizens and taxpayers of the governmental units who may be adversely affected in the future. While the Congress in the Employee Retirement Income Security Act of 1974 exempted the pension plans of state and local governmental units, it must be recognized that this exemption relates to pension plans in an area where perhaps the greatest need for reform has existed. While the condition of these plans is not the subject of this hearing, this matter should be of concern to the Congress.

Depreciable Property. The recording of property and the related depreciation are necessary to secure a full costing of the services to the current citizens. Since property is a part of the services received, it should be considered in the costs, as an essential aspect of accrual accounting.

Research Project for Accounting and Disclosure Requirements

There is considerable debate in accounting circles over whether the necessary upgrading of the accounting and reporting can be accomplished on a timely basis. I do not view this as an overwhelming task because the experience of the private sector should be helpful. To aid in this effort, our firm has commissioned the Center for the Management of Public and Nonprofit Enterprise in the Graduate School of Business of The University of Chicago to carry out a study of the standards of accounting and financial disclosure for state and local governments. This research is scheduled to commence during the spring of this year and to be concluded by October 1, 1976. This study will cover not only current practices, but also recommendations for what the practices can and should be. The findings of this study will be published and available to the SEC, the Congress, and other interested parties without cost.

This study will be an interdisciplinary project, incorporating accounting, law, finance, and public administration. The guidance and cooperation of representatives of the Municipal Finance Officers Association as well as the accounting and legal professions and the investment banking community will be elicited. Areas to be covered by the study will include:

1. Reconciliation for financial reporting purposes of generally accepted accounting principles and various accounting requirements for legal compliance.

2. Adoption of accrual accounting (as opposed to modified accrual accounting) in financial reports.

3. Appropriateness of financial statements consolidating financial data for various funds and/or divisions within a governmental entity.

4. Current and continuing financial disclosure requirements in official statements for bond offerings.

Conclusion

In conclusion, I want to emphasize that as a general proposition I do not favor any more regulation by the Federal government than is necessary. Further, I am well aware of the traditional prerogatives of the state and local governments with respect to the issuance of municipal securities. However, there is an urgent need for improvements with respect to financial and other data related to the issuance of municipal securities; and, therefore, I believe that The Municipal Securities Full Disclosure Act of 1976 should be enacted.

In my opinion, the only way that sufficient progress can be made in a reasonable time is for a central authority with the necessary statutory power to take the lead with respect to the many thousands of issuing entities. The SEC is the only logical place for this responsibility. The welfare not only of investors but also of the citizens of the various governmental entities is importantly at stake. The ability of many of these entities to borrow adequate amounts for schools, police, fire, and other governmental services on a reasonable basis may also be at stake. Those from the states and cities who may oppose any type of Federal regulation and are in favor of a continuation of the do-it-yourself approach are actually performing a disservice to the citizens they represent.

The proposed bill, in my opinion, is a practical and minimum step at this time, and as indicated earlier, I fully support it. However, I do believe that a modification to provide for a monitoring function by the SEC and an annual report to the Congress would add a great deal in accomplishing the objectives and should be adopted. No area is more important for our elected leaders to be concerned than with the viability of our local communities where we reside and work and raise our families.

APPENDIX A

11

WILSON & McILVAINE

135 SOUTH LASALLE STREET

CHICAGO, ILLINOIS 60603

CABLE ADDRESS "WILVAINE"

TELEPHONE (312) 263-1212

DEX 312 263-1231

TELEX 25-3786

SHELDON LEE
CHARLES W. BOAND
WM. R. DICKINSON, JR.
THOMAS F. GERAGHTY, JR.
F. A. REICHELDERFER
KENT CHANDLER, JR.
DAVID G. CLARKE
GEORGE W. THOMPSON
STEPHEN L. SEFTENBERG
JOHN E. McGOVERN, JR.
VERNON T. SQUIRES
PAUL S. GERDING
KELVYN H. LAWRENCE
CHARLES R. STALEY
ANTHONY N. GRAHAM
DANIEL V. O'LEARY, JR.
GARY H. KLINE
THOMAS A. POLACHEK
JAMES A. WINKLER
JERRY D. JONES

COUNSEL
KENNETH F. MONTGOMERY
JOHN P. WILSON, JR.

JOHN P. WILSON (1867-1922)
WM. B. McILVAINE (1888-1943)

ASSOCIATES
BLAIR P. FRIEDERICH
ROBERT F. FORRER
RICHARD C. FIDDES
WALTER W. BELL
CHARLES W. DEUSER, II
JOHN D. LIEN
CAROL A. KIPPERMAN
KENDALL R. MEYER
JOHN MICHAEL RYAN
ROBERT E. RILEY
JOHN M. CYTRON
MARC P. SEIDLER
PETER A. SARASEK
TERRY ELLEN POLSON
RICHARD B. THIES
LEONARD S. SHIFFLETT
JAMES C. NOONAN
PETER M. BARNETT

February 19, 1976

Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60602

Gentlemen:

You have requested our views with respect to the power of the United States Congress under the Constitution of the United States to enact a law with respect to securities issued by a State of the United States or a political subdivision or public instrumentality of a State ("municipal securities") which would contain provisions comparable to those contained in the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") requiring the registration of securities and the filing of reports, and imposing criminal and civil sanctions.

In our opinion the Congress of the United States has the power under the Commerce Clause of the United States Constitution (Article I, Section 8, Clause 3) to subject issuers of municipal securities to requirements of registering the same and to reporting requirements comparable to those included in the 1933 and 1934 Acts in respect of other domestic issuers. (See, Maryland v. Wirtz, 392 U.S. 183 (1968); Fry v. United States, 421 U.S. 542 (1975)).

In view of the dual sovereignty which exists in our system of government, we are of the opinion that the Federal Constitution would not permit enforcement of criminal provisions against an

issuer of municipal securities, and it is doubtful whether criminal provisions could be enforced against an elected or appointed official of an issuer of municipal securities unless his conduct were so aggravated as to place him outside the scope of his official capacity.

In our opinion the Federal Constitution would permit the use of civil injunctions comparable to those provided for in the 1933 and 1934 Acts against an issuer of municipal securities and officials of such issuer to prohibit future violations. (See, Employees v. Dept. of Public Health and Welfare, 411 U.S. 279 (1973); Edelman v. Jordan, 415 U.S. 651 (1974)).

We doubt whether civil provisions comparable to those of the 1933 and 1934 Acts, other than injunctive relief against future violations, could be enforced in most cases against an issuer of municipal securities or an elected or appointed official thereof unless such official's conduct were so aggravated as to place him beyond the scope of his official capacity. Cf., O'Connor v. Donaldson, U.S. , 95 S.Ct. 2486 (1975); Scheuer v. Rhodes, 416 U.S. 232 (1974); Wood v. Strickland, 420 U.S. 308 (1975).

Enforcement of civil liability provisions comparable to those of the 1933 and 1934 Acts would be further complicated by the constitutional restriction on jurisdiction of the Federal courts in suits by a citizen (including a corporation). The Eleventh Amendment to the Federal Constitution reads as follows:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

The 1934 Act vests in the Federal courts exclusive jurisdiction in respect of all violations thereof or rules and regulations thereunder, and of all suits in equity and actions at law to enforce any liability or duty created thereby. (Section 27; 15 U.S.C. §78aa). However, the 1933 Act vests in the Federal courts exclusive jurisdiction over offenses and violations only,

but confers upon them jurisdiction concurrent with State courts of all suits in equity and actions at law to enforce any liability or duty created thereby. (Section 22; 15 U.S.C. §77v). The Eleventh Amendment would not bar access by the United States or an agency or instrumentality thereof, such as the Securities and Exchange Commission, to the Federal courts, and the Federal courts could hear injunction suits filed by the Securities and Exchange Commission. However, in our opinion the Federal courts would not have jurisdiction to hear any suit by a citizen (including a corporation) arising under the 1933 or 1934 Act against a State or an arm or alter ego of a State. (See, Hans v. Louisiana, 134 U.S. 1 (1893); Employees v. Dept. of Public Health and Welfare, supra). The Federal courts would, however, have jurisdiction to hear such a suit by a citizen (or a corporation) against a county, city, or lesser governmental unit of a State (Lincoln County v. Luning, 133 U.S. 529 (1890); see, Edelman v. Jordan, supra), but, as stated above, we doubt whether the Federal Constitution would permit the imposition of any liability upon an issuer of municipal securities. While the 1933 Act would afford a citizen (including a corporation) access to a State court, resort to a State court would be necessary only in a suit against a State or arm or alter ego of a State. We believe, as stated above, that such a suit would fail in most cases and would introduce other complex issues of both Federal and State law and of the right of Federal courts to review decisions of State courts on such Federal questions.

We have made no distinction between municipal securities issued to raise funds for governmental operations and those issued to raise funds for proprietary operations since it seems to us that the borrowing of money and the issuance of municipal securities are essential to the control of fiscal policy which is essentially governmental. It is, of course, possible that the United States Supreme court may attempt such a distinction and impose civil liability in cases where the funds were for proprietary purposes and the control of fiscal policy is not significantly impaired.

Annexed hereto as Exhibit 1 is a brief outline of matters which would appear to require consideration by the Congress in connection with any contemplated amendment of the 1933 and 1934 Acts to regulate further municipal securities.

Yours very truly,

WILSON & McILVAINE

by Charles W. Boand

Charles W. Boand

1a
Exhibit 1 attached

EXHIBIT 1

1933 Act

Revision of the following provisions of the 1933 Act should be considered if issuers of municipal securities are required to register their securities under the 1933 Act:

1. Section 3(a)(2)

This provision presently exempts municipal securities from all provisions of the 1933 Act except Section 17. Deletion of the language in Section 3(a)(2) relating to municipal securities would be the basic amendment required to bring offerings by such issuers under the 1933 Act.

2. Section 6

The provisions relating to execution of registration statements would be ambiguous with respect to issuers of municipal securities, particularly the requirement of execution by a majority of the board of directors or persons having the power of management of the issuer. If the latter requirement were applied to governmental issuers, then members of state legislatures and city councils might be required to sign registration statements and be exposed to the civil liability provisions of the 1933 Act. Section 6 expressly provides that registration statements filed by foreign governments need only be signed by their authorized representative in the United States or the underwriter who sells their securities. This sensitivity to the special execution problems posed by governmental units strongly suggests the need for amendment of Section 6 to specifically deal with execution of registration statements by issuers of municipal securities.

3. Sections 7 and 10

These provisions deal with the required content of the registration statement and prospectus. At present they provide that the information required of foreign governments and political subdivisions is set forth in Schedule B to the 1933 Act while information required of all other

69-141 O - 76 - 5

issuers is set forth in Schedule A. Schedule A describes information in the main related to a for-profit business and would not be applicable to an issuer of municipal securities. On the other hand, Schedule B describes information clearly related to governmental entities but by its terms applies only to a foreign government or political subdivision thereof. Accordingly, if registration of municipal securities is required, then Sections 7 and 10 should be amended to provide expressly for another Schedule which sets forth the information required in the registration statement and prospectus covering such securities and such a Schedule should be added to the Act.

1934 Act

In considering the possible application of the 1934 Act to issuers of municipal securities, the following matters are of special significance:

1. If an issuer of municipal securities were required to register an offering of its securities under the 1933 Act, then such an issuer would become subject to the limited periodic reporting requirements under Section 15(d) of the 1934 Act and the liability and enforcement provisions relating to persons who file 1934 Act reports. (It is noteworthy that foreign governments and their subdivisions are expressly excluded from the filing requirements of Section 15(d).)

2. If issuers of municipal issues were required to register under the 1933 Act, then it might be advisable to amend Section 15B(d)(1) of the 1934 Act to delete the provision prohibiting the Commission from requiring issuers of municipal securities to make filings under the 1934 Act of documents to be used in connection with an offering of securities. This amendment, however, would not be critical because at present there are no ancillary 1934 Act pre-offering filings required in connection with 1933 Act registrations.

3. In the event Congress desired to subject to the 1934 Act all issuers of municipal securities which had a publicly held class of securities outstanding, then many policy considerations would be required with respect to the extent

that the 1934 Act should apply to such issuers and their securities. At present, issuers with a class of publicly held securities (subject to certain exclusions) are required to register such class under Section 12 of the 1934 Act and the issuers thereby become subject to the reporting requirements under Section 13 and the proxy rules under Section 14 and their officers, directors and 10% stockholders become subject to the reporting and short-swing profit recapture rules under Section 16. Sections 14 and 16 would have no applicability to issuers of municipal securities and, therefore, it would be inappropriate to amend Section 12 to require full 1934 Act registration by issuers with a publicly held class of municipal securities. Rather, it would be preferable to add a new provision to the 1934 Act requiring periodic reporting by such issuers. Such a provision could define publicly held by reference to a class of securities held of record by a certain number of persons and it should set forth the general types of information to be contained in the reports. Finally, adding a new 1934 Act provision requiring periodic reports by such issuers would require an amendment to Section 3(a)(12) which defines "exempted securities" for purposes of the 1934 Act and which provides a partial exemption for municipal securities from many of the provisions of the 1934 Act. Any amendment to Section 3(a)(12) should be done with precision because, for many purposes under the 1934 Act, municipal securities should remain within the definition of exempted securities.

WILMER, CUTLER & PICKERING
1666 K STREET, N.W.
WASHINGTON, D.C. 20006

CABLE ADDRESS: WICRING WASH., D.C.
INTERNATIONAL TELEX: 440-239
TELEX: 89-2402
TELEPHONE 202 872-6000

EUROPEAN OFFICE
5, CHEAPSIDE
LONDON, EC2V 6AA, ENGLAND
TELEPHONE 01-236-2401
TELEX: 851 883242
CABLE ADDRESS: WICRING, LONDON

RICHARD H. WILMER
LLOYD N. CUTLER
JOHN H. PICKERING
MANUEL F. COHEN
HUGH R. H. SMITH
LOUIS F. OBERDORFER
J. ROGER WOLLENBERG
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SALLY KATZEN
F. DAVID LAKE, JR.
PAUL J. MODE, JR.
STEPHEN F. BLACK
C. BOYDEN GRAY
RONALD J. GREENE
JAY F. LAPIN
DEANNE C. SIEMER
GARY D. WILSON

EZEKIEL G. STODDARD
GERARD C. SMITH
COUNSEL

RICHARD A. ALLEN
PETER D. BEWLEY
STEWART A. BLOCK
LACKLAND H. BLOOM, JR.
MICHAEL L. BURACK
RICHARD W. CASS
BARRY O. CHASE
WILHELMINA REUBEN COOKE
MICHELE B. CORASH
PATRICIA D. DOUGLASS
S. ALLEN EARLY, III
JAMES R. FARRAND
NANCY C. GARRISON
NEAL M. GOLDBERG
CORNELIUS J. GOLDEN, JR.
FRANCES M. GREEN
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C. LORING JETTON, JR.

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NOEL ANKETELL KRAMER
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MARY A. McREYNOLDS
A. DOUGLAS MELAMED
ROBERT R. MORRIS
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PHILLIP L. RADOFF
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JOHN ROUNSAVILLE, JR.
MICHAEL S. SCHOOLER
KAREN KOSER SCHWARTZ
THEODORE S. SIMS
MARIANNE K. SMYTHE
DOUGLAS G. THOMPSON, JR.
ALAN S. WEITZ
WALTER T. WINSLOW, JR.
ROGER M. WITTEN

February 20, 1976

Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60602

Dear Sirs:

You have requested our opinion concerning the constitutionality of federal legislation requiring states, cities and other political subdivisions that sell securities to the public to prepare and publish financial statements and other appropriate information. Our opinion is as follows:

1. Congress has the power under Article I, Section 8, Clause 3 (the "Commerce Clause") of the Constitution to require states, cities and other political subdivisions to publish financial statements and other appropriate information in connection with the sale of their securities in interstate commerce and to publish such statements and information periodically as long as securities thus sold remain outstanding.

2. Congress has the power under the Commerce Clause to prescribe, or authorize an appropriate agency to prescribe, appropriate rules governing the form and content of such financial statements and other appropriate information.

3. Congress has the power under the Commerce Clause to authorize an appropriate agency to enforce such requirements by seeking appropriate injunctive relief against the issuer of such securities and its officials, and Congress can constitutionally confer on the courts of the United States the power to award such relief in appropriate cases.

Very truly yours,

Wilmer, Cutler & Pickering

Wilmer, Cutler & Pickering

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 94th CONGRESS, SECOND SESSION

Vol. 122 WASHINGTON, TUESDAY, FEBRUARY 17, 1976 No. 20

S 1632 CONGRESSIONAL RECORD — SENATE February 17, 1976

By Mr. WILLIAMS (for himself and Mr. TOWER):

S. 2969. A bill to amend the Securities Exchange Act of 1934 to require the preparation of annual reports and distribution statements by issuers of municipal securities, and for other purposes. Referred to the Committee on Banking, Housing and Urban Affairs.

THE MUNICIPAL SECURITIES FULL DISCLOSURE ACT OF 1976

Mr. WILLIAMS. Mr. President, I am today introducing, on behalf of Senator TOWER and myself, a bill to amend the Securities Exchange Act of 1934 to upgrade the quality and uniformity of financial and other information concerning State and local issuers of municipal securities.

Until enactment of the 1975 Securities Acts Amendments, municipal securities—the debt obligations of State and local governments—were exempted from all but the antifraud provisions of the Federal securities laws. However, the increasing incidence of sharp and illegal practices led Congress in 1975, to subject the municipal securities industry—bank and nonbank dealers and underwriters—to SEC jurisdiction. This action was taken in order to protect unwary investors, and ended 40 years of nonregulation.

Now, in view of the widespread concern over the financial condition of many of our largest cities, and the obvious lack of adequate disclosure and standardized municipal accounting practices, it is clear that the time has come for the Congress to reexamine the validity of the "hands-off" treatment of municipal securities issuers in the primary market.

Since 1933, municipal securities have been expressly exempted from the full disclosure requirements of our securities laws. As a result, municipal securities have been distributed under practices involving far less disclosure and recognition of fundamental investor protections than is the case for corporate issuers.

The reasons for the original exemptions are not well documented in legislative history, but several factors seem to have influenced the 73d Congress when it considered the Securities Act of 1933. First, there were only rare instances of misrepresentation by municipalities. As evidence of this, the House committee report on the Securities Act of 1933 stated that municipal securities were beyond the need of public protection because of the lack of "recurrent demonstrated abuses." The principal reason for the exemption, however, was the concern that the costs of SEC regulation would be passed on to State and local issuers and the belief that investors in municipal securities were sophisticated institutions able to look after their own interests.

Forty-three years of municipal finance corroborates the continuing validity of the finding that "recurrent abuses" have not occurred—New York City being atypical and unusual. This is not so however, with respect to the remaining arguments that were so persuasive in 1933.

For example, for many years, it was true that sophisticated investors—those generally considered to be able to protect themselves and therefore not in need of the statutory protections of the securities laws—were the principal purchasers of municipal securities. Until very recently, municipal financing demands were satisfied by commercial banks, high income individuals, and fire and casualty insurance companies.

However, according to Federal Reserve estimates, the commercial banks' share of the new issue market has steadily declined during this decade—from 95 percent in 1970 to 32 percent in 1974. Moreover, insurance companies and other financial intermediaries are not likely to increase their holdings substantially to offset the commercial banks' declining market participation.

A corollary of this is that these tax exempt securities are no longer the province of wealthy and institutional investors. An increasingly large proportion of municipal debt has been sold to individuals of small and moderate means. Rising personal incomes and significant increases in municipal bond interest rates and yields have caused a major upsurge in private investor interest—the very category of investors intended to receive the protections mandated by our securities laws.

Also, the historical concern that application of the securities laws to State and local issuers would increase costs and otherwise interfere with essential capital raising efforts has been superseded by a potentially far more serious concern—the erosion of investor confidence. Attractive municipal securities may have once been relatively risk free and safe of municipal credit and the financial condition of governmental borrowers, as well as the accuracy with which information is described and disseminated.

New York City has left in its wake serious disruptions and uncertainties. Some State and local governments have not been able to get to the market at all; others have only been able to sell new issues at extraordinarily high interest rates. In some cases, underwriters have declined to bid on issues where they have been unable to satisfy their legal duties to prospective investors. And banks and other institutional investors have greatly reduced their participation in both the

primary and secondary markets. The heretofore highly efficient operations of the primary municipal bond markets have been strained as a result.

Finally, Mr. President, the dimensions of this component of our capital markets is vastly different in terms of size than anyone could have predicted in 1933. Between 1950 and 1974 municipal bond volume grew at about a 10 percent annual rate. In recent years, this growth rate has accelerated. During 1972 alone, long-term municipal bond sales—$23 billion—were 3½ times greater than in 1960. In 1975, total issuers of both long- and short-term debt securities were approximately $60 billion—16 percent higher than the previous year.

The almost $22.8 billion of total long-term municipal securities issued in 1974 as compared to the approximately $26.4 billion of new corporate securities—including common, preferred stock, and debt issues—which were registered with the SEC during that year, alone justifies a reexamination of the status of State and local issuers under the securities laws.

In 1928, one commentator described municipal reporting in the United States as:

A jungle through which run only little trails and some of those are little used . . .

Everyone concedes that some reports are indispensible, but a few consider what the reports should contain, for whom they should be prepared, in what form they should be presented, how they might most advantageously be circulated, how their content and form might be improved.

The general absence of uniform and standardized municipal reporting is of no less concern today. According to a 1974 Report of the Twentieth Century Fund Task Force of Municipal Bond Credit Ratings:

A major problem, admitted by both the rating agencies and others interested in fiscal affairs, is the lack of uniformity in accounting practices and timeliness in the reporting of state and local government statistics. Furthermore, not only do the reports differ in definitions, detail and quality, but their veracity and accuracy are often neither examined nor guaranteed by an independent audit.

* * * * *

The accounting and reporting problem is a deepseated one because the states either passively or actively have created a hodge-podge of practices and requirements.

Sound financial management and fiscal responsibility by State and local officials will not, in my opinion, occur without definite accounting and reporting standards.

Last year, Arthur Andersen & Co., a well-known international accounting firm, published a report entitled "Sound Financial Reporting in the Public Sector: A Prerequisite to Fiscal Responsibility" to encourage public discussion on the need for sound accounting controls and financial reporting in all units within the public sector. Arthur Andersen concluded:

Cities, states and other political subdivisions should be required to publish [. . . financial] statements annually and in connection with the sales of securities to the public.

It is somewhat anomalous that major private corporations have audits performed by independent certified public accountants, but municipalities do not.

The need for this basic information by bondholders, prospective investors, the electorate, and by all branches of government is obvious.

Mr. President, each level of government—city, State, and Federal—is confronted with an array of problems that cannot go unanswered. These problems are particularly acute for our urban centers; outdated capital facilities, demands for increased services for the poor and the elderly, and obsolete equipment are just a few. Clouds of doubt over the willingness of investors to purchase municipal securities can only interfere with our progress toward long-term solutions of these problems.

It is therefore imperative that all State and local governments, regardless of size and geographic location, join with the executive branch and the Congress to improve and fine-tune the operations of our markets for municipal securities. An essential and significant first step must be improved disclosure to promote investor confidence in the integrity and efficiency of the capital raising system—a system which governmental entities will have to rely upon more heavily in the years ahead.

Mr. President, the public policy underpinning of 43 years of Federal securities regulation has been full and complete disclosure. Full disclosure has worked well both to facilitate investment decisions and to allow for the optimal use of capital among competing sources. Notwithstanding the relative agreement that the "truth in securities" and "investor protection" framework of the Securities Act of 1933 and the Securities Exchange Act of 1934 are conceptually adaptable to public issuers, it must not be overlooked that the reasons for and the provisions of these laws are in large measure unrelated to the characteristics or needs of governmental issuers or the underwriting and offering process for their securities.

First, municipal securities as a class continue to be relatively safe investments—there have been no Penn Centrals or W. T. Grants, and municipal defaults are almost nonexistent.

Second, municipal issuers provide the ultimate safety for their securities through the exercise of the general taxing power.

Third, the political process prior to which an offering is conducted insures "sunshine" via public meetings, periodic elections and other publicity.

Finally, there are important legal distinctions between government and corporate borrowers.

All of these points render the full range of regulation, registration, and reporting under the 1933 and 1934 acts inappropriate. Nor would their application be practicable from an administrative standpoint. Although there are no accurate figures on the number of public instrumentalities issuing securities, estimates range from 20,000 to 100,000. At either extreme, the practical limitations on the SEC if the procedures and requirements of full registration and presale review under the 1933 act were to be applied to municipal issuers are clear when viewed in light of the cumulative total of corporate registration statements processed by the SEC from 1935 to 1974 which add up to a mere 47,223.

It may be argued that the requirements of the anti-fraud provisions, which are applicable even to "exempt" securities, are sufficient to require disclosure of all material facts and to permit informed investment decisions. However, investors in many instances are not receiving substantial disclosures and when they do, they are not standardized. And as I mentioned earlier, the veracity of such financial information is often open to doubt.

I stronlgy believe that what is needed in this area, is an approach that allows for limited SEC authority to develop improved and standardized disclosure but which avoids the formalities, administrative delays and costs of full registration which are inappropriate for municipal bonds. Such an approach must recognize and respect the prerogatives of State and local governments and encourage a more active role by them in assuring investor protection. In a nutshell, these are the views embodied in the bill which I am introducing today. I have discussed these views with the Chairman of the Securities and Exchange Commission, and I am pleased that he is in general agreement.

The Municipal Securities Full Disclosure Act of 1976 is the product of extensive consultations between Chairman Hills and myself and our staffs. Both Senator Tower and I, appreciate the Chairman's willingness to lend the Commission's considerable expertise and experience in navigating through previously unchartered areas of Federal securities regulation and the legal and economic concepts on which those laws and regulations are based.

The bill relies heavily and borrows frequently from longstanding practices and procedures employed by issuers, underwriters and their counsel in marketing municipal securities. Major changes would not be required by this bill. For example, the methods of syndication and distribution would continue to be governed by State law.

However, the bill would require the preparation of annual reports and distribution statements and specify their contents. In this way bondholders and prospective investors would be fully informed of the precise nature and terms of the bonds being offered, as well as various other relevant matters concerning the issuer. But, the bill does not contemplate direct regulation of the issuer through registration, waiting periods of through prefiling of sale documents with the SEC. Even the content of the required disclosures are taken from the "Disclosure Guidelines for Offerings of Securities by State and Local Governments," prepared by the Municipal Finance Officers Association. The streamlined approach of this bill would rely solely upon the antifraud provisions of the Exchange Act in lieu of registration with the SEC.

I have prepared a detailed explanation of the bill which I request be placed in the RECORD at the conclusion of my remarks. But it may be helpful to summarize the bill's most salient features. Briefly, the bill would amend the Securities Exchange Act of 1934 to require the preparation of annual reports and distribution statements by issuers of municipal securities in the following manner.

First, issuers of municipal securities with an aggregate principal amount of securities outstanding exceeding $50 million would be required to prepare, but not file with the SEC, annual reports. General information to be included in the reports is enumerated and would include financial statements audited and reported on by an independent public or certified accountant as prescribed by the Commission. Although the Commission would have rulemaking authority to require the inclusion of other information in the annual report, the Commission's discretion is limited by carefully drawn statutory language.

Second, the bill would require distribution statements to be prepared by issuers prior to the public offer or sale of an issue of securities exceeding $5,000,000. The contents of the distribution statement are specified and the Commission would be empowered to insure their proper dissemination. It is anticipated that distribution statements would, to the maximum extent possible, incorporate information available in the annual report, although the Commission would have latitude in prescribing additional content. However, these statements would not be filed with the SEC.

Third, the bill would expressly recognize the initiatives some States have taken in closely supervising the marketing of local government bonds and encourage the further development of this pattern. Thus, where the offer or sale of municipal securities has been approved by a State authority, an exemption from the requirements of this bill would be available. Other exemptions are available for issuers satisfying the criteria specified in various sections of the Securities Act of 1933.

Fourth, the Commission would be authorized to establish the accounting standards and practices to be followed in the preparation of financial statements.

Fifth, the bill would authorize the SEC to assure the annual reports and distribution statements required by the bill are made available to investors and others.

Finally, the bill would limit the liability of underwriters of municipal securities in a manner similar to that provided by section 11(e) of the Securities Act of 1933.

Perhaps as important as to what the bill would do is what the bill is not intended to do. For example, it is not intended to draw any regulatory parallels between municipal and corporate securities or their issuers. Unlike the 1933 act, no registration is required nor is there any requirement of prefiling review by the SEC. Underwritings of municipal securities will not, as a result of this bill, be highly regulated as are corporate securities. This is not practicable or necessary to assure adequate and accurate disclosure of material facts. Instead, the bill specifies mandatory minimum standards of disclosure and limits the SEC's responsibility and authority to administering the new reporting requirements.

Aside from the limited and measured authority conferre. on the Commission, the bill takes congressional notice of traditional State prerogatives by encouraging more active supervision of municipal borrowings at the State level. According to the Twentieth Century Fund Report:

The leading example is the close supervision exercised by the Local Government Commission of North Carolina. The Commission approves and centrally sells local bond and note issues, provides financial advisory services in debt management, supervises local government accounting standards, and maintains and publishes local government data, including the advertising of bids and distribution of bond prospectuses. . . .

A recent study indicates that the bonds of North Carolina communities often have higher credit ratings than the bonds of similar communities . . .; that more bids are received on the average for local government issues; and that the higher ratings and additional bids help to lower interest costs.

State supervision of this kind has served to assure investors that correct procedures have been followed and that data is accurate and reliable. Lower borrowing costs have thus resulted from the underwriters' knowledge of the State's standards and the uniformity of offering procedures.

Mr. President, the absence of uniformity, or governmental supervision and the inadequacy of information creates serious problems in the marketing of municipal securities far different from those faced in the past. Unless Congress acts to facilitate informed investment decisions and to promote sound municipal fiscal practices, essential public services at every level of State and local government may be placed in jeopardy.

The bedrock of efficient capital raising—whether by a company or a city—is investor confidence. This is conspicuously lacking today, posing unacceptably high legal, economic, and social risks for citizens, investors, underwriters, rating agencies, issuers, and for the Federal Government. Local governments must be able to borrow at reasonable costs.

In introducing this bill, I recognize that many difficult questions will have to be resolved during the deliberative process. This process begins next week, when the Subcommittee on Securities will hold 3 days of hearings. As a result, however, I am confident that the overriding objectives—the development of guidelines and disclosure standards which will be accepted by investors and the various governmental, trade, and professional groups concerned with these offerings—will be accomplished.

Mr. President, I ask unanimous consent that the text of the bill and a section-by-section analysis be printed in the RECORD.

There being no objection, the bill and analysis were ordered to be printed in the RECORD, as follows:

S. 2969

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Municipal Securities Full Disclosure Act of 1976".

SEC. 2. (a) Section 3(a)(12) of the Securities Exchange Act of 1934 is amended by inserting "13A," immediately after the phrase "for the purposes of sections".

(b) Section 3(a)(10) of such Act is amended by inserting "guarantee of," immediately after "receipt for,".

(c) Section 12(h) of such Act is amended by inserting "13A," immediately after "section 13,".

(d) Section 15B(d)(1) of such Act is amended by striking out "Neither the Commission nor the Board is" and inserting in lieu theerof "The Board is not", and by striking out "with the Commission or the Board" and inserting in lieu thereof "with the Board".

(e) Such Act is further amended by inserting after section 13 the following new section:

"MUNICIPAL SECURITIES DISCLOSURE

"SEC. 13A. (a)(1) Any issuer of municipal securities which has outstanding during any portion of a fiscal year an aggregate principal amount of municipal securities exceeding $50,000,000 shall prepare for such fiscal year an annual report and reports of events of default in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or for the protection of investors.

"(2) The annual report required by paragraph (1) shall contain the following information, if applicable:

"(A) An identification and description of the issuer of the securities outstanding;

"(B) A description of any legal limitation on the incurrence of indebtedness by the issuer or the taxing authority of the issuer;

"(C) A description of the issuer's debt structure, including information with respect to amounts of authorized and outstanding funded debt; estimated amount of short term debt, character of amortization provisions of funded debt, sinking fund requirements, security for debt, nature and extent of guaranteed debt, and debt service requirements;

"(D) A description of the nature and extent of other material contingent liabilities or commitments of the issuer;

"(E) If any payment of principal or interest on any security of the issuer or any predecessor thereof has been defaulted on, or has been postponed or delayed, within the past twenty years, a description of the date, amounts and circumstances of such event and of the terms of any succeeding arrangements thereof;

"(F) A description of the issuer's tax authority and structure over the past five years including the nature of taxes levied, tax rates, property (real and personal) valuation and assessment procedures, amounts of property valuations and assessments, amounts of tax levies, amounts of tax collections and delinquent tax procedures and experience;

"(G) A description of the issuer's major taxpayers;

"(H) A description of the principal governmental and other services provided or performed by the issuer, the extent to which similar or differing services are performed by other governmental entities which serve the same geographic area and any major changes in such services in the last ten years;

"(I) A description of the nature and extent of Federal or other assistance programs available to the issuer; and

"(J) Financial statements of the issuer in such detail and form and for such periods beginning not earlier than the fifth previous

fiscal year as the Commission may prescribe, which statements for any fiscal year commencing on or after December 31, 1978 shall be audited and reported on by an independent public or certified accountant in such manner as the Commission may prescribe.

"(3) The reports of events of default referred to in paragraph (1) shall contain such of the information required by paragraph (2) as the Commission may by rule or regulation prescribe.

"(4) The reports required by paragraph (1) shall, in addition, contain such other similar and specific information as the Commission may by rule or regulation prescribe as being necessary or appropriate in the public interest or for the protection of investors.

"(b)(1) Except as provided in subsection (c), any issuer that offers or sells an issue of municipal securities, the aggregate principal amount of which exceeds $5,000,000, to or through a municipal securities broker, municipal securities dealer, or bank acting as agent, shall, prior to such offer or sale, prepare a distribution statement in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or the protection of investors.

"(2) The distribution statement required by paragraph (1) shall contain such of the information pertaining to the issuer required by subsection (a)(2) as the Commission may by rule or regulation prescribe, and the following:

"(A) A description of the offering, including amount to be offered, price, plan of distribution, and underwriting arrangements and compensation;

"(B) A description of the security to be offered, including provisions as to security, events of default, payment of principal and interest, sinking fund, redemption, debt reserve funds, priority, legality and authorization for issue and rights of security holders to bring suit against issuers;

"(C) A description of any project or enterprise of the issuer to be financed from the proceeds of revenue or special assessment securities, and any engineering or financial feasibility reports or studies on the construction and operations of the project or enterprise;

"(D) A description of the intended use of the proceeds of the offering;

"(E) A statement of counsel's opinion as to the legality of the issuance ofthe securities to be offered;

"(F) A statement of the availability of the reports required by this section; and

"(G) Such other similar and specific information as the Commission may by rules or regulations require as necessary or appropriate in the public interest or for the protection of investors;

except that, prior to any sale, the information specified in subparagraphs (A), (B) and (E) may be set forth in preliminary form.

"(c) The provisions of subsection (b) shall not apply to an issuer solely by reason of an offer or sale of municipal securities—

"(1) the disclosure with respect to which has been approved, after hearing, as adequate for the protection of investors by a State governmental authority (other than the issuer) expressly authorized by law to grant such approval, or

"(2) which would meet the criteria set forth in sections 3(a)(9), 3(a)(10), 4(1), 4(2), 4(3), or 4(4) of the Securities Act of 1933 if such offer or sale were not within the scope of section 3(a)(2) thereof.

"(d) The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, change the minimum amounts set forth in subsections (a)(1) and (b)(1) if, giving due regard to such factors as general economic conditions, costs involved, and the nature of the distribution system for municipal securities, such change is deemed to be appropriate in the public interest.

"(e) The Commission may prescribe, in regard to reports and distribution statements made pursuant to this section, the form or forms in which the required information, including the financial statements, shall be set forth, and the accounting methods to be followed in the preparation of financial statements.

"(f)(1) The issuer shall make the reports required by subsection (a)(1) of this section available upon request to security holders at the issuer's expense and to others at their expense and shall give appropriate public notice of such availability.

"(2) The issuer shall make the distribution statement required by subsection (b)(1) of this section available to municipal securities brokers, municipal securities dealers, and banks acting as agent for delivery to prospective purchasers in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(3) The reports and distribution statements required by this section shall also be maintained by the issuer at a designated location for examination by the public in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Commission may also contract to establish a central repository which shall receive and maintain such reports, and may require the contractor to adhere to such rules and regulations as the Commission may prescribe in furtherance of the purposec of this sectiog. Each person subject to the requirements of this section shall, upon the establishment of any such repository, thereafter file copies of reports and distribution statements required to be prepared by this section with the repository in accordance with such rules and regulations as the Commission finds are necessary or appropriate in the public interest.

"(g) In no event shall any underwriter of an issue of municipal securities (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in, or as a consequence of, any suit for damages in excess of the total price at which the issue was sold by it to the public."

"SEC. 3. The amendments made by section 2 take effect on January 1, 1977.

SECTION-BY-SECTION ANALYSIS

This bill would amend the Securities Exchange Act of 1934 (the "Act") to provide for limited regulation of municipal securities. Section references are to sections of the bill, otherwise indicated.

Section 1 would provide the short title of the bill, the Municipal Securities Full Disclosure Act of 1976.

Section 2(a) would amend the definition of "exempted securities" in Section 3(a)(12) of the Act to provide that municipal securities would not be deemed "exempted securities" for purposes of new Section 13A of the Act.

Section 2(b) would amend the definition of "security" in Section 3(a)(10) of the Act to include a "guarantee" of certain types of securities. Thus, the reporting requirements of new Section 13A of the Act would be specifically applicable to the guarantor of a municipal security. Section 2(1) of the Securities Act of 1933 defines "security" in a similar manner.

Section 2(c) would amend Section 12(h) of the Act to provide the Commission with authority to exempt any municipal issuer or class of municipal issuers from the provisions of new Section 13A of the Act if the Commission finds such action is not inconsistent with the public interest or the protection of investors.

Section 2(d) of the bill would amend Section 15 B(d)(1) of the Act to provide the Commission with authority to require an issuer of municipal securities to comply with applicable disclosure requirements.

Section 2(e) would amend the Act to add a new Section 13A to the Act, entitled "Municipal Securities Disclosure" to provide for limited regulation of municipal securities by the Commission and to require the preparation of annual reports and distribution statements by issuers of municipal securities.

Subsection (a)(1) would require a municipal issuer with more than $50,000,000 of municipal securities outstanding during any portion of a fiscal year to prepare for each such fiscal year an annual report and reports of events of default in accordance with the rules and regulations promulgated by the Commission. The Commission would have authority to specify by rule or regulation the period of time within which such reports must be prepared. In addition, the method for computing the amount of municipal securities would be defined by the Commisaion.

Subsection (a)(2) would set forth, in general categories, the information to be contained in the annual report, including an identification and description of the issuer, as well as information concerning any legal limitations on the debt ceilings of the issuer or the issuers taxing authority; the nature and extent of other material contingent liabilities or commitments of the issuer; the issuer's tax authority and structure over the past five years; the principal governmental and other services provided or performed by the issuer and the extent to which similar or differing services are performed by other governmental entities serving the same geographic area and any major changes in such services in the last ten years; a description of the nature and extent of federal or other assistance programs available to the issuer; and financial statements in such detail and form as the Commission may prescribe. Commencing on or after December 31, 1978, the financial statements shall be audited and reported on by an independent public or certified accountant in the manner prescribed by the Commission.

Subsection (a)(3) would require that reports of events of default contain such of the information in the annual report as the Commission may, by rule, determine.

Subsection (a)(4) would authorize the Commission with rulemaking authority to require additional information to be included in the annual report and reports of events of default. However, the Commission's discretion would be limited to requiring "similar and specific information" to that required by new Section 13(a)(2) of the Act.

Subsection (b)(1) would require a municipal securities issuer that offers or sells an issue of municipal securities of an aggregate principal amount exceeding $5,000,000 to or through a municipal securities broker (defined in section 3(a)(3) of the Act), municipal securities dealer (defined in section 3(a)(30) of the Act) or a bank acting as agent, to prepare a distribution statement prior to the offer or sale in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Subsection (b)(2) would set forth the information to be included in the distribution statement. This information would consist of such of the data required in the annual report of the issuer as the Commission may prescribe, together with specified additional information concerning the particular offering. The Commission would be given flexible authority. If, for example, the issuer had prepared an annual report for the fiscal year preceding the offer or sale of municipal secu-

rities, the distribution statement might consist of the information concerning the particular offering and be accompanied by the issuer's annual report together with a statement of any material current developments required to make the information in such report not misleading. Alternatively, the Commission might prescribe the preparation of a brief distribution statement incorporating annual and other reports by reference, in a manner similar to the Commission's development of S-7 forms for corporate issuers. The objective would be to minimize interference with the natural workings of the marketing system.

Subsection (c) would provide exemptions from the distribution statement provisions of subsection (b) for offers and sales of municipal securities by issuers under specified conditions. Exemptions would be available to municipal issuers in those states which actively supervise local financings and where the disclosure with respect to such offer or sale of municipal securities has been approved by a State governmental authority (other than the issuer) expressly authorized to grant such approval. Other exemptions from the distribution statement provisions of this section would be available to offers or sales by a municipal securities issue meeting the criteria of sections 3(a)(9) and 3(a)(10) concerning exemptions from registration, and sections 4(1), 4(2), 4(3) and 4(4) concerning exempted transactions, under the Securities Act of 1933.

Subsection (d) grants the Commission authority to change the minimum dollar amounts set forth in the provisions requiring the preparation of annual reports and distribution statements if, giving due regard to such factors as general economic conditions, costs involved, and the nature of the distribution system, such change is deemed to be appropriate in the public interest. Allowing the Commission to adjust these levels appears appropriate in light of the lack of the Commission's experience in administering such disclosure requirements, its general unfamiliarity with the operations of the municipal markets, and the absence of any accurate figures to indicate the type and quantity of issuers affected at any specific level.

Subsection (e) would grant the Commission authority to prescribe the form or forms in which reports and distribution statements shall be set forth and the accounting methods to be followed in the preparation of financial statements.

Subsection (f) is intended to ensure that reports and distribution statements are made available to investors.

Subsection (g) provides a limitation on the liability of underwriters of municipal securities similar to that provided by section 11(e) of the Securities Act of 1933 for underwriters of corporate securities offerings.

The bill contains no specific provisions regarding civil liability for material misstatements and omissions. Instead, the general antifraud provision would apply here as well as in those cases in which a municipal securities broker, municipal securities dealer, and bank acting as agent, received copies of a distribution statement pursuant to subsection (f)(2) in connection with an underwriting. Such persons would be responsible to perform such reasonable investigation as the antifraud provisions are deemed to require.

Documents prepared pursuant to section 13A would not be "filed" with the Commission. Of course, the general antifraud provisions of the securities law would remain applicable.

Section 3 provides the effective date for the bill.

Mr. TOWER. Mr. President, I am joining Senator WILLIAMS in cosponsoring the Municipal Securities Full Disclosure Act of 1976 only because I believe that it is one approach to the issue of municipal securities disclosure that should be given fair and bipartisan consideration by the Securities Subcommittee during its upcoming hearings. I also believe that this approach to disclosure is preferable to other suggestions which would subject municipalities to the full registration and disclosure requirements imposed on corporations. That is an approach which I would strongly oppose.

This does not mean to say that I wholeheartedly endorse the approach in this bill nor necessarily endorse all of its provisions. I have serious reservations over the role which the Federal Government could come to play over State and local units of government. For that reason, I will be interested in hearing from the various witnesses on how they feel State and local prerogatives would be protected under this bill and whether or not they feel this is a viable approach.

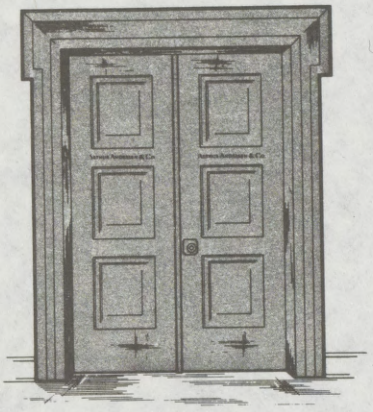
This is an important issue that will need a lot of hard work and careful thinking on all sides. Certainly, if it is evident that changes are needed in present disclosure arrangements, my hope would be that an approach will be taken that preserves, to the maximum extent possible, the rights of State and local governments and the use of market forces.

Senator WILLIAMS. Arthur Andersen sponsored a study which led to the preparation and publication of the booklet 'Sound Financial Reporting in the Public Sector—A Prerequisite to Fiscal Responsibility." It is a significant document. All that have seen it agree and I'm going to include it in the record of our hearings. I'm sure it will be very useful to members in coming to a judgment on this pioneering legislative approach, an area that has been exempt from all but the antifraud provisions of the Federal securities laws for 43 years now while all other issuers have been included.

[The booklet is reprinted as follows:]

SOUND FINANCIAL REPORTING IN THE PUBLIC SECTOR

A PREREQUISITE TO FISCAL RESPONSIBILITY



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ARTHUR ANDERSEN & CO.

PREFACE

In our democratic society, all citizens, groups and organizations need to speak out on issues which they consider important to maintain the effectiveness of our political and economic system. If this country is to maintain effective checks and balances in our political system, public officials must be held accountable for the financial affairs of the activities in the government for which they are responsible. To achieve accountability, effective accounting controls and sound financial reporting are essential.

We are not experts in politics, international relations or economics—we are, however, experts in financial reporting, accounting controls and financial systems. Because of our concerns over current financial problems in certain governmental units, many of which problems are accelerating because of the recent recession, inflation and other serious developments, we inquired about the accounting controls and financial reporting of the United States Government. Certain interesting and surprising observations resulted from this inquiry.

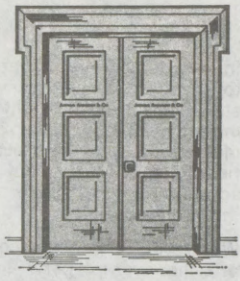
In order to encourage public discussion on the need for sound accounting controls and financial reporting in all units within the public sector, we are publishing a summary of our findings, conclusions and recommendations. For illustrative purposes, a set of consolidated financial statements for the United States Government was prepared on the accrual basis using the reporting format followed in the private sector. This booklet presents the results of that effort. Detailed documentation of the sources used and the derivation of the amounts reflected in the accompanying financial statements is available upon request.

Our discoveries in this effort, combined with our experience with financial reporting, caused us to raise a number of questions, some of which are set forth herein. We do not present answers to these questions because many of them involve economic or political issues. However, certain of these questions are those which Government officials and leaders in the financial community will face in the next few years. Many of the same questions, issues and concerns are applicable to cities and states as well as to other nations and their governmental units.

During this inquiry we contacted numerous departments, agencies and other units in the Government. We want to acknowledge the significant enthusiasm with which our project was received, the serious interest on the part of Government employees with whom we discussed the financial data needed to complete our project and the sincere desire each of them had to be helpful to us. Without this cooperation, this project could not have been completed.

ARTHUR ANDERSEN & CO.

September 10, 1975.



CONTENTS

Overall Summary 1

Observations Concerning Current United States Government Accounting and Financial Reporting 3

Questions Related to Governmental Financial Reporting 5

Illustrative Consolidated Financial Statements—United States Government 7

- Consolidated Balance Sheet 8
- Consolidated Statement of Revenues and Expenses 10
- Consolidated Statement of Changes in Cash and Cash Equivalents 11
- Notes to Consolidated Financial Statements 12

Certain Economic Questions Related to Consolidated Financial Statements 23

Conclusions and Recommendations for United States Government .. 27

APPENDICES

Appendix 1 Financial Highlights 30

2 Government Expenditures and Gross National Product 31

3 History of Accounting in the United States Government 32

4 Accounting and Reporting Questions Raised by Illustrative Consolidated Financial Statements 34

5 Excerpts from Section 3 of Securities Act of 1933 .. 35

OVERALL SUMMARY

- In the past 40 years, the government or public sector of our economy has been steadily growing from less than 10% of our Gross National Product to about 33% in 1974. If government credit, tax expenditures and "off budget" items were included, total government expenditures would probably exceed 40%. Within a few years, the combined budgets (Federal, state and local) may exceed $1 trillion. With a public sector this large, its operations have a major impact on the economy. This impact could be positive if properly planned. However, it could also accelerate economic problems if not properly coordinated.

- Several large cities, states and other governmental units appear to be in serious financial difficulties. These problems may produce a devastating financial crisis unless timely corrective action is forthcoming. All too often, the financial statements of governmental units have proven to be less than adequate for providing basic financial information. Decision-makers, investors and the public have been misled by not being alerted to the problems which were developing. When difficulty occurred, they were confused and frustrated in their attempts to deal with the emerging financial crises.

- Knowledge of current deficits and surpluses is important for the annual evaluations of our financial affairs. To be meaningful, these amounts should include all costs whether paid or accrued. Furthermore, the total accumulated deficit is crucial because this is the amount of future taxes required to pay present liabilities. To the extent that this amount exceeds the amounts that can reasonably be expected of future taxpayers, a potential for crisis develops. The crisis could become real if taxpayers are no longer willing to pay for the current costs of government or if investors become concerned that governmental units may default on their obligations.

- In the private sector, proper accounting controls and sound financial reporting on an accrual basis are basic prerequisites to fiscal responsibility and a meaningful understanding of a unit's financial condition. If we are to have the same degree of accountability in the public sector, similar controls should be exercised over governmental affairs and meaningful financial reporting should be implemented.

- As a result of our inquiry and our conviction that sound financial reporting is required to inform both shareholders in the private sector and the electorate in the public sector of the economic results for their specific groups, we have arrived at the following conclusions:

  –The United States Government should provide annual consolidated financial statements on an accrual basis including all entities in the Government and all programs which may require future taxes for present liabilities.

  –Cities, states and other political subdivisions should be required to publish similar statements annually and in connection with sales of securities to the public.

OBSERVATIONS

Concerning Current United States Government Accounting and Financial Reporting

- The Federal Government does not have a central accounting department. The Treasury Department consolidates and reports the status of funds and certain other accounting statistics. These summaries are not on a full accrual basis and are incomplete. The General Accounting Office, as the auditing arm of the Congress, approves the conceptual design of accounting systems for various departments or agencies. The Office of Management and Budget has responsibility for budget policy and procedures. The General Services Administration evaluates and recommends improvements to financial management systems. The Joint Financial Management Improvement Program, representing the above organizations, has as its objective the improvement of financial management practices.

- Governmental accounting is designed to facilitate control over expenditures by limiting the amounts which each Governmental entity can spend. It is essentially a cash-basis system and is generally not designed to summarize and report on operating results. The underlying arrangements and systems necessary to assemble financial reports are as important as the reports themselves. The final product is useful and reliable only to the extent that the data is complete, accurate and functional.

- The Government produces an enormous amount of financial data and a wide variety of financial reports. However, such information is often duplicative and is not accumulated in one place or consolidated into reports or statements which permit an assessment of the overall financial condition or operating results of the entire Government.

- Both Hoover Commissions recommended accrual accounting, and this led to the passage of Public Law 84-863. This law, supplemented by related Treasury Regulations, specifies that Government agencies must prepare business-type, accrual-basis financial reports. These laws and regulations have been in existence since 1956 but have been only partially implemented.

- There are no related requirements for the reports to be summarized, consolidated or disseminated to the public. Through nearly 200 years, the United States has been trying to develop and strengthen the constitutional checks and balances and has attempted to incorporate into this structure the concept of accountability. A missing link is a unified and comprehensive report of the financial results of the Government's operations.

QUESTIONS

Related to Governmental Financial Reporting

An accrual accounting system which produces sound and consistent financial reports is essential to the concepts of financial responsibility in the private sector of the economy. Absence of a comparable system in the public sector raises numerous questions concerning the financial status of the Government. Some of these questions are set forth below.

–Would an integrated financial reporting system and the related information be useful to the Legislative and the Executive Branches in understanding the financial impacts of their decisions on present and future generations?

–Many of the elected or appointed officials responsible for Government decisions are frequently in their positions for relatively short periods of time. Without adequate financial reports, can elected or appointed officials comprehend the complexities with regard to their financial decisions?

–Would adequate financial information assist the electorate in understanding the governmental process and evaluating the performance of their elected representatives, thus improving fiscal accountability by such elected representatives? Would such financial information help the electorate develop views on priorities to select among various alternatives?

–Would appropriate accounting controls and financial reporting reduce the costs of Government by helping the public realize the total costs of decisions that are made, the cumulative impact on present and future taxes and the priorities under which such costs have been incurred?

–Can Government have effective long-range planning without adequate financial reporting as a base point to develop such plans?

–Can Government properly measure the costs, efficiency, productivity and impact of its programs and develop costs for the services it provides without using accrual accounting which includes all costs?

–Would improved financial control and accountability over transfer payments and major Government assistance programs, such as welfare, food stamps, unemployment, medicare and student loans, assist Government officials to better estimate and plan for these needs in order to provide proper stewardship over Governmental funds?

–Could improved "early warning" systems (especially where costs start to increase significantly) be developed if adequate financial information on major programs were available?

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ILLUSTRATIVE CONSOLIDATED FINANCIAL STATEMENTS

UNITED STATES GOVERNMENT

June 30, 1974 and 1973

For purposes of illustration, we have collected financial information currently available in several publications of the United States Government and have used this information as a basis for preparing consolidated financial statements of the United States Government in conventional format as of June 30, 1974 and 1973, and for the years then ended.

The amounts reflected in the following illustrative financial statements and notes thereto have not been audited by Arthur Andersen & Co., and accordingly, we do not express an opinion on them. Even though these financial statements may not be complete and accurate in all respects, they do provide the necessary background for discussion of some of the issues involved.

UNITED STATES GOVERNMENT

ILLUSTRATIVE CONSOLIDATED BALANCE SHEET

(Unaudited) (Notes 1 and 2)

JUNE 30, 1974 AND 1973

ASSETS

	Millions	
	1974	1973
CASH AND CASH EQUIVALENTS	$ 18,127	$ 22,797
GOLD, at official rate (Note 3)	11,567	10,410
RECEIVABLES (net of allowances):		
Accounts	5,490	4,859
Taxes (Note 4)	14,960	12,844
Loans (Note 5)	65,836	62,985
	86,286	80,688
INVENTORIES, at cost (Note 6):		
Military and strategic system supplies	28,019	25,173
Stockpiled materials and commodities	11,526	12,693
Other materials and supplies	11,026	12,012
	50,571	49,878
PROPERTY AND EQUIPMENT, at cost:		
Land (Note 7)	6,686	6,415
Buildings, structures and facilities (Note 8)	88,649	86,129
Strategic and tactical military assets (Note 9)	119,913	117,670
Nonmilitary equipment (Note 9)	39,708	37,377
Construction in progress	19,400	17,169
Other	2,118	1,848
	276,474	266,608
Less—Accumulated depreciation (Note 10)	129,000	122,000
	147,474	144,608
DEFERRED CHARGES AND OTHER ASSETS	15,297	15,369
	$329,322	$323,750

LIABILITIES AND DEFICIT

	Millions	
	1974	1973
FEDERAL DEBT (Note 11):		
Gross debt outstanding	$ 486,247	$ 468,426
Less—Intragovernmental holdings—		
Trust funds	(129,745)	(114,852)
Federal Reserve	(80,649)	(75,182)
Other	(10,449)	(10,529)
Debt outstanding with the public	265,404	267,863
Less—Unamortized discount	2,506	2,243
	262,898	265,620
FEDERAL RESERVE LIABILITIES:		
Federal Reserve Notes outstanding	64,263	58,754
Deposits of member banks	26,760	25,506
Other	2,286	1,725
	93,309	85,985
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES:		
Accounts payable	32,491	30,757
Accrued interest, annual leave and other	11,187	11,819
Deferred revenue	6,734	6,565
	50,412	49,141
OTHER LIABILITIES	18,991	19,836
RETIREMENT AND DISABILITY BENEFITS (Note 12):		
Civil Service	108,000	97,000
Military	80,380	70,950
Veterans	110,980	110,850
	299,360	278,800
ACCRUED SOCIAL SECURITY (Note 13)	416,020	340,930
CONTINGENCIES (Note 14)		
Total liabilities	1,140,990	1,040,312
LESS—ACCUMULATED DEFICIT	811,668	716,562
	$ 329,322	$ 323,750

The accompanying notes are an integral part of this balance sheet.

UNITED STATES GOVERNMENT

ILLUSTRATIVE CONSOLIDATED STATEMENT OF REVENUES AND EXPENSES

(Unaudited) (Notes 1 and 2)

FOR THE YEARS ENDED JUNE 30, 1974 AND 1973

	Millions	
	1974	1973
REVENUES:		
Individual income taxes	$118,952	$103,246
Social Security and unemployment taxes and retirement contributions	76,780	64,541
Corporate income taxes	40,736	37,588
Excise taxes	16,844	16,260
Estate and gift taxes	5,035	4,917
Outer continental shelf rents and royalties	6,748	3,956
Other (Note 3)	6,539	4,970
Total revenues	271,634	235,478
EXPENSES (including transfer payments):		
National defense—		
Military personnel	23,728	23,246
Operations and maintenance	27,698	24,980
Research and development	8,582	8,157
Depreciation (Note 10)	11,100	10,800
Other	1,371	3,091
	72,479	70,274
Other operating expenses, including depreciation of $2,100 million in 1974 and $2,000 million in 1973 (Note 10)	41,982	36,328
Grants-in-aid, primarily to state and local governments	41,500	40,400
Transfer payments to individuals—		
Income security, including retirement, unemployment and Social Security payments made	69,381	60,373
Health care	11,300	9,000
Veterans' benefits and services	10,400	9,700
Other	6,900	4,800
	97,981	83,873
Noncash provision for retirement and disability benefits—		
Social Security (Note 13)	75,090	63,670
Other (Note 12)	20,560	13,360
	95,650	77,030
Interest expense (net of interest income)	17,148	14,146
Total expenses	366,740	322,051
EXCESS OF EXPENSES OVER REVENUES (Note 15)	$ 95,106	$ 86,573

The accompanying notes are an integral part of this statement.

UNITED STATES GOVERNMENT

ILLUSTRATIVE CONSOLIDATED STATEMENT OF CHANGES IN CASH AND CASH EQUIVALENTS

(Unaudited) (Notes 1 and 2)

FOR THE YEAR ENDED JUNE 30, 1974

		Millions
SOURCES OF CASH:		
Excess of expenses over revenues		$(95,106)
Add (deduct) items not affecting cash—		
Depreciation (Note 10)		13,200
Noncash provision for retirement and disability benefit expense (Notes 12 and 13)		95,650
Revenue attributable to change in gold valuation (Note 3)		(1,157)
Increase in accrued corporate income taxes receivable		(2,116)
Effect of other accrual adjustments (net)		(151)
Cash provided by operations		10,320
Increase in Federal Reserve liabilities		7,324
Total sources of cash		17,644
USES OF CASH:		
Decrease in net Federal debt—		
Increase in gross debt outstanding	$17,821	
Less—Increase in intragovernmental holdings:		
Trust funds	14,893	
Federal Reserve	5,467	
Other	(80)	
	20,280	
Decrease in debt outstanding with the public	2,459	
Increase in unamortized debt discount	263	2,722
Additions to property and equipment		16,066
Increase in loans receivable		2,851
Net change in other assets and liabilities		675
Total uses of cash		22,314
DECREASE IN CASH		(4,670)
CASH AT BEGINNING OF YEAR		22,797
CASH AT END OF YEAR		$ 18,127

The accompanying notes are an integral part of this statement.

UNITED STATES GOVERNMENT

Notes to Illustrative Consolidated Financial Statements
(Unaudited)

June 30, 1974 and 1973

1. SOURCES OF DATA

The United States Government does not have a centralized accounting system which would furnish data necessary for the preparation of consolidated financial statements on an accrual basis. The asset and liability amounts included herein were obtained from several sources within the Government. For some agencies, numbers purporting to reflect the same items were available from more than one source and differed as to amount. In such instances, the sources which appeared to be the most reliable were used.

2. PRINCIPLES OF CONSOLIDATION

The accompanying financial statements include the accounts of all significant agencies and funds included in the Unified Budget of the United States Government, plus those of the traditional "off budget" agencies and the Federal Reserve System. Government-sponsored enterprises such as Federal Land Banks have been excluded because they are privately owned. Amounts reflected are as of June 30, 1974 and 1973, except for the Federal Reserve System, which reports on a calendar-year basis and for which December 31, 1973 and 1972, amounts were used. Intragovernmental assets, liabilities and revenue/expense items of significance have been eliminated in consolidation.

The Federal Reserve System (which operates independently from the Executive and Legislative branches of the Government) has been included in the accompanying financial statements because of the interrelationships between the Federal Reserve System and the Treasury.

a. A large portion of the Federal debt is held by Federal Reserve banks.

b. Virtually all of the gold has been "pledged" to the Federal Reserve banks in return for Treasury demand deposits.

c. The net income of the Federal Reserve System is transferred annually to the Treasury.

d. In the event of liquidation, after capital contributed by member banks is returned, residuals of Federal Reserve banks would be transferred to the Treasury.

The effect of including the Federal Reserve System in the consolidated balance sheet as of June 30, 1974, is summarized below.

	Millions
Increase total assets	$ 3,089
Reduce Federal debt	$(80,649)
Eliminate gold certificate liability	(11,460)
Add Federal Reserve Notes	64,263
Add deposits of member banks	26,760
Increase other liability accounts	2,286
	1,200
Reduce deficit	1,889
	$ 3,089

Government trust funds have been included in the accompanying consolidated financial statements. This reporting has been adopted because the trust funds are included in the Unified Budget and because the assets in such funds are almost exclusively Federal debt securities. In substance, the Government trust funds serve as segregated accounts for specific purposes rather than as trusts.

3. GOLD

Gold has been recorded at the official rate established by Congress ($42.22 per ounce at June 30, 1974, and $38.00 per ounce at June 30, 1973). Although the free market rate for gold is currently much higher, a different rate was not used because (1) the official rate is the basis upon which the Treasury uses the gold as security to increase its demand deposits with the Federal Reserve (most of the gold has been utilized in this way) and (2) it is not possible to determine what effect sales of the Treasury's gold would have on the free market price and, therefore, what alternative value would be appropriate. If the free market rate as of June 30, 1974, of $144.50 per ounce had been used, the aggregate carrying value of gold would have been $39,586 million.

The effect of the change in the official rate for gold between June 30, 1973, and June 30, 1974, is reflected as revenue of the Government in the accompanying consolidated statement of revenues and expenses because such a valuation increase allows the Treasury to increase its cash balances.

4. TAXES RECEIVABLE

The total for taxes receivable includes $5.0 billion (net) for delinquent taxes owed and $10.0 billion of accrued corporate income taxes receivable as of June 30, 1974; the comparable amounts as of June 30, 1973, were $5.1 billion and $7.7 billion, respectively. No accrual has been made for individual income taxes because of the payroll withholding system. Also, assessed tax deficiencies pending settlement have not been included in receivables because the ultimate settlement value is indeterminable.

5. LOANS RECEIVABLE

Interest rates and loan repayment terms vary considerably for outstanding loans, with rates ranging from zero to 12.0% and terms from as short as 90 days to well over 40 years. The longer terms and lower rates generally apply to loans to foreign governments. Outstanding balances and allowances for losses have been recorded as reported by the various lending agencies. No attempt has been made to evaluate collectibility or the adequacy of the allowances for losses. Loans outstanding are summarized below by major classification of borrower.

Classification	Millions 1974	1973
Business entities	$20,434	$17,200
Students, farmers and other individuals	22,502	21,264
Foreign	19,794	21,588
State and local governments	2,123	1,838
Other	2,513	2,251
	67,366	64,141
Less—Allowances for losses	1,530	1,156
	$65,836	$62,985

6. INVENTORIES

Inventories include nondepreciable personal property and are generally stated at cost. The major components of inventory are summarized below.

Classification	Millions 1974	1973
Military and strategic system supplies—		
Ammunition	$ 9,387	$ 6,944
Materials related to missile, air and weapons systems	11,293	11,167
Repair parts for weapons and vehicles	2,545	2,425
Excess materials awaiting disposition	2,354	2,862
Miscellaneous	2,440	1,775
	28,019	25,173
Stockpiled materials and commodities—		
Nuclear materials	6,599	6,611
Metals and like materials	4,417	5,595
Helium	510	487
	11,526	12,693
Other materials and supplies—		
Electric, industrial and petroleum supplies	4,094	4,141
Clothing, subsistence and general supplies	1,936	1,799
Excess materials awaiting disposition	2,190	2,333
Miscellaneous	524	1,395
Subtotal—Department of Defense	8,744	9,668
Agencies other than Department of Defense	2,282	2,344
	11,026	12,012
	$50,571	$49,878

The inventory accounts do not include the weapons stockpile of the Atomic Energy Commission, since the extent of this inventory is classified information.

7. LAND

Land owned by the Government as of June 30, 1974, is summarized below by predominant usage.

Usage	Acres (Millions)	Cost (Millions)
Forest and wildlife	503.2	$ 497
Grazing	163.5	26
Parks and historic sites	25.1	477
Alaska oil and gas reserves	23.0	—
Military (except airfields)	18.1	314
Flood control and navigation	8.0	3,256
Reclamation and irrigation	7.0	305
Industrial	2.9	204
Airfields	2.3	203
Power development and distribution	1.5	272
Other	5.9	979
	760.5	6,533
Outside United States	.6	153
	761.1	$6,686

The outer continental shelf and other offshore land are not included above.

The Government owns approximately 33.5% of the total acreage of the United States, or 761 million acres (of which 352 million acres are located in Alaska). This total includes 704 million acres of public domain land (land vested in the United States by virtue of its sovereignty).

Cost represents cost to the Government, except that the cost of land acquired through donation, exchange, devise, forfeiture or judicial process is estimated at amounts the Government would have had to pay for the properties if purchased at the date of acquisition by the Government. Public domain land is included at no cost.

A committee of the House of Representatives reported as of June 30, 1972, that the estimated current value of the 704 million acres of public domain land was approximately $29.9 billion. No similar reports are available estimating current values for other land, mineral resources or the outer continental shelf.

8. BUILDINGS, STRUCTURES AND FACILITIES

This category includes all real property owned by the Government except land. Approximately $36 billion of the total at June 30, 1974, and $35 billion at June 30, 1973, reflects the acquisition cost of buildings, whereas the balance includes the costs of acquiring or erecting dams, utility systems, monuments, roads and bridges. The following table summarizes the buildings, structures and facilities reported.

Agency or Department	Millions 1974	1973
Air Force	$16,738	$16,859
Army—		
Corps of Engineers	14,309	13,752
Other	12,105	11,898
Navy	12,168	11,839
Interior	9,018	8,885
Tennessee Valley Authority	4,769	4,490
Atomic Energy Commission	4,171	4,061
Agriculture	3,035	2,914
NASA	2,471	2,475
General Services Administration	2,373	2,315
Other	7,492	6,641
	$88,649	$86,129

9. DEPRECIABLE PERSONAL PROPERTY

Depreciable personal property has been divided into two categories to split out that portion which relates solely to defense of the nation from that which may have nonmilitary applications. The assets are recorded at acquisition cost and include only those which are currently in use or in usable condition. The major components of each category are summarized below.

Classification	Millions 1974	1973
Strategic and tactical military assets—		
Aircraft and related equipment	$ 51,032	$ 49,891
Ships and service craft	36,268	36,081
Combat and tactical vehicles	16,923	18,324
Missiles and related equipment	9,746	9,255
Weapons	1,091	509
Other (primarily ground support)	4,853	3,610
	$119,913	$117,670

Classification	Millions 1974	1973
Nonmilitary equipment—Department of Defense—		
Industrial plant equipment	$14,028	$13,833
Communication and electronics	4,123	3,997
Vehicles	2,149	2,168
Other	1,435	459
	21,735	20,457
Atomic Energy Commission	5,814	5,548
Maritime Administration	1,538	1,729
Tennessee Valley Authority	1,348	1,206
U. S. Postal Service	1,158	984
Other agencies	8,115	7,453
	$39,708	$37,377

10. DEPRECIATION

Most Government agencies do not depreciate property and equipment. Accumulated depreciation as of June 30, 1974 and 1973, for such agencies was estimated based on available information; reported amounts were used for those agencies (e.g., AEC and TVA) which do depreciate property and equipment. The methods used to arrive at accumulated depreciation for the major categories of property and equipment are described below.

Buildings—Acquisition dates and original costs were obtained for all buildings owned by the Government as of June 30, 1974, and accumulated depreciation was determined based on the number of years each building had been owned.

Structures and Facilities—Net additions in this category were obtained for the last 21 years, and accumulated depreciation was computed under the assumptions that the balance as of June 30, 1953, was one-half depreciated as of that date, that such balance would be depreciated evenly over the remaining one-half of the estimated useful life for this classification, and that there were no sales or retirements since 1953 for this category.

Military Assets and Nonmilitary Equipment—Net additions by major category were obtained for the past 20 years for the Department of Defense. Budget outlays for major equipment purchases were compared to net addition amounts to arrive at estimated percentages for retirements, and the available information and estimates were extended to cover all assets within these categories to arrive at gross addition and retirement figures by year. Estimated useful lives were then used to determine the remaining undepreciated portions of gross additions.

Depreciation by year was computed on a straight-line basis with no salvage values.

Useful lives were selected for major categories to spread the acquisition costs over the periods during which the average asset in each group could reasonably be expected to be useful at the time of acquisition. The useful lives adopted for agencies for which estimates were required are listed below.

Classification	Life
Buildings, structures and facilities	50 years
Ships and service craft	30 years
Industrial plant equipment	20 years
All other depreciable assets	10 years

Accumulated depreciation balances so computed as of June 30, 1974 and 1973, are shown below by balance sheet classification.

	Millions	
Classification	1974	1973
Buildings, structures and facilities	$ 45,000	$ 43,700
Strategic and tactical military assets	63,500	59,700
Nonmilitary equipment	20,000	18,100
Other	500	500
	$129,000	$122,000

11. FEDERAL DEBT

The gross amount of Federal debt outstanding at June 30, 1974, and June 30, 1973, consisted of the securities summarized below.

	Millions	
Type of Security	1974	1973
Marketable—		
Treasury bills	$105,019	$100,060
Treasury notes	128,419	117,840
Treasury bonds	33,137	45,071
	266,575	262,971
Nonmarketable—		
U. S. Savings bonds	61,921	59,418
Foreign series	25,011	28,524
Government account series (special issues related to specific funds)	115,442	101,738
Other	5,286	4,666
Total Treasury obligations	474,235	457,317
Agency securities	12,012	11,109
	$486,247	$468,426

Maturities of the outstanding marketable securities are reflected in the following table.

Due Within	Millions 1974	1973
One year	$139,942	$122,803
One to five years	77,199	88,223
Five to ten years	26,957	31,111
Ten to twenty years	17,403	14,477
Twenty years or longer	5,074	6,357
	$266,575	$262,971

The gross amount of Federal debt outstanding has been reduced by the holdings of entities included in the consolidated financial statements. The largest such reduction reflects the holdings of Government trust funds. Significant trust fund holdings of Federal debt securities are summarized below.

Trust Fund	Millions 1974	1973
Social Security Administration—		
Federal old-age and survivors' insurance	$ 37,717	$ 35,501
Federal disability insurance	8,195	7,803
Federal hospital insurance	7,864	4,222
Federal supplementary medical insurance	1,231	700
	55,007	48,226
Civil Service Commission—		
Civil Service retirement and disability	34,331	30,866
Other	1,672	1,468
	36,003	32,334
Department of Labor—Unemployment	12,121	10,957
Department of Transportation—		
Highway	7,599	5,550
Other	878	—
	8,477	5,550
Veterans Administration	7,567	7,428
Federal Deposit Insurance Corporation	5,861	5,636
Other	4,709	4,721
	$129,745	$114,852

Of the debt outstanding with the public at June 30, 1974, and June 30, 1973, approximately $57.7 billion and $60.2 billion, respectively, was held by foreign and international investors.

12. RETIREMENT AND DISABILITY BENEFITS

Liabilities for military retirement benefits and for retirement and disability benefits provided under Civil Service have been recorded, irrespective of whether trust funds exist for the programs, because the liabilities are those of the Government and not of the trust funds and since the covered individuals worked directly for the Government. The recorded amounts are based on the estimated present values of vested benefits, which were derived from the actuarially computed present values of future benefits (as computed by the Government) less the present values of future employee contributions, if any.

The liability for Veterans Administration benefits represents the computed present value of annual benefit payments, which have been estimated by the Government to the year 1999.

The noncash provisions for retirement and disability benefits of $20,560 million for 1974 and $13,360 million for 1973 represent the combined changes in the liabilities for Civil Service, military retirement and veterans' benefits between years.

No attempt has been made to record liabilities for several other Government plans providing future benefits, since the total liabilities for such plans would not be significant in relation to those recorded and certain basic information was not readily available.

13. ACCRUED SOCIAL SECURITY

The Government computes two estimates of future liabilities for Social Security. These estimates are based on a present-value approach, taking into consideration future contributions and benefits which have been established by present laws. Beginning in 1972, benefits are automatically adjusted for changes in the consumer price index. The first estimate, usually referred to as the Official Actuarial Concept, indicates that the excess of benefits to be paid to present and future participants over anticipated receipts for the next seventy-five years on a present-value basis is $1.312 trillion as of June 30, 1974. The second estimate, usually referred to as the Full-Reserve Actuarial Concept, estimates that the excess of benefits to be paid to present participants over contributions by present participants on a present-value basis is $2.460 trillion as of June 30, 1974. This estimate is based on concepts that more closely approximate those used in the private sector.

An accrual for Social Security benefits is reflected in the accompanying financial statements because it appears that such benefits could not be terminated or substantially curtailed without serious social and political implications. Social Security receipts and disbursements are also included in the Unified Budget. Further, in principle, the consolidated financial statements and the accumulated deficit should reflect a liability for the amount of future benefits that will not be covered by future contributions under present law. Under this principle, inclusion of an accrual would seem to be both proper and required. It is recognized that the Social Security Act states that payments should be made only to the extent of the trust funds and that covered individuals who have contributed to the fund have no contractual right to receive benefits; however, this does not negate the need to accrue a liability.

An argument could be made to support the current accrual in full of the estimated present value of the difference between future revenue and benefits, i.e., $2.460 trillion for the Full-Reserve Actuarial Concept. However, it was concluded that a more realistic approach would be to accrue for such amounts over a reasonable future period. In determining such period, recognition was given to the fact that the estimated average period for present participants to contribute revenue under the Full-Reserve Actuarial Concept would approximate 25 to 30 years; further, the

Government amortizes its prior service costs for Civil Service retirement benefits over a thirty-year period, and any period up to 40 years could be used to amortize prior service costs in the private sector. A period of 30 years was used as a reasonable period in this regard for establishing the amount to be accrued.

The estimated amounts by which the present values of future benefits exceed future receipts, determined on an annual basis for the past five years under the Full-Reserve Actuarial Concept, are as follows (in billions): 1970—$415; 1971—$435; 1972—$1,865; 1973—$2,118; and 1974—$2,460. Using the thirty-year period to amortize the increase for each year results in an accrual of $416 billion as of June 30, 1974, and $341 billion as of June 30, 1973, as reflected in the accompanying balance sheet.

The noncash provisions for Social Security benefits of $75,090 million for 1974 and $63,670 million for 1973 represent the changes in accrued Social Security between years.

14. CONTINGENCIES

Several Government agencies insure businesses and individuals against various risks. The amount of insurance coverage in force, representing the maximum contingent exposure of the Government, is summarized below as of June 30, 1974.

Nature of Coverage	Millions
Federal Deposit Insurance Corporation	$ 442,000
Federal Savings and Loan Insurance Corporation	220,000
Housing and Urban Development—Riot Reinsurance	175,000
Atomic Energy Commission	60,000
Other	144,000
	$1,041,000

The Government, under several agencies and programs, guarantees loans made to businesses and individuals by non-Government enterprises, such as commercial banks, and by privately owned, Government-sponsored enterprises, such as Federal Land Banks. These guarantees become assets and/or liabilities of the Government only when the Government is required to honor its guarantees. Loan guarantees in force at June 30, 1974, are summarized below.

Guarantee Related To	Amount Outstanding (Millions)
Federal Housing Administration	$ 97,753
Veterans Administration	27,053
Farm Credit Administration	23,612
Federal Home Loan Bank Board	20,733
Federal National Mortgage Association	25,828
Other	32,583
	$227,562

The annual rental of real property leased throughout the world to the United States Government is approximately $600 million.

15. RECONCILIATION OF BUDGET DEFICIT

The following tabulation reconciles the reported budget deficits for the years ended June 30, 1974 and 1973, to the excess of expenses over revenues reflected for each year in the accompanying statement of revenues and expenses.

	Millions	
	1974	1973
Reported budget deficit (Appendix 1)	$ 3,460	$14,300
Add—		
Noncash provisions for retirement and disability benefits	95,650	77,030
Depreciation	13,200	12,800
Net expenses of off budget agencies	2,675	607
	111,525	90,437
Deduct—		
Capital outlays	16,066	16,117
Net effects of accrual adjustments	2,267	1,586
Revenue attributable to change in gold valuation	1,157	—
Seigniorage	321	400
Earnings of Federal Reserve	68	61
	19,879	18,164
Excess of expenses over revenues	$ 95,106	$86,573

CERTAIN ECONOMIC QUESTIONS

Related to Consolidated Financial Statements of the United States Government

- The gross Federal debt increased from $250 billion in 1949 to $382 billion in 1970 and to $486 billion in 1974 (see Appendix 1). The amount owned by domestic private investors (as distinguished from foreign investors, trust funds and the Federal Reserve) increased from $190 billion in 1949 to $212 billion in 1970 and decreased to $207 billion in 1974.

  What is the significance of these changes— will the Federal debt approach a level where it will be difficult to obtain new funds from the public? Is the gross amount approaching a level where the carrying cost will be unduly burdensome? Does this mean that between 1949 and 1974 the amount required to finance the increase of $236 billion in the gross amount of debt had little impact on the capital available for private purposes?

- The amount of Federal debt owned by foreign investors increased from $3 billion in 1949 to $14 billion in 1970 and to $57 billion in 1974.

  Has the rapid increase in Federal debt held outside the United States created a serious potential for future problems? Is there a possibility of sizable amounts being returned to the United States for sale or redemption, thus creating an immediate drain on the national capital markets?

- The amount of Federal debt held by Government trust funds increased from $38 billion in 1949 to $97 billion in 1970 and $140 billion in 1974.

  Is it proper for trust funds to be invested in Federal securities? If so, when such funds are needed, does this create a double requirement for our capital markets? What is the merit of having an organization invest funds held in "trust" in its own securities? Is this a major defect in concept of "trust fund"? Would the implication be any different if states and cities bought securities of their own governmental unit for "trust funds"? Could the Government invest large sums of trust fund money in the private capital markets without disturbing these markets?

- The amount of Federal debt held by the Federal Reserve increased from $19 billion in 1949 to $57 billion in 1970 and to $80 billion in 1974.

  What are the implications of continuing to increase the money supply by purchasing more Federal securities?

69-141 O - 76 - 7

- The average maturity of Federal debt has decreased from 5.3 years in 1965 to 3.0 years in 1974.

  Does the substantial amount of debt in short-term maturities create a major uncertainty for our capital markets? Does this also create a serious situation for Government when combined with other demands for capital?

- Transfer payments for retirement benefits and salaries for Government employees are a significant portion of the total costs of Government.

  Can we adequately manage our financial affairs when retirement benefits are indexed to inflation? From a control standpoint, how can effective financial control be maintained over such costs?

- The accumulated deficit on an accrual basis has increased from over $700 billion to over $800 billion from 1973 to 1974.

  Is there any practical limit on the amount of the accumulated deficit?

- Retirement benefits, for both Social Security and retirement programs for Government employees, have increased significantly during the past few years.

  Are the present values of future retirement benefits increasing at rates that may substantially restrict the future financial flexibility of the Government? Should the reporting and management policies imposed on the private sector by the Pension Reform Act be extended to cover Government plans?

- There are significant Government assets, such as certain land, which could be sold if it were not required for public purposes.

  Should the Government adopt a policy that all assets not required for public purposes be sold under a controlled program with such funds designated to pay for present liabilities? Is the Government able to sell assets and use the funds for new programs without the electorate realizing this under the present reporting?

- The additions to property represent a sizable investment each year.

  With the significance of capital outlays, should a standby plan be developed whereby certain items would be delayed by Government during high economic activity to provide jobs during recession when the private sector has substantial excess capacity? Can such interface be of prime benefit to both the private and public sectors and reduce the cost of unemployment and other transfer payments during periods of low economic activity?

- The amount of Federal Government transfer payments to individuals has increased from $84 billion in 1973 to about $98 billion in 1974 and is on an increasing trend.

  With the size of transfer payments today, and with such payments increasing during periods of low economic activity,

should the Government's financial planning provide for surpluses during periods of high economic activity?

- The excess of expenses over revenues in 1974 on an accrual basis was over $95 billion.

  Should the Government develop a five- or ten-year plan to phase in a program to overcome such increases in accumulated deficits?

- Assets are valued at cost in conventional balance sheets. A committee of the House of Representatives reported as of June 30, 1972, that the estimated current value of the public domain lands was approximately $30 billion. No similar reports were available estimating current values for other land, mineral resources or the outer continental shelf. The accumulated deficit as of June 30, 1974, on an accrual basis was in excess of $800 billion.

  Would the increase in values from cost for properties not required for public purposes have a significant offsetting influence on the accumulated deficit?

- The United States dollar has been devalued twice in recent years. A flexible exchange rate is now in effect.

  Would the availability of consolidated financial statements have an impact on the value of the dollar in world markets?

CONCLUSIONS AND RECOMMENDATIONS

For United States Government

- Financial management systems and functions of the Federal Government should be strengthened and integrated to achieve financial accountability at all levels.

- A strong and well-staffed central accounting department should be established in the Executive Branch.

- The accounting system should contain internal checks and balances to assure reliability of the data produced. Such internal controls should be supplemented by annual financial audits.

- Accrual accounting should be adopted. This was recommended by both Hoover Commissions and is required by Public Law 84-863, which was passed in 1956.

- The Federal Government should take the leadership now in developing fiscal responsibility by preparing and publishing consolidated financial statements.

APPENDICES

Appendix No.		
1	Financial Highlights	30
2	Government Expenditures and Gross National Product	31
3	History of Accounting in the United States Government	32
4	Accounting and Reporting Questions Raised by Illustrative Consolidated Financial Statements	34
5	Excerpts from Section 3 of Securities Act of 1933	35

APPENDIX 1

UNITED STATES FEDERAL GOVERNMENT
FINANCIAL HIGHLIGHTS

Fiscal Year	Total Government and Military Employees	Federal Budget (In Billions)			U. S. Federal Debt (In Billions)					
						Held By		Held By		
		Receipts	Disbursements	Surplus (Deficit)	Total Federal Debt	Government Accounts	Federal Reserve	Total Private and Foreign	Foreign Investors	Private Investors
	(Rounded)									
1929	793,000	3.9	3.1	.7	16.9	N/A	N/A	N/A	N/A	N/A
1939	1,275,000	5.0	8.8	(3.9)	39.9	5.6	2.6	31.7	.2	31.5
1949	3,525,000	39.4	38.8	.6	250.7	38.3	19.3	193.1	3.0	190.1
1959	4,785,000	79.2	92.1	(12.9)	287.8	52.8	26.0	209.0	10.1	198.9
1960	4,784,000	92.5	92.2	.3	290.9	53.7	26.5	210.7	12.3	198.4
1961	4,851,000	94.4	97.8	(3.4)	292.9	54.3	27.2	211.4	12.7	198.7
1962	5,168,000	99.7	106.8	(7.1)	303.3	54.9	29.7	218.7	14.1	204.6
1963	5,096,000	106.6	111.3	(4.7)	310.8	56.4	32.0	222.4	15.8	206.6
1964	5,087,000	112.7	118.6	(5.9)	316.8	59.2	34.8	222.8	15.6	207.2
1965	5,101,000	116.8	118.4	(1.6)	323.2	61.6	39.1	222.5	15.7	206.8
1966	5,687,000	130.8	134.6	(3.8)	329.5	64.8	42.2	222.5	15.4	207.1
1967	6,165,000	149.5	158.3	(8.7)	341.3	73.8	46.7	220.8	14.7	206.1
1968	6,272,000	153.7	178.8	(25.9)	369.8	79.1	52.2	238.4	12.9	225.5
1969	6,264,000	187.8	184.5	3.2	367.1	87.7	54.1	225.4	11.1	214.3
1970	5,919,000	193.7	196.6	(2.8)	382.6	97.7	57.7	227.2	14.8	212.4
1971	5,513,000	188.4	211.4	(23.0)	409.5	105.2	65.5	238.8	32.7	206.1
1972	5,133,000	208.6	231.9	(23.2)	437.3	113.6	71.4	252.3	50.0	202.3
1973	4,989,000	232.2	246.5	(14.3)	468.4	125.4	75.1	267.9	60.2	207.7
1974	4,954,000	264.9	268.4	(3.5)	486.2	140.2	80.6	265.4	57.7	207.7

APPENDIX 2

GOVERNMENT EXPENDITURES AND GROSS NATIONAL PRODUCT
Calendar Years 1929-1976

Year	Gross national product	Government expenditures[a]					
		Amount[b]			As a percentage of gross national product		
		Total	Federal	State and local	Total	Federal	State and local
	(Billions)						
1929	$ 103.1	$ 10.3	$ 2.6	$ 7.6	10.0	2.5	7.4
1930	90.4	11.1	2.8	8.3	12.3	3.1	9.2
1931	75.8	12.4	4.2	8.2	16.4	5.5	10.8
1932	58.0	10.6	3.2	7.5	18.3	5.5	12.8
1933	55.6	10.7	4.0	6.7	19.2	7.2	12.0
1934	65.1	12.9	6.4	6.5	19.8	9.8	9.9
1935	72.2	13.4	6.5	6.8	18.5	9.0	9.4
1936	82.5	16.1	8.7	7.4	19.5	10.5	9.0
1937	90.4	15.0	7.4	7.6	16.6	8.2	8.4
1938	84.7	16.8	8.6	8.2	19.8	10.2	9.7
1939	90.5	17.6	8.9	8.6	19.4	9.8	9.5
1940	99.7	18.4	10.0	8.5	18.5	10.0	8.5
1941	124.5	28.8	20.5	8.3	23.1	16.5	6.7
1942	157.9	64.0	56.1	7.9	40.5	35.5	5.0
1943	191.6	93.3	85.8	7.4	48.7	44.8	3.9
1944	210.1	103.0	95.5	7.5	49.0	45.4	3.6
1945	211.9	92.7	84.6	8.1	43.7	39.9	3.8
1946	208.5	45.5	35.6	9.9	21.8	17.1	4.7
1947	231.3	42.4	29.8	12.6	18.3	12.9	5.4
1948	257.6	50.3	34.9	15.5	19.5	13.5	6.0
1949	256.5	59.1	41.3	17.8	23.0	16.1	6.9
1950	284.8	60.8	40.8	20.0	21.3	14.3	7.0
1951	328.4	79.0	57.8	21.2	24.0	17.6	6.4
1952	345.5	93.7	71.0	22.6	27.1	20.5	6.5
1953	364.6	101.2	77.0	24.2	27.8	21.1	6.6
1954	364.8	96.7	69.7	27.0	26.5	19.1	7.4
1955	398.0	97.6	68.1	29.5	24.5	17.1	7.4
1956	419.2	104.1	71.9	32.2	24.8	17.2	7.7
1957	441.1	114.9	79.6	35.3	26.0	18.0	8.0
1958	447.3	127.2	88.9	38.3	28.4	19.9	8.6
1959	483.7	131.0	91.0	40.0	27.1	18.8	8.3
1960	503.7	136.1	93.0	43.1	27.0	18.4	8.6
1961	520.1	149.0	102.1	46.9	28.6	19.6	9.0
1962	560.3	159.9	110.3	49.6	28.5	19.7	8.8
1963	590.5	167.0	113.9	53.1	28.3	19.3	9.0
1964	631.7	175.6	118.1	57.5	27.8	18.7	9.1
1965	681.2	185.8	123.4	62.5	27.3	18.1	9.2
1966	749.9	212.3	142.8	69.5	28.3	19.0	9.3
1967	793.9	242.9	163.6	79.3	30.6	20.6	10.0
1968	864.2	270.2	181.5	88.7	31.3	21.0	10.3
1969	930.3	287.9	189.2	98.7	30.9	20.3	10.6
1970	976.4	312.2	204.5	107.7	32.0	20.9	11.0
1971	1,050.4	338.5	220.8	117.7	32.2	21.0	11.2
1972	1,158.0	372.1	244.7	127.4	32.1	21.1	11.0
1973	1,294.9	408.0	264.2	143.8	31.5	20.4	11.1
1974	1,396.7	460.9	298.6	162.3	32.9	21.3	11.6
1975	1,498.0	509.7	323.7	186.0*	34.0	21.5	12.4
1976	1,686.0	570.8	361.0	209.8*	33.9	21.4	12.4

[a] Expenditures on income and product account. They are on an accrual basis, include trust account transactions with the public, and exclude capital transactions that do not represent current production, etc.

[b] Federal data include expenditures for grants-in-aid to state and local governments. These amounts have been excluded from state and local expenditures to avoid duplication.

* Projected using straight-line interpolation of actual 1974 expenditures and projected 1977 expenditures.

Sources: **Facts and Figures on Government Finance**, 1973, Tax Foundation, p. 33.
Survey of Current Business Statistics, U. S. Department of Commerce, February 1975, pp. 15 and 16.
Economic Report of the President, U. S. Government Printing Office, February 1975, pp. 249 and 328.

APPENDIX 3

HISTORY OF ACCOUNTING IN THE UNITED STATES GOVERNMENT

1789—The first important legislation dealing with the fiscal authority of Congress was the Treasury Act of 1789, which created the Department of the Treasury. This Act established an auditor and comptroller within the Treasury. The Treasury was to submit an annual report to Congress.

1921—The Budget and Accounting Act was passed by Congress in 1921. This law made a number of important changes in the financial management of the Government, the most significant being the creation of the Bureau of the Budget and the General Accounting Office (GAO). The Bureau of the Budget was established in the Treasury Department to be administered by a director who was responsible only to the President. The GAO was established independent of the Executive Branch. It became the auditing department for Congress and also kept the ledger accounts for disbursing and collecting offices.

1933—In 1933, the President proposed that accounting should be the responsibility of the Executive Branch, and that auditing should remain the responsibility of the Legislative Branch.

1937—In 1937, the Senate commissioned the Brookings Institute to study the financial administration of the Federal Government. Among their findings was, "there exists no control over the preparation of government financial statements."

1939—The Bureau of the Budget was transferred from the Treasury to the Executive Office of the President.

1947—The Joint Program for Improving Accounting in the Federal Government (JPIAFG) was established in 1947. This was the forerunner of the present Joint Financial Management Improvement Program (JFMIP).

1949—The first Hoover Commission recommended the creation of an "Accountant General" in the Treasury to prescribe financial and administrative controls. The first Hoover Commission recommended use of accrual accounting.

The Federal Property and Administrative Services Act was passed in 1949. This Act required the Administrator of the General Services Administration (GSA) to work with the Comptroller General to formulate principles and standards for accounting for property and aid in developing this segment of the accounting systems.

1950—The Budget and Accounting Procedures Act of 1950 gave the establishment and maintenance of accounting systems to the individual agencies. The GAO maintained its authority to prescribe accounting principles and standards. The GAO also was given the authority to approve the accounting systems of the individual agencies, and prescribed accounting principles and standards for Federal Agencies which required the use of accrual accounting to supplement the "obligation" basis of accounting in Government. Its primary function was now auditing. It would make post-audits of operations and report to Congress.

1956—The second Hoover Commission made a strong recommendation for accrual accounting and this led to Public Law 84-863 which required all Government agencies to install accrual accounting "as soon as practical."

1967—The President's Commission on Budget Concepts made several recommendations as a result of its study in 1967. It recommended against a separate capital budget, but called for a unified budget which included the trust funds. The Commission recommended getting away from the singular concern with the bottom line of the budget (surplus or deficit), and emphasized the financing of the deficit. Most of its recommendations regarding the budget were adopted. However, it also recommended accrual accounting and that the annual budget be presented on an accrued expenditure basis. This was endorsed by two Presidents but was not implemented during their administrations. Again, the Congress appeared to prefer the "obligation" type budget. There were some improvements made in accruals for the year-end statements of the Federal Government, but not always at the installation or operating level.

1970—The President created the Office of Management and Budget (OMB), replacing the Bureau of the Budget. The Legislative Reorganization Act directed OMB and Treasury to modernize budget and fiscal management through installation of a new EDP system. To date, this project is still in the planning phase.

1973—The President transferred much of the Executive Branch responsibility for accounting and financial reporting from OMB to GSA. In addition, the administrator of GSA was made a member of the JFMIP.

1974—The Congressional Budget and Impoundment Act of 1974 created the Congressional Budget Office and a new budget committee for each house of Congress. The new budget committees and the Congressional Budget Office were charged with the responsibility for overseeing the Congress' work on the budget and insuring that the budget was reviewed as a whole and not just by individual appropriation. The new Congressional Budget Office is to be the OMB of the Legislative Branch of Government—coordinating and assisting the work of the two Congressional budget committees.

APPENDIX 4

ACCOUNTING AND REPORTING QUESTIONS RAISED BY ILLUSTRATIVE CONSOLIDATED FINANCIAL STATEMENTS

With respect to the illustrative financial statements, the following are some of the accounting and reporting questions that arise.

–Are the criteria established herein for including Government and quasi-Government entities in these statements appropriate to best reflect the overall financial position and operating results of the Government?

–Should future retirement and Social Security benefits as shown be treated as liabilities?

–Should increases in the official rate for gold be treated as income?

–Should individual income taxes receivable be recorded on an accrual basis?

–Does the Government have adequate procedures to properly account for inventory items on hand?

–Have "excess materials awaiting disposition" been stated at net realizable values?

–Does the Government have adequate procedures to properly account for capital assets?

–Is it appropriate for the Government to capitalize and depreciate the cost of assets?

–Are reserves for loan guarantee defaults and other contingencies required to reflect potential losses or present liabilities?

APPENDIX 5

EXCERPTS FROM SECTION 3 OF SECURITIES ACT OF 1933

Exempted Securities

Sec. 3. (a) Except as hereinafter expressly provided the provisions of this title shall not apply to any of the following classes of securities:

Securities of Governments and Banks

(2) Any security issued or guaranteed by the United States or any territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory, or by any public instrumentality of one or more States or Territories, or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States—

Senator WILLIAMS. There seems to be some question about whether generally accepted accounting principles exist for local units of government. Do such standards exist now?

Mr. KAPNICK. Well, there's a great number of booklets that have been prepared on what the proper accounting should be, Mr. Chairman, for governmental units. For example, the American Institute of Certified Public Accountants has published an audit guide which has certain data. The Municipal Finance Officers Association has also published certain ones. The real need in this area is for leadership in getting a uniform approach to financial reporting. I believe that as outlined in your bill the leadership that the SEC would be required to give in this area in developing uniform standards is an approach that is desirable at this point in time.

Obviously, there's been several points that have not been covered in some of these audit guides because the profession has not necessarily ever faced the real issue of what is it the investor needs. You're forcing them to take a look at this and this can be done within a very short period of time in getting uniform standards.

Senator WILLIAMS. Now this Industry Audit Guide for Audits of State and Local Government Units prepared by the American Institute of Certified Public Accountants is an imposing document that I'm holding and showing to you. I would think that would be a very useful guide for State and local governmental units. Am I right?

Mr. KAPNICK. It is a very useful guide. However, there are two or three areas which I'm sure they're going to want to be given more attention to such as consolidation statements and the appreciation of fixed assets which gets into the allocation of costs to programs and to specific generations of taxpayers.

Senator WILLIAMS. This AICPA book probably in many areas is probably gathering dust on some shelf in the city hall in many areas.

Mr. KAPNICK. I'm afraid so.

Senator WILLIAMS. What we're trying to do is to bring the best of your profession to bear not only on an orderly basis but a required basis.

Mr. KAPNICK. That's right.

Senator WILLIAMS. We have two bills before us. Under either bill, the SEC would have the authority and responsibility to prescribe the forms and practices to be used in municipal accounting and reporting. Should the SEC attempt to exercise the power directly or would you recommend that the Commission play a residual role as it has in the corporate area, allowing the industry to develop appropriate standards in the first instance?

Mr. KAPNICK. I would recommend that the SEC play a residual role and also a leadership role in developing these standards quickly. The merit of your bill it seems to me in one respect is to develop a uniform approach on a timely basis. That can only be done by a regulatory agency such as the SEC. They then should have the residual responsibility whereby in my opinion they retain the documents that are being filed, not necessarily on a pre-compliance basis, as your bill recommends this is the difference between yours and Senator Eagleton's bill. I believe that you and the other Members of the Congress as you get experience with what is happening as a result of

this bill, could then address yourselves to whether or not there's added requirements in the future. I'm afraid that my experience in this area indicates to me that this may not be the last hearing that you will have on this subject. We must all look at whether or not we are getting responsible fiscal management over the funds in our society in municipalities. The services that are needed in these municipalities are essential because that's our way of life.

Now if what your bill is doing as a minimum standard does not provide that over the long period, then I know that the Congress is going to address themselves again to it. At that proper point they can require pre-compliance on registration, I would recommend between the two bills, Mr. Chairman, that only the minimum requirements be adopted at this point.

Senator WILLIAMS. Perhaps I'm not complete in my understanding of your position in disagreement with the bill. The one area that concerns you most, as I heard your statement and I will study it further, is the lack of built-in required monitoring by the SEC. Is that central to your concern?

Mr. KAPNICK. Yes. That's central to my concern and if we're going to have a central repository for these documents then I believe that the SEC should be the place where that repository is. Then they can monitor and come back to you as the Congress and say here are the things we found and they can prepare an annual report. I believe that, without some form of a monitoring function, Mr. Chairman, it is going to create difficulty for you because the compliance is the area, either on a test basis, or some other basis will indicate it and see whether or not people are complying. Then you can take the legislative action that's necessary, or you finally get into enforcement where something happens. I prefer a monitoring before the problem.

Senator WILLIAMS. How would you change the provision that creates a central repository under contract with the SEC? Could you adapt this requirement of SEC monitoring to this contracting out of the repository? That's really a receipt and orderly filing I would think.

Mr. KAPNICK. That's right.

Senator WILLIAMS. Would your idea adapt to that?

Mr. KAPNICK. No. I would make the SEC that repository rather than a placing out under contract, the same as they have their corporate securities that are all in one place where you can do testing.

The other thing that is very important is if you're testing in an audit type of operation is that the person being tested should not know whether he's been selected or not. If we're going to have a prefiling where a regulatory agency says, "OK, everything now looks all right." That's one thing, that type of compliance. But if you're going to have a testing type of compliance which I visualize as being a part of this system, then it should be with the regulatory body. It's going to cost us money as a nation to have it either in a private repository or in a public repository. I prefer to have it, because of the convenience and the control that is established not only for the SEC but for the Congress of the United States, in a public repository. I would change your bill to provide that the repository be, not under contract, but a part of the SEC function.

Senator WILLIAMS. We didn't deal in the hearing this morning in any detail at all on this requirement and provision with the Chairman of the SEC. I do know, though, that on using a preissue registration statement, that the SEC feels as though this is an unnecessarily heavy burden that they don't want to shoulder with this new development in municipal finance. The preissue registration statement which is the idea that's in Senator Eagleton's bill, how many issuers are there of municipals?

Mr. KAPNICK. I think according to the chairman, there were—or one of the documents I saw—78,000, but don't misunderstand my position, Mr. Chairman. The prefiling that you discussed with Chairman Hills, I would not support at this point because I believe that your bill provides a minimum standard and therefore we should go forward with a minimum standard, not with a prefiling under the Securities Act of 1933, and get our experience and then decide what else needs to be done, if anything.

The only question I would suggest you consider is where the documents are filed. The SEC has the most experience in handling this type of large operation and they should be the ones, in my opinion, that would do it.

Senator WILLIAMS. Bureaucracy and paperwork and Federal Government demands are not held in the highest appreciation these days. Those that are caught in the snows of New Hampshire compare the avalanche of snow up there to the avalanche of paper filings here in Washington. It's a massive new paperwork burden we're talking about here, and the national mood seems to be to try to get the job done effectively without the burdens of unnecessary filings and reviews. You get the feeling that comes out, well, all you have to do is listen to any political speech these days—everybody who's campaigning seems to be against this big, massive burdensome government.

Mr. KAPNICK. And I am, too.

Senator WILLIAMS. But you're adding a new significant dimension in your suggestion I believe.

Mr. KAPNICK. Yes, but not really.

Senator WILLIAMS. By the way, I am not out making these speeches, but I'm listening carefully.

Mr. KAPNICK. Let me point a couple things out to you, Mr. Chairman, that I'm sure you're aware of. No. 1, under your bill, it's my recollection that the estimates are less than maybe 10 percent of those who are municipalities may be required to file. In other words, when you get down to school districts and some of those governmental units, when we talk about 78,000, there's not that many that will be required to file.

Senator WILLIAMS. I'm glad you clarified that because we have a threshold that reaches only about 6 percent of the issuers.

Mr. KAPNICK. That's right. Now, Mr. Chairman, that is the important area of regulation. To me that takes care of that mass that we need to have taken care of so that we all reestablish our confidence in our governmental process. Now you're not going to get away from the mass of paperwork by deciding whether it's deposited in the private sector or in the SEC. The paperwork you have created

by this bill and we have endorsed the bill, is needed at this point in time.

I think the point, however, that you get into when you consider the priorities and I would say to you that I congratulate you on this bill because I know of no higher priority today in saving our way of life than this legislation. I say that for several reasons.

One of the most important reasons that I would say is if you stop to think about some of the indiscretions in the private sector where we have had bankruptcies, who loses? The investor loses. But if we have failures and financial difficulties in the public sector, who loses? Obviously, the investor; but more importantly, the citizen loses because if those hidden costs which are going to create the writeoffs, just like many of the corporate writeoffs, those writeoffs are not going to go away. Those writeoffs are going to have to be taken care of in some fashion. For example, the hidden pension costs, the hidden services that are not being put on the financial statement, many of those are going to have to be borne by us as citizens in some fashion. I'm sure that with all of your experience in the labor and legislation area, Mr. Chairman, that you can fully realize that if the pension trusts which are underfunded in many cases were not handled, that those people must be protected, and I'm sure that you and others would be the first to handle it as a national problem.

So we're looking here at a priority that goes much more basic to our society than probably any that I have seen in recent years.

Senator WILLIAMS. That's a very fine statement of need and I appreciate it.

Just one final question. I had a lot of questions in mind, but your comprehensive statement has been helpful in all of the areas of concern. There is one thing that I do want to ask, though, and that is the role of the financial reporting services. Their analysis, of course, has been the one area that people have relied on and their rating systems. I wonder what elements are there in the financial rating by the services and what is lacking and what is needed, because obviously notwithstanding ratings, we have had our critical problems.

Mr. KAPNICK. Well, let me address myself to that issue. I'm sure you're going to have testimony from those involved in the rating services. On the other hand, I think the most important thing to me is the need for the uniformity of data. The rating services can only do the job if they've got adequate information. Now let me tell you that I believe that in what we're seeing today as we have encountered the problems in the last few months, is a build-up of analysis capability within the private sector and in various banks, in various other institutions, who are going to try to pull together all the data. If you get into the question even in the trust companies as the prudent man rule with which I'm sure you're familiar, they've got to start getting more complete data.

In my opinion, we can have one of two approaches. We can have a uniform approach to the reporting of data which is what your legislation is providing. Or we can have everybody going out trying to find it themselves and getting more information here and less information there. The banks and the rating services which are providing

ratings can only do the job based upon the information that's available to them.

Sometimes I realize the rating services have been criticized the same as the accountants, but you can only do the job if you've got the data that is there with which to do it.

Senator WILLIAMS. There is within the accounting profession a consensus of the minimum standards that can be made uniform for the underpinning of this kind of financial reporting.

Mr. KAPNICK. Absolutely.

Senator WILLIAMS. I'm sure in certain areas within the accounting profession there are controversies and conflicts, but the foundation of reliability has a common consensus. Is that a fair statement?

Mr. KAPNICK. That is a fair statement, Mr. Chairman.

There's one area that probably you might be interested in as you look at some of the problems that's been surfaced in recent years. This is an issue which I address myself in my written statement, namely the consolidation of municipalities into a unit.

Our view, and this is something that the SEC in their determination of regulations would prescribe the same as they prescribe the consolidations for industrial companies, is in many cases you need to know the whole picture in order to avoid getting into trouble. You get into trouble when the combined needs of the taxes and services become so great that the citizens say, "Wait a minute. We can't afford it any longer." Now if you take it fund by fund, not only the investor can get misled because he doesn't see the total package, but also the individual citizen can get misled. I think the consolidation statement for a municipality is essential, which incidentally is essentially a modification of the consolidation technique that was used by New York City the minute they had to put together a financial plan for the Congress and for others. So the need is to put it all together so that you don't have to look at a hundred funds as a citizen of your community, so you know what the total package is. I would encourage the SEC—and we will file our documents with them when they consider this. Because there again it goes not only to the investor but to our way of life, the need for the community to have adequate funding for the services that they are looking forward to.

Senator WILLIAMS. I won't deal with the complexity or the imponderables in that. It comes to me with the greatest common sense and logic and I know your counsel will be appreciated by those who now have it. I know we will find it very useful as we go forward with our legislation. Thank you very much.

[Whereupon, at 12:25 p.m., the hearing was recessed to reconvene Wednesday morning, February 25.]

MUNICIPAL SECURITIES FULL DISCLOSURE ACT OF 1976

WEDNESDAY, FEBRUARY 25, 1976

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room 5302, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr., chairman of the subcommittee, presiding.

Senator WILLIAMS. We will continue our hearings on S. 2574 and S. 2969, the second day of hearings.

The first witnesses this morning are Mr. Brenton W. Harries, president, Standard and Poor's Corp.; and Mr. Jackson Phillips, Executive Vice President, Moody's Investor Services, Inc.

STATEMENT OF BRENTON W. HARRIES, PRESIDENT, STANDARD & POOR'S CORP. AND JACKSON PHILLIPS, EXECUTIVE VICE PRESIDENT, MOODY'S INVESTOR SERVICES, INC.

Mr. HARRIES. Senator Williams, in my oral remarks here today I will be quite brief in light of the lengthy witness list scheduled.

Since receiving a copy of this bill last Thursday and in preparing my written testimony, I have had an opportunity to reflect more deliberately on the provisions of S. 2969 and particularly I took the opportunity yesterday to listen to the remarks of Senator Eagleton and then what I would regard as the more reasoned approach of Chairman Hills.

My conclusion is that I continue to believe that this bill is not the ultimate answer to the problem but that indeed it appears to present a reasonable framework for further dialog and possible solution.

I have been impressed by what I would regard on the part of the committee staff and the committee itself as a reasonable, constructive approach. If this bill, S. 2969, can be a way to proceed to what I regard as the real solution to the problem of disclosure, assuring proper disclosure not just to investors but to underwriters as well, then I would commend your effort and hope that there would be time in the process of the congressional activity in this area for further study as to just what is a distribution statement and what is needed in it.

If I may, Senator, I would like to present for just a couple of minutes for the record the present state of the market as reflects how a bond comes to market today, and if I may, I would use the ex-

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ample of your State and mine, New Jersey, and show you the kind of documents that New Jersey used to prepare and today what is being prepared. It will only take a moment.

In 1973 when New Jersey sold $75 million of general obligation bonds, they prepared a four-page piece with a cover page— which I am holding in my hand, and for the record I will describe this— with a cover page giving the name, when the bonds were due and when the sale date was. The inside left-hand page carried the actual bid form. The right-hand page was one page of statistical data, this particular one carrying a statement of total debt authorized and outstanding and all future debt service. That was it. Page 4 was blank.

Last month New Jersey prepared an enlarged proposal to bid consisting also of four pages, but in this case the fourth page had more financial data on it. Therefore, there were, in effect, two pages of financial material relative to the State that was provided to potential bidders. Under the light of disclosure rules today, hardly enough.

Senator WILLIAMS. This was prepared for potential underwriters?

Mr. HARRIES. Yes, sir. The sale date was January 7, 1976. Several underwriters did not bid on the basis of the information presented but there was, however, a bid conditioned upon a fuller disclosure statement. The State then prepared this document I am holding. It consists of 32 pages. It has a good deal of financial, demographic, and economic data relative to the State.

The question I pose to you—and ask that we focus on as you go through these hearings is—does your bill provide that this document contains all material information and that no material information has been omitted? I submit, sir, that I don't think it does yet. At great effort I brought this pile of material from New York. This 5 inches of documents was supplied to Standard and Poor's Corp. by the State of New Jersey in just the last 4 months. Now in this material that the State has disclosed to us and makes available to major underwriters and to major investors—but obviously because of its very volume they don't attempt wide distribution of it—I submit to you that New Jersey has disclosed, that it has put in this material all the information necessary for an investor to make a reasoned investment decision.

And the question I think that has to be answered is, how do we get from this voluminous pile to this 32-page disclosure piece that can be given to investors so that they can rely upon it with proper certifications from the State? I submit, Senator Williams, that although your bill may be an effort in this regard, to me the ultimate solution lies in a State agency certifying that this document has sufficient information in it, and I'm pointing to the document of 32 pages.

Senator, what I'm suggesting for State endorsement of municipal bond issues is not new ground. I would urge that the committee might consider examining what has been done in North Carolina. They have a State agency. In the testimony yesterday I don't think enough differentiation was made between what a State agency is and what a quasi-agency is. In Texas we have the Municipal Bond Advisory Council of Texas. This is an industry-supported function. I repeat, in North Carolina it is a State agency consisting of 12 people. It is

not a bureaucracy. It's within the Department of the Treasury of the State. This is where the information is correlated, checked, verified, and then released.

In New Jersey we have a Commission on Local Government which uses more moral suasion in assisting borrowers rather than having the teeth of what I'm really talking about for a State agency. I think we have done well in New Jersey because we don't have the short-term borrowings in Newark and Trenton that affected New York City and it's precisely that type of State overview which has prevented it.

I will pause now because I know you have many questions. Thank you.

[Complete statement follows:]

STATEMENT OF BRENTON W. HARRIES, PRESIDENT, STANDARD & POOR'S CORP.

I am pleased to present this statement in response to the Chairman's letter of February 16 and address myself to points raised in this and other communications.

It seems to me that the problem the municipal market finds itself in today is not so much that full disclosure to ultimate investors is lacking, but rather that the Securities Law Amendments Act of 1975 has put potential muncipal bond underwriters in an untenable position. On the one hand they are prevented from requiring what the potential issuer must disclose, while on the other they are required to exercise due diligence in their distribution efforts. The need is to establish what is material, accurate information, and then insure that it is disclosed and certified as being complete. Then the underwriter can be assured as to disclosure and bid accordingly.

Would S.2969 accomplish this? I think not, except through the indirect route embodied in section (c), which provides an exemption from the act if the issue is processed through a state agency set up for the purpose of approving bond issues:

"(c) The provisions of subsection (b) shall not apply to an issuer solely by reason of an offer or sale of municipal securities—

"(1) the disclosure with respect to which has been approved, after hearing, as adequate for the protection of investors by a State governmental authority (other than the issuer) expressely authorized by law to grant such approval."

I have stated repeatedly in other forums and before the Joint Economic Committee last month that I believe disclosure is a state problem, and can and should be handled at the state level. Disclosure must be a living thing and not an annual report that sits in some repository such as a town hall. The disclosure information must flow smoothly into the marketplace where it can be synthesized and distilled in a variety of ways that will make it palatable for a potential investor to digest. The needs of full disclosure will not be satisfied by producing bigger and bigger official statements and annual reports. The challenge is to develop a procedure through which full disclosure may be accommodated and at the same time sustain and improve market performance.

In every state the principal public mechanism for municipal debt issuance already resides in some type of system. It should be acknowledged that a great deal has already been done in this complicated effort and that we should attempt to capitalize on existing strengths rather than create an entirely new and foreign mechanism. Therefore, if by exempting from the requirements of S.2969 those states which have mechanisms set up that meet the requirements of section (c), all other states will be motivated to set up their own mechanisms, then the positive affects are apparent. Many states now have agencies or commissions which assist local governments in debt planning, cash management and budgeting. These state units already are producing full disclosure documents. An outstanding agency in this regard is cited in Senator Williams' introductory remarks. The North Carolina Local Government Commission is perhaps the most outstanding example of a state agency, structured

within the Treasury Department of the state, which has regulatory power over every public bond sold by an issuer in North Carolina including the state itself. They are familiar with the handle local problems with expertise which simply cannot be matched by a federal bureaucracy. Other states should emulate this example.

A state-related structure, though superficially more complex than a single national organization, might in fact prove far more efficient in the functions for which it is designed and would have the additional advantage of avoiding the creation of a Federal bureaucracy. Many reasonable people fear that a Federal body would inevitably intervene in the financial and even the administrative functions of municipalities everywhere. It was surely the fear of just such a bureaucracy that inspired the Tower Amendment to the 1975 Securities Act Amendments. The state approach would allay the probably well-placed fears of the Tower Amendment advocates while still providing a vehicle for effective disclosure for the benefit of bond investors.

It may be said that this proposal is too cumbersome to be implemented and it is superficially true that there is more work involved in creating 50 or so bodies than in creating one. However, wouldn't the obvious attractions of this approach generate enthusiasm which would more than compensate the extra initial effort? And wouldn't the continuing operations of the state organizations likely be so much more efficient and responsive to the legitimate needs of issuers, underwriters and investors than a national bureaucracy that the extra start-up effort would be repaid many times?

Turning to some specific questions pertaining to S.2969 which have been raised by the staff: At Standard & Poor's we obviously receive a great deal of information which is not normally disseminated to the general public because of the volume and complexity of the data. Annual reports, budget statements, viability and engineering reports in their entirety are supplied to us when rating reviews are in order. Obviously we feel we receive full disclosure or we would not assign a rating. There have been instances when we felt disclosure was inadequate and we refused to rate. In 90 percent of all the rating reviews we do, we receive independently audited financial statements. We are not auditors and do not attempt to perform that function; therefore, we rely upon such audits in our examination.

It is difficult to answer whether more complete disclosure would result in lower borrowing costs. If greater disclosure could increase investor acceptance, obviously demand for the issue will be greater and this might affect the price. But if greater disclosure means that a potential investor is loaded down with far more information than he would ever use, then the additional cost of preparing extraneous matter is unnecessarily burdensome to the issuer.

Adequate disclosure on issues below the $5 million par value mentioned in the bill is a recurring problem. These are the smaller issuers who sell infrequently and often have little idea what is required. This group of issuers would be greatly aided by a state agency designed to provide the mechanisms of market access.

The provision in the bill setting up a central repository for current information is particularly appealing. A logical by-product of this base could be electronic tiering of information, depending on the sophistication of the user who would determine how much disclosure he wishes.

I believe it important to stress that the goal of better disclosure should be more efficient marketing. The target of an efficient market should not be hampered by efforts to stop incomplete or fraudulent disclosure. We have other laws to handle the latter and the goal of 2969 should be to improve marketability. I do not believe that SEC imposed accounting standards, for example, would accomplish that goal, or even is a realistic idea.

Guidelines for adequate disclosure are currently being worked on by the Municipal Finance Officers Association. Much in their guidelines is the same material required by us in a credit rating application. Certainly this is the best source from which to begin to formulate appropriate guidelines.

To sum up, I believe the problem can best be handled by agencies within the respective state governments. Their costs of operation could be paid by fees on local bond sales. I fear greatly—and share Senator Tower's concerns about—what role the Federal government could come to play over state and local units of government if S.2969 were enacted in its present form.

As to S.2574, much of my foregoing comments apply. Furthermore, I think the proposal of 2574 to subject municipal issues to corporate registration requirements is unworkable and unnecessary.

Senator WILLIAMS. Shall we take both statements? You came up together and you are listed together. Why not proceed with Mr. Phillips and then we will ask questions.

Mr. PHILLIPS. Senator, thank you for the opportunity of appearing before you.

My name is Jackson Phillips. I am an executive vice president and the director of Municipal Bond Research for Moody's Investors Service, Inc. with headquarters in New York City. We have been invited to testify in connection with S. 2574 and the bill introduced by Senator Williams relating to municipal securities full disclosure.

We provide several services to and for the municipal bond market. We gather and publish factual information on some 13,500 State and local governments annually in our Municipal and Government Manual, which also includes data on Canadian and other international governmental issues. We gather more detailed information for analyses of municipal bonds and publish our analyses in individual credit reports. We reach conclusions as to the relative credit worthiness of issuers and publish these as our ratings in the credit reports, our bond record, our bond survey, as well as carrying them in the manual. All data are from official sources, that is from officials who by law are charged with recording and reporting information.

The municipal market in the United States is a unique one. (1) It is big, with some $250 billion outstanding obligations of State and local governments, each secured by sources of revenue of those governments. (2) It is diverse. Out of the roundly 78,000 governments in the United States, about one-third have outstanding bonds and notes. While a few large issuers account for the largest part of the dollar volume, many small issuers account for the large number of market participants. The diversity is maintained, as each year some 8,000 new issues come into the market, slightly over half for bonds, the remainder for short-term financing. (3) Interest on the securities in this market is exempt from Federal income taxes, permitting the issuers to obtain a lower rate of interest. (4) The market is unregulated. Except for fraud provisions of the Securities and Exchange Act and for the creation of the Rulemaking Board under the auspices of the SEC last year, issuers, dealers, and others in the market operate without many of the Federal regulatory controls imposed on other security markets.

There are, of course, good reasons for the lack of regulation and for the tax exemption, and some are rooted in the Federal system of government as embodied in the constitution. The reasons are such an integral part of our system of government that they cannot be ignored. Nor can it be argued that the municipal market is inefficient. This is the market which serves a great number of small participants, maximizing their freedom of choice by utilizing the free market process. This is the market in which freedom of entry permits every small unit of government in the United States with the authorization of their State governments to obtain the capital they need for the purposes they feel they need it, subject to the requirements of the

marketplace. This is the market that permits State and local governments to satisfy what they perceive to be their needs without resort to a centralized bureaucracy. The record is impressive in many ways, because it is through this market that our local capital plant is in place: the schools, the street systems, State highway networks, and other local improvements. A central government could better have located the schools perhaps but only at the cost of local self-determination. And it should be born in mind that State governments have often shown the Federal Government the way: after all, several States built turnpikes, the forerunners of our Interstate System, with some operations beginning as much as 18 years before the Federal Interstate System legislation was worked out.

Into this workable market have come some problems, and the current one is called investor confidence. It should be noted that a major cause of investor shakiness has been inflation, which does not arise from activities of State and local governments. Because of inflation, interest rates on all fixed income obligations have risen, as investors seek an offset to an expected deterioration in their principal. Much of the market's queasiness is traceable back to 1974 when for the year inflation averaged 11 percent. Another impairment to investor confidence has come through scattered cases of alleged misrepresentation. This uncertain feeling of deception has certainly been compounded by the New York City debacle. Still another assault on investor confidence lies purely within the area of credit. Local borrowers must have both the means to repay and the willingness to repay in order to maintain a credit standing. And under the impact of major social and economic changes, credit bases have changed and some have deteriorated sharply in recent years. One body of thought holds that the large cities have lesser means of debt repayment than formerly, and it is certainly true that there has been a fundamental shift in the public finance system in the United States. The property tax, the life support of U.S. local government, has continued to decline in relative yield, coincidentally with the ascendancy of the Federal income tax. But this has been going on for the last 50 years and is nothing new.

The attempt of the bills under consideration, as I understand them, is to restore investor confidence by providing uniformity in some degree to reporting and disclosure of information by borrowers in the municipal security market. It is ironic that informational short-comings are felt to exist in the tax-supported, general obligation bond area, rather than in the revenue bond area. Revenue bonds are patterned after corporates generally, and information requirements are usually specified in the bond contract. By contrast, the tax-supported obligation has always been deemed to be covered adequately by laws which seek primarily to inform the taxpayer what is happening to his money. The current problem arises apparently out of the immeasureable magnitude of the responsibility that has been thrown on underwriters. Underwriters now feel the liability has been thrown on them in the event something later goes wrong with an issue, and they have not been able to secure all of the information necessary to protect themselves in the first place. Therefore,

full disclosure is called for, together with the necessary accompaniments of standardized accounting and uniform reporting.

Certainly there can be no dispute with full disclosure, which as I understand it, means ultimately that the issuer must provide all of the information necessary to a proper evaluation of the security he offers. The market model provided by the classical economists rests on an assumption greatly strained in the real world, that all market participants, all buyers and sellers, have complete and perfect knowledge of the product. Any lack of information leads to imperfections in the working of the market. Any suppression or failure to provide information in the municipal market can only lead to suspicion of the motives of the participants involved. The definition of full disclosure remains vague, however, and ultimately must embrace everything which a qualified analyst decides is necessary to his reaching a conclusion. The need to evoke full disclosure through national law must be based on the assumption that the market has become inadequate in some measure to do the job. It can be argued, however, that the market has done this job in the past and is continuing to do it now.

Despite what the market has been doing successfully, however, the proposed legislation has several appealing features to the bond analyst and bond rater. To have standardized information served up to him certainly lessens the load of gathering information, which is a time-consuming part of his work. The provision of a centralized location where all information would be on file is the dream of the scholar and the hope of the bond analyst who is dependent on files of information, which are costly to compile and to maintain.

But these gains, if indeed they are gains, must be weighed against the costs, which are both political and economic. By political costs is meant any further dilution of the sovereign areas of State governments and of their local governments. Certainly, out of this development could be expected litigation which would disrupt the municipal market further and which would slow down capital programs under way. By economic costs is meant cost of compliance, by local governments, cost of administration by the Commission with the great number of governmental units involved, and cost of market rigidities introduced by another set of check points.

The Eagleton bill would certainly raise the sovereignty question and involve the maximum of added costs. The Williams bill offers an option, which has a great deal of merit. In effect, it says to the States that if you will take care of disclosure matters on new issues through your own central agency, then the provisions of this bill regarding new issues are of no concern to you. This may disturb those home rule enthusiasts who interpret their ideal position as being free of any control, but it attempts to avoid the question of Federal versus State powers. Based on the existing State agency which is concerned with the new issue market for local government bonds—that's North Carolina, as you know—this solution is workable and helpful both to the buyers and sellers of municipal bonds.

A question would arise if a State decided it did not wish to establish such an agency. The same question remains with respect

to the annual report provision. With this question, there are several features of the Williams bill worthy of comment.

(1) Both the fixed amount of $50 million for the annual report and of $5 million for the distribution report are subject to change as the Commission deems necessary. In addition, the Commission is authorized to modify the list of data and information prescribed in the first instance by the legislation.

On the $50-million amount, the figure would surely have to be changed. Generally, issuers with this amount outstanding are those that presently are professional in their approach to the market and exceed standards established in the legislation. It is suggested that thornier problems arise with issuers with lesser amounts outstanding. A similar observation might be made for the $5 million limitation. There is certainly no criticism here of the Commission which does an excellent job, but it is suggested pressures would arise immediately to force lowering the amounts and accordingly raise compliance costs. Again, a similar observation should be made for the prescription of data. It is short of what many analysts would consider necessary for the evaluation of a municipal security, but extension of it holds the possibility of bringing the Commission into difficult areas.

(2) The Commission may prescribe forms in which information would be provided and after 1978 prescribe accounting formats to be used by a required independent auditor. Because the National Council on Governmental Accounting, which is the authority on these matters, recogizes several forms of municipal accounting, any prescription would certainly have to follow these lines, in accordance with existing differences in practice in different States. Accounting systems that do not conform to budget systems are of minimal use, and it is difficult to see on what grounds a Federal statute could successfully supersede State and local budget laws.

A single system, cash or accrual basis, would not meet existing differences and hence would cause governmental conflict. This is not to say that the Commission would not recognize such problems, but we can always think about the possibilities the future holds.

As an organization, Moody's would have no difficulty with either of these bills. We also rate corporate bonds, both domestic and international, and international governmental issues as well. The information we derive from SEC registration statements and other forms is important to us, although invariably as analysts we must go beyond the basic minimum which is provided. But as municipal analysts, we are mindful of the fact that we are already working with official, legally prescribed data.

Nowhere in the proposed legislation is what I consider necessary attention to the urgency of time and the timeliness of reporting. Situations can deteriorate rapidly in the economic excesses of our time. Right now, as the country is coming out of a recession, many State and local units are only beginning to show the full effects of entering it. This year's tax receipts reflecting last year's economic slowdown are creating cash flow problems that in some cases will not find their way into the best of reports until they are over. Acceptable credits, however, have means of informing us and the market of these problems, and despite all the obstacles involved, we think

that investment-grade municipal credits in the United States will continue to do so.

Thank you, sir.

Senator WILLIAMS. Thank you very much, Mr. Phillips.

Gentlemen, yesterday and today, one State's activity in this area has been singled out as responsive to the need, the State of North Carolina. We have in the committee's offices and I hope we can find it, for purposes of the discussion, an example of what is presented on a new issue under their State laws. Are the requirements contained in the State law?

Mr. HARRIES. I don't believe the requirements of the disclosure are in the State law. I think they are mandated by the agency itself, the local government commission.

Senator WILLIAMS. Are you talking about State issues and municipal issues?

Mr. HARRIES. Yes. They also have the right to approve or disapprove a State issue, a State general obligation of North Carolina.

Senator WILLIAMS. So this is a State commission?

Mr. HARRIES. Yes. I spent probably 1½ hours, Senator, last week on the phone with them in preparation for this testimony. The Commission consists of 12 people. The supervisor is an assistant treasurer of the State of North Carolina. They have office space in the State capitol building. Their budget is included in the State budget. They are all State employees. They do a good bit of traveling out to the hinterland to talk to the county officers, the towns and the cities, who anticipate coming to market for sale or whenever these counties report on an annual basis to the local government commission. They supervise the independent accounting audits and insist on independent audits of all the local government entities. They have the power to approve or disapprove a bond issue. I think that is rather important. They are of great assistance in attempting to have uniform accounting statewide but even they admit that they run into difficulties in applying uniform standards and, therefore, they permit local deviations from what might be a State uniform code because of local laws. But once they understand them, they present them to us so that we then can understand them. It is a regulatory agency. I would stress that word.

Senator WILLIAMS. It is unique. I do have a description here of their operating methods as well as some of the——

Mr. HARRIES. Senator, may I interject that one of the big problems in getting to this, which I call as near Utopia as we might get, is that obviously many local communities resist State supervision and in States like California and Connecticut there literally is no supervision of the local community. In Illinois, Chicago is bigger than the State and frequently has difficulty, as you may be aware, of getting things done in Chicago that require State concurrence.

North Carolina was born from the fire of the ashes of 1931 and that's when the bill was passed creating that agency and, of course, the climate was such that the communities there were casting about for any type of assistance which would allow them to continue to survive.

Senator WILLIAMS. In the description of their system the first item mentioned is close supervision of local funding plans which adds

to the attractiveness of the securities offered. That gets the State deeply involved.

Mr. HARRIES. Very deeply.

Senator WILLIAMS. In local—what might be considered local decisions, but what I'm getting at is that you feel that this is most ideally a State activity that we are talking about here?

Mr. HARRIS. Absolutely, I do.

Senator WILLIAMS. The requirements for bringing forth all of the elements for intelligence on the part of underwriters, investors, and rating agencies, I would suggest.

Mr. HARRIES. Yes, sir. That is correct. It makes the rating agency job easier. We send a man to North Carolina each year in January for a week or two and they bring into their offices all the potential issuers that they know about who may be coming to market that year, and they talk with our people and we discuss areas where we see problems, where we might want more information, et certa. He spends a week, perhaps two. Then as the issuer comes to market, he goes through the local Government Commission and then the papers come to New York and many of the problems have already been talked about.

Senator WILLIAMS. There seems to be a consensus that one state has found a very worthy answer here.

Mr. PHILLIPS. North Carolina certainly presents an ideal solution from the State point of view; yes.

Mr. HARRIES. May I add one more thing? One thing I talked about with North Carolina was the problem of sign off, the problem of who is going to attest to the fact that no material facts have been omitted and none have been excluded, et cetera. That still isn't done in North Carolina and they are attempting to have it done in two ways. They hope by the end of March to accomplish it. That the senior officer of the issuing unit, be it the mayor or the State treasurer, will attest to the papers filed for the bond issue; that no material facts have been omitted, and hopefully include that no material facts have been deleted, and all facts are accurate. Then the Commission will put some type of approval, quasi-State approval on it.

I submit, Senator Williams, that that bond issue, held up to a Merrill Lynch or a First National City Bank or some of the people you will hear today as a representative of underwriters, will go a long way in reassuring that due diligence has been performed in trying to solve the problem we have today.

Senator WILLIAMS. We are pointing in the direction of guiding, I hope, states to this conclusion. Now this doesn't suggest necessarily the full procedures of a uniform act for all the 50 States. That's a long process. The uniform commercial code took how long? A long, long time. We are in a situation that recent events have suggested is an emergency situation, a crisis of confidence because of such a vast amount of investment may be made without adequate knowledge of what the basic really is for the investment. Isn't this what we're talking about? The investor just doesn't know enough to make a fully intelligent decision.

Mr. HARRIES. Well, the investor must have available to him a document that he is capable of digesting, not a tome the size of

what I have been describing here, and to get to that point is the Utopia that I see.

The distribution statement as described in your bill, if that accomplishes that, I would be in favor of it.

Senator WILLIAMS. Do you feel that between now and the time when all States are adequately functioning under necessary regulation that national guidelines for disclosure such as we are putting into this legislation are necessary?

Mr. HARRIES. That's a difficult question. If your bill will assist us as a step in getting to the point which I regard as Utopia, then I would answer your question and say yes; but I would hope that with the interplay that you're conducting we would have the opportunity to deliberate and get more of a colloquy going as to whether this would really be that step. We are not sure yet.

Senator WILLIAMS. I don't see what promise there is in relatively early results without some unifying national stimulant to our States and communities. That's the way it looks to me.

Mr. HARRIS. Well, let me make one more comment and then Mr. Phillips can answer it as he wishes.

The market has already had some issues as in New Jersey. I would emphasize for your own knowledge that there were two underwriting accounts that did not bid for New Jersey bonds because they did not have a proper disclosure statement. However, New Jersey still got a fine bid, 5.7-percent interest cost on a $50 million issue, which I submit is a rather reasonable rate to have paid. So I would not stress that the market is in—I believe yesterday you used the word "chaos"—I would not refer to it as chaos. There are confusing circumstances as people come to market and I'm not certain that under the provisions of S. 2969 all of that confusion can be removed at this point.

Mr. PHILLIPS. Sir, I think the municipal market is continuing right now. There's a lot of noise. There's a lot of confusion about certain big issuers. Very often these have some credit problems which have suddenly become quite prominent and it is in this area I think that the market is struggling—generally big names—but in terms of the great number of issues, things are going right on. I think the most recent 2 months for which I have looked at the market, there have been still a great number of issuers going through without any fuss or bother. The yield indexes are dropping. The market is functioning. I would hope that these States which have these problems could look quickly and recognize what the situation is. We suggest the North Carolina situation because this has done so much for the borrowers of North Carolina and I would hope that States would look to this and get to it in the sense of helping their local issuers, many of which need help in getting into the market.

Senator WILLIAMS. Mr. Harries, you appeared before the Joint Economic Committee quite recently. What was the date on that?

Mr. HARRIES. January 22, 1976, Senator.

Senator WILLIAMS. You said at that time "as for individuals the loss of investor confidence caused by the events in New York has been shattering. Some of the prices on municipals today are ludicrous, totally out of proportion with actual risk, but investors' psy-

chology has been badly hurt and will take a long time to mend." However, I was referring primarily to loss of investor confidence due to the bankruptcy bill and the New York moratorium legislation, not necessarily disclosure.

It would seem to me that what we are proposing here would hasten that mending process. Would you agree with that?

Mr. HARRIES. Yes, I expect it would.

Senator WILLIAMS. The object here is to get all the necessary information for intelligence on the borrowing, the issue, and in a form that is understandable, and that's not easy, is it—for the layman, the investor? You mentioned New Jersey's February offering of $50 million of general obligation bonds. Now this is quite a document requiring some sophistication to really make an evaluation of the State's situation with respect to this particular issue. Is this the one that you were referring to?

Mr. HARRIES. Yes, sir. The date on the bottom is January 20, 1976, in the lower left-hand corner.

Senator WILLIAMS. This was for the investor. This wasn't for the underwriter. The underwriter has already been chosen.

Mr. HARRIES. No. Let me give you the chronology. The issue came to sale on January 7. There were two bids submitted, one by the Smith Barney syndicate and one by Chase Bank. In the course of attempting to obtain bids, two major banks in New York dropped from managing underwriting accounts so instead of four or possibly five bids being submitted competitively, only two were submitted; one by Smith Barney and one by Chase.

Chase requested a great deal more additional information than was contained in the four page bid form. They also requested certifications as to completeness of the material from the State treasurer, the State attorney general, and the Governor. Since they didn't win the bonds, those further requirements didn't take place. Smith Barney, after being awarded the bonds but prior to delivery, insisted that the State supply it, Smith Barney, with a document which would more fully meet disclosure requirements.

I asked the State comptroller this question Monday and I forget—I believe he told me there were 7,000 copies of this printed. It cost them $50,000 because of counsel fees involved to get this material together, and this then was mailed to those people who had purchased the bonds but prior to receiving the actual definitive bonds. It was submitted to the investor after he had committed to take the bond but prior to actual transfer of the money.

Senator WILLIAMS. The chronology of disclosure here to the underwriter rather escapes me.

Mr. HARRIES. It's backward.

Senator WILLIAMS. Yes.

Mr. HARRIES. May I try to clarify this? This document I am holding is an official statement for the New Jersey Housing Financing Agency. This is a revenue bond. You will notice the red on it. This is similar to what we would call a red herring in corporate funds.

Senator WILLIAMS. What is the date on this?

Mr. HARRIES. There is no date. It's August blank, 1975. This type of document on a revenue bond is frequently issued well in advance

of the sale so that prospective investors receive this just as a corporate stock or bond offering, may look it over, ask questions, make their decision, and at the time of sale they are given a final document, hopefully with very modest change from the so-called red herring or preliminary prospectus. That is the normal chronology of sale.

I think it's a fair statement to say that the next time New Jersey sells, Senator, and we are picking on New Jersey solely because it's current and it's a big State and other States will emulate it—this type of 32-page document will probably be issued prior to the sale date.

Senator WILLIAMS. All right. Now turning to the bill that Senator Tower and I introduced, S. 2969, as we go through the provisions under municipal securities disclosure, are these the significant items that you look to in evaluating an issue—not the issuer but an issue?

Mr. HARRIES. For the general obligation bond, they are the basic parameters that we look at, yes.

Mr. PHILLIPS. Yes. These cover the items that we look at, although as I said, I think any one analyst might come up with some additional points. For example, I'm not sure I see here the concept of overlapping debt which requires that the government issuing also take account of other governments occupying the same area which also have taxing power and which have debt outstanding. There are certain items of this kind that any one analyst might bring up.

Senator WILLIAMS. Let me understand who's overlapping here. The same governmental jurisdiction?

Mr. PHILLIPS. Well, for example, sir, a city where there was also a county which functioned perhaps—a school district, perhaps a flood control district, et cetera—all of which have both taxing power and debt outstanding. The important thing is to measure the burden, the total burden of the debt on the taxpayer who's sitting in Los Angeles, let's say.

Mr. HARRIES. Senator, I have a house in Brick Township. I pay taxes to Ocean County on the same house, overlapping.

Senator WILLIAMS. Separately stated?

Mr. HARRIES. Yes. One is a sewer tax to the county.

Senator WILLIAMS. That's unique in our State.

Mr. HARRIES. It's a sewer tax to the county for the Ocean County Sewer Authority.

Senator WILLIAMS. But that is unique in New Jersey?

Mr. HARRIES. I do not think that's unique.

Mr. PHILLIPS. I'm also in New Jersey and I have a municipal school district and perhaps something else.

Senator WILLIAMS. All separately stated?

Mr. PHILLIPS. Yes, sir.

Senator WILLIAMS. Different tax bills?

Mr. HARRIES. Yes, sir.

Senator WILLIAMS. This is common in many other States. You get the water district, the whole range of services are separately stated.

Now beginning at the bottom of page 3, item H, a "description of the principal governmental and other services provided or performed by the issuer, the extent to which similar or different serv-

ices are performed by other governmental entities which serve the same geographic area and any major changes in such services in the last 10 years." Whether that approaches it, I am not sure.

Mr. PHILLIPS. That is the area of it, sir, but I'm referring to the debt that each of these different units would have outstanding as well as the proportion of that debt which would be attributed to the primary unit, the issuer.

Senator WILLIAMS. I do not think we meet the overlap that you have described precisely here, but the other items are the essentials of the intelligent evaluation? Am I right?

Mr. HARRIES. Yes, sir.

Mr. PHILLIPS. Yes.

Senator WILLIAMS Well, coming from you with such depth of experience in this area is, I would suggest for my purposes, confidence and assurance that we are moving in the right direction.

Mr. HARRIES. I would agree with that completely.

Senator WILLIAMS. Very good. We'll stop there on that question.

How about you, Mr. Phillips?

Mr. PHILLIPS. Yes, sir. You're moving in the right direction.

Senator WILLIAMS. I certainly think that the full impact of the corporate side registration, preregistration with the Securities and Exchange Commission referred in the other bill, is an unnecessarily heavy burden, and I would think because of the practical questions, not the most effective approach.

Mr. HARRIES. I agree completely.

Mr. PHILLIPS. Yes.

Senator WILLIAMS. What is your feeling on the Tower amendment, Mr. Harries?

Mr. HARRIES. I testified before the Economic Committee that I felt the Tower amendment possibly put in proper perspective the position of the Rulemaking Board relative to the problems that the municipal finance officers felt and that if it continued to provide protection from what I thought would have been the Eagleton bill I was in favor of leaving the Tower amendment just the way it is.

On the other hand, because of your bill and now my understanding, which was incorrect before, indeed the amendment did not prevent the SEC from oversight of municipals, I'm inclined to rethink the question.

In light of what your bill has offered, which I take is a much more pallatable solution, it may be that a way out of this—and this now gets us into more of this problem—is to get rid of the Tower amendment, bring in the Williams bill with greater Federal sanctions to make the States do it themselves. I'm sorry if I confuse you, but I'm trying to look at the whole problem and I'm not sure we're going to get there just now at this point.

Senator WILLIAMS. I appreciate that. Just one final thing.

Now in the essential services that both of you perform for investors, the information that you require is not mandated to be made public in disclosure to you. You have to dig, do you not?

Mr. HARRIES. Frequently, yes, sir. We do have to dig. I speak for Standard and Poor's. We do have to dig, particularly in the smaller issuers, the ones that come in for a million or less. They are the very

small towns or counties or very small school district where the town clerk is a part-time job. You have to phone them back for further information, more details, more facts coming to the market as a relatively infrequent thing. Yes, we do have to dig. There are very few occasions when we have not rated for lack of disclosure; however, there have been some.

Mr. PHILLIPS. We have to search out every point to satisfy ourselves that we know what we have to know to reach a conclusion and there's a lot of work involved in getting this information together. We have considered this, though, to be our job, to work at it until we have it.

Senator WILLIAMS. I wonder, gentlemen, as we continue our deliberations here on these bills, if we have other questions, if we could put them to you in writing and get the replies for our record.

Mr. HARRIES. Certainly.

Mr. PHILLIPS. I would welcome it, sir.

Senator WILLIAMS. Thank you.

Our next witness is Richard Kezer, president of the Dealer Bank Association and speaking for the Dealer Bank Association. I recognize you're accompanied by Henry Rathbun, and we are pleased that he is here.

STATEMENT OF RICHARD KEZER, PRESIDENT OF THE DEALER BANK ASSOCIATION, ACCOMPANIED BY HENRY RATHBUN

Mr. KEZER. Mr. Chairman, I am Richard Kezer, president of the Dealer Bank Association and senior vice president of First National City Bank, New York. I am pleased to appear before you today on behalf of the Dealer Bank Association, a group of approximately 140 commercial banks that actively underwrite and make markets in almost all forms of public securities. As you have noted, with me is Mr. Henry Rathbun of the firm of Wilmer, Cutler and Pickering, which acts as counsel to our association.

The Dealer Bank Association, which I will refer to as the DBA, strongly supports disclosure of material information by issuers of municipal securities. We believe that such disclosure will help bring investor confidence back to the municipal securities market. We also strongly support clarification and delineation of the municipal securities underwriter's obligations. We believe that such clarification will permit issuers to sell their securities more quickly and at a lower cost than is often the case today.

The DBA also believes that appropriate Federal legislation is likely to provide the quickest and surest means of reaching these goals. Accordingly, we applaud this subcommittee's decision to hold hearings on municipal securities disclosure, and we look forward to working with this subcommittee, as we have in the past, to develop sound and sensible legislation.

My statement today will focus on S. 2969, The Municipal Securities Full Disclosure Act of 1976, introduced last week by Senator Williams and Senator Tower. After briefly reviewing the nature of the market with which we are dealing, I will describe the DBA's views on several of the major provisions of S. 2969, and then discuss

more extensively what the role of the municipal securities underwriter ought to be under new Federal legislation. I ask that my full statement be printed in the record of these hearings.

Senator WILLIAMS. It will be.

[Complete statement follows:]

STATEMENT OF RICHARD KEZER, PRESIDENT OF THE DEALER BANK ASSOCIATION

Mr. Chairman and distinguished members of the Committee: I am Richard Kezer, President of the Dealer Bank Association and Senior Vice President of First National City Bank, New York. I am pleased to appear before you today on behalf of the Dealer Bank Association, a group of approximately 140 commercial banks that actively underwrite and make markets in almost all forms of public securities.

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The municipal securities market is an extremely large one. According to statistics prepared by The Bond Buyer, a total of 7,701 issues were brought to market in 1974, and a total of $51.9 billion of municipal securities were sold that year. About $22.8 billion of the municipal securities sold in 1974 were long-term bonds, and about $29.1 billion were short-term (12 months or less) securities. There are perhaps 750 participants in the market, including bank dealers, non-bank dealers and brokers. And, of course, there are many thousands of issuers of municipal securities—states, state agencies, cities, counties, school districts and many others.

Historically, municipal securities have been extremely safe investments. In the last forty years particularly, there have been very few municipal defaults. Investors have been able to invest billions of dollars in municipal securities with a high degree of confidence that they will receive the interest and principal they expect. The recent problems of New York City aside, municipal securities have been considered second only to federal government securities in safety. Moreover, issuers and underwriters of municipal scurities have only rarely been charged with misleading investors about the nature of the issuer and its financial resources.

The municipal market is characterized by competitive bidding in which syndicates of underwriters bid against one another to buy an issuer's securities for resale. Competitive bidding makes it impractical for a prospective underwriter to obtain access to the issuer's files and personnel and to commit the staff needed to conduct an independent investigation into the accuracy and completeness of all the information provided by an issuer. An underwriter, when the market is operating properly, would typically be a part of syndicates bidding on a large number of issues in any given time period, and be a part of the successful syndicate only about a quarter of the time that he bids. For example, in 1975 my bank, First National City, was a member of syndicates that bid on 434 issues of long-term bonds; these syndicates were successful 110 times. By way of comparison, we were the underwriters in just 22 negotiated transactions in 1975.

Recently, however, we—like other underwriters—have refrained from bidding in situations in which we would previously have bid because of uncertainties concerning the obligations of underwriters with respect to municipal securities. These uncertainties have prevented some issues from coming to the market at all, and have decreased the number of bidders and increased interest costs for other issuers. As Senator Williams said when introducing S.2969, "[t]he heretofore highly efficient operations of the primary municipal bond markets have been strained" as a result of recent events.

One important element in returning the market to its previous efficient condition is, in our view, uniformly to require disclosure by issuers of municipal securities. To the maximum extent practical all issuers of any given type of municipal security ought to provide the same kind and amount of disclosure. Of course, disclosure standards should vary for different types of securities. Different information will be important depending on whether the municipal security being sold is a short-term note, a long-term general obligation bond, or a revenue bond. The disclosure system to be established must have sufficient flexibility to permit varying standards to be set for different types of municipal debt instruments. Uniform accounting standards for issuers of municipal securities are also an important part of uniform disclosure, because otherwise an investor, or an underwriter, cannot compare with confidence the strengths and weaknesses of various municipal securities being offered for sale.

S.2969 provides a sound basis for implementing the goal of uniformity. We believe, however, that it should be made clearer in the bill that the amount of information and the type of information to be contained in the distribution statement could vary with the type of debt instrument being offered. In addition, further study is necessary to determine precisely how many issuers would be reached by the $50 million annual report threshold and the $5 million distribution statement threshold. If the number of issuers subject to those requirements is too small, then the goal of uniformity in disclosure will not be achieved and we would support lower thresholds. Issuers that do not make disclosures about themselves may be at a disadvantage in selling their securities, so it is not improper to require every issuer to comply with some disclosure requirements, appropriately adjusted to reflect the issuer's size.

One of the most important issues that any federal legislation will have to deal with is the appropriate institution to prepare the disclosure standards and administer the law. The issue is a sensitive one because the issuers of the securities with which we are dealing are states and their political subdivisions. Thus the relationship between the federal government and the issuers must be structured with great care, and must not do damage to the principles of federalism. We think that the question of the proper institutional structure is one primarily for the Congress and the representatives of municipal issuers to resolve. As underwriters our concern is with the substance of the rules and with the administration of the law. The rules must provide for the disclosure of sufficient information to enable underwriters and investors to make sound judgments without placing an unreasonable burden on the issuer, and the law must be administered in a way that promotes an efficient municipal market.

A central purpose of any federal legislation should be to assure that investors in municipal securities have available to them the information needed to make reasoned investment decisions. The responsibility for assuring that the information provided does not omit a material fact and is not misleading must rest with the issuer. This is so because the issuer is obviously in the best position to determine whether the information about itself in its disclosure documents is complete and accurate. Accordingly, an investor ought to be able to look to the issuer for compensation for damages suffered on account of material misstatements or omissions in disclosure documents. The issuers here are units of government, and to have them bear this responsibility does no more than recognize their public responsibilities. It seems to us entirely proper for the Congress to provide that any issuer who wishes to use interstate commerce to sell municipal securities should waive whatever jurisdictional defenses arising out of its governmental status it might otherwise have against suits by investors.

69-141 O - 76 - 9

Officials of the issuer, on the other hand, ought to be protected from personal liability in the event they acted reasonably. But there should be anti-fraud provisions which contain criminal sanctions for fraudulent actions by any issuer official who willfully and knowingly makes a misstatement or omission in a disclosure document relating to municipal securities. This would be consistent with the present structure of the Securities Exchange Act of 1934. While we believe that S.2969 is consistent with these principles, we also believe that the bill could profitably deal with issuer responsibility more clearly and in more detail.

In our view S.2969 has properly utilized an annual report supplemented by a distribution statement as the basis for municipal securities disclosure. Since many issuers are already required by local law to prepare annual reports or do so as a matter of practice, basing a disclosure system on such reports minmizes the burden and cost to issuers. And using a distribution statement that provides information about the underwriting and the use of the proceeds, and updates material information from the last annual report, will, at least for those issuers who are subject to the annual report requirement, permit an issuer to go to market quickly and without any unnecessary red tape. We suggest that, in order to protect investors who purchase municipal securities, and in order to permit secondary market purchasers and sales of municipal securities to be made with confidence, the Committee consider establishing a mechanism by which an issuer would make public announcements of material events affecting its creditworthiness between annual reports.

We support the provisions in S.2969 that call for independently audited financial statements in annual reports. Independently audited financial statements, the most important information contained in any disclosure document, provide a high degree of investor protection and investor confidence. The primary objection to such audits, as we understand it, is their cost. It is possible that this problem could be alleviated by the use of auditors other than those in private firms. The critical requirement for an auditor is, in our view, independence from the issuer. It should be possible to structure a disclosure system in such a way that a government agency with adequate assurances of independence from the issuer can perform the auditing function called for by the bill.

I will turn now, Mr. Chairman, to the DBA's primary concern: the role of the underwriter in the municipal securities market. The precise nature of the obligations and liabilities of an underwriter of municipal securities today is not clear. At present these obligations and liabilities are tested only under the general anti-fraud provisions of the securities laws. Over time, the underwriter of municipal securities may get from the courts the kind of guidance we seek, but in the interim the uncertainties will continue, to the detriment of issuers, investors and underwriters. This is one of the reasons that we support prompt federal legislation to deal with municipal securities disclosure.

In the context of the new system of municipal securities disclosure, it is necessary to review and to define the role that underwriters should play. As I have said, competitive bidding, not negotiated transactions, is dominant in the municipal market. An underwriter will typically be part of a successful syndicate only a quarter of the time he bids. Accordingly, there are severe practical problems of time and access to information that keep an underwriter from performing the sort of independent investigation to determine whether the issuer has provided complete and accurate data that is performed in other markets. Since competitive bidding keeps costs to the issuer (and the issuer's taxpayers) low, it is highly desirable as a matter of public policy to preserve competitive bidding in the municipal market by carefully defining the underwriter's obligations and liabilities.

Moreover, we are dealing here with issuers that are governmental entities, raising funds for public purposes, not issuers that are private organizations raising funds in the hope of private profit. Thus, many of the reasons that justify compelling an underwriter to make an independent investigation about the accuracy and completeness of the information provided by an issuer of corporate securities are not applicable when one is dealing with municipal securities. Further, there are checks on a governmental issuer of securities that do not apply with equal force to a corporate issuer—government in the

sunshine laws, periodic elections and press scrutiny of local governments are examples.

Finally, the costs of an extensive underwriter investigation of the accuracy and completeness of the information provided by an issuer, even if it could practicably be done, would have to be passed on to the issuers and would substantially raise the cost to the issuer of selling municipal securities. The issuer's cost would increase both because the underwriter's cost of doing business would escalate, and because there are many smaller underwriters who would stop bidding rather than arranging for and conducting extensive investigations into the accuracy and completeness of the information provided by an issuer. The issuers would have to bear the increased cost, and this would have the effect of increasing taxes or decreasing services in virtually every state, county and city in the country. The increased cost might even discourage some local governments from raising the funds needed for essential public projects. And some issuers might find it impossible to raise funds at all.

In light of these factors as well as the history of the market, we do not believe that the costs that would be imposed on issuers by requiring extensive underwriter investigation of the accuracy and completeness of the information provided by an issuer are worth the small benefits to be gained. Meeting disclosure requirements alone will impose new costs on issuers; and while that cost can be justified by the investor protection it provides, the additional costs of a second level of investigation by an underwriter cannot be expected, when we are dealing with local government securities, to provide enough additional protection to make it worthwhile. This seems to us particularly true if the bill that is adopted by Congress provides, as S.2969 does, for certified financial statements and issuer responsibility for the accuracy and completeness of the disclosure. These provisions assure the investor the protection he needs in this market; there is no reason to impose on the taxpayers any additional expense.

Accordingly, we believe that the underwriters of municipal securities under any new disclosure system should not be called upon to perform an independent investigation concerning the accuracy and completeness of the information contained in a disclosure document prepared by an issuer. In our view reliance on the statements of public officials is entirely reasonable unless an underwriter in fact has different information. In the absence of knowledge of an omission or misstatement, an underwriter should have no liability for a misstatement or omission by an issuer of municipal securities. This is essentially the same public policy already reflected in Section 11(b)(3)(D) of the Securities Act of 1933. Under that provision an underwriter may rely in good faith on statements made by "official person" or copies or extracts from a "public official document" which are contained even in a corporate prospectus.

S. 2969 in its present form does not deal with these questions. Senator Williams' statement suggests, instead, that the general anti-fraud provisions of the securities laws should continue to apply. We do not believe that it is desirable from the point of view of issuers or investors, and we know it is not desirable or practical from the point of view of the efficient functioning of the municipal securities market, to continue the present uncertainty concerning the liability and obligation of underwriters. The market is presently not functioning in the way that it should, and we respectfully suggest that the Congress should not enact legislation which would perpetuate that state of affairs. We believe that there are sound and persuasive reasons of public policy for providing in S.2969 that an underwriter of municipal securities will be liable only for an issuer's misstatements or omissions of which he had knowledge.

I appreciate the opportunity to appear before this Committee on a matter of great importance to the DBA and to the municipal securities market as a whole. Prompt action by Congress is, in our view, necessary and appropriate so that the market can once again efficiently and effectively perform its historic function of providing to state and local governments the funds that they need to fulfill their responsibilities to the public.

Thank you.

Mr. KEZER. The municipal market is characterized by competitive bidding in which syndicates of underwriters bid against one another

to buy an issuer's securities for resale. However, a consequence of competitive bidding is that it becomes impractical for a prospective underwriter to obtain access to the issuer's files and personnel and to commit the staff needed to conduct an independent investigation into the accuracty and completeness of all the information provided by an issuer. An underwriter, when the market is operating properly, would typically be a part of syndicates bidding on a large number of issues in any given time period, and be a part of the successful syndicate only a fraction of the times that he bids. For example, in 1975, my bank, First National City, was involved in syndicates that bid on 434 issues of long-term bonds, these syndicates were successful only 110 times. By way of comparison, we were the underwriters in just 22 negotiated transactions during that same period.

Recently, however, we—like other underwriters—have refrained from bidding in situations in which we would previously have bid because of uncertainties concerning the obligations of underwriters with respect to municipal securities. These uncertainties have prevented some issues from coming to the market at all, and have decreased the number of bidders and increased interest costs for other issuers. As you, Mr. Chairman, said when introducing S. 2969, "the heretofore highly efficient operations of the primary municipal bond markets have been strained" as a result of recent events.

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S. 2969 provides a sound basis for implementing the goal of uniformity. We believe, however, that further study is necessary to determine precisely how many issuers would be reached by the $50 million annual report threshold and the $5 million distribution statement threshold. If the number of issuers subject to those requirements is too small, then the goal of uniformity in disclosure will not be achieved and we would support lower thresholds.

One of the most important issues that any Federal legislation will have to deal with is the appropriate institution or institutions to prepare the disclosure standards and administer the law. The issue is a sensitve one because the issuers of the securities with which we are dealing are States and their political subdivisions. Thus the relationship between the Federal Government and the issuers must be structured with great care, and must not do damage to the principles of federalism. Because of the political and economic complexities of this, we think that the question of the proper institutional structure is one primarily for the Congress and the representatives

of municipal issuers to resolve. As underwriters, our concern is with the substance of the rules and with the administration of the law.

A central purpose of any Federal legislation should be to assure that investors in municipal securities have available to them the information needed to make reasoned investment decisions. The responsibility for assuring that the information provided does not omit a material fact and is not misleading must rest with the issuer. This is so because the issuer is obviously in the best position to determine whether the information about itself in its disclosure documents is complete and accurate. Accordingly, an investor ought to be able to look to the issuer for compensation for damages suffered on account of material misstatements or omissions in disclosure documents. The issuers here with which we are dealing are units of government, and to have them bear this responsibility does no more than recognize their public responsibilities. It seems to us entirely proper for the Congress to provide that any issuer who wishes to use interstate commerce to sell municipal securities should waive whatever jurisdictional defenses arising out of its governmental status it might otherwise have against suits by investors.

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We support the provisions in S. 2969 that call for independently audited financial statements in annual reports. Independently audited financial statements, the most important information contained in any disclosure document, provide a high degree of investor protection and investor confidence. The primary objection to such audits, as we understand it, is their cost. It is possible that this problem could be alleviated by the use of auditors other than those in private firms. The critical requirement for an auditor is, in our view, independence from the issuer. It should be possible to structure a disclosure system in such a way that a Government agency with adequote assurances of independence from the issuer can perform the auditing function called for by the bill.

I will turn now, Mr. Chairman, to the DBA's primary concern: the role of the underwriter in the municipal securities market. The precise nature of the obligations and liabilities of an underwriter of municipal securities today is not clear. At present these obligations and liabilities are tested only under the general antifraud provisions

of the securities laws. Over time, the underwriter of municipal securities may get from the courts the kind of guidance we seek, but in the interim the uncertainties will continue, to the detriment of issuers, investors and underwriters. This is one of the reasons that we support prompt Federal legislation to deal with municipal securities disclosure.

In the context of the new system of municipal securities disclosure, it is necessary to review and to define the role that underwriters should play. As I have said, competitive bidding, not negotiated transactions, is dominant in the municipal market. An underwriter will typically be part of a successful syndicate only a quarter of the time he bids. Accordingly, there are severe practical problems of time and access to information that keep an underwriter from performing the sort of independent investigation to determine whether the issuer has provided complete and accurate data that is performed in other markets. Since competitive bidding keeps costs to the issuer (and the issuer's taxpayers) low, it is highly desirable as a matter of public policy to preserve competitive bidding in the municipal market by carefully defining the underwriter's obligations and liabilities.

Moreover, we are dealing here with issuers that are governmental entities, raising funds for public purposes, not issuers that are private organizations raising funds in the hope of private profit. Thus, many of the reasons that justify compelling an underwriter to make an independent investigation about the accuracy and completeness of the information provided by an issuer of corporate securities are not applicable when one is dealing with municipal securities. Further, there are checks on a governmental issuer of securities that do not apply with equal force to a corporate issuer—Government in the sunshine laws, periodic elections and press scrutiny of local governments are examples.

Finally, the costs of an extensive underwriter investigation of the accuracy and completeness of the information provided by an issuer, even if it could practically be done, would have to be passed on to the issuers and would substantially raise the cost to the issuer of selling municipal securities. The issuer's cost would increase both because the underwriter's cost of doing business would escalate, and because there are many smaller underwriters who would stop bidding rather than arranging for and conducting extensive investigations into the accuracy and completeness of the information provided by an issuer. The issuers would have to bear the increased cost, and this would have the effect of increasing taxes or decreasing services in virtually every State, county, and city in the country. The increased cost might even discourage some local governments from raising the funds needed for essential public projects. And some issuers might find it impossible to raise funds at all.

In light of these factors, as well as the history of the market, we do not believe that the costs that would be imposed on issuers by requiring extensive underwriter investigation of the accuracy and completeness of the information provided by an issuer are worth the small benefits to be gained. Meeting disclosure requirements alone will impose new costs on issuers; and while the cost can be justified by the investor protection it provides, the additional costs

of a second level of investigation by an underwriter cannot be expected, when we are dealing with local government securities, to provide enough additional protection to make it worthwhile. This seems to us particularly true if the bill that is adopted by Congress provides, as S. 2969 does, for certified financial statements and issued responsibility for the accuracy and completeness of the disclosure. These provisions assure the investor the protection he needs in this market; there is no reason to impose on the taxpayers any additional expense.

Accordingly, we believe that the underwriters of municipal securities under any new disclosure system should not be called upon to perform an independent investigation concerning the accuracy and completeness of the information contained in a disclosure document prepared by an issuer. In our view, reliance on the statements of public officials is entirely reasonable unless an underwriter in fact has different information. In the absence of knowledge of an omission or misstatement, an underwriter should have no liability for a misstatement or omission by an issuer of municipal securities. This is essentially the same public policy already reflected in section 11(b)(3)(D) of the Securities Act of 1933. Under that provision an underwriter may rely on good faith on statements made by an "official person" or copies or extracts from a "public official document" which are contained even in a corporate prospectus.

S. 2969 in its present form does not deal with these questions. Senator Williams' statement suggests, instead, that the general antifraud provisions of the securities laws should continue to apply. We do not believe that it is desirable from the point of view of issuers or investors, and we know it is not desirable or practical from the point of view of the efficient functioning of the municipal securities market, to continue the present uncertainty concerning the liability and obligation of underwriters. The market is presently not functioning in the way that it should, and we respectfully suggest that the Congress should not enact legislation which would perpetuate that state of affairs. We believe that there are sound and persuasive reasons of public policy for providing in S. 2969 that an underwriter of municipal securities will be liable only for an issuer's misstatements or omissions of which he had knowledge.

I appreciate the opportunity to appear before this committee on a matter of great importance to the DBA and to the municipal securities market as a whole. Prompt action by Congress is, in our view, necessary and appropriate so that the market can once again efficiently and effectively perform its historic function of providing to State and local governments the funds that they need to fulfill their responsibilities to the public.

Thank you.

Senator WILLIAMS. Mr. Kezer, how do you describe the present test in determining underwriter liability?

Mr. KEZER. I think that's——

Mr. RATHBUN. Mr. Chairman, if I could address myself to that point, I think the situation is characterized today largely by a great deal of uncertainty. There is presently pending litigation concerning the New York City situation. There is also pending for possible review by the Supreme Court the *Nuveen* case in which underwriters

were held by the lower court to have an extremely high degree—I would say an unwarranted degree—of responsibility to go behind such things as statements of auditors to look at their work papers. But the short answer to your question is that the law today in both the municipal and the corporate field is uncertain.

We think here that what has been suggested in Mr. Kezer's statement that imposing liability where we think it belongs on the State and local issuers to make complete disclosure is adequate protection for the investing public. I think in that connection we are supported by the following elements:

The first is that if you look at the history of this market, almost never have investors lost their money because of issuer fraud. Secondly, there are many safeguards in your bill, Mr. Chairman, particularly the requirement for audited financials. We think that those protections go about 98 percent of the way to solve investor protection problems.

Third, in these bond issues we are relying on statements of public officials. There is no private profit motive and as we pointed out in our statement, the Securities Act of 1933 recognizes that it is entirely appropriate to rely on those statements in a corporate prospectus. We have also pointed out the desirability from a cost point of view to the issuers of coming to market with their issues at competitive sale. We have adverted to the problems of an underwriter, whose bids may be successful only 25 percent of the time, going to those municipal bodies to undertake what might be described as the typical corporate due diligence investigation.

We think that the the added costs to the issuer provided in your bill of requiring certified financials are worth it. I think in the long run certified financials will provide a more efficiently functioning market which will probably return those costs to the issuers. But I submit that there is very little benefit that would justify the additional cost of requiring an additional level of investigation by the underwriters. I think the benefits to the investing public would be very minimal and that this would add a very substantial financial load on the issuers. When you refer to the issuers you're talking about the State and local taxpayers.

I would suggest this further, Mr. Chairman, and I will conclude, that if it should develop over the years that the protection of investors provided by S. 2969 and imposing express liability on the issuers for material misstatements or omissions fails to provide the investing public with the protection to which it is entitled, that at that point and at that point only should Congress decide to impose additional liabilities which we think are presently adversely affecting the market in terms of the uncertainty of underwriters' liability.

Senator WILLIAMS. Would you repeat that last statement?

Mr. RATHBURN. Yes, Mr. Chairman. I'm suggesting that it would amount to overkill at this point, to go beyond the protections now set forth in your bill—such things as audited financials—and, as we would suggest, adding an express provision to your bill to require that issuers who use the facilities of interstate commerce to market their securities waive any jurisdictional defenses they may have. That would put the responsibility where it belongs, on the issuers, to make full and complete disclosure. We think it amounts to over-

kill, which has no offsetting benefit to the cost involved by imposing on the underwriters a requirement that they conduct an additional investigation going into every fact and record of a municipal issuer before they are willing to assume the risk of taking an issue to the marketplace.

Senator WILLIAMS. It seems to me that you are first suggesting that the underwriter be in a position to be able to rely completely on the attested information that comes to him from the issuer. Is that right?

Mr. RATHBUN. With the addition of audited financials and the fact that this marketplace has functioned pretty effectively and honestly over the years, the fact that public officials are subject to the disciplines of reelection, State government in the sunshine laws, I think that this gives the investing public adequate protection; yes, sir.

Mr. KEZER. With the exception that if there is knowledge of a misstatement, that that should——

Senator WILLIAMS. My next point. It suggests to me that with that statement you are almost telling the underwriter that he had better not look any farther because he can just sit there on all the certifications that come from the issuer and be protected.

Mr. RATHBUN. He would still certainly be subject to liability for any information which he knew to be incorrect.

Senator WILLIAMS. It almost is an invitation to protect himself by putting blinders on and earmuffs, too.

Mr. RATHBUN. I don't think so, Mr. Chairman. I think that the provisions in your bill today, provided that you do impose direct liability on these issuers as to which there is at least uncertainty today will provide no such incentive. These are public officials who have to be reelected. I think the major safeguard that your legislation provides is the requirement for independently audited financials, If this bill had been in place a few years ago with the requirement that the financials of New York City be subject to independent audit, I don't think we'd be here this morning. That's a personal opinion.

Senator WILLIAMS. You have no suggestions for any other reasonable requirements on the underwriter for further investigation other than reading the material that comes attested and certified and with the independent audits that you just mentioned?

Mr. RATHBUN. Mr. Chairman, I will say again that if you impose a requirement of independent investigation upon the underwriters, you're going to add materially to the cost of the issuers. It was stated yesterday by public officials in testimony that the underwriters are not in a position to and will not absorb those costs. It seems to me that this, as in many legislative situations, calls for striking a reasonable balance and I think that the requirement in your legislation as it is presently drafted calling for this form of disclosure places a heavy burden on the officials of the issuer to comply. There is no reason to think that they are not going to do their level best to comply with those requirements. I don't want to sound like a broken record, but the requirement of independently certified financials is a major step in protecting the investing public and to add this an additional level requiring underwriters to make their independent

investigation would be unwarranted. Mr. Chairman, I suspect I'm speaking against my interests here—because I think if you provide by implication or directly an obligation on underwriters to conduct an independent investigation of the issuer, you could retitle the bill "The Lawyer Full Employment Act of 1976 Ad infinitem."

Senator WILLIAMS. This puts the responsibility and really the liability back on those who are certifying, doesn't it?

Mr. RATHBUN. Yes, sir.

Senator WILLIAMS. Now the independent auditor, he's the one that is going to have to shoulder the big burden. He will not be able to take figures that are given to him and consider that his only obligation.

Mr. RATHBUN. And he shouldn't.

Senator WILLIAMS. He is going to have to go back and look behind figures to see if there's any reason to doubt their authenticity.

Mr. RATHBUN. You're right, Mr. Chairman, and an independent auditor should not accept the figures that are provided him. It's his obligation to——

Senator WILLIAMS. Somewhere in the chain someone has to do more than accept as absolutely accurate figures that come to him.

Mr. RATHBUN. And I think that's the proper function of the independent auditor.

Mr. KEZER. The presumption also is, if the underwriters had a responsibility to conduct a separate investigation, that they would then have to go back and revisit the numbers behind the numbers again.

Senator WILLIAMS. I gather ultimately the liability goes to the issuer and the individuals that are presenting the material that is to be disclosed. So the municipal official is really the one that faces ultimate liability. Are there constitutional questions here?

Mr. RATHBUN. Mr. Chairman, we have suggested that the public officials individually should not be subject to criminal liability in the absence of a knowing misstatement or omisson. This is essentially the same policy reflected in the securities laws today. But for willful violations, fraud, active fraud, if you will, we think it's appropriate for public officials to be subject to the criminal liabilities. We think that this is another mechanism which adds to investor protection.

As to the constitutionality point, Senator, my firm was recently asked for an opinion as to whether legislation placing these kinds of burdens on State and local officials would be constitutional, and our conclusion was, yes, that it would be.

Senator WILLIAMS. There would be no question where there was actionable fraud involved. What is the situation with respect to civil damages running against the individuals at the municipal level?

Mr. RATHBUN. Mr. Chairman, I have not really focused on that question. I would certainly think that for willful misstatements or omissions——

Senator WILLIAMS. That is fraud.

Mr. RATHBUN. Right.

Senator WILLIAMS. But short of fraud, just plain negligence on the part of the individual?

Mr. RATHBUN. I think that liability would go to the issuer but would stop short of attaching to the issuing official.

Senator WILLIAMS. What forum would receive that question of civil damages running against the issuer?

Mr. RATHBUN. Well, typically, it could be brought in a Federal district court, because undoubtedly you would have purchasers of one State suing issuers of another. If that wasn't available, I assume it could be brought in the local courts.

Senator WILLIAMS. Now isn't that an 11th amendment question? I'll tell you, this isn't really the forum to struggle through some of these very, very complex and profound legal questions. You have written opinion letters in some of these areas, haven't you?

Mr. RATHBUN. We have, sir.

Senator WILLIAMS. I wonder if you could focus on this additional authority in terms of the civil liability and whether there are constitutional questions of bringing that into Federal court.

Mr. RATHBUN. We would be glad to.

Senator WILLIAMS. I wonder if you could speculate on whether this bill with its disclosure requirements, if it were to become law, would be another reason to allow banks to underwrite revenue bonds.

Mr. KEZER. Most assuredly.

Senator WILLIAMS. You struggled long and hard on this and I thought——

Mr. KEZER. I wanted to phrase as positive an answer as I could.

Senator WILLIAMS. This would be an additional reason, would it not?

Mr. KEZER. Yes. It seems to me that we have now got the business itself, the markets, being regulated through the Municipal Securities Rulemaking Board. If we have legislative mandate for disclosure, it seems to me there's no reason why banks should not be permitted to underwrite investment quality revenue bonds, even absent this bill.

Senator WILLIAMS. Until this bill comes along, there's some question, isn't there?

Mr. KEZER. Yes.

Senator WILLIAMS. Thank you very much.

Mr. KEZER. Thank you.

Senator WILLIAMS. Mr. Wallace Sellers from Merrill Lynch Pierce, Fenner, & Smith, David Taylor from Continental Illinois National Bank and Trust Co. of Chicago, Gedale Horowitz, from Salomon Brothers, and William Hough, Municipal Federal Legislation Committee, Public Finance Council for the Public Finance Council of the Securities Industry Association.

Gentlemen, you're all present and accounted for and, Mr. Sellers, you appear to be chairman of this group.

STATEMENT OF WALLACE O. SELLERS, MERRILL, LYNCH, PIERCE, FENNER, & SMITH, INC.; DAVID G. TAYLOR, CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO. OF CHICAGO; GEDALE B. HOROWITZ, SALOMON BROTHERS, CO-CHAIRMAN, MUNICIPAL FEDERAL LEGISLATION COMMITTEE; AND ARTHUR FLEISCHER, JR., FRIED, FRANK, HARRIS, SHRIVER & JACOBSON; FOR THE PUBLIC FINANCE COUNCIL OF THE SECURITIES INDUSTRY ASSOCIATION

Mr. SELLERS. I'm Wallace Sellers, chairman of the Public Finance Council of the Securities Industry Association, and vice president of Merrill Lynch, Pierce, Fenner, & Smith. With me today are Mr. David Taylor, executive vice president of Continental Illinois National Bank and vice chairman of the Public Finance Council; Mr. Gedale Horowitz, cochairman of the Municipal Federal Legislation Committee of the Public Finance Council, and partner of Salomon Brothers in New York; and Arthur Fleischer, a partner of Fried, Frank, Harris, Shriver, and Jacobson.

We are pleased to have the opportunity to testify before you today on S. 2969, the Municipal Securities Full Disclosure Act of 1976. We have previously submitted for the record a more fully detailed statement on our views of the bill as well as the general need for legislation mandating disclosure with respect to the issuance of municipal securities.

The Public Finance Council supports the concept of a Federal statute that provides a vehicle for creating uniform disclosure standards for offerings of State and municipal securities, and endorses the bill's approach of not simply repealing the exemption of municipal securities from the Securities Act of 1933.

Municipal issuers need a regulatory pattern different from the one applicable to corporate issuers. However, we believe the bill presently before the committee does not reflect all of the basic features which are essential in legislation relating to municipal issuers. Therefore, we recommend the enactment of legislation in accordance with the following principles:

One: Federal legislation should provide a vehicle for the creation of uniform standards for offerings of State and municipal securities. These disclosure guidelines should be set by an organization of State and municipal issuers. Regulation by State and municipal issuers would have several advantages. In the first place, it would enable Federal legislation to take into account very difficult and important questions of Federal-State relations. Second, this structure would give responsibility for writing regulations to the group that is most familiar with the requirements of State and municipal financng. Third, it would help enlist the support of the issuers on behalf of a Federal regulatory scheme. The SEC would still participate in the regulatory process for State and municipal securities through its responsibilities for enforcing the anti-fraud provsions of the Securities Exchange Act. Finally, disclosure guidelines developed by an organization of issuers would also be more flexible in adapting to different types of issues and issuers and to changing conditions than if disclosure requirements were written into the legislation as the bill attempts to do.

Two: Offering circulars used in connection with the issuance or distribution of municipal securities should contain audited financial statements prepared in accordance with generally accepted accounting standards and certified by either independent public accountant or a duly constituted independent state auditing firm.

Three: One of the most encouraging developments in the field of municipal finance has been a movement by States to assume responsibility for disclosure by their municipal issuers. For example, the

local government commission of the State of North Carolina has recently announced that it is considering a procedure by which officials of municipal issuers would be required to certify information in their disclosure documents and the commission would certify that this information has been confirmed through other data available to the commission. The bill recognizes the benefits of State regulation in providing an exemption from the Federal disclosure system for offerings complying with the State disclosure requirements.

The Public Finance Council recommends enactment of a provision that underwriters and dealers should not be liable for misstatements or omissions in offering materials from municipal securities if they rely in good faith on a State certification that these disclosure terms appear to comply with the requirements of applicable law.

Senator WILLIAMS. When you say "rely in good faith," either they rely or they don't. What is "relying in good faith?" That suggests to me that you are inviting more investigation than just reading the attested documents. "Rely in good faith," what does that mean to you?

Mr. SELLERS. No, sir. I think if a State agency had certified that the disclosure document of an issuer is adequate and fulfills the requirements of the law, then I think the underwriters should be able to rely on that, period, unless he has knowledge that it is——

Senator WILLIAMS. How would he get it? Does he go out and do his own investigation or does it just, by chance, come to him?

Mr. SELLER. Just by chance. I think if there is State certification——

Senator WILLIAMS. No other requirement upon him?

Mr. SELLER. If there is State certification; no.

Mr. TAYLOR. The State has done the certifications.

Mr. SELLERS. And North Carolina will be doing this. They will say that disclosure is adequate.

Underwriters and dealers would, of course, continue to be legally responsible if they are aware of the material misstatements or omissions in the offering materials. An authorization for underwriters to rely on State certification would give underwriters an incentive to press for State regulation and would recognize the ability of the States to assume responsibility for disclosure of municipal issuers. It would also give appropriate recognition to a basic distinction between corporate and municipal underwriters. While corporate underwriters are generally done on a negotiated basis, most municipal offerings are competitively bid. This means that it is usually impracticable for underwriters of municipal securties to participate in the preparation of the offering circular or to make a type of investigation that is customary in negotiated corporate underwritings.

Another basic principle applicable to municipal offerings is that issuers who receive the proceeds of any offering and who control and should have knowledge of the material facts should be primarily responsible for the contents of disclosure documents. Hence, in addition to the authorization for underwriters to rely on State certification of offering materials, there should be an express recognition of contribution rights as well as acknowledgement of the ability of municipal issuers to indemnify underwriters and others.

Four: The bill contains a provision limiting the liability for damages of an underwriter of municipal securities to the total price at which it sold securities to the public. This measure, while a desirable clarification of the law, needs to be expanded and refined. The ceiling on liability should apply to actions for rescission as well as suits for damages. It should protect not only underwriters—a Securities Act term which is not defined in the Securities Exchange Act—but any dealer who participates in the distribution process; and there should be a provision similar to the one in the Securities Act limiting the amount recoverable from such participants from the price at which the security was offered in public.

Five: Disclosure materials issued in connection with offerings of municipal securities should not be subject to prior review or approval by the SEC or any other Federal agency. The prior review concept was explicitly rejected by Congress when it enacted the 1975 amendments to the securities laws. We strenuously oppose the provisions of the bill that would appear to permit the SEC to institute such procedures.

Six: We are opposed to any exemption from the disclosure requirements for offerings of municipal securities based upon the size of the issuer. An exemption based on size tends to brand the exempt issue in the marketplace as an inferior class of security. The better way of handling this problem is to prescribe reduced disclosure requirements for these issuers. This committee stated that it was unaware of any abuses which would justify a radical incursion on the States' prerogative by overturning the exemption from the registration and disclosure processes of the Securities Act of 1933 and the Securities Exchange Act of 1934. It is our view that even in the absence of an express statutory disclosure system for municipal issuers, on balance, the financing of our municipalities has historically worked in an extraordinary fashion. Defaults on municipal bonds in the past have been so rare that since 1966 statistics on defaults have not been generally maintained. To be sure the Public Finance Council is concerned by the default of the Urban Development Corporation in New York, the moratorium for certain New York City obligations and evidence of financial instability in other municipal issuers. These factors appear to have affected investor confidence and have caused problems for certain issuers. We applaud the serious efforts which are being made to raise disclosure standards on a voluntary basis. We also clearly recognize that disclosure alone is not the answer to basic financial problems confronting certain municipalities. At the same time, the Public Finance Council would support a proposal for a mandatory disclosure system which does not unnecessarily increase the cost of municipal financing, which establishes reasonable standards of responsibility for the participants, and which produces a national system of minimum disclosure designed to enhance investor confidence in the municipal market.

In the context of the principles that we have outlined, we stand ready for further discussions to help achieve a satisfactory resolution and are willing to work with all interested parties toward this end.

Senator WILLIAMS. Thank you, Mr. Sellers.

[Complete statement follows:]

STATEMENT OF THE SECURITIES INDUSTRY ASSOCIATION

The purpose of this statement is to set forth the views of the Public Finance Council of the Securities Industry Association (the "SIA") on Senate Bill, S.2969, the Municipal Securities Full Disclosure Act of 1976 (the "Bill"). The basic purpose of the Bill is to establish defined disclosure obligations for issuers of state and municipal securities, thereby changing the approach to disclosure that has existed in this area since the inception of the federal securities laws over 40 years ago.

The SIA supports the concept of a federal statute imposing disclosure obligations for state and municipal issuers. However, our support is in the context of certain principles set forth in this statement. The Bill does not reflect all the basic features which we believe essential in legislation relating to state and municipal issuers. Therefore, we oppose the Bill in its present form and recommend the enactment of legislation in accordance with the following principles:

(1) There should be uniform disclosure standards in offerings of state and municipal securities. These disclosure guidelines should be set by an organization of state and municipal issuers.

(2) Offering circulars for state and municipal securities should be required to include certified financial statements.

(3) Underwriters and dealers should not be liable for misstatements or omissions in offering materials for municipal securities if they rely in good faith on a state certification that these materials appear to comply with the requirements of applicable law.

(4) The limits on liability of underwriters and dealers in offerings of municipal securities and their rights of contribution and indemnification should be clarified.

(5) Disclosure materials issued in connection with offerings of municipal securities should not be subject to prior review or "approval" by the SEC or any other federal agency.

(6) There should be no exemption from disclosure requirements for offerings of municipal securities based on the size of the issue.

We offering our assistance to the Committee and to other interested persons, including the Securities and Exchange Commission, to the end of formulating legislation that will be in the public interest and will recognize the particular requirements, needs and characteristics of state and municipal issuers and the participants in the underwriting process.

Last year, the Congress adopted the Securities Acts Amendments of 1975 which created a comprehensive regulatory system for the professionals in municipal securities, both securities firms and banks, and created the Municipal Securities Rulemaking Board, composed of industry and public representatives, to adopt regulations for the municipal market place. The SIA supported this legislation, having actively worked on predecessor forms of regulation with Congressional staff and staff of pertinent agencies, including the Securities and Exchange Commission. The 1975 Amendments specifically recognized and emphasized (through the express prohibitions against the Rulemaking Board or the SEC requiring municipal issuers to make prior filings of offering materials or to furnish documents to dealers and others) the continuation of the exemption of municipal securities from the registration and disclosure process of the Securities Act of 1933 and the Securities Exchange Act of 1934. Indeed, this Committee in its Report, dated April 14, 1975 [Senate Report No. 94–75] on the Securities Acts Amendments of 1975 (the "Report"), stated that it was unaware of any abuses which would justify a radical incursion on the states prerogatives by overturning the exemption. It is our view that even in the absence of an express statutory disclosure system governing the issuance of state and municipal securities, on balance, the financing of our municipalities has historically worked in an extraordinary fashion. Municipal borrowings have proceeded along with a happy balance of reasonable cost to the municipalities and lack of large scale losses to investors. Defaults on municipal bonds in the past have been so rare that since 1966 statistics on defaults have not been generally maintained. To be sure the public Finance Council is concerned by the default of the Urban Development Corporation in New York, the moratorium for certain New York City obligations and evidence of financial

instability in other municipal issuers. These factors apepar to have affected investor confidence and have created problems for certain issuers. We applaud the serious efforts which are being made to raise disclosure standards on a voluntary basis. We also clearly recognize that disclosure alone is not the answer to basic financial problems confronting certain municipalities. At the same time, if a mandatory disclosure system can be devised which does not unnecessarily increase the cost of municipal financing, which will establish reasonable standards of responsibility for the participants and which will produce a national system of minimum disclosure designed to enhance investor confidence in the municipal market, the Public Finance Council would support such proposal. We believe that any regulatory proposal must take into account the very difficult and important questions of federal state relationships. We also respectfully suggest that legislation must respect and acknowledge the unique characteristics of municipal issuers and the manner in which their securities are distributed.

I. THE PRESENT DISCLOSURE SYSTEM

At present there is no established disclosure system governing the issuance of State and municipal securities. Several states have adopted programs requiring various disclosures by municipalities issuing debt. However, there is no uniformity among these state programs and there is no federal program for state and municipal issuers. Rule 10b–5, the basic antifraud provisions of the Securities Exchange Act of 1934, does apply to municipal securities, however; and a series of recent lawsuits, court decisions and Commission proceedings have made issuers, public officials and underwriters sensitive to disclosure questions.

The legal proceedings, in conjunction with the difficult financial problems confronting certain municipalities, have created increasing pressures for improved disclosure in the distribution of municipal securities. Thus, there have been several recent instances where municipal offerings have been postponed or delayed at least in part because the official statements or offerings documents have not, in the judgment of the prospective bidding groups or others, disclosed information regarded as material. Furthermore, the practice has increasingly developed for underwriters to request state or municipal officials to certify as to the accuracy and completeness of statements made in offering materials. Another indication of the concern for improved disclosure is contained in the draft of "Disclosure Guidelines for Offerings of Securities" published in November 1975 by the Municipal Finance Officers Association (MFOA). The purpose of the exposure draft is to establish disclosure guidelines for security offerings by state and local governments. These guidelines are presently being commented on and revisions may be anticipated.

We subscribe to the concept that improved disclosure practices will enable the marketplace to assess in a more meaningful fashion the value and creditworthiness of different issuers and their outstanding obligations. The marketplace has become more sensitive to the differences in creditworthiness of various municipal issuers and is beginning to express this by increasing the divergence in yields, as shown in Exhibit 1, between AAA and BAA rated general obligation bonds of municipalities. The Exhibit also shows the rise in the ratio of yields of tax exempt to taxable securities in 1975. Some have questions whether these differences in interest rates paid by variously rated issuers and the rise in the ratio of tax exempt yields to taxable yields accurately reflect the ability of municipalities to service their debt and have suggested that interest rates might be more in line with the financial capabilities of issuers if there were uniform disclosure standards, leading to better informed judgments in the marketplace.

The various responses to date to the pressures for improved disclosures in municipal securities offerings highlight a number of facts which, we believe, must be considered in any legislation. The first is the great diversity of state and municipal issuers, their variance in size and function, the many types of obligations that may be issued and the enormous number of issuers. Exhibit 2

shows the distribution according to size of the approximately 6,500 general obligation and revenue bonds issued during the 18 month period January 1974 through June 1975. During this period, approximately 84 percent of the general obligation bonds and 65 percent of the revenue bond issues were under $5 million. In the United States at the end of 1974 there were 78,268 state and local government bodies which had an outstanding publicly held indebtedness aggregating $207 billion. In this regard, Congress should consider whether industrial revenue bonds and pollution control bonds issued by governmental entities for the benefit of private enterprises organized for profit should continue to qualify for the municipal securities exemption from the registration requirements of the Securities Act of 1933. According to the "Bond Buyer", industrial revenue and pollution control bonds accounted for approximately $3 billion of the total $29.2 billion of state and local government bonds issued in 1975.

Secondly, there do not currently exist any generally accepted or uniform standards or practices for the disclosure of material information about the issuer of a municipal security. A widely accepted practice in an "Official Statement" for general obligation bonds is to identify the issuer or obligator, the terms and conditions of the bonds, the legal opinion of issuer's counsel, and, possibly, some general information about the issuer. When issuers have responded to recent concerns for more detailed disclosure, the nature and type of data disclosed have varied as has the character of the disclosure. The Municipal Finance Officers Association's guidelines, when issued in definitive form, should be a stimulus to a more uniform approach to disclosure.

Thirdly, uniform accounting practices do not exist. Two accounting auditing standards have been published: one by the National Committee on Governmental Accounting and the other by the American Institute of Certified Public Accountants. While these two standards appear to be quite similar, very few municipalities have had their financial statements audited pursuant to these standards. The difficulty in establishing uniform accounting practices on a voluntary basis for the municipal industry is illustrated by a 1972 study by Robert Merriam, reported in "The Rating Game," which indicated that only 233 out of 1,822 cities belonging to the MFOA had agreed to comply with the set of uniform accounting standards promulgated by the MFOA in 1946. Many States do mandate the accounting or auditing practices to be employed by the various state and municipal agencies within the State. However, there is no assurance of comparability among these various legislatively mandated accounting systems and practices. Furthermore, the principle of independently audited financial statements has not been widely accepted in the municipal area.

Another problem in developing a disclosure program is in the inexperience and lack of expertise of certain municipalities in the disclosure process. The concept of disclosure so widely accepted in the corporate securities market is alien to segments of the municipal market. This condition is a product of different regulatory and economic environments.

II. THE REGULATORY APPROACH OF THE BILL

We endorse the Bill's approach in treating disclosure questions affecting state and municipal issuers separately from those affecting corporate issuers. We are opposed to legislation which would simply repeal the exemption of municipal securities from the Securities Act of 1933 and subject municipal issuers to the same disclosure requirements and legislative pattern applicable to corporate issuers. We believe that the relative safty of municipal issues, the many material distinctions between municipal and corporate issuers, and the significant differences between the problems that led the Congress to adopt the Securities Act of 1933 for corporate issuers and the problems that currently exist in the municipal securities market do not prompt the same response for municipal securities as that which is appropriate for corporate securities. Any legislation, and any rules issued under the legislation, should recognize the substantial differences between municipal issuers and corporate issuers. Certain of the major differences include the following:

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1. State and municipal issuers are governments or agencies of governments and function on a not-for-profit basis. Corporate issuers operate for profit.

2. State and municipal issues finance essential government services. Statutory prohibitions often bar state and local governments from using other sources of funds such as bank loans to finance these services.

3. The state and municipal securities market is enormous in scale and range in comparison to the corporate market. According to the "Bond Buyer," in 1975 state and local governments had 8,107 public offerings of short and long term debt aggregating $58.3 billion. According to our records, in 1975 corporations marketed 844 public offerings of stocks and bonds in an aggregate amount of $46.7 billion.

4. The underwriters of state and municipal securities are to a significant extent a different group of dealers from those engaged in corporate underwriting, and within those firms actively engaged in both corporate and municipal underwritings there is generally little overlap or interchange between the corporate underwriting department and the municipal underwriting department. This is, in part, because of the enormous size of the state and municipal market, the participation of banks in state and municipal underwritings and the substantial number of dealers that specialize in trading municipal bonds. Furthermore, there are many more state and municipal underwritings than corporate underwritings in process at any single time. This limits the resources that underwriters can devote to disclosure in connection with any particular state or municipal offering.

5. Most state and municipal issues are competitively bid. Many states have statutes that require competitive bidding. In corporate finance, negotiated offerings are predominant. This difference is germane to the degree of disclosure that can be elicited because there is far less opportunity in a competitively bid underwriting than in one that is negotiated for underwriters to participate in the preparation of disclosure materials.

6. The state and municipal market encompasses many different types of securities. Some of these securities, such as tax anticipation notes and state agency bonds, are quite dissimilar to corporate debt securities and may require a very different disclosure pattern from the one that has developed under the securities laws for corporate securities.

While we endorse the approach of the Bill in not simply transfering the regulatory scheme of the Securities Act to state and municpal securities, we believe that the new regulatory structure that the Bill would create for state and municipal issuers needs substantial revision. The Bill would create a new Section 13A of the Securities Exchange Act of 1934 ("Exchange Act") which would include the following provisions:

1. Section (a)(1) would require state and municipal issuers with more than $50 million in outstanding securities to prepare annual reports and reports of events of default. The SIA endorses this concept. The annual report is the best means of keeping the market place informed regarding issuers of large amounts of outstanding municipal securities which have stopped issuing securities and therefore no longer publish official statements. Another virtue of the annual report is that it can serve as the basis for disclosure materials issued in connection with offering of securities by the issuer. Although a $50 million minimum sum is an arbitrary figure, it would exclude relatively small issuers which are unlikely to have a substantial secondary market in their securities and which would find the annual report requirement to be a costly burden.

Section (d) would authorize the SEC to change the minimum amount of outstanding securities that would trigger the reporting requirements. The SIA opposes this provision. We believe that a decrease in the minimum amount is too important a decision to be delegated to an administrative agency, in view of the burden that an annual report requirement might impose on small issuers.

2. Under Section (b) a distribution statement would have to be prepared in connection with each issue of state or municipal securities in excess of $5 million, subject to the SEC's power to change this minimum amount pursuant

to Section (d). While the SIA approves of requiring issuers to prepare official statements, we believe it is a mistake to exempt issues of less than a specific amount. This tends to brand exempt issues in the marketplace as an inferior class of securities. The better way to handle the problem of the small issue is to permit the classification of issues by size for purposes of establishing disclosure requirements.

Under Section (b)(1), only issuers that offer or sell securities through a "municipal securities broker, municipal securities dealer or bank acting as agent * * *" would be required to prepare a distribution statement. This would exclude from the distribution statement requirement offerings that were self-underwritten or used some other unorthodox distribution method in which brokers, dealers and banks acting as agent were not involved. The SIA believes it would be a mistake to include such an exemption in the legislation. Investors would have a greater, not a lesser, need for disclosure material prepared in accordance with official guidelines if brokers, dealers and banks acting as agents did not participate in the distribution process. This exemption might encourage the creation of unorthodox distribution techniques in order to avoid the disclosure requirements of the Bill, a development which would not be in the public interest.

3. The Bill requires specific disclosures to be made in both annual reports and distribution statements, pursuant to Sections (a)(2) and (b)(2). We believe it is a mistake under current conditions, when disclosure standards for municipal issuers are in a state of flux, to seek to prescribe legislatively the content of disclosure materials. Rulemaking is a better means than legislation for setting disclosure standards because it allows more room for developing separate forms for different types of issues and issuers and provides greater flexibility to adapt disclosure requirements to changing conditions.

The specific disclosures mandated by the Bill illustrate the disadvantages of prescribing disclosure standards legislatively. For example, the Bill would require the annual report to include descriptions of the issuer's major taxpayers and the nature and extent of the federal or other assistance programs available to the issuers. These requirements, while reasonable in the context of a water district or other specific purpose issuer, would be completely unmanagable for a state like California or a city like New York.

In any case, if legislation is adopted that prescribes the content of annual reports or distribution statements, only items material to the issuer should have to be included.

One item of disclosure that should be specifically required in the legislation is the inclusion of independently audited financial statements. The SIA endorses Section (a)(2)(J) which would require such financial statements in annual reports for fiscal years commencing on or after December 31, 1978. We believe, however, that as an alternative to certification by an independent public accountant a municipal issuer should have the option of complying with a state certification procedure for financial statements. With this modification, we believe that the financial statement requirement should apply to distribution statements as well as annual reports.

3. The SEC would be empowered to require certain information to be included in annual and event of default reports and distribution statements, in addition to the items specifically required by the Bill. The SIA believes that the SEC is not the appropriate body to have this power and opposes this grant of authority. Because state and municipal securities are different in numerous respects from the corporate securities the SEC has experience in regulating, we believe it would be preferable for the disclosure guidelines for state and municipal securities to be set by an organization of issuers which would be more familiar with these securities.

The legislation should instruct the body that sets the disclosure guidelines to prescribe different forms for different types of issues and issuers.

4. Section 2(d) of the Bill would repeal the provision in the Securities Acts Amendments of 1975 that the Commission is not authorized to require an issuer of municipal securities, prior to selling the securities, to file any application, report or document with the Commission. A similar restriction ap-

plicable to the Municipal Securities Rulemaking Board would be left intact. The Report indicated that the filing prohibition had been inserted in the 1975 Amendments in response to "the fear * * * that requirements could be imposed which would have the effect of subjecting the information disclosed by issuers in connection with an offering to prior review or approval, thus resulting in a de facto registration requirement for municipal bonds." The repeal of this prohibition would in effect authorize the SEC to institute such a "de facto registration requirement."

The Report stated that "no case has been made for the pre-filing review, either directly or indirectly, of such sales documents * * *" The SIA believes that this statement remains true today. Based on our experience as underwriters of corporate and municipal securities, we believe that pre-filing and staff review would add material costs and delays to the process of state and municipal financing, while not offering comparably significant benefits in terms of improved disclosure. It would also raise delicate questions of federal-state relations and might overburden the staff of the SEC, thereby increasing the time required to obtain staff review of offering materials of both corporate and state and municipal issuers. The number of state and municipal issues in 1975, it should be remembered, was 8,107 compared to 844 corporate issues.

We are concerned that additional authority to institute a pre-filing requirement would be given to the SEC by the provision in Section (b)(1) of the new Section 13A of the Exchange Act that distribution statements shall be prepared "in accordance with such rules and regulations as the Commission the protection of investors." As we have stated before, we oppose giving the Commission powers to regulate the form and content of distribution statemay prescribe as being necessary or appropriate in the public interest or for ments and the process for making such statements available to prospective purchasers.

5. Section 2(c) includes several exemptions from the distribution statement requirements, which in concept are desirable. A distribution statement would not have to be prepared for an issue "the disclosure with respect to which has been approved, after hearing, as adequate for the protection of investors by a State governmental authority (other than the issuer) expressly authorized by law to grant such approval * * *." While the SIA endorses the idea of allowing disclosure to be regulated at the state rather than the federal level, we think that this goal can best be accomplished by having the states administer uniform guidelines set by an organization of issuers and permitting underwriter and dealer reliance on this system, as provided in item 6 below. Furthermore, the reference in the Bill to a "hearing" on the adequacy of the protection for investors implies a proceeding too elaborate to be a workable alternative to compliance with the federal regulations. The exemption should be available if the issuer complies with a state procedure for staff review of disclosure materials.

There are also exemptions based on Sections 3(a)(9) (securities exchanged with existing securities holders), 3(a)(10) (securities issued in reorganizations approved by court or governmental authority) and 4(2) (private placements) of the Securities Act of 1933—all of which are desirable. In addition, any legislation should include an exemption for intra-state offerings, comparable to the exemption contained in Section 3(a)(11) of the Securities Act.

6. The Bill would limit the liability for damages of any underwriter of municipal securities to the total price at which it sold securities to the public. Section 2(g). The SIA believes this is a desirable clarification of the law, but that further limitations are needed: the Bill should limit an underwriter's liability to that amount it directly sells to the public; the ceiling should apply to actions for rescission as well as suits for damages; it should protect not only "underwriters" (a Securities Act term which is not defined in the Exchange Act) but any broker, dealer or bank that participates in the distribution process; and there should be a provision similar to the one in the Securities Act limiting the amount recoverable from such participants to the price at which the security was offered to the public. Furthermore, the SIA recommends enactment of a provision that underwriters and dealers shall not be liable for misstatements or omissions in offering materials for municipal se-

curities if they rely in good faith on a state certification that these disclosure materials appear to comply with the requirements of applicable law. One of the most encouraging developments in the field of municipal finance has been a movement by states to assume responsibility for disclosure by their municipal issuers. For example, the Local Government Commission of the State of North Carolina has announced that it is considering requiring municipal officials to certify as to the adequacy and accuracy of their disclosure documents and the Commission would certify that the information in these documents has been confirmed through other data available to the Commission. The provision we have recommended would give underwriters an incentive to encourage states to develop such procedures. Finally, there should be an express recognition of contribution rights, as well as an acknowledgement of the ability of municipal issuers to indemnify underwriters and others. We have further set forth below our views on the responsibilities of underwriters of municipal issues.

7. Section (f)(2) gives the SEC authority to make regulations regarding the delivery of distribution statements to prospective purchasers, while Section (c)(2) incorporates the Securities Act exemptions (Sections 4(1), 4(3) and 4(4)) from the prospectus delivery requirements. The SIA endorses the concept of requiring issuers to provide distribution statements to brokers, dealers and banks acting as agent and the idea of setting legislative limits on the duty of persons other than the issuer to deliver distribution statements to prospective purchasers. The patterns established under the Securities Act for corporate underwritings, however, may not be an appropriate model to follow in state and municipal offerings. Further thought should be given to the distribution statement delivery requirements that would make sense in the context of established patterns of state and municipal government financing, and legislative exemptions should be adopted that reflect this pattern. If the legislation leaves room for administrative rulemaking in this area, we believe the responsibility should be given to the Municipal Securities Rulemaking Board, rather than the SEC, since this is an activity that primarily involves brokers, dealers and bankers which are under the Board's jurisdiction.

IV. STANDARDS OF RESPONSIBILITY

We believe that any legislation should embody, or provide for the development of, specific standards for state and municipal issuers. At present, Rule 10b–5, the general anti-fraud rule issued under the Securities Exchange Act of 1934, is the source of legal accountability. State and municipal governments appear to be subject to Rule 10b–5, although constitutional questions have been raised concerning the extent of which a state is subject to suit for violation of the federal securities laws. More importantly, since it is so-called "implied" rights of action that have been created under Rule 10b–5, many basic issues remain unanswered. These include the type of conduct that will result in a liability under the Rule (whether the conduct must be wilful or simply negligent); the ability of an underwriter to rely on experts, such as accountants or governmental officials; and the extent of an issuer's or underwriter's liability for damages (whether for out-of-pocket damages or the benefit of the bargain). At this time, the nature of a person's responsibilities is uncertain and depends essentially upon the views of the particular United States Court of Appeals in which his conduct is adjudicated. This kind of uncertainty is undesirable and the Bill represents an appropriate opportunity to remedy it.

We subscribe to certain basic principles, many of which Congress has already articulated in the federal securities laws. First, state and municipal issuers should have a degree of liability which reflects the critical factors that it is the state or municipality which receives the proceeds of the offering, and that it is the state or municipality which knows the facts about itself. The officials of the state and municipal governments are the ones who are aware of both the strengths and weaknesses of their governmental units. Their knowledge of the situation is primary and fundamental and not derivative like other participants in the process. Under these circumstances, the

state or municipal issuer should have a primary and major accountability for the disclosure material.

We support the Bill's implied recognition that it is inappropriate to import from the Securities Act the concept of an underwriters' obligation to conduct a "due diligence" investigation. While the underwriters' investigation has played a key role in the disclosure system that has been developed for corporate offerings, we believe it is inappropriate in state and municipal finance where the institutional setting is different and where the Congress may be less willing than in the corporate area to run the risk of discouraging small-to-medium issues through the high costs of disclosure. There should be no mistaking the fact that, if such a responsibility were imposed on underwriters of state and municipal securities, the cost of raising funds for state and local governments would increase substantially.

The underwriter's role is further limited by the dominant part that competitive bidding plays in municipal finance. The laws of many states require that general obligation and revenue bonds be sold through competitive bidding. In states where negotiated sales are permitted, negotiated sales are used irpmarily for revenue-type bond issues, as well as by issuers that are infrequent visitors to the market or are relatively small borrowers.

During 1975, there were 8,107 public offerings of state and local securities, virtually all of which were by sale to underwriting syndicates. Approximately 21% of these offerings were in negotiated underwritings while some 79% were competitively bid. We estimate that the comparable figures in the corporate field were 13% competitively bid and 87 percent negotiated. Consequently, we estimate that in 1975 there were 6,404 competitivly bid municipal offerings as compared to 110 competitively bid corporate offerings.

In a competitive bidding situation the practice has been for the offering documents to be prepared exclusively by the municipal issuer and submitted to the bidding groups. The number of bidding groups will vary with the size of the issue and frequently there are six or more bids for an offering. Moreover underwriters may at any time be a part of several different groups that are bidding on different issues. It has not been the practice for underwriters in competitive bidding situations in the municipal area to participate in the preparation of the offering circular. At the same time, it should be recognized that the underwriters have been involved over several years in repeated financings for the issuer and, in general, are informed as to financial and political developments affecting the municipality. For a variety of reasons, including the typical quality and safety of the security involved, the large number of issues on which an underwriter is bidding, the fact that the bidder does not know whether it will be successful, the general time pressures involved and simple historical tradition, underwriters in competitive bidding situations have believed that their opportunities for inquiry were limited and that they were entitled to rely on documents prepared by responsible public officials. Where these documents on their face did not appear to adquately reflect possible problems known to the underwriters, the underwriters would either not bid or request the issuer to make appropriate revisions in its material.

The obligations of an underwriter in a competitive bidding are unclear under present law. Counsel has advised that there is no authority on the subject. At the same it is possible that the courts may impose, under both Section 11 of the Securities Act of 1933 and Rule 10b–5 of the Securities Exchange Act of 1934, a standard of conduct on underwriters that takes into account the competitive bidding context. Thus, the reasonableness of the underwriter's conduct would be measured by such factors as its analysis of the offering documents, its past familiarity with the municipality, its lack of opportunity for inquiry and the relative safety of the security being offered. Moreover, the fact that it is a municipal security and not a corporate security is highly relevant. Unlike corporate officers that are employed by profit-making organizations and who may have a self interest in promoting their securities, public officials do not appear to have the same incentive. Underwriters and others, thus, should be entitled to rely on the statements of public officials. Congress has already recognized, in Section 11(b)(3)(D) of the Securities Act of 1933, the principle that statements made by an official person or pur-

porting to be an extract from a public official document may be relied on in the same manner as information furnished by an expert, such as an accountant. We think that this acknowledgment of an ability to rely on the integrity and credibility of public officials is particularly appropriate in the circumstances of competitive bidding for municipal securities.

Finally, we believe that any legislation should expressly set forth the measure and scope of damages. We have indicated in our analysis of the Bill the type of provisions that should be included in the legislation.

V. REGULATORY STRUCTURE

The regulatory framework in respect of administration, rulemaking and enforcement under a disclosure statute for municipal issuers raises, in our judgment, most difficult and sensitive questions of federal-state relations. These considerations underlay in part our previously articulated opposition to any requirement that municipalities pre-file their offering materials for review and "clearance" by the Commission. We do not have a fixed vision as to an appropriate structure. However, we do oppose the provisions of the Bill vesting the regulatory authority in the Securities and Exchange Commission.

We believe that the disclosure rules and guidelines should be established initially, and subsequently interpreted, by a representative group of municipal issuers. These are the people most familiar with the problems of municipal finance and sensitive to its uniqueness and nuances; these are the people who must abide by the rules promulgated; and these are the representatives of the taxpayers who have a direct interest in the raising of capital and the cost of capital. We observe that the Commission would, in any case, be involved in the municipal issuer disclosure process since it would continue to have its authority to promulgate and enforce rules in respect of municipal securities dealers and rules under the anti-fraud provisions of the Federal Securities laws. Moreover, the Commission may be able to proceed against issuers who violate the anti-fraud provisions.

One possibility would be to add a group of issuer representatives to the Municipal Securities Rulemaking Board, giving the issuer representatives responsibility for developing disclosure guidelines for state and municipal securities. These guidelines could be subject to review by the SEC in accordance with the existing legislative framework of the Rulemaking Board.

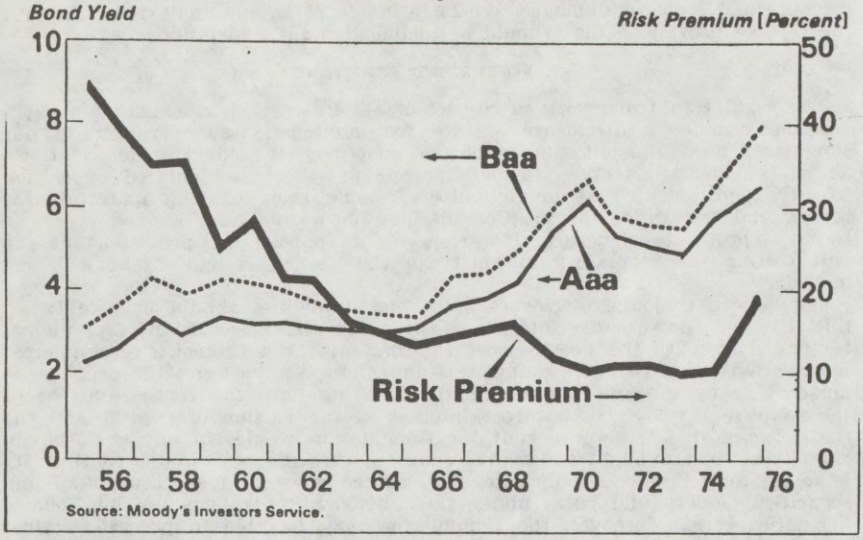
We also believe that any regulatory structure should seek to effect a system of uniform regulation throughout the 50 states. The municipal securities market is a national market. It would be highly undesirable if different standards applied to the marketing of a single issue.

Finally, we believe that every effort should be made to keep the costs of the regulatory structure to the necessary minimum. All additional costs will be passed on to the municipal issuers and render more expensive their raising of funds. Ultimately, these greater costs will be passed on to our citizens in terms of greater taxes. As we stated at the outset, the Securities Industry Association recognizes the benefits of legislation respecting municipal issuer disclosure. We also believe that this is not a situation where there is an immediate call to action, but an environment in which minimum disclosure standards may improve investor confidence and the ability of municipalities to market their securities at appropriate rates. Although there have been certain unfortunate developments in the municipal area, these cannot be blamed on the absence of disclosure laws alone. It should be clearly understood that a disclosure statute will not provide market access to financially unstable state or local governments. Moreover, the municipal securities markets have, in general, worked well to raise substantial sums for state and local governments at reasonable costs. This is clearly evidenced by the record level of financing that occurred in 1975. Thus, we must proceed cautiously so that costs and benefits are in balance.

In conclusion, the Public Finance Council of the Securities Industry Association expresses its support for legislation that would produce improved and more uniform disclosure for municipal securities offerings. We offer our support in the context of the principles that we have outlined. We stand ready for further discussion to help achieve a satisfactory resolution.

EXHIBIT 1

NEW ISSUE MARKET YIELDS ON Aaa AND Baa RATED GENERAL OBLIGATION BONDS
(Annual Averages in Percent)



Source: Moody's Investors Service.

TAX EXEMPT/TAXABLE YIELD RATIO

	Short-term	Intermediate				Long			
		Aaa	Aa	A	Baa	Aaa	Aa	A	Baa
1974:									
September	50.7	.....	57.6	61.0	50.0	64.6	63.4	61.8	.....
October	51.6	55.1	54.9	54.0	55.3	66.0	66.0	66.6	.....
November	50.3	59.4	58.4	55.5	54.4	71.1	70.4	68.0	.....
December	49.4	.....	66.0	58.1	.....	69.9	72.4	74.3	.....
1975:									
January	52.7	59.7	64.0	62.8	51.5	74.1	76.4	73.5	.....
February	53.3	58.0	62.0	59.9	50.8	69.6	70.9	69.9	.....
March	53.0	62.8	66.5	64.7	57.5	72.1	68.2	70.3	.....
April	56.9	61.3	65.4	64.0	57.7	70.8	72.0	68.5	67.5
May	54.3	.....	65.4	62.9	53.7	71.9	69.4	73.1	69.3
June	51.3	58.8	67.4	65.1	58.0	71.4	75.2	76.0	.....
July	53.3	59.5	65.8	62.1	57.8	72.5	70.4	77.9	65.7
August	54.9	.....	66.2	59.2	56.4	.....	71.8	73.5	.....
September	52.7	63.9	64.0	60.1	.....	69.2	72.0	75.9	.....
October	52.7	58.0	58.9	62.9	54.0	72.9	75.9	80.9	.....
November	51.0	62.1	.....	65.2	48.0	70.8	72.4	78.0	71.5
December	50.9	57.3	.....	65.8	55.1	69.5	75.8	78.4	67.6

Sources: Short-term: Federal Reserve bulletin, Bank of America quote sheet; intermediate: Daily Bond Buyer. Rand and Co., "Yields on Municipal Issues"; Long-term: Moody's Bond Survey.

EXHIBIT 2

SIZE DISTRIBUTION OF MUNICIPAL BOND ISSUES

[January 1974–June 1975]

Size of issue	Number of general obligation bonds	Dollar amount (millions)	Number of revenue bonds	Dollar amount (millions)
Less than $500,000	1,497	321.0	186	48.2
$500,000 to $1,000,000	787	547.7	182	134.5
$1,000,000 to $2,500,000	1,066	1,680.0	430	636.8
$2,500,000 to $5,000,000	648	2,227.9	327	1,159.7
$5,000,000 to $10,000,000	380	2,544.5	232	1,605.2
$10,000,000 to $25,000,000	184	2,736.8	216	3,304.9
$25,000,000 to $50,000,000	82	2,781.1	103	3,385.2
In excess of $50,000,000	97	9,951.2	57	5,299.7
Total	4,741	22,790.2	1,733	15,574.2

Source: SIA municipal data file.

Senator WILLIAMS. The conclusion in the last paragraph describes this legislation and then indicates that this is what the Public Finance Council supports. That is the way I read your statement.

Mr. SELLERS. Senator Williams, I think we have basically two problems with the bill as drafted. First, we think that State and local governments should have a greater voice in setting guidelines for their own issuers and that can be accomplished in any number of ways.

I think our second problem is that we do not believe that the bill addresses fully the question of underwriters' liability. I think the problem in the marketplace is not just investors losing confidence because of inadequate disclosure, but of underwriters losing confidence because of too much liability.

Senator WILLIAMS. Put aside for a moment the very complex liability questions, and deal with the guts of something new in the marketplace for municipals. That is a requirement for the disclosure of those essential elements for intelligent decisions by the underwriter and by the investor, and we do this mindful of the fact that there is not anything in existence now uniform throughout the country. There are spotty examples of very worthy requirements of disclosure at the State level. Everybody has mentioned North Carolina and evidently that State is the model that everybody applauds. Even they are in evolution and are about to impose additional requirements on the issuer. They are considering saying to the municipal officials or to their commission, rather, that the commission certify what comes to them from the local units government. Is that right?

Mr. SELLERS. That's right, and in effect they are saying they have performed due diligence. We think if they say it that there should not be an additional requirement for us to perform it.

Senator WILLIAMS. In other words, certification by local issuers and confirmation by the commission should put the burdens and responsibilities on them and remove the burdens and responsibilities as well as liabilities for underwriters.

Mr. SELLERS. That's right. Now, again, I would certainly agree that the audited financial statement is perhaps the single most important provision and that alone should solve a lot of problems. Now we would have one modification there. We suggest that they could either be done by an independent public accountant or an independent State auditing official to give somewhat more flexibility to the State and local governments.

Senator WILLIAMS. What do you think of the itemized requirements included in our bill, the bill that I have introduced with Senator Tower? Are all of those essentials?

Mr. SELLERS. I think a lot of them—certainly, they are all important. There might be a problem. I think one of the provisions is a list of the major taxpayers and, as we mentioned in our statement, this might turn out to be a very large document in the case of something like New York City or the State of California. I think there should be some flexibility in interpreting the requirements.

Senator WILLIAMS. This, of course, is not for distribution to the potential investor. This is the annual report.

Mr. SELLERS. Yes, I understand. This is not the distribution statement, but I think even this could be quite difficult for a large government body to comply with.

Senator WILLIAMS. I suppose that could be amplified if it were to be meaningful in the description of major taxpayers who are in arrears and a few other things. I was thinking of that which is the action document that is for distribution . . . the distribution statement. How about the elements there?

Mr. SELLERS. Yes, sir. I think that the bill certainly covers a lot of them. The disclosure for municipalities is a pretty complicated problem. Recently a number of us have listened to some of the public accounting firms discuss this and there is variation in the way that different municipalities present their financial statements, and I think that probably they need to have flexibility and help from the AICPA and other experts on government accounting in order to present fairly the statements of different types of municipalities.

Senator WILLIAMS. I think we better clarify your position on the most effective and the most desirable route from your standpoint of how we are going to have this beneficial effect on this particular marketplace, whether it is through national standards as we have done it here, or through a self-regulatory body.

Mr. SELLERS. No, sir. We think there should be a Federal statute creating uniform disclosure standards. We would like to see those standards drafted by State and local governments rather than either being embodied in the legislation or done by the SEC.

Senator WILLIAMS. I missed that.

Mr. SELLERS. We would like to see those disclosure standards drafted by State and local governments rather than by the SEC or in the legislation.

Senator WILLIAMS. Now I am confused. First of all, all of the ele-

ments that you think are of critical importance are in the bill. Is that right?

Mr. SELLERS. Yes, sir.

Senator WILLIAMS. Now what are you talking about—somebody else drafting what?

Mr. SELLERS. I think the disclosure guidelines should be drawn up in some fashion by a group of State and local governments.

Senator WILLIAMS. You mean the guidelines that would further define the elements that we describe in the bill?

Mr. SELLERS. Yes, sir.

Senator WILLIAMS. I see, you mean instead of the more specificity that would follow these broad guidelines as required by SEC rules and interpretations. Is that what you are saying?

Mr. SELLERS. Well, no. I'm suggesting that the State and local governments in some fashion—and there are any number of ways this could be done—but that they be the primary source for the disclosure guidelines.

Senator WILLIAMS. Well, what further do you need when you say a statement of counsel's opinion as to the legality of the issuance of the securities to be offered? Does that have to be refined in another way or supplemented by some other entity making a guideline in that area? That's one of the specifics. It is not clear to me why we have to create another entity to interpret a bill which really codifies what the municipal finance officers are circulating as a model. The Municipal Finance Officers' Association guidelines have been taken and incorporated into this legislation.

Mr. FLEISCHER. Mr. Chairman, may I respond to that?

Senator WILLIAMS. Yes.

Mr. FLEISCHER. I think the concept here is that there should be flexibility in rule making just as the Securities and Exchange Commission—the forms for disclosure have developed over the years and the statute contained only minimum direction. We believe that the same concept should apply here so that a rulemaking board, if you will, of State and municipal issuers would have the authority to prescribe different disclosure standards. These standards might be tailored to the size of the issue, the nature of the issuers, and also as experience develops would change over the years. So essentially, what we are talking about here is to provide the needed flexibility as experience changes and depending on the nature of the issuers this rulemaking authority would be the basic authority to operate here. So that these various items that you have set forth in your legislation, a number of them will and some of them would not probably or possibly be in any disclosure form that was put out by the rulemaking authority.

Mr. TAYLOR. I think, as a member of the banking business right now, we are going through a situation with the SEC where the disclosure standards are changing day by day and disclosure can tend to be a very living, vibrant thing.

Senator WILLIAMS. Where would you strike, and how much would you strike, from this bill and what would you put in its place?

Mr. SELLERS. I think it's hard to do that here.

Senator WILLIAMS. I would say that you would start on page 2, and strike from line 10 through the rest of the bill—the municipal securities disclosure provisions.

Mr. SELLERS. I don't understand that. As I said, we support the Federal statute creating uniform disclosure standards. We support the certified independent audit. We support annual audits of issuers over $50 million. We support a distribution statement. We even go further than the bill and suggest that an annual audit be available for all issuers

So I think that our feelings about disclosure in itself are strong and perhaps even stronger than the bill. The structure or the formulation of the disclosure guidelines is I think where we have some problems with it; and our other problem, as I said, we do not think the bill truly addresses the liability problem.

Senator WILLIAMS. That we put aside for a moment. Now we have to amend and add for that. You are accepting all that is here, you still are not satisfied with what follows evidently. I just don't see what you want added to this that you evidently agree with.

Mr. SELLERS. Well, to point out on page 2, after the first paragraph, the last sentence, "in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or the protection of investors." We think State and local government issuers would be a better group to come up with the rules and regulations.

Senator WILLIAMS. What are you reading? Page 2 of which document?

Mr. FLEISCHER. This is page 2 of S. 2969, Senator.

Mr. SELLERS. It's section 13A.

Mr. FLEISCHER. It's somewhat difficult to draft here, but the basic concept, as Mr. Sellers said, we are simply talking about who the rulemaking authority is. This bill speaks in terms of such rules and regulations as the Commission may prescribe. The concept here is that the rulemaking authority would be a designed rule of State and municipal issuers.

Senator WILLIAMS. This is where you would change our structure and take this rule and regulation-writing authority from the Commission and give it to the states? Is that it?

Mr. SELLERS. Yes, sir, or to state and local government issuers. I think there are any number of ways it could be done and I think there are various ways that perhaps would be in between the position in the bill and our written statement.

Senator WILLIAMS. What confidence do you have that this would be done by the states? That authority is certainly there. They don't need us to tell them they have the authority. They have it.

Mr. SELLERS. Well, I would think there should be Federal legislation requiring the establishment of a uniform disclosure standard. We're not opposed to Federal legislation. We are simply saying that the disclosure standards would be more appropriate written by the State and local governments than by the SEC.

Senator WILLIAMS. And then come back here and we would put it into Federal statute?

Mr. SELLERS. Not necessarily. I think you could draft it so that it would apply the way they were drawn up. I see no reason to come back.

Senator WILLIAMS. Would you give them a date by which they must accomplish this?

Mr. SELLERS. Yes, sir. That would be one way of doing it. Setting up some type of advisory committee for the SEC would be another way of doing it. Expanding the Rulemaking Board is another way of doing it.

Senator WILLIAMS. We have a State exemption here. If the States have the substance of what is included in the requirements of this bill, they are out from under the operations of the proposed Federal law.

Mr. SELLERS. Yes, sir. We think that is a very, very desirable and very innovative addition.

Senator WILLIAMS. Isn't that exactly what you are talking about?

Mr. SELLERS. Yes, sir.

Senator WILLIAMS. Then wouldn't this bill accomplish the result, you are proposing with the State exemption?

Mr. SELLERS. Well, again, not quite, because I don't believe the State exemption applies to the annual report, does it?

Senator WILLIAMS. That's the one area, the first requirement of the annual report. But on the other—and again, the more pertinent and fixed responsibility of the distribution statement for any issue, it does apply.

Mr. SELLERS. Yes, sir. As I said, I think that is a tremendous addition.

Senator WILLIAMS. There's one thing that does disturb me personally and I have a feeling that we might have to review the threshold figures. You're concerned about that, aren't you?

Mr. SELLERS. Yes, sir. We believe that there may be some invidious distinctions between a $4.5 million issue and a $5 million issue.

Mr. HOROWITZ. I think also, Senator, that the type of issue that is sold makes a difference, too. Some of them are revenue bonds, general obligation and tax bonds, and so on, and the protection granted, if the fellow sells $4.5 million of a way-out bond as opposed to $6 million of a normal, ordinary bond would not be very good because the $6 million was something which somebody could probably look at pretty easily and the $4.5 million, where the reporting requirements would not be the same, could be a most complicated issue.

Senator WILLIAMS. What is the nature of the issues that would be disturbing to you?

Mr. HOROWITZ. I don't want to say any issue would be disturbing. What I want to say is there are different types of issue in the municipal issues. We're not dealing with the corporate market where basically any issue is related to the corporate balance sheet and corporate figures. You have bonds which are payable from special assessment, from special revenues, as well as bonds that are payable from ad valorem taxes. So there could be various types of issue. You have pollution bonds and different types of bonds completely. So that the question could come up, not because of what I'm saying, not because of the size, but I'm saying a $10 million or a $6 million general obligation issue might be a lot easier to look at than a $4 million special assessment on properties in the District.

Mr. SELLERS. What we would like to see is some ability to classify different issues and different disclosure guidelines based on that rather than a fixed dollar amount.

Senator WILLIAMS. Who has the present competence to do that?

Mr. SELLERS. At the moment, I'm not sure that anybody has. I suspect that some of the public accounting firms or the Municipal Finance Officers Association might come closer to that type of competence than anybody else. At the moment, I don't think anybody has thought about it.

Mr. HOROWITZ. I think there's some competence in the industry and some competence in the rating services, too.

Mr. SELLERS. Yes. The industry could certainly offer some suggestions. The Municipal Securities Rulemaking Board is another source of help on it.

Senator WILLIAMS. You overlooked any Federal area of responsibility.

Mr. SELLERS. Carefully.

Senator WILLIAMS. We granted authority and responsibility in the 1975 Act Amendments to the Commission and the Board of Governors of the Federal Reserve System to classify. Don't you think that they might have the competence over there to deal with this?

Mr. SELLERS. I think there are any number of bodies, if they don't have the competence now, could certainly develop it within a reasonable period of time. It's a problem no one has addressed.

Mr. HOROWITZ. I don't think we're excluding anybody, Senator.

Senator WILLIAMS. Now you are broadly representative of the industry, speaking for the SIA and its specialized committee dealing in municipal finance; is that right? All of you come from the——

Mr. SELLERS. I think it's certainly fair to say that there are some members of the Securities Industry Association that don't think any legislation is necessary, but I think we are certainly speaking for the majority of the members of the industry.

Senator WILLIAMS. When I said the industry, I didn't mean to include the banks.

Mr. SELLERS. Mr. Taylor is a bank representative and the Council is about one-third bank.

Senator WILLIAMS. There isn't a consensus in your group of bankers on this, I don't believe.

Mr. TAYLOR. I really don't find the DBA statement and our statement to be in conflict. I think ours goes somewhat further by actually suggesting a regulatory structure or a disclosure structure. But obviously, there will be disagreement in all circles at times, but I don't think you have identified a rift or anything.

Senator WILLIAMS. You don't deal with the other bill before us in any detail. We have two bills.

Mr. SELLERS. No, sir. We simply do not feel that that is at all necessary.

Senator WILLIAMS. If you have any further ideas of who should be included and what amounts and how to classify, if it could be approached in broad terms in the legislation, I would really appreciate it. Otherwise, thank you very much.

[Whereupon, at 12:05 p.m., the hearing was recessed to convene the following day, Thursday, February 26 at 10 a.m.]

MUNICIPAL SECURITIES FULL DISCLOSURE ACT OF 1976

THURSDAY, FEBRUARY 26, 1976

U. S. SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to call, in room 5302, Dirksen Senate Office Building, Senator Harrison A. Williams, Jr., chairman of the subcommittee, presiding.

Senator WILLIAMS. We will come to order. The Securities Subcommittee will return to consideration of the two bills that are before us dealing with municipal securities full disclosure.

First this morning we have the Honorable Richard Carver, Mayor of Peoria, Illinois, for the National League of Cities and the U.S. Conference of Mayors; and the Honorable Jim Flaherty, Chairman of the Allegheny County Board of Commissioners for the National Association of Counties.

STATEMENT OF RICHARD CARVER, MAYOR, PEORIA, ILL., REPRESENTING THE NATIONAL LEAGUE OF CITIES AND THE U.S. CONFERENCE OF MAYORS

Mr. CARVER. Mr. Chairman, I'm Richard Carver, the mayor of Peoria, Ill. I've got a written statement that I will not attempt to read in its entirety this morning, but I will request that it be made a part of the record in this particular hearing.

Mr. CARVER. What I will try to do is try to emphasize some of what we personally believe to be the very important points relative to this matter.

As the chairman of the National League of Cities Committee on Effective Government, we have a policy committee that has jurisdiction over this particular issue. Our committee has not dealt with it but it's still my opinion and the opinion of those that I have talked to and I believe the opinion of the National League of Cities and the U.S. Conference of Mayors that we are opposed to this kind of control or suggestion of control over the municipal securities that are issued by local units of government in this nation.

We believe that the history of the issuance of municipal securities over the past 43 years supports this particular position. We feel that the record of this type of security, the record of its safety, the record that we have been able to generate the type of capital

that's been needed by State and local units of government and further the record of losses that have been actually had by those who have invested in this type of security demonstrates that we have in fact had an excellent type of program existent to date.

I think it's important to make added note, because it's my belief and I think the belief of many, that this particular type of legislation has been brought forward because of the situation concerning New York. We do think that was a unique type of circumstance.

The National League of Cities Board of Directors did establish a policy statement concerning assistance to the city of New York. I'd like to read that just for a moment to illustrate the type of position that we have taken in matters of this sort and I think underscore the fact that we believe as cities that this was a fairly unique type of circumstance.

The policy statement read that the Congress and the administration should be prepared to assist a municipality to obtain either credit during a financial emergency only if it is apparent that the municipality and State government have exhausted all constitutional, legal and fiscal remedies available under their respective authorities. Assistance measures which may be appropriate in a financial emergency should not be made a permanent feature of Federal policy with regard to municipal bond financing.

I personally believe that the National League of Cities Board at that time were trying to emphasize that they did not want a Federal involvement in the tax exempt municipal bond market and I personally believe that they were stating that they felt that it was inappropriate both in terms of the record as well as the future costs in this particular market. There are 39,000 local units of government that could be adversely affected by the type of legislation that would add to their bond selling additional cost that in my opinion would not be necessary.

There simply have not been recurrent abuses int his particular area, Mr. Chairman, as you yourself pointed out, and we would like to state that New York City has been not typical and it has been very unusual. We believe that municipal bonds as a class are an extremely safe investment and we believe as you have stated that the Penn Central and W. T. Grant bankruptcies seldom occur in the public sector. We think that State and local governments provide an ultimate safety for the securities through the exercise of the general tax authorities and we also believe that the normal political processes associated with the issuance of State and local government debt ensure close public scrutiny through hearings, elections and referendums.

We also would like to make note of the fact that there already exists antifraud provisions in the Securities Act and that certainly if misrepresentations have taken place that this already provides a mechanism that will take care of those kind of abuses. It's my belief that the cost of this type of regulation at a time when the fiscal problems of the cities are at their greatest, added cost of selling municipal bonds would be a very unfortunate occurrence. Many people in the fall of last year believed that the security market, the

municipal security market, would be very adversely affected by the New York City crisis and yet at that particular time the bond index stood at 27.67 and today it's gone down 72 basis points to 6.95, and I might add that the city of Peoria just recently had a sale of municipal securities below 6 percent which is not unusual in our State. So we obviously do not agree that the impact of the problem of New York City have in fact upset the market to the extent that cities like ours and I would like to sugest the vast majority of the cities in the United States have found themselves unable to sell at what we would classify bonds at a reasonable rate.

I think it's important to point out that from 1935 to 1974 approximately $5 million of municipal debt has gone in default. This represents 42 percent of the outstanding municipal debt at the end of 1974. This figure is even further reduced when we take a look at it in terms of what has actually been lost by the investor, which amounts to approximately $10 million, 1/1,000 of the outstanding municipal debt at the end of 1965.

We don't choose to pay higher interest rates, Mr. Chairman, and we are vitally concerned about the individuals who purchase the securities that we have to sell and we do think that there are needs for having more uniform methods of reporting and I'm sure it will be suggested this morning that there are mechanisms available for such to take place.

In Illinois we are in the process right now of developing uniform accounting procedures for all of the units of local government. I happen to be a member of the State of Illinois Comptroller's Committee on municipal audit, and I can personally tell you that those of us in local government and those in State government not only recognize that where a problem exists something ought to be done, but are taking affirmative actions to see that it occurs and I'd like to personally believe that we should be given that opportunity prior to any Federal intrusion in this area, and I would like to personally believe that the Federal relationship should allow and also should mandate that such should occur. It's my personal feeling——

Senator WILLIAMS. Say that again, please.

Mr. CARVER. I happen to think, Mr. Chairman, that the cities and States ought to be given the opportunity to solve this particular problem on their own and I happen to personally believe that the Federal relationship, the concept of the relationship that I personally believe in in terms of the Federal Government with the States and the cities, should allow this opportunity, and I happen to personally believe in Illinois we are proving that such is the case.

Senator WILLIAMS. I thought you used the word "mandate" in there.

Mr. CARVER. No sir; I did not, and if I did I will withdraw the statement.

Senator WILLIAMS. Did anybody else hear that?

Mr. CARVER. If I did, Mr. Chairman, I was only using it for emphasis in terms of suggesting that this opportunity for solving the problem at the local level ought to be allowed to occur, and I think all of us recognize that there are some difficulties that have

occurred but that they are quite few, quite small, and the impact has been almost miniscule and rather than go much further with this I think I'd like to close by stating that if given the opportunity I'm sure the State of Illinois and the city of Peoria, and for that matter all the cities of this Nation, will be moving ahead with their own programs in the area of standard accounting and that the type of market that has existed for municipal bonds is dramatically different than that that's always existed for private securities. The mere fact that we need bond opinion by bond counsel in itself is unique and the type of requirements there are those that have been freely and not mandated by law, but simply mandated by practice, recognizing that there is a need in this particular area, and I would suggest that in the other aspects of the sale of municipal bonds that will occur as well.

Thank you very much.

Senator WILLIAMS. Thank you very much, Mayor. I think we will turn to Mr. Flaherty, but first let me just understand your representative position here. I have you listed for the National League of Cities and the U.S. Conference of Mayors. It is helpful to us to know how an association like the league or the U.S. Conference comes to any position. Now we read in the paper, of course, of other mayors, and there are mayors that recognize that the crisis has highlighted the need for this approach to a new basic understanding by investors of what they are investing in and that is municipals.

When was the last meeting on this of the U.S. conference or the League of Cities?

Mr. CARVER. Well, Mr. Chairman, in my opening comments I pointed out that the policy committee of the National League of Cities, which I chair, has not met on this particular issue. So, as a result, to try to tell you that anything more than an attempt to evaluate the other positions of the League has taken together with discussions with the significant number of mayors has taken place. In fact it has not. I'm also an advisory board member of the U.S. Conference of Mayors and in that capaicty we have discussed certainly issues that revolve around the problems of New York City, the problem New York City had in the sale of its bonds and municipal securities, the problem that New York City may have had that would impact on the sale of municipal securities in other cities and communities throughout this country and in those discussions the very reason why I read the policy statement was to emphasize the fact that the cities of this country have in fact adopted a policy that they do not want intrusion into the municipal bond market.

Senator WILLIAMS. When was this now? Are you talking about the League or the Conference right now?

Mr. CARVER. I'm sorry, Mr. Chairman. What was it?

Senator WILLIAMS. First, you said the league had not met on this issue and the U.S. conference had informally discussed this.

Mr. CARVER. Mr. Chairman, don't misunderstand me. I'm talking about the particular bill that's under discussion this morning, and I'm talking about that issue in a more specific sense. In the general sense, in Houston, the National League of Cities adopted a policy

that states the Federal Government should not submit the local government authority in its bond issuance procedures to the jurisdiction of the private security regulatory bodies, and that was adopted in Houston by the National League of Cities in its total convention.

Senator WILLIAMS. What page?

Mr. CARVER. In its stated policy. It's on page 5, Mr. Chairman.

Senator WILLIAMS. What does that mean, "should not submit?" The Federal Government should not submit the local government authority in its bond issuance procedures to the jurisdiction of the private security regulatory bodies, what does that mean?

Mr. CARVER. I think more specifically, it's talking about the SEC, and if you will note in the sentence just in advance of that, it states that our position on the Tower amendment in the National League of Cities is it's strongly opposed to the regulation of State and local government issues by the SEC and then it goes on to embellish that by relating the policy statement that has been adopted by the National League of Cities in its convention.

Senator WILLIAMS. When was that meeting?

Mr. CARVER. The meeting was approximately a year ago, Mr. Chairman.

Senator WILLIAMS. I see, long before S. 2969 was fashioned into legislation and introduced. Really, this legislation, S. 2969, is more than an invitation to the States to do the job. It clearly says that when the States do, as North Carolina has done, and we have heard this through almost every witness, gear up to provide to investors just the rudiments of understanding what lies behind an issue, then any Federal guidelines would be unnecessary. You say in Illinois there is something germinating. What is it? Has the State legislature done anything with this?

Mr. CARVER. The State constitution, Mr. Chairman, adopted approximately 3 years ago mandated that there be uniform accounting procedures and reporting procedures for all units of local government.

Senator WILLIAMS. Now who is——

Mr. CARVER. The State comptroller is charged with that responsibility.

Senator WILLIAMS. And could we have a copy of what he says are uniform standards? That would be helpful.

Mr. CARVER. I will see that such a thing is made available, Mr. Chairman, to the committee.

Senator WILLIAMS. In other words, all municipals are now operating under uniform accounting standards?

Mr. CARVER. At this time they are not, Mr. Chairman, but that is mandated and that will have to occur.

Senator WILLIAMS. And that is all that we are asking. That is ultimately what we are asking for.

Mr. CARVER. Well, Mr. Chairman, in reading the bill, it suggests that the commission——

Senator WILLIAMS. Before we come to that in the bill, if a municipality does not conform to the accounting standards, does that

mean they can't go to market?

Mr. CARVER. Well, it goes well beyond that, Mr. Chairman. In the particular instance we're talking about, uniform accounting procedures for all activities of municipal governments and local government, and there will be actual audit procedures and the comptroller will be charged with coming in and making an audit of the internal procedures and activities financially of the local government. So the net result would be that when you go to market the information would be available primarily because of a much greater responsibility that's been placed upon the units of local government by the State.

Senator WILLIAMS. Is there any certification from the State that a municipality has conformed?

Mr. CARVER. Yes, sir. They will, by making an internal audit, either approve or disapprove the financial condition of that particular unit of local government. If they disapprove, obviously they will make requirements that will necessarily have to be met in order for them to get a clean audit, the very same sort of thing that occurs in the private sector when you have a certified public accountant firm come in and actually give you an unqualified audit.

Senator WILLIAMS. Well, it seems to me if this bill were in place in Illinois and the State had to certify the municipality had conformed, why that is the sort of State law that would exempt that State from the coverage of this bill. So therefore, I conclude that we are not in disagreement that underwriters and investors ought to have that certainty that there are clear accounting procedures and that there should be disclosure of the basis for the issuance of the bond; in other words, the financial condition of the municipality.

Mr. CARVER. Well, Mr. Chairman, I think we are in very strong disagreement as to whether the Federal Government ought to prescribe the rules.

Senator WILLIAMS. No; I didn't say the Federal Government. I'm saying the underwriter and the investor ought to know just what he's asked to consider in bidding or buying.

Mr. CARVER. Well, I think investors have been able to make those type of decisions in the past. I would agree with you that an investor ought to know those things that he feels are his need to know and I would further suggest that that kind of a situation, given the performance of the market in the last 43 years has existed and I would suggest that where it has not existed that that's been almost a unique occurrence. I myself have invested in a great variety——

Senator WILLIAMS. Well, these are unique times. I have been here for 20 years or so and this is the first time I have seen—this year, within the last 6 months—mayors—this morning paper carries an article about the Mayor of Detroit—talking bankruptcy peril in our great cities. He lists the other cities. So these are unique times.

Mr. CARVER. Mr. Chairman, I'm not even sure if the mayors of the other cities that my friend Coleman Young has suggested would necessarily agree that they are in as bad a shape as he's suggested they are, but I think that what we're talking about gets right back

to the very point that I made earlier. There are 39,000 units of local government and these, with rare exceptions, have had absolutely no problem, and the number might even be greater. Some people tell me they don't know how many numbers there are. But the need might be quite great for a city like New York, but those of us in the rest of the Nation feel that to bring all of us in the $5 million limit, believe me, Mr. Chairman, brings a great number of local government units under the control of the SEC if in fact this legislation would be passed.

Senator WILLIAMS. What is the big new burden? I don't understand resistance to something that seems so fundamental to an intelligent investment community and the protection of investors, just a fair disclosure of what you're asking the people to invest in.

Mr. CARVER. Well, if you take a look at your legislation, first it's suggested that the commission will have the right to pass what—I'm going to have to find—in accordance with such rules and regulations as the commission finds are necessary or appropriate in the public interest, and it goes on to expand that they can go well beyond the items that are just simply listed out. These are costly, preparing the reports. For instance, in Illinois, if we had to prepare a report on a municipal security on the basis of a Federal guideline at the same time maintain all of your accounts on the basis of a State guideline, and if those didn't happen to come together simply because the SEC decided that the rules in Illinois did not adequately meet what they felt were necessary, we could have a double burden. There are many units of Government who have absolutely no problem in selling securities who have no problems in staying behind those securities, and yet they would be caused to bear the cost of uniform accounting according to a Federal guideline and making reports available and all the other attendant administrative requirements, and each and every time adding to the cost of preparing those bonds for the market. The suggestion that I think we're trying to make in the statement that has been prepared, you will note that there is an impact on the cost. We don't know exactly what it is. We suspect no one else does either. We do, however, feel that that's a very important thing to be developed because I personally believe and I think the League of Cities and the U.S. Conference of Mayors believe that as it is developed it will be found that this is going to be a very important cost and it's going to be quite a substantial cost being asked to be borne by cities who have had absolutely no problem, not only in the sales of their securities but the redemption of the same securities as well.

Senator WILLIAMS. Now, has the conference of Mayors met within this year? Have they considered this bill?

Mr. CARVER. No, sir.

Senator WILLIAMS. How do you define your present liability? You mentioned that the fraud provisions of the securities acts do apply, and now we come to this question of the municipalities' liabilities. Where you are operating under procedures and you have not followed procedures and you are developing them in Illinois, what is the situation on liability, civil liability, on the issuer?

Mr. CARVER. It's my understanding, Mr. Chairman, that if in fact knowing misrepresentation takes place, that under the 1933-34 acts there is, if you do in fact have a case of fraud, that the SEC has the authority to prosecute under those conditions and it's my understanding that as a result in those types of misrepresentations the financial information has been provided, there are penalties involved.

Senator WILLIAMS. How about in cases where there isn't fraud but there is a failure short of fraud at the municipal level? Do you believe that suits could or should be possible against the municipality?

Mr. CARVER. Mr. Chairman, that's I think speculation. Let's take a look at the record. The record is that the occurrence of that kind of an instance or condition has almost been nonexistent and the underwriters——

Senator WILLIAMS. But the question is, whether as a matter of law, this remedy should be available?

Mr. CARVER. I would have to suggest that taking into account first that a bond opinion must be gotten before the bonds can be sold, taking into account that the underwriters do very carefully review every bond issue before it's sold, and taking into account that if fraud actually takes place, there are penalties, now the question then becomes, as I think you're suggesting, what happens when fraud doesn't occur but unknowingly a misrepresentation takes place, and what type of penalty or not necessarily a penalty, but shouldn't the investor who's lost their money under those kind of conditions have an opportunity to receive that money back.

Senator WILLIAMS. Recover in a damage suit, yes.

Mr. CARVER. And I would suggest that on the surface it would have to appear that the logic would be in favor of the investor having the opportunity because a misrepresentaion, even though it's unknowing and not fraud, has taken place, that an investor ought to have the right to get that money back.

But I think the point I'm trying to make this morning, Mr. Chairman, is that if we take that to the extent that's suggested in the bill and if we cause all of the units of local government to have to conform to the standards that are set up and conform to them on a uniform basis nationally, and if we take into account all the costs that are attendant to that—and I happen to personally believe that those could be quite high—that our efforts to save those very, very few investors who might potentially lose money is taking a great deal more of the taxpayer's and the other investors' money in accomplishing that goal.

Senator WILLIAMS. You are really reducing your arguments to the additional cost burden. That's basically what you're talking about.

Mr. CARVER. I'm bringing it basically down to the additional cost burden to a question about the need, and finally I think for a request to allow the cities of this country to have an opportunity to develop, if necessary, more uniform standards in this area, and I think this morning there will be testimony from municipal finance

officers suggesting that such is possible, and I would further suggest that the very same process that took place that has now evolved into the practice of obtaining a bond opinion from counsel concerning the sale of municipal bonds which has not been by the way mandated by law, can just as easily occur in the accounting and reporting area as well.

Senator WILLIAMS. Thank you very much.

[Complete statement follows:]

STATEMENT OF RICHARD CARVER, MAYOR OF PEORIA, ILL., ON BEHALF OF THE NATIONAL LEAGUE OF CITIES AND THE UNITED STATES CONFERENCE OF MAYORS

I am Richard Carver, Mayor of Peoria, Illinois, and I am testifying this morning on behalf of the National League of Cities and the United States Conference of Mayors. Together these two organizations represent nearly 15,000 municipal governments in all fifty states. Recently, I have been appointed Chairman of the National League of Cities' Effective Government Committee, which is the League's policy committee which has jurisdictions over municipal bond financing issues. I can assure this Committee that the legislative proposals being considered during these hearings will receive careful scrutiny by my committee.

Mr. Chairman, in your remarks which accompanied the introduction of S. 2969, the Municipal Securities Full Disclosure Act of 1976, you spoke of the serious disruptions and uncertainties that have arisen in the municipal bond market as a result of the New York City fiscal crisis—uncertainties that have led to record high interest rates and cancellations, postponements, and rejections of municipal bond issues. During the past six months, many Members of Congress have become extremely concerned, not only about New York City securities, but about the functioning of the bond market in general. For perhaps the first time, the operations of this multi-billion dollar market are being closely scrutinized by several Congressional Committees. Important questions are being asked about the adequacy of the tax-exempt market—about its efficiency and equity and its ability to provide adequate safeguards to investors and taxpayers.

All of these questions must be addressed, and the National League of Cities and U.S. Conference of Mayors are prepared to work with the Congress in developing appropriate remedies where necessary. For example, earlier this year we testified before the House Ways and Means Committee and endorsed legislation which would allow cities to issue taxable bonds, the interest on which would be partially paid for by the federal government. This proposal, which is commonly referred to as the taxable bond option, is designed to insure an adequate supply of capital to the nation's cities and at the same time improve the efficiency and equity of the bond financing mechanism.

However, our support for improvements in the capital financing system for state and local governments must not be interpreted as an abandonment or weakening of our continued commitment to the existing tax-exempt bond market. During the past 40 years, this market has proven its ability to generate the capital needed by state and local governments. And most importantly, that capital has been provided in a manner which promotes fiscal independence and rewards fiscal responsibility.

When examining the strengths and weaknesses of today's tax exempt bond market, it is imperative that the conclusions that are drawn be based upon the broadest possible study of the market and not simply upon the specific difficulties associated with the New York crisis. While many of the fiscal and economic difficulties which exist in New York City are also prevalent in other cities, the financial emergency which engulfed New York was indeed unique. During the height of the New York City crisis, many observers failed to make a distinction between New York's specific difficulties and the financial plight of other American cities. Those that failed to differentiate came forward with proposed solutions to the New York crisis which would have been automatically applicable to other governments. As Members of this Committee are well aware, both the National League of Cities and U.S. Conference of Mayors vigorously supported federal financial assistance for New York City. However,

in so doing, we made some very careful and important distinctions. The NLC Board of Directors' policy statement regarding the New York City crisis illustrates this point. I quote:

"Congress and the Administration should be prepared to assist a municipality to obtain needed credit during a financial emergency only if it is apparent that the municipality and its state government have exhausted all constitutional, legal and fiscal remedies available under their respective authorities. Assistance measures which may be appropriate in a financial emergency, should not be made a permanent feature of federal policy with regard to municipal bond financing.

"In addition, municipal governments oppose a continuing system of federal government guarantees or insurance of tax-exempt or taxable municipal bonds."

Many critics of federal involvement in the New York crisis have claimed that a precedent would be established and that city officials would line up at the federal treasury demanding similar relief. The NLC Board, however, made it abundantly clear that the nation's cities have no interest, and are in fact opposed, to any across-the-board federal involvement in the tax-exempt municipal bond market.

I bring this policy position to your attention because it underscores a very real concern that we have—namely, that the New York City crisis may lead to inappropriate federal involvement in the fiscal affairs of all state and local governments. The issue before us today, the establishment of federal reporting and disclosure guidelines for the issuers of municipal bonds, is directly related to the events surrounding the New York crisis. If that crisis had not occurred, I believe the disclosure issue would never have been elevated to the federal level. I point this out, not because I believe that accurate and complete financial disclosure is simply a New York City problem, but because I fear that the New York crisis may so dominate the discussion that erroneous and unfair conclusions may be drawn—conclusions that could adversely affect the other 39,000 local governments in the country. As you, Mr. Chairman, stated in your remarks which accompanied the introduction of S. 2969, "Forty-three years of municipal finance coorroborates the continuing validity of the finding that 'recurrent abuses' have not occurred—New York City being atypical and unusual."

I hope these introductory remarks will serve as an appropriate framework for our discussion of the legislative issues before us today. Members of this Committee are well aware of our strong support for the Tower Amendment which exempted states and local governments from reporting requirements under the 1975 Securities Act Amendments. In a letter to this Committee, we stated that without the Tower Amendment, "extensive and expensive reporting requirements would be imposed upon state and local issuers." We concluded by saying: "Such reporting requirements would seriously hamper the ability of local government to freely market their debt. We remain unpersuaded that additional issuer information requirements would serve any useful purpose to a federally-mandated Municipal Rule-making Board."

In addition to our position on the Tower Amendment the National League of Cities is strongly opposed to regulation of state and local government issuers by the Security Exchange Commission. Our policy states, "The federal government should not submit the local government authority and its bond issuance procedures to the jurisdiction of the private security regulatory bodies . ." We are in full agreement with those who argue that SEC coverage, as envisioned in the Eagleton bill, S. 2574, should not be extended to municipal bond issuers. The three reasons set forth in the introductory remarks accompanying S. 2969 are precisely the same points we wish to make:

First, municipal bonds as a class are extremely safe investments. Penn Central and WT Grant bankruptcies seldom occur in the public sector;

Secondly, state and local governments provide an ultimate safety for their securities through the exercise of their general taxing authorities; and

Third, the normal political processes associated with the issuance of state and local government debt ensure close public scrutiny through hearings, elections and referendums.

The position of the National League of Cities and the U.S. Conference of Mayors, however, goes beyond opposition to outright coverage by the Securities Acts of 1933 and 1934. We will vigorously oppose any attempt to regulate,

directly or indirectly, state and local issuers through the Security Exchange Commission. While we understand that the intent of S. 2969 is to minimize the role of the SEC and to avoid "the formalities, administrative delays and costs of full registration," the language of the legislation does not support the stated intent. For example:

Section 13A (a)(1) states that annual reports must be prepared in accordance with such rules and regulations as the SEC may prescribe."

Section 13A (a)(2) subparagraph J states that issuers shall be audited by an independent public or certified accountant in "such a manner as the Commission may prescribe."

Section 13A (b)(1) requires an issuer selling securities exceeding $5,000,000 to prepare a distribution statement "in accordance with such rules and regulations as the Commission may prescribe."

Section 13A (d) grants the Commission authority to change the minimum dollar amount that determines which issuers must comply with the reporting and disclosure standards.

Section 13 A(f)(3) gives the Commission authority to ccntract for the establishment of a central repository to receive and maintain all reports. All such reports would be required to be filed in "accordance with such rules and regulations as the Commission fiinds are necessary or appropriate in the public interest."

I submit to the Committee that the discretionary authority granted to the SEC under S. 2969 is tantamount to registration with the Commission. The nation's cities cannot support such an approash.

I would like to return for a moment to the remarks which accompanied the introduction of S. 2969. In those remarks the original reasons for public issuers being exempt from the Securities Acts of 1933 and 1934 were discussed. The statement identified three such reasons.

1. The rare instance of misrepresentation by municipalities.
2. The costs of SEC regulation that would be imposed upon state and local government.
3. Sophistication by the investment community that permitted them to protect their own interests.

During the past 40 years, a great deal of change has occurred in the municipal bond market. However, we believe that the three basic reasons for exempting public issuers in 1933-1934 are valid today. To those who support SEC regulatory authority being extended to state and local government, we must ask the following questions. If recurring misrepresentation of financial information has occurred, why has the SEC failed to prosecute the offenders under the anti-fraud provision of the original Securities Act? Are cities so affluent today that the cost of regulation by the SEC is no longer a troublesome issue? Have the underwriters of municipal bonds lost their ability to discriminate between a good and poor investment risk?

In addition, we must respectfully take issue with the Chairman's statement that the historical concern that SEC regulation would increase costs to state and local government has been superseded by a potentially more serious concern—"the erosion of investor confidence." I can assure this Committee that the imposition of federal regulations and their associated costs are just as objectionable today as they were 40 years ago.

In analyzing the merits of the proposed legislation, the cost factors to cities must not be overlooked. Over the years, the federal government, by executive, legislative and judicial action, has mandated numerous requirements and responsibilities for local government without providing the necessary financial resources to meet these added responsibilities. These requirements have often had a negative and severe impact upon local budgets. It is clear that the trend is toward more frequent and costly government regulations. The impact of this increased federal involvement in local budgets must be clearly understood if the current urban financial situation is to be well managed.

Fiscal responsibility requires that the full costs of governmental programs and regulations be publicly known. It is seldom that a federal agency concerns itself with the cost effects of its decisions on state and local budgets. I see little evidence that the SEC, which contains no local government representation and is primarily oriented towards the corporate security industry, would prove more sensitive to cost-impact than other federal

agencies. Analyzing the cost of federal reporting and disclosure standards must therefore rest with the Congress. Before proceeding, this Committee must attempt to ascertain the costs to state and local government that the various legislative alternatives would impose. Only then can the alleged benefits of federal involvement in municipal bond financing be accurately assessed.

Given the conditions in the municipal bond market during 1975, a great deal of concern has been expressed regarding investor confidence. This issue appears to be at the core of the debate surrounding the adequacy of current reporting and disclosure practices. All of us must be concerned about the sudden rise in interest rates in the municipal bond market which occurred during the past year. In October, the 20 Bonds Index of medium grade securities reached a record-high of 7.67 percent. Clearly, the New York City crisis and its "ripple effect" was one reason for these unprecedented rates. But our analysis leads us to the conclusion that other factors were also involved; factors such as the withdrawal of commercial banks from the market, the "crowding" in the market caused by sharp increases in pollution control bonds, and the general rise in interest rates associated with the nation's fiscal and monetary policies.

If lack of investor confidence continues to be a critical issue in the bond market, then we should expect a continuation of record interest rates. However, since October 2, the 20 Bonds Index has declined by 72 basis points, with the February 11 figure standing at 6.95 percent. The current rates reveal that, with some exceptions, municipalities have had little trouble in issuing their securities at significantly lower interest rates. Today, investor fear of default appears to be minimal. Confidence has returned to the market—a confidence that has dominated the municipal bond market for the past 30 years. The statistics speak for themselves. From 1945-1974 approximately $500 million in municipal debt has gone into default. This represents only 0.42 percent of outstanding municipal debt at the end of 1974. This figure is even further reduced when the permanent loss to the investor is measured. It is estimated that from 1945-1965 that less than $10 million or 1/10,000 of outstanding municipal debt at the end of 1965 was permanently defaulted.

The facts clearly show that the investor in municipal securities runs very little risk of losing his or her investment. Are we not potentially getting ourselves into a position of overkill as a result of the reaction to the New York situation which, Mr. Chairman, you yourself have described as being atypical?

Members of this Committee surely realize that no city official freely chooses to pay higher interest rates. If providing more detailed financial information is a prerequisite to continued investor confidence, I can assure you that the necessary information will be forthcoming. The National League of Cities and U.S. Conference of Mayors fully support the current drive within the bond market to insure complete and accurate financial disclosure. We are extremely pleased with the initiatives taken by the Municipal Finance Officers' Association in developing their Financial Disclosure Guidelines. Later this morning you will have the opportunity to discuss this initiative with them. We believe that these voluntary guidelines should be given the opportunity to work before federal intervention is seriously contemplated by the federal government. The responsibility is now upon us to provide complete and accurate financial data. I firmly believe that the higher standards of financial disclosure being demanded by the investment community will be voluntarily met.

Senator WILLIAMS. Mr. Flaherty.

STATEMENT OF JIM FLAHERTY, CHAIRMAN, ALLEGHENY COUNTY BOARD OF COMMISSIONERS FOR THE NATIONAL ASSOCIATION OF COUNTIES; ACCOMPANIED BY ALICEANN FRITSCHLER

Mr. FLAHERTY. I'm Jim Flaherty, Chairman of the Board of County Commissioners of Allegheny County, and I thank you for the invitation to be here today representing the National Association

of Counties (Naco) to discuss the proposals before your subcommittee regarding disclosure requirements for issuers of municipal securities. I am accompanied by Aliceann Fritschler, the deputy director for Federal Affairs for the National Association of Counties.

I serve as chairman for tax policy on the Naco taxation and finance steering committee, which will be meeting at the end of March to consider our position regarding the specific legislation before your subcommittee. Today I want to discuss with you some general principles regarding disclosure by State, county, and city issuers. Also, I would like to share with you the results of a recent bond sale by Allegheny County which I think the subcommittee will find particularly interesting. We believe that by disclosing additional information the county was able to attract more bidders and save approximately $2 million.

As you may know, there are 3,101 counties in the United States but Allegheny County is the ninth largest serving 1.6 million people, one-third of whom live in the city of Pittsburgh. I, myself, have been in office less than 60 days.

After I was in office only 3 weeks, I was faced with the prospect of opening bids for county general obligation bonds with only one firm interested in bidding. I was advised at that time that the customary sparse four-page bond prospectus—which we provided as exhibit No. 1—for $27 million worth of bonds was insufficient. Based on that original prospectus, which disclosed very little financial information about Allegheny County, the different bidders had individually requested additional data by telephone for 2 weeks prior to the intended bid opening. After consultation with bond counsel and review of recent Municipal Finance Officers Association disclosure guidelines, the Allegheny County Commissioners decided to delay the opening of bids for 2 weeks in order to resolve the lack of information situation.

Up to this time the previous Board of Commissioners had depended solely on maintaining a high bond rating with the bond rating firms and did very little to improve financial disclosure. The county comptroller and members of my staff went to New York City and met with representatives and municipal bond analysts from 10 major municipal bond bidders. Upon their return, the county developed a "full disclosure" prospectus for official statement which was expanded from the 4-page statement to 24 pages of information which has been provided to you as exhibit No. 2, and which is based on the published disclosure guidelines of the MFOA which was done on a voluntary basis.

I am happy to relate to you that as a result of these efforts, Allegheny County received four bids from four independent municipal bond syndicates at an interest rate more favorable than a previous interest rate received by Allegheny County 4 years before. We have calculated that by delaying the opening bids for 2 weeks along with preparing a full disclosure statement, my county saves approximately $2 million over the 30-year life of the bonds offered. This anecdote is intended to demonstrate before this subcommittee

that local governments can respond effectively to the requirements of full disclosure and remain financially solvent.

We realize that the proposals being made regarding fuller disclosure are a direct result of the financial problems of New York City. Although the problems of New York City have had an impact on some cities' and counties' abilities to borrow funds at a reasonable rate, not all governments have been affected or found it more difficult to borrow. In fact, some issuers have found it easier to borrow because their credit ratings were excellent.

The National Association of Counties strongly supported Federal assistance for New York City on an emergency basis because our members felt that the city's problems were so severe and unique that a Federal guarantee was needed for taxable bonds issued by that city.

However, our recent experience in Allegheny County seems to show that the bond market has settled down and that by fully disclosing all pertinent information investors will be available for higher quality municipal issues. We believe it is important that the Congress not overreact to the New York City situation and impose a great many requirements and reports on all States, counties and cities—the majority of whom are still able to borrow funds at fair rates.

Although strict regulation and registration on a national basis is required of corporate issuers in the private sector, we do not believe that such regulation is required for State, county, and city issuers. The specter of paperwork, redtape and its attendant costs which would be imposed on States, counties, and cities by such registration is not appealing. The right of local self-determination is certainly a fundamental part of our American system. National Association of Counties American county platform states that national action should be reserved for residual participation where State and local governments are not fully adequate and for the continuing responsibilities that only the national government can undertake. I might point out to you that back in July the National Association of Counties had their annual meeting and passed as part of its basic statement of philosophy and policy the following statement:

> Leave to private initiative all the functions that citizens can perform privately. Use the level of government closest to the community for all public functions it can handle. Utilize cooperative intergovernmental agreements where appropriate to attain economical performance and popular approval. Reserve national action for residual participation where State and local governments are not fully adequate and for the continuing responsibilities that only the national government can undertake.

Mr. FLAHERTY. We do not believe that there is a need for Federal regulation of State and local issuers at this time. We believe that counties, cities, and States should be free to develop their own operating policies in all programs not financed wholly or substantially by Federal or State funds, providing that these policies are set forth in writing.

The Steering Committee of which I'm a part met 2 weeks ago. In fact, it met on the day our county's bond issue results came in.

So we have met recently on this matter and on this philosophy and what you are now being presented is a statement of the National Association of Counties and that Steering Committee. We intend to meet again in March to prepare a broader statement and to take a further position on all of the legislation. My function was to reveal to them the Allegheny County experience that full disclosure is beneficial, that it can be done voluntarily, that there isn't a need for the Federal Government to enter into another area. In fact, in our State, I actually think that we may be exempt from your regulation. We have a local debt limit act and under our local government debt limit act we have to receive State approval before we can borrow any money because there are certain requirements that we have to meet based on our tax position and our revenue position over the past 5 years on a formula basis. But I still think that this is not an area in which there is a need for Federal intervention and I think that is supported by the position of the National Association of Counties.

[Complete statement follows:]

STATEMENT BY JIM FLAHERTY, CHAIRMAN OF THE BOARD OF COUNTY COMMISSIONERS, OF ALLEGHENY COUNTY PENNSYLVANIA

Mr. Chairman, I am Jim Flaherty, Chairman of the Board of County Commissioners of Allegheny County, Pennsylvania. I am pleased to be here today representing the National Association of Counties (NACo) to discuss the proposals before the Subcommittee regarding disclosure requirements for issuers of municipal securities. I am accompanied by Aliceann Fritschler, Deputy Director of Federal Affairs for the National Association of Counties.

I would like to thank the Chairman and Senator Tower for being willing to discuss their proposals with state, county and city officials who are so vitally affected by them.

I serve as Chairman for Tax Policy on the NACo Taxation and Finance Steering Committee, which will be meeting at the end of March to consider our position regarding the specific legislation before your subcommittee. Today I want to discuss with you some general principles regarding disclosure by state, county and city issuers. Also, I would like to share with you the results of a recent bond sale by Allegheny County which I think the Subcommittee will find particularly interesting. We believe that by disclosing additional information the County was able to attract more bidders and save approximately $2 million.

After only three weeks as Chairman of the Board of Commissioners of Allegheny County, I was faced with the prospect of opening bids for county general obligation bonds with only one firm interested in bidding. I was advised at that time that the customary sparce four-page prospectus (which we provided as Exhibit 1) for $27 million worth of bonds was insufficient. Based on that original prospectus, which disclosed very little financial information about Allegheny County, the different bidders had individually requested additional data by telephone for two weeks prior to the intended bid opening. After consultation with bond counsel and review of recent Municipal Finance Officers Association disclosure guidelines, the Allegheny County Commissioners decided to delay the opening of bids for two weeks in order to resolve the lack of information situation.

Up to this time the previous Board of Commissioners had depended solely on maintaining a high bond rating with the bond rating firms and did very little to improve financial disclosure. The County controller and members of my staff went to New York City and met with representatives and municipal bond analysts from ten major municipal bond bidders. Upon their return, the County developed a "full disclosure" prospectus for official statement which was expanded to 24 pages of information (provided as Exhibit 2) based on the published disclosure guidelines of the MFOA.

I am happy to relate to you that as a result of these efforts, Allegheny County received four bids from four independent municipal bond syndicates at

an interest rate more favorable than a previous interest rate received by Allegheny County four years before. We have calculated that by delaying the opening bids for two weeks along with preparing a full disclosure statement, my County saved approximately $2 million over the 30-year life of the bonds offered. This anecdote is intended to demonstrate before this Subcommittee that local governments can respond effectively to the requirements of full disclosure and remain financially solvent.

We realize that the proposals being made regarding fuller disclosure are a direct result of the financial problems of New York City. Although the problems of New York City have had an impact on some cities' and counties' abilities to borrow funds at a reasonable rate, not all governments have been affected or found it more difficult to borrow. In fact, some issuers have found it easier to borrow because their credit ratings were excellent.

The National Association of Counties strongly supported federal assistance for New York City on an emergency basis because our members felt that the city's problems were so severe and unique that a federal guarantee was needed for taxable bonds issued by that city.

However, our recent experience in Allegheny County seems to show that the bond market has settled down and that by fully disclosing all pertinent information investors will be available for higher quality municipal issues. We believe it is important that the Congress not overreact to the New York City situation and impose a great many requirements and reports on all states, counties and cities—the majority of whom are still able to borrow funds at fair rates.

Although strict regulation and registration on a national basis is required of corporate issuers in the private sector, we do not believe that such regulation is required for state, county and city issuers. The specter of paper work, red tape and its attendant costs which would be imposed on states, counties, and cities by such registration is frightening. The right of local self-determination is certainly a fundamental part of our American system. NACo's American County Platform states that national action should be reserved for residual participation where state and local governments are not fully adequate and for the continuing responsibilities that only the national government can undertake. We do not believe that there is a need for federal regulation of all state and local issuers.

We believe that counties, cities and states should be free to develop their own operating policies in all programs not financed wholly or substantially by federal or state funds, providing that these policies are set forth in writing.

The Allegheny County experience demonstrates that investors in municipal bonds are helping make the system strong by requiring more information and by evaluating local government credit in the same way as they evaluate the credit of private businesses.

My recent experience with the bond sale in Allegheny County has shown me that disclosure of more information was beneficial to our county and all its taxpayers. I believe that elected officials at the state, county and city level are ready and willing to provide timely and detailed information concerning bond issues. The National Association of Counties has agreed to join with the Municipal Finance Officers' Association and other concerned groups to develop a meaningful set of disclosure guidelines which can be used by all issuers.

We hope that the members of the Subcommittee and their staffs will join with our associations in working together to formulate meaningful workable guidelines for disclosure by all issuers that will not unduly burden our governments or interfere with state and local decisionmaking. We feel this kind of approach could serve as a model for problem solving in many areas where there is concern by federal officials but where operational responsibilities rest solely with state and local officials.

It is important to remember that there are a wide variety of state and local government organization and financing mechanisms. We would oppose any national system which might unnecessarily impose restrictions on either local organization or financing. We urge the subcommittee to follow the advice given by Senator Tower that "an approach be taken that preserves, to the maximum extent possible, the rights of state and local governments and the use of market forces."

We think these hearings are a good start toward coming up with solutions for disclosure problems that exist now and appreciate this opportunity to be heard.

ALLEGHENY COUNTY BONDS

General Obligation Bonds	ISSUE OF MARCH 1, 1976 SERIES C-24	Amount $27,000,000

SALE OF BONDS
$27,000,000
COUNTY OF ALLEGHENY, PENNSYLVANIA
GENERAL OBLIGATION BONDS, SERIES C-24

Sealed proposals for the purchase of all, but not less than all, of $27,000,000 par value general obligations coupon bonds of the County of Allegheny, Pennsylvania, will be received by the undersigned County Controller or his Deputy at the office of the County Controller, Room 104, Court House, Pittsburgh, Pennsylvania, until 10:00 o'clock A.M., Pittsburgh local time, on Thursday, January 22, 1976, without adjournment of the hour of receipt, and will be opened and considered immediately thereafter by the County Controller or his Deputy and the County Commissioners, in the meeting room of the County Commissioners, 410 Court House, Pittsburgh, Pennsylvania.

All of said bonds are registrable as to principal only and are dated March 1, 1976, and are of the denomination of $5,000.

The maturities of the series of bonds is as follows: $900,000 on March 1 of the years 1977 to 2006, both inclusive, with interest payable March 1 and September 1 in each year, commencing September 1, 1976. The interest on and principal of the bonds will be payable at the office of the County Controller, Pittsburgh, Pennsylvania. The cost of printing the bonds will be paid by the County of Allegheny.

The County will pay or refund any tax (except gift, succession or inheritance tax) which may be legally levied or assessed upon the bonds or upon the debt secured thereby under any present or future law of the Commonwealth of Pennsylvania.

The Ordinance authorizing the bonds establishes a sinking fund into which the County shall pay all monies required for debt service and from which the bonds shall be paid.

The County of Allegheny reserves the right to call, redeem and pay on March 1, 1986, or on any interest payment date thereafter, in the inverse order of their stated maturity dates, and by lot within a maturity, any or all of the bonds maturing on or after March 1, 1987, or not less than thirty (30) days notice to the holders thereof, upon payment of the applicable redemption price as set forth in the following schedule, in each case together with accrued interest to the date fixed for redemption:

If Redeemed During the Following Periods (Both Dates Inclusive)	Redemption Price (Percentage of Principal Amount)
March 1, 1986 to February 29, 1988	102 %
March 1, 1988 to February 28, 1990	101½ %
March 1, 1990 to February 29, 1992	101 %
March 1, 1992 to February 28, 1994	100½ %
March 1, 1994 and thereafter	100 %

Each bid shall specify a single rate of interest which all of the bonds offered for sale are to bear, expressed in a multiple of one-eighth of one per centum. Proposals must be unconditioned and for the total of the issue, aggregating $27,000,000, and must be upon blank forms which will be furnished by the County Controller upon application. Each bid shall be enclosed in a sealed envelope marked on the outside "Proposal for Allegheny County Bonds" and must be accompanied by a certified check or official bank check payable to the order of the County of Allegheny, Pennsylvania, for $540,000 as security for the performance of such bid. No bid for less than par and accrued interest will be accepted.

The bonds will be awarded to the highest responsible bidder, who shall be the one, who having complied with the conditions of sale, offers to take all of the bonds at the lowest net interest cost to the County, calculated by the street method as defined in Section 709 of the "Local Government Unit Debt Act", Act 185 of 1972, as amended.

The sale of these bonds is subject to the approval of the proceedings authorizing the bonds by the Department of Community Affairs of the Commonwealth of Pennsylvania.

In the event that prior to the delivery of the bonds, the interest received by private holders from bonds of the same type and character shall be taxable by the terms of any Federal income tax law, the successful bidder, may at his election, be relieved of his obligation under the contract to purchase the bonds and in such case the deposit accompanying his bid shall be returned.

The successful bidder will be furnished with the unqualified approving opinion of Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, Pittsburgh, Pennsylvania, to the effect, inter alia, that the bonds are valid general obligations of the County of Allegheny, and that the County of Allegheny, pursuant to Act No. 185 approved July 12, 1972, has covenanted with the holders, from time to time, of the bonds and the coupons, that the County shall include the amount of the debt service charges, for each fiscal year in which said sums are payable, in its budget for each year and shall appropriate such amount to the payment of such debt service, and shall duly and punctually pay the principal of every bond and the interest thereon at the dates and places and in the manner stated on the bonds and coupons, according to the intent and meaning thereof, and that the County of Allegheny pledges its full faith, credit and taxing power, and that the covenant shall be specifically enforceable. A copy of the text of such opinion will be printed on the reverse of each bond. The County of Allegheny will also furnish the usual closing papers, including a certificate that there is no litigation pending affecting the validity of the bonds. These bonds will be delivered to the purchaser of the same at Pittsburgh, Pennsylvania, or New York City, New York, or other mutually agreeable location on or about March 1, 1976 as may be agreed upon by the said purchaser and the authorities of the County, against payment in immediately available federal funds in Pittsburgh.

The right is reserved to deliver a temporary bond or bonds, the same to be exchanged for definitive bonds as soon as same are prepared and executed.

The County of Allegheny reserves the right to reject any and all bids.

JOHN P. LYNCH
County Controller

Alexander J. Jaffurs, Solicitor
County of Allegheny
Jones Law Building Annex
Ross Street
Pittsburgh, Pennsylvania 15219

Debt Statement

of the County of Allegheny as of December 31, 1975

As Required By Local Government Unit Debt Act No. 185 of 1972

Gross Revenue—Year 1972	$119,621,619.72
Gross Revenue—Year 1973	152,141,954.34
Gross Revenue—Year 1974	148,373,635.07
Total	420,137,209.13
Average	$140,045,736.38

MULTIPLES TO DETERMINE GROSS BORROWING CAPACITY

For Counties: 300%	$420,137,209.14
For Counties With Lease Rental Debt: 350%	490,160,077.33
For Financing Capital Facilities Relating to Specific County-Wide Functions and Responsibilities: Additional 100%	140,045,736.38[1]

STATEMENT OF INDEBTEDNESS

GROSS COUNTY DEBT			
Bonds Issued and Outstanding:			
Electoral	$ 88,412,000.00		
Non-Electoral	253,918,200.00	$342,330,200.00	
Uncompleted Bond Contracts:			
Electoral	$ 270,846.03		
Non-Electoral	5,189,918.82	5,460,764.85	
Bond Anticipation Notes		14,000,000.00	
Early Action Program—Port Authority:			
Contractual Obligations		6,201,225.00[2][3]	
Capital Improvement Grant—Port Authority—Phase IV		$ 60,637.00[2]	
Total Gross County Debt			$368,052,826.85
Less: Electoral Debt			88,412,000.00
GROSS COUNTY NON-ELECTORAL DEBT			$279,640,826.85
Offsetting Credits			
Bond Reserves:			
Electoral	$ 270,846.03		
Non-Electoral	—	$ 270,846.03	
Current Debt Service Appropriation		123,544.69	
Delinquent Taxes—66⅔% Collectible		7,276,454.78	
Subsidized Debt		[4]	
Accounts Receivable		2,178,244.34	
Total Offsetting Credits			9,849,089.84
			269,791,737.01
Add: Interest—Non-Electroral			109,544.69
NET COUNTY NON-ELECTORAL DEBT			$269,901,281.70

STATEMENT OF INDEBTEDNESS (Continued)

GROSS LEASE RENTAL DEBT		
Bonds Issued and Outstanding:		
Auditorium Authority	$ 7,965,000.00	
TOTAL GROSS LEASE RENTAL DEBT		$7,965,000.00
Offsetting Credits		
Current Debt Service Appropriation	$ —	
Subsidized Debt	2,000,000.00	
Total Offsetting Credits		$2,000,000.00
NET LEASE RENTAL DEBT		$5,965,000.00
NET COUNTY NON-ELECTORAL DEBT	$269,901,281.70	
NET LEASE RENTAL DEBT	$ 5,965,000.00	
TOTAL NET DEBT	$275,866,281.70	

APPROPRIATIONS—1975

	County	Road	Park	Bond Interest, etc.	Liquid Fuel	Federal Revenue Sharing	Total
Budget 1975..	$99,247,409.84	$4,030,528.07	$2,975,460.13	$35,161,432.85	$3,778,191.16	$14,211,000.00	$159,404,022.05

MILLAGE

	1975	1974
County	4⅞	4⅝
Road	¾	⅝
Park	⅜	⅜
Bond Interest, Etc.	7½	6⅝
	13½	12¼
Institution District	2	3¼
Total	15½	15½
POPULATION—1970 Census		1,605,016
POPULATION—1960 Census		1,628,587

NOTE:

1. This capacity not needed for this issue; a portion was used for an earlier bond issue.
2. November 30, 1975 balances used—Final year-end balances unavailable until year-end audit completed.
3. This represents the amount awarded under third party contracts. The County's ultimate long-range commitment of $52,348,940.00 for Phases I, II, and III of the Early Action Program would mature into debt only as work progresses over the years. Moreover, one-half of the County's commitment will be offset by Commonwealth of Pennsylvania's contributions as authorized by the General Assembly in the 1971 Session.
4. Non-electoral debt of the County as of December 31, 1975 for capital costs of the Community College is $5,455,000.00. The subsidized portion of this debt, or $2,727,500.00 was not recognized as an offsetting credit. This portion of debt could be excluded as subsidized debt under Section 204 of the Local Government Unit Debt Act but application for this exclusion has not been made.

REMARKS

There is no litigation pending or threatened concerning the validity of these bonds. All legal details pertaining to said bonds have been passed upon by Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, of Pittsburgh, Pa., Bond Counsel, and the Solicitor for Allegheny County, and the successful bidder will be furnished with a certified copy of Bond Counsel's written opinion stating that the bonds are valid and binding general obligations of said County of Allegheny, payable from its revenues including ad valorem taxes levied on all taxable property within the county, and that the county has power to levy taxes on the taxable real property therein for the payment of these bonds without limitation of rate or amount, and has covenanted to pay same as provided by Section 404 of the Local Government Unit Debt Act, No. 185 of 1972, which covenant is specifically enforceable. The bond issue is for the purpose of providing funds to retire bond anticipation notes, dated August 28, 1975, in the amount of $14,000,000, and to partially finance the 1975-76 Capital Improvement Program.

The interest on and principal of the bonds will be payable at the office of the Controller of the County of Allegheny, Pittsburgh, Pennsylvania.

NOTE: In Submitting Bid use Proposed Blank on reverse side of this sheet.

ALLEGHENY COUNTY BONDS

ISSUE OF MARCH 1, 1976

General Obligation Bonds	SERIES C-24	Amount $27,000,000

Pittsburgh, Pa. January . ., 1976

To the County Commissioners and County Controller
of Allegheny County, Pennsylvania.

Gentlemen:

Subject to all the conditions set forth in the offering of bonds hereto attached, we submit the following bid for the above Allegheny County Bonds, aggregating $27,000,000.

This bid is based upon an interest rate of .....%.

The bid for all or none of the bonds above mentioned is $..... ....., together with accrued interest thereon to date of delivery computed on a basis of 360 days to the year.

We enclose herewith a duly certified check or official bank check, payable to the order of the County of Allegheny, Pennsylvania, for $540,000 to secure the County against any loss resulting from our failure to comply with the terms of this bid. It is understood that no interest will be allowed upon this deposit.

For the information of the County only, and not as part of this proposal, the undersigned calculates that the net interest cost under this proposal, in conformity with the aforesaid public invitation, is $..... or .....% per annum.

Said bonds are to be duly and legally executed and issued as evidenced by a certified copy of the written legal opinion of Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, Pittsburgh, Pennsylvania, and are to be delivered to us on March 1, 1976 at a place agreed upon between ourselves and the authorities of said County, against payment in immediately available federal funds in Pittsburgh.

.....
Signature of Bidder

NEW ISSUE

$27,000,000

ALLEGHENY COUNTY, PENNSYLVANIA

GENERAL OBLIGATION BONDS

DATED: March 1, 1976

COUNTY COMMISSIONERS
Jim Flaherty, Chairman
Thomas J. Foerster
Robert N. Peirce, Jr.

COUNTY CONTROLLER
John P. Lynch

DIRECTOR OF BUREAU OF ACCOUNTS AND STATISTICS
Nicholas Stabile

COUNTY SOLICITOR
Alexander J. Jaffurs, Esq.

LEGAL OPINION
Baskin, Boreman, Wilner, Sachs, Gondelman & Craig
Pittsburgh, Pennsylvania

Bids Received
Office of County Controller
Room 104, Courthouse
Pittsburgh, Pa. 15219,
to 10 A.M., February 11, 1976.

ALLEGHENY COUNTY BONDS

General Obligation Bonds	ISSUE OF MARCH 1, 1976 SERIES C-24	Amount $27,000,000

SALE OF BONDS
$27,000,000
COUNTY OF ALLEGHENY, PENNSYLVANIA
GENERAL OBLIGATION BONDS, SERIES C-24

Sealed proposals for the purchase of all, but not less than all, of $27,000,000 par value general obligations coupon bonds of the County of Allegheny, Pennsylvania, will be received by the undersigned County Controller or his Deputy at the office of the County Controller, Room 104, Court House, Pittsburgh, Pennsylvania, until 10:00 o'clock A.M., Pittsburgh local time, on Wednesday, February 11, 1976, without adjournment of the hour of receipt, and will be opened and considered immediately thereafter by the County Controller or his Deputy and the County Commissioners, in the meeting room of the County Commissioners, 410 Court House, Pittsburgh, Pennsylvania.

All of said bonds are registrable as to principal only and are dated March 1, 1976, and are of the denomination of $5,000.

The maturities of the series of bonds is as follows: $900,000 on March 1 of the years 1977 to 2006, both inclusive, with interest payable March 1 and September 1 in each year, commencing September 1, 1976. The interest on and principal of the bonds will be payable at the office of the County Controller, Pittsburgh, Pennsylvania. The cost of printing the bonds will be paid by the County of Allegheny.

The County will pay or refund any tax (except gift, succession or inheritance tax) which may be legally levied or assessed upon the bonds or upon the debt secured thereby under any present or future law of the Commonwealth of Pennsylvania.

The Ordinance authorizing the bonds establishes a sinking fund into which the County shall pay all monies required for debt service and from which the bonds shall be paid.

The County of Allegheny reserves the right to call, redeem and pay on March 1, 1986, or on any interest payment date thereafter, in the inverse order of their stated maturity dates, and by lot within a maturity, any or all of the bonds maturing on or after March 1, 1987, on not less than thirty (30) days notice to the holders thereof, upon payment of the applicable redemption price as set forth in the following schedule, in each case together with accrued interest to the date fixed for redemption:

If Redeemed During the Following Periods (Both Dates Inclusive)	Redemption Price (Percentage of Principal Amount)	If Redeemed During the Following Periods (Both Dates Inclusive)	Redemption Price (Percentage of Principal Amount)
March 1, 1986 to February 29, 1988.....	102 %	March 1, 1992 to February 28, 1994.....	100½%
March 1, 1988 to February 28, 1990.....	101½%	March 1, 1994 and thereafter	100 %
March 1, 1990 to February 29, 1992.....	101 %		

Each bid shall specify a single rate of interest which all of the bonds offered for sale are to bear, expressed in a multiple of one-eighth of one per centum. Proposals must be unconditioned and for the total of the issue, aggregating $27,000,000, and must be upon blank forms which will be furnished by the County Controller upon application. Each bid shall be enclosed in a sealed envelope marked on the outside "Proposal for Allegheny County Bonds" and must be accompanied by a certified check or official bank check payable to the order of the County of Allegheny, Pennsylvania, for $540,000 as security for the performance of such bid. No bid for less than par and accrued interest will be accepted.

The bonds will be awarded to the highest responsible bidder, who shall be the one, who having complied with the conditions of sale, offers to take all of the bonds at the lowest net interest cost to the County, calculated by the street method as defined in Section 709 of the "Local Government Unit Debt Act", Act 185 of 1972, as amended. (a)

The sale of these bonds is subject to the approval of the proceedings authorizing the bonds by the Department of Community Affairs of the Commonwealth of Pennsylvania.

In the event that prior to the delivery of the bonds, the interest received by private holders from bonds of the same type and character shall be taxable by the terms of any Federal income tax law, the successful bidder, may at his election, be relieved of his obligation under the contract to purchase the bonds and in such case the deposit accompanying his bid shall be returned.

The successful bidder will be furnished with the unqualified approving opinion of Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, Pittsburgh, Pennsylvania, to the effect, inter alia, that the bonds are valid general obligations of the County of Allegheny, and that the County of Allegheny, pursuant to Act No. 185 approved July 12, 1972, has covenanted with the holders, from time to time, of the bonds and the coupons, that the County shall include the amount of the debt service charges, for each fiscal year in which said sums are payable, in its budget for each year and shall appropriate such amount to the payment of such debt service, and shall duly and punctually pay the principal of every bond and the interest thereon at the dates and places and in the manner stated on the bonds and coupons, according to the intent and meaning thereof, and that the County of Allegheny pledges its full faith, credit and taxing power, and that the covenant shall be specifically enforceable. A copy of the text of such opinion will be printed on the reverse of each bond. The County of Allegheny will also furnish the usual closing papers, including a certificate that there is no litigation pending affecting the validity of the bonds. These bonds will be delivered to the purchaser of the same at New York City, New York, or other mutually agreeable location on or about March 31, 1976 as may be agreed upon by the said purchaser and the authorities of the County, against payment in immediately available federal funds in Pittsburgh.

The right is reserved to deliver a temporary bond or bonds, the same to be exchanged for definitive bonds as soon as same are prepared and executed.

The County of Allegheny reserves the right to reject any and all bids.

JOHN P. LYNCH
County Controller

Alexander J. Jaffurs, Solicitor, County of Allegheny
Jones Law Building Annex, Ross Street
Pittsburgh, Pennsylvania 15219

(a) "Under the street method a dollar amount shall be determined by computing the total amount of interest payable over the life of the series to stated maturity dates or earlier mandatory call dates and subtracting therefrom the amount of any premium paid above the aggregate principal amount of the bonds or notes, or adding thereto the amount of any discount lawfully allowed in the sale."

"..... For a series sold under the street method the net interest rate shall be determined by dividing the net interest cost by the product of: (i) one thousand dollars ($1,000) multiplied by (ii) the number of bond years from the date of the bonds or notes to the stated maturity or earlier mandatory call dates. A bond year shall be one full year that one thousand dollars ($1,000) of principal amount shall be outstanding and less than full years shall be fractionalized on a three hundred and sixty-five-day year basis." 1972, July 12, No. 185, §709.

INDEX

	Page No.
Notice of Bond Sale	1
Official Statement	3
Description of the Bonds	3
Authorization and Purpose	3
Purpose	3
Present Projections as to Additional Issues	4
Borrowing Capacity	4
Taxing Power of the County	4
Real Property	4
Personal Property	4
Real Estate Assessments, Levies and Collections, 1970-75	5
Short Term Debt Projections	5
County Indebtedness	6
Percentage of Total Expenditures Allocated to Debt Service	6
Annual Bond and Interest Maturity Requirements 1976-2004, Excluding this Issue	7
Electors Bonds (Peoples Bonds)	8
Indebtedness by Purpose	8
Underlying Indebtedness	8
Overlapping Debt	9
Transfer of Funds from Bond Accounts	9
Debt Statement	9
Percentage of Debt Service to Revenues	11
Statement of Cash Balances, Receipts, Transfers, Expenditures, and Encumbrances (1971-75)	11
Analysis of Operating Funds Revenue by Source (1971-75)—Schedule A	12
Analysis of General Operating Fund Expenditures by Function (1971-75)—Schedule B	12
Consolidated Balance Sheet—Operating Funds, 1970-74	13
Allegheny County	14
The Community—General Information	14
Government	14
Relationship With the City of Pittsburgh	17
Transportation	17
Relevant Statistical Data Concerning Allegheny County and Its Metropolitan Region	17
Economic Activity	17
County Population	18
Family Income Distribution, 1970-75	18
Median Income	19
Employment—SMSA	19
Area Employment Statistics	19
Employment Description	19
Largest Area Private Employers	20
Leading Taxpayers of the County	20
Coal	21
County Pension Program	22
Closing Certificates	22
Certain Legal Matters	22
Sale Information	22
Financial Statement Certificate	23
Miscellaneous	23
Appendix "A"	24
Legal Opinion	24
Appendix "B"	
Bid Form	

OFFICIAL STATEMENT
OF ALLEGHENY COUNTY, PENNSYLVANIA

Relating to

$27,000,000 GENERAL OBLIGATION BONDS

This Official Statement, which includes the cover page, has been prepared by Allegheny County, Pennsylvania (the "County") in connection with the sale of $27,000,000 aggregate principal amount of General Obligation Bonds (the "Bonds").

DESCRIPTION OF THE BONDS

The Bonds are general obligations of the County. The County pledges its full faith, credit and taxing power. By section 404 of the Pennsylvania Local Government Unit Debt Act (1972, July 12, No. 185, as amended), the Authorizing Ordinance is required to contain a covenant that proper budgetary provisions will be made each year for the debt service and that the County shall appropriate annually the necessary amounts to the debt service and levy the required taxes. This covenant is specifically enforceable. The County has unlimited tax power for debt service purposes, under the terms of the Second Class County Code (1953, July 28, P. L. 723). This statutory taxing power renders the specifically enforceable covenant specially meaningful.

The Bonds, as indicated in the offering, are in denominations of $5,000, dated March 1, 1976, with maturities ranging from March 1, 1977 through March 1, 2006.

AUTHORIZATION AND PURPOSE

The Bonds are issued pursuant to the Constitution and statutes of the Commonwealth of Pennsylvania, particularly as set forth in the Local Government Unit Debt Act, Act 185 of 1972, as amended.

The Local Government Unit Debt Act authorizes local debts, but also imposes limitations on borrowing capacity.

A County may incur new debt if the aggregate net principal amount of the non-electoral debt of the County does not exceed three hundred percent of its borrowing base. An additional one hundred percent of the borrowing base is authorized for certain specific county-wide projects such as public health, hospitals, sewage, pollution, flood control, highways, public transportation, education, water systems, and similar projects.

Where lease rentals are included, the basic three hundred percent of borrowing capacity is increased to three hundred fifty percent.

"Electoral debt" is all debt incurred with the assent of the electors, whereas "non-electoral" debt means all debt other than electoral or rental debt. The term "borrowing base" means the annual average of the total revenues for the three full fiscal years ended next preceding the incurring of the non-electoral debt. A non-electoral debt is incurred under the terms of the law when the first ordinance authorizing the debt has been adopted.

On December 18, 1975, the County Commissioners of Allegheny County, being the legislative and executive officers of the County, adopted the necessary ordinance authorizing the $27,000,000 bond issue.

Purpose:

The $27 Million bond issue is designed to repay $14 Million in bond anticipation notes sold on August 28, 1975, due March 1, 1976, and extended in accordance with the "roll over" provisions of the Local Government Unit Debt Act. The balance of the funds will be used to finance the remainder of the 1975-76 County Capital Improvements Program.

The $27 Million bond sale will be distributed as follows: (*These figures include the $14 Million in bond anticipation notes)

Account	Bank Loan*	Remainder	Total
Bridge Bonds	$ —0—	$1,800,000	$ 1,800,000
Road Bonds	2,400,000	—0—	2,400,000
County Building Bonds	3,000,000	3,900,000	6,900,000
Juvenile Home Bonds	1,500,000	—0—	1,500,000
Airport Bonds	5,000,000	5,400,000	10,400,000
Park Bonds	600,000	900,000	1,500,000
Planning Development Bonds	400,000	150,000	550,000
Misc. Bond Accounts and expense	1,500,000	450,000	1,950,000
			$27,000,000

Present Projections As to Additional Issues:

Normally Allegheny County enters the capital market each year for sufficient financing to meet its capital needs. There was no sale in 1975. It is the present intention of the Board of Commissioners of the County to limit spending as much as possible during 1976; and, at the same time, consider alternative methods of financing certain projects. If the County enters the bond market again in 1976, it will only be for on-going projects such as airport improvements, County building projects, and transit construction.

Borrowing Capacity:

Under the three hundred percent rule the borrowing capacity of the County as of December 18, 1975, was $420,137,209.14; the net statutory debt, excluding the electoral debt and excluding this issue, was $275,866,281.70, leaving a net borrowing capacity for this and any other issues of $144,270,927.44. In addition, the County has statutory borrowing capacity of $210,068,345.07 for special purposes as indicated in the Debt Statement.

TAXING POWER OF THE COUNTY

Allegheny County has the power to levy ad valorem taxes on real estate, as well as a personal property tax.

In Pennsylvania, local governments are limited by state law as to the type and amount of taxation permissible. A search of present law indicates that the following taxes are available to counties of the Second Class, which is the classification into which Allegheny County falls:

Real Property:

County Fund	10 mills	
Park Fund	3 mills	
Road Fund	2 mills	
Bond and Interest	Unlimited	
Community College	5 mills	
TOTAL COUNTY	20 mills	(plus bond and interest levies)

In addition to this 20 mills, the Institution District is entitled to an additional 10 mills of taxing authority for real property.

The total levy for all funds in 1975 was: 13½—County, and 2—Institution District, for a total of 15½ mills. Neither the County nor the Institution District has ever imposed taxes up to the authorized limitations.

Personal Property:

County Fund	4 mills

The Personal Property Tax in Pennsylvania is a tax on certain intangibles, including the following: mortgages, promissory notes or bonds, judgments, public loans or bonds issued by any state or foreign country, except those issued by the United States or the State of Pennsylvania; shares of stock, except stock of Pennsylvania corporations and foreign corporations liable for a capital stock tax; articles of agreement; and equitable interests.

The County also receives State and Federal grants. In 1974 approximately 56% of the County's gross revenue was derived from State and Federal sources. (Allegheny County Controller's Report, 1974)

Between 1968 and 1974, revenues to Allegheny County's tax budget (including the Institution District) increased $94.1 million or 122.2 percent; expenditures increased $91.6 million or 115.6 percent. Of the growth in revenues, 52.3 percent resulted from increased state and federal grants.

Real Estate Tax collections over the years have been good. In 1974, for example, 95.8% of the real estate taxes levied were collected as of December 31, 1974. As reflected in the Debt Statement hereinafter set forth as of December 31, 1975, the "collectible" delinquent taxes for all prior years through 1974 are estimated at $7,276,454.78, based on 66⅔% as conservatively collectible. Tax collections, levies, and millages for the years 1970-1975 are as follows:

ALLEGHENY COUNTY
REAL ESTATE ASSESSMENTS, LEVIES AND COLLECTIONS*
1970-1975

Year	Assessed Valuation	Total Levy	Rate	Uncollected On Dec. 31
1970	$4,207,513,864.00	$62,074,264.80	14⅝	$2,829,848.19
1971	$4,609,703,501.00	$62,307,269.03	13⅜	$3,658,497.78
1972	$4,696,745,771.00	$62,055,300.54	13⅛	$3,791,366.79
1973	$4,773,452,802.00	$62,567,100.61	12¾	$2,784,988.25
1974	$4,840,892,123.00	$59,844,196.90	12¼	$2,508,022.11
1975	$4,936,943,902.00	$66,649,167.94	13½	$3,279,244.06

Delinquent taxes under existing law are liened against the property every three years. Property may be sold for payment of delinquent taxes. In 1974, Pennsylvania enacted a statute which gives the County Commissioners authority to create a Tax Claim Bureau to collect taxes or sell property on an annual basis. This procedure has not been utilized to date because of the good record on real estate tax collections.

Since the Local Government Unit Debt Act of 1972 provides that a holder of a bond has the right to specifically enforce the covenant that the debt with interest shall be "punctually" paid and that the "full faith, credit and taxing power" of the County is pledged for this purpose, the holder of the bond is given ample protection to insure payment of the principal and interest.

SHORT TERM DEBT PROJECTIONS

By law, Allegheny County taxes are not due at face until August 1 of each year. Traditionally the County has not passed its budget until February with tax bills going out in April. While the present administration is attempting to improve cash flow by adopting the budget at the beginning of the fiscal year (January 1) and to have the law amended to permit sending out tax bills immediately, it is still necessary to borrow on short term tax and/or revenue anticipation notes as provided for in Pennsylvania law. The 1976 budget has not yet been adopted or millage set.

The Board of County Commissioners has authorized a $32 Million revenue anticipation loan,** with funds to be taken down as needed and repaid on or before August 16, 1976. The Board accepted proposals from three banks, two of which bid for portions of the loan at the floating municipal prime rate and one at the fixed municipal prime rate. The first take down will be in February, 1976.

Under Pennsylvania law, all tax anticipation and revenue anticipation loans must be paid back by the end of the fiscal year in which they are borrowed and are certified by the first collection of revenues or taxes. The County has not failed to redeem these notes during any current year.

*Source: County Controller's Annual Report (1971-1974). 1975 figures taken from current ledgers of the County, subject to final Report.

**$3 million of this loan will be used for the Allegheny County Institution District and the balance for general County purposes.

It is anticipated at this time that the above mentioned loan will be the only operating fund loan during 1976. The other existing short term debt obligation for Allegheny County is the $14 Million in bond anticipation notes which will be retired out of the proceeds of this bond sale.

It should also be pointed out that the Local Government Unit Debt Act provides (Section 610, Act 185 of 1972) that whenever the interest rate to the local government unit shall exceed six percent, "the government shall, and in other cases may" issue and sell over the counter term-bonds in $100 denominations, "payable in not more than ten years." The amount issued shall be "not less than one-half of one per cent and not more than one and one-half per cent of the principal amount" of the concurrent issue. At present the Commissioners have authorized $400,000 in such term-bonds, if the interest exceeds 6%. Whether such bonds will be issued if such is not the fact, has to be determined by the Commissioners.

COUNTY INDEBTEDNESS

Percentage of Total Expenditures Allocated to Debt Service:

During the past six years, between 1/5 and 1/4 of the total operating expenditures were allocated to debt service, i.e. principal and interest. These percentages are as follows:

Allegheny County
Debt Service as a Per Cent of Total Operating Expenditures

Year Ending December 31	Actual Debt Service	Debt Service As a Per Cent of Total Operating Expenditures
1970	$16,766,781.54	19.03%
1971	$19,055,546.73	20.05%
1972	$22,939,145.48	23.23%
1973	$28,372,419.67	21.23%
1974	$33,298,662.28	22.91%
1975	$34,588,002.05	23.06%

In the proposed 1976 Budget, a sum sufficient to pay the September 1 interest on this issue has been added to the sum necessary for all prior bond issues, but because no bonds were issued in 1975 the estimated debt service for 1976 has been reduced to $33,704,517.15 from the $34,588,002.05 paid in 1975, excluding this issue.

ALLEGHENY COUNTY
ANNUAL BOND MATURITY & INTEREST REQUIREMENTS
1976-2004

December 31, 1975

Year	NON-ELECTORAL		ELECTORAL		TOTAL	
	Maturities	Interest	Maturities	Interest	Maturities	Interest
1976	$ 11,745,000.00	$ 12,896,266.95	$ 4,950,000.00	$ 4,113,250.20	$ 16,695,000.00	$ 17,009,517.15
1977	11,673,000.00	12,346,044.45	4,896,000.00	3,909,545.20	16,569,000.00	16,255,589.65
1978	11,574,000.00	11,798,368.20	4,736,000.00	3,708,393.95	16,310,000.00	15,506,762.15
1979	11,457,000.00	11,253,178.20	4,402,000.00	3,512,336.45	15,859,000.00	14,765,514.65
1980	11,359,200.00	10,711,801.34	4,145,000.00	3,321,728.35	15,504,200.00	14,033,529.69
1981	10,908,000.00	10,177,136.34	4,095,000.00	3,135,635.85	15,003,000.00	13,312,772.19
1982	10,648,000.00	9,653,285.09	4,095,000.00	2,950,043.35	14,743,000.00	12,603,328.44
1983	10,287,000.00	9,138,605.09	4,095,000.00	2,764,450.85	14,382,000.00	11,903,055.94
1984	10,312,000.00	8,626,813.21	4,082,000.00	2,578,858.35	14,394,000.00	11,205,671.56
1985	9,973,000.00	8,121,686.89	4,042,000.00	2,394,114.40	14,015,000.00	10,515,801.29
1986	9,847,000.00	7,619,629.39	3,985,000.00	2,210,486.90	13,832,000.00	9,830,116.29
1987	9,713,000.00	7,120,999.39	3,985,000.00	2,027,500.65	13,698,000.00	9,148,500.04
1988	9,559,000.00	6,624,379.39	3,981,000.00	1,844,514.40	13,540,000.00	8,468,893.79
1989	9,380,000.00	6,135,066.89	3,814,000.00	1,662,534.40	13,194,000.00	7,797,601.29
1990	9,265,000.00	5,649,985.49	3,500,000.00	1,487,653.57	12,765,000.00	7,137,639.06
1991	9,083,000.00	5,170,276.74	3,346,000.00	1,322,829.82	12,429,000.00	6,493,106.56
1992	8,976,000.00	4,696,925.49	3,236,000.00	1,163,373.57	12,212,000.00	5,860,299.06
1993	8,772,000.00	4,227,945.94	3,010,000.00	1,007,232.50	11,782,000.00	5,235,178.44
1994	8,577,000.00	3,762,842.19	2,952,000.00	856,763.75	11,529,000.00	4,619,605.94
1995	8,135,000.00	3,308,154.69	2,900,000.00	708,700.00	11,035,000.00	4,016,854.69
1996	7,975,000.00	2,863,992.19	2,745,000.00	561,831.25	10,720,000.00	3,425,823.44
1997	7,630,000.00	2,430,198.44	2,340,000.00	423,287.50	9,970,000.00	2,853,485.94
1998	7,535,000.00	2,004,773.44	1,910,000.00	298,037.50	9,445,000.00	2,302,810.94
1999	7,385,000.00	1,583,267.19	1,445,000.00	190,525.00	8,830,000.00	1,773,792.19
2000	6,965,000.00	1,168,885.94	725,000.00	105,100.00	7,690,000.00	1,273,985.94
2001	6,225,000.00	778,654.69	485,000.00	61,075.00	6,710,000.00	839,729.69
2002	5,205,000.00	433,748.44	255,000.00	31,750.00	5,460,000.00	465,498.44
2003	3,190,000.00	174,679.69	140,000.00	17,300.00	3,330,000.00	191,979.69
2004	565,000.00	38,137.50	120,000.00	8,100.00	685,000.00	46,237.50
GRAND TOTAL	$253,918,200.00	$170,515,728.88	$88,412,000.00	$48,376,952.76	$342,330,200.00	$218,892,681.64

Electors Bonds (Peoples Bonds):

During the period 1924 through 1965, the electorate approved bond issues for various specified purposes. Of these authorized issues, approximately $14,457,000 were not issued by the County to date. Some of the unissued bonds were formally abandoned by action of the County Commissioners from time to time because the intended use no longer existed. The remaining bonds approved by the electorate may still issue for the purposes approved by the voters. Such voter approved bonds do not reduce the gross borrowing capacity of the County under Pennsylvania law, as indicated in the Debt Statement which is part of this Official Statement.

Indebtedness By Purpose:

The following table summarizes the indebtedness of the County as of December 31, 1975, by purpose, without giving effect to the sale of this issue.

ALLEGHENY COUNTY
STATEMENT OF NON-ELECTORAL INDEBTEDNESS BY PURPOSE
As of December 31, 1975
(In Thousands)

	Bonds Issued	Amount Redeemed to 12-31-75	Outstanding Bonds As of 12-31-75
Airport	$ 94,533	$ 28,415	$ 66,118
Authority for Improvements in Municipalities	4,950	740	4,210
Bridges	22,230	12,820	9,410
Computer Systems	4,350	445	3,905
Community College	6,150	695	5,455
Equipment	3,270	1,995	1,275
Parks	43,410	12,674	30,736
Planning	4,380	818	3,562
Port Authority	80,000	6,090	73,910
Roads	31,590	14,263	17,327
Public Buildings	39,510	11,962	27,548
Tunnel	570	401	169
Voting Machines	900	170	730
Urban Redevelopment	360	144	216
Stadium Redevelopment	6,345	1,904	4,441
Sewage Facilities	4,650	360	4,290
	$ 347,198	$ 93,896	$253,302

TOTAL (30 Year Bonds Outstanding at 12-31-75)—$253,302,000

Plus—10 Year Term Bonds—Outstanding

Due—October 1980	$ 134,200
July 1981	132,000
April 1982	150,000
August 1984	200,000
Total (Non-Electoral Debt—12-31-75)	$253,918,200

Underlying Indebtedness:

Each of the local municipalities and school districts previously referred to are separate entities, with each having its separate borrowing base and borrowing capacity under existing law. In addition, there are approximately 90 authorities legally functioning in various school districts and municipalities, each having its own borrowing capacity.

The Department of Community Affairs of the Commonwealth of Pennsylvania furnished the following information concerning the debt in such municipalities, authorities and school districts:

Various Municipal and County Authorities 1974 Fiscal Year	$684,527,000.00
129 Townships, Boroughs and Cities (as of December 31, 1974)	142,000,000.00
47 School Districts (as of June 30, 1974—fiscal year)	153,390,000.00
Total	$979,917,000.00

Overlapping Debt:

The City of Pittsburgh and a substantial number of local municipalities are parties to agreements securing the debt of the Allegheny County Sanitary Authority. However, the bonds issued by the Sanitary Authority are self-liquidating. The users of the service pay an amount calculated to meet the debt service requirements. Such bonds, under Pennsylvania law, do not reduce borrowing capacity. The County could become involved only in the very remote circumstance that the sewer bills are not paid by either the user or the local community which is primarily responsible for its citizen users.

The County is also party to an agreement with the City of Pittsburgh securing the debt of the Pittsburgh Public Auditorium Authority and appoints two members to its board. This, as reflected in the Debt Statement hereinafter set forth, is a lease rental debt, part of which is self-liquidating. The County and City each pay $420,502.82 a year on the bonded indebtedness and are equally responsible for any deficits. Since 1961 when the auditorium began operations, it has had net operating earnings of $215,123.00 and since 1965 it has not had a deficit in operations. Since 1961 the City has received $4,583,341.00 in admission taxes and $890,860.00 in parking taxes.

The County is obligated to assist the Port Authority of Allegheny County, but the amount of aid is a budgetary matter. The Port Authority of Allegheny County capital improvement program is discussed on page 17. Also, see footnote 3 on page 10.

Transfers of Funds From Bond Accounts:

During the year ending December 31, 1975, the net sum of $3,382,825.67 was temporarily transferred from the general fund to the various bond accounts for payment of current capital improvement bills. This sum was not reflected in the Debt Statement because it constituted an internal transfer of funds and not a "debt" as defined by the Pennsylvania Local Government Unit Debt Act. These funds were used for the ongoing capital improvements at the County Airport and are to be reimbursed to the general fund from the proceeds of this bond issue.

DEBT STATEMENT

The Local Government Unit Debt Act No. 185 of 1972 requires the preparation of a Debt Statement to accurately reflect the borrowing capacity of the municipality, before delivering any bonds. Such statement in accordance with the law is as follows:

Debt Statement

of the County of Allegheny as of December 31, 1975

As Required By Local Government Unit Debt Act No. 185 of 1972

*Gross Revenue—Year 1972	$119,621,619.72
*Gross Revenue—Year 1973	152,141,954.34
*Gross Revenue—Year 1974	148,373,635.07
Total	420,137,209.13
Average	$140,045,736.38

*All monies received from all sources during the fiscal year, as defined by Act 185 of 1972, including special recurring revenues received from State and Federal programs for special purposes which are not budgetary items.

MULTIPLES TO DETERMINE GROSS BORROWING CAPACITY

For Counties: 300%	$420,137,209.14
For Counties With Lease Rental Debt: 350%	490,160,077.33
For Financing Capital Facilities Relating to Specific County-Wide Functions and Responsibilities: Additional 100%	140,045,736.38[1]

STATEMENT OF INDEBTEDNESS

GROSS COUNTY DEBT			
Bonds Issued and Outstanding:			
Electoral	$ 88,412,000.00		
Non-Electoral	253,918,200.00	$342,330,200.00	
Uncompleted Bond Contracts:			
Electoral	$ 270,846.03		
Non-Electoral	5,189,918.82	5,460,764.85	
Bond Anticipation Notes		14,000,000.00	
Early Action Program—Port Authority:			
Contractual Obligations		6,201,225.00[2][3]	
Capital Improvement Grant—Port Authority—Phase IV		$ 60,637.00[2]	
Total Gross County Debt			$368,052,826.85
Less: Electoral Debt			88,412,000.00
GROSS COUNTY NON-ELECTORAL DEBT			$279,640,826.85
Offsetting Credits			
Bond Reserves:			
Electoral	$ 270,846.03		
Non-Electoral	—	$ 270,846.03	
Current Debt Service Appropriation		123,544.69	
Delinquent Taxes—66⅔% Collectible		7,276,454.78	
Subsidized Debt		—[4]	
Accounts Receivable		2,178,244.34	
Total Offsetting Credits			9,849,089.84
			269,791,737.01
Add: Interest—Non-Electroral			109,544.69
NET COUNTY NON-ELECTORAL DEBT			$269,901,281.70
GROSS LEASE RENTAL DEBT			
Bonds Issued and Outstanding:			
Auditorium Authority		$ 7,965,000.00	
TOTAL GROSS LEASE RENTAL DEBT			$7,965,000.00
Offsetting Credits			
Current Debt Service Appropriation		$ —	
Subsidized Debt		2,000,000.00	
Total Offsetting Credits			$2,000,000.00
NET LEASE RENTAL DEBT			$5,965,000.00
NET COUNTY NON-ELECTORAL DEBT		$269,901,281.70	
NET LEASE RENTAL DEBT		$ 5,965,000.00	
TOTAL NET DEBT		$275,866,281.70	

NOTE:

1. This capacity not needed for this issue; a portion was used for an earlier bond issue.
2. November 30, 1975 balances used—Final year-end balances unavailable until year-end audit completed.
3. This represents the amount awarded under third party contracts. The County's ultimate long-range commitment of $52,348,940.00 for Phases I, II, and III of the Early Action Program would mature into debt only as work progresses over the years. Moreover, one-half of the County's commitment will be offset by Commonwealth of Pennsylvania's contributions as authorized by the General Assembly in the 1971 Session.
4. Non-electoral debt of the County as of December 31, 1975 for capital costs of the Community College is $5,455,000.00. The subsidized portion of this debt, or $2,727,500.00 was not recognized as an offsetting credit. This portion of debt could be excluded as subsidized debt under Section 204 of the Local Government Unit Debt Act but application for this exclusion has not been made.

Percentage of Debt Service to Revenues:

During the years 1971-1975 the Debt Service requirements as related to Gross Revenues were as follows:

	Gross Revenues*	Debt Service	Percentage
1971	$ 86,990,874.38	$19,055,546.73	21.9%
1972	110,872,169.03	22,939,145.48	20.7%
1973	140,496,842.47	28,372,419.67	20.2%
1974	135,081,780.86	33,298,662.28	24.7%
1975	141,462,668.06	34,588,002.05	24.5%

*Gross Revenues as used herein do not include special recurring revenues received from State and Federal programs for special purposes, which are included in the Debt Statement hereinbefore set forth which was compiled to comply with the Local Government Unit Debt Act of Pennsylvania. This does include revenues from real estate taxes, personal property taxes, departmental earnings, liquid fuel tax (State), Health Department fees, Community College income, interest on time deposits, Federal Revenue sharing, fees from Mental Health program, fines and fees from the Courts and certain miscellaneous income.

ALLEGHENY COUNTY
STATEMENT OF CASH BALANCES, RECEIPTS, TRANSFERS, EXPENDITURES AND ENCUMBRANCES
1971-1975
(In Thousands)

	1971	1972	1973	1974	1975
Cash Balance January 1	$ 9,909	$ 7,242	$ 17,020	$ 16,628	$ 10,749
Operating Funds Receipts (Schedule A following)	86,991	110,872	140,497	135,082	141,463
Transfers to Operating Funds	52,997	52,282	41,132	79,369	70,342
TOTAL	$149,897	$170,396	$198,649	$231,079	$222,554
Operating Funds Expenditures (Schedule B following)	$ 95,049	$ 98,737	$133,621	$145,329	$149,997
Transfers from Operating Funds	47,606	54,639	48,400	75,001	65,322
TOTAL	$142,655	$153,376	$182,021	$220,330	$215,299
Net Cash Balance 12-31	$ 7,242	$ 17,020	$ 16,628	$ 10,749	$ 7,225
Reserves:					
Open Purchase Orders	595	664	896	1,284	735
Contracts	57	37	106	70	66
TOTAL RESERVES	$ 652	$ 701	$ 1,002	$ 1,354	$ 801
Unencumbered Cash Balance	$ 6,590	$ 16,319	$ 15,626	$ 9,395	$ 6,454

Source: County Controller's Annual Report (1971-1974). 1975 figures taken from current ledgers of the County, subject to final Report.

Schedule A

ALLEGHENY COUNTY
ANALYSIS OF GENERAL OPERATING FUNDS REVENUES BY SOURCE
1971-1975
(In Thousands)

Source of Revenues	1971	1972	1973	1974	1975
Taxes—Real Estate and Personal Property	$61,504	$ 61,705	$ 61,430	$ 59,392	$ 64,721
State Aid for General Fund Purposes	4,693	13,765	24,834	25,995	29,294
Federal Aid for General Fund Purposes	679	3,710	443	106	156
Federal Revenue Sharing	—	5,820	15,658	14,041	12,754
Departmental Earnings	17,856	20,615	29,610	28,369	26,370
Miscellaneous	2,259	5,257	8,522	7,179	8,168
TOTAL	$86,991	$110,872	$140,497	$135,082	$141,463
	% To Total				
Taxes—Real Estate and Personal Property	70.7%	55.7%	43.8%	44.0%	45.8%
State Aid for General Fund Purposes	5.4	12.4	17.7	19.2	20.7
Federal Aid for General Fund Purposes	.8	3.3	.3	.1	.1
Federal Reserve Sharing	—	5.2	11.1	10.4	9.0
Departmental Earnings	20.5	18.6	21.1	21.0	18.6
Miscellaneous	2.6	4.8	6.0	5.3	5.8
	100.0%	100.0%	100.0%	100.0%	100.0%

Schedule B

ANALYSIS OF GENERAL OPERATING FUND EXPENDITURES BY FUNCTION
1971-1975
(In Thousands)

	1971		1972		1973		1974		1975	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Administrative	$13,362	14.1	$13,146	13.3	$ 14,553	10.9	$ 14,314	9.8	$ 15,490	10.3
Corrections	4,113	4.3	2,887	2.9	5,609	4.2	10,272	7.1	3,928	2.6
Debt Service	19,056	20.0	22,939	23.3	28,372	21.2	33,299	22.9	34,588	23.1
Education and Civic	7,943	8.4	9,310	9.4	12,372	9.3	13,807	9.5	12,762	8.5
Fringe Benefits	5,769	6.1	5,893	6.0	7,775	5.9	8,339	5.7	9,571	6.4
Human Services	6,615	7.0	6,449	6.5	22,834	17.1	23,479	16.2	26,386	17.6
Judicial	14,075	14.8	14,084	14.3	15,141	11.3	15,540	10.7	17,252	11.5
Miscellaneous	2,519	2.6	2,069	2.1	1,999	1.5	2,772	1.9	2,677	1.8
Parks and Conservation	4,893	5.1	3,568	3.6	5,761	4.3	5,425	3.7	5,009	3.3
Public Safety	1,496	1.6	1,691	1.7	2,711	2.0	3,026	2.1	3,499	2.3
Transportation	15,208	16.0	16,701	16.9	16,494	12.3	15,056	10.4	18,815	12.6
TOTAL	$95,049	100.0	$98,737	100.0	$133,621	100.0	$145,329	100.0	$149,977	100.0

Source: County Controller's Annual Report (1971-1974). 1975 figures taken from current ledgers of the County, subject to final Report.

COUNTY OF ALLEGHENY
CONSOLIDATED BALANCE SHEET—OPERATING FUNDS
Years 1970-1974

	As Of Dec. 31, 1970	As Of Dec. 31, 1971	As Of Dec. 31, 1972	As Of Dec. 31, 1973	As Of Dec. 31, 1974
ASSETS					
Cash	$ 9,908,735.11	$ 7,241,450.99	$ 11,200,132.58	$ 16,627,579.64	$ 10,749,114.43
Taxes Receivable	4,689,728.92	6,698,594.10	8,365,352.73	8,126,910.04	5,757,774.30
Lien Docket Taxes Receivable	4,473,615.51	4,831,983.34	5,252,502.97	6,528,603.49	7,573,419.71
Accounts Receivable	1,621,136.21	2,840,618.53	5,314,443.65	3,819,919.58	2,967,081.89
Temporary Loans	3,912,000.00	2,622,000.00	5,250,000.00	4,675,851.00	2,302,851.00
Amount to be Provided for Retirement of Bonds	207,728,200.00	235,677,200.00	288,626,200.00	354,472,200.00	359,044,200.00
Total Assets and Bond Issues	$232,333,415.75	$259,911,846.96	$324,008,631.93	$394,251,063.75	$388,394,441.33
LIABILITIES					
Bonds Payable	$207,728,200.00	$235,677,200.00	$288,626,200.00	$354,472,200.00	$359,044,200.00
Reserve for Open Market Orders	783,369.36	671,889.10	663,895.64	895,912.25	1,284,139.43
Reserve for Contracts	32,745.19	56,684.21	37,536.79	105,975.95	69,911.88
Temporary Loans	8,500,000.00	12,348,000.00	11,350,000.00	6,500,000.00	10,000,000.00
Revenue Accrued in Excess of Above Requirements	15,289,101.20	11,158,073.65	23,330,999.50	32,276,975.55	17,996,190.02
Total Fund Liabilities, Reserves, and Surplus	$232,333,415.75	$259,911,846.96	$324,008,631.93	$394,251,063.75	$388,394,441.33

ALLEGHENY COUNTY

The Community—General Information:

Allegheny County, Pennsylvania, comprising 727.9 square miles in the western end of the Commonwealth of Pennsylvania, is the nation's ninth largest county in population with 1,605,016 persons as of the 1970 Census.

The County is made up of 129 separate municipalities, including the City of Pittsburgh, which is the second largest city in the Commonwealth of Pennsylvania. Economically, the County is a diversified community composed of some 1,400 manufacturing units, 7,300 service industries and 2,200 wholesale trade industries. Even though it is an urban County, there are still 499 operating farms within the County boundaries. The City of Pittsburgh is reported to be the third largest port city in America, second only to New York and New Orleans in tonnage.*

In addition to river transportation, the County is developing land transportation through a system of bus, rail and rapid transit vehicles. The County government operates two airports, including the Greater Pittsburgh International Airport, which last year processed some 7.5 million passengers and 170 million pounds of cargo. The airport provides either direct or spinoff employment for some 50,000 people at an estimated economic value of between $300 million and $500 million to the region.

Allegheny County is enhanced by a series of cultural and educational facilities, including some 46 separate school districts, eight institutions of higher learning, some of the nation's most respected museums and art galleries, as well as a group of cultural organizations, including such famous companies as the Pittsburgh Symphony, Pittsburgh Ballet Theater, Civic Light Opera, and the American Wind Symphony. The County supports a Community College with three campuses. Other institutions of higher learning located in the County include the University of Pittsburgh, Carnegie-Mellon University, Chatham College, Carlow College, a campus of Penn State University, Duquesne University, LaRoche College, Robert Morris College, Point Park College, and the Pittsburgh Theological Seminary.

The City of Pittsburgh, the largest municipality within Allegheny County, has a population of 520,117. The city is a center of commerce, culture, education, and transportation. Some 24 major corporations maintain their corporate headquarters within the City of Pittsburgh, including Mellon Bank NA, United States Steel Corporation, Westinghouse Electric Corporation, Gulf Oil Corporation, Rockwell International, Koppers, and others.

Government:

The Legislative and Executive arm of county government is the three-member Board of County Commissioners. The Commissioners are elected for parallel four-year terms with the proviso that the Board be composed of at least one representative from an alternate political party, thus providing for representation by the minority political party.

The Commissioners are responsible for managing county government, including adoption of a final budget and levying the tax millage; appointing of department heads and members of various boards and commissions; approval of all contracts, expenditures, incurring debt and property sales.

In addition to their role as County Commissioners, the Commissioners serve as the Executive and Administrative Officers of the Allegheny County Institution District. Created by statute, Institution Districts in Pennsylvania are authorized for counties performing certain humanitarian functions such as indigent ill care, child welfare and senior citizen protection. The Institution District is given separate taxing authority by law and separate power to incur debt within the limits of the Local Government Unit Debt Act, which specifically limits this borrowing capacity to 250% of its borrowing base. Although the county and the district are functionally one government, the law does provide these distinctions and for borrowing purposes it is a totally separate entity.

Generally, counties in Pennsylvania are creatures of the state, and have no inherent right of self government, although limited home rule is available with the approval of the electorate. In Allegheny County, the electorate recently rejected home rule. The relationship between the county and the state is spelled out in the Pennsylvania Constitution and various state laws such as the Second Class County Code.

*Based on tons shipped via waterways.

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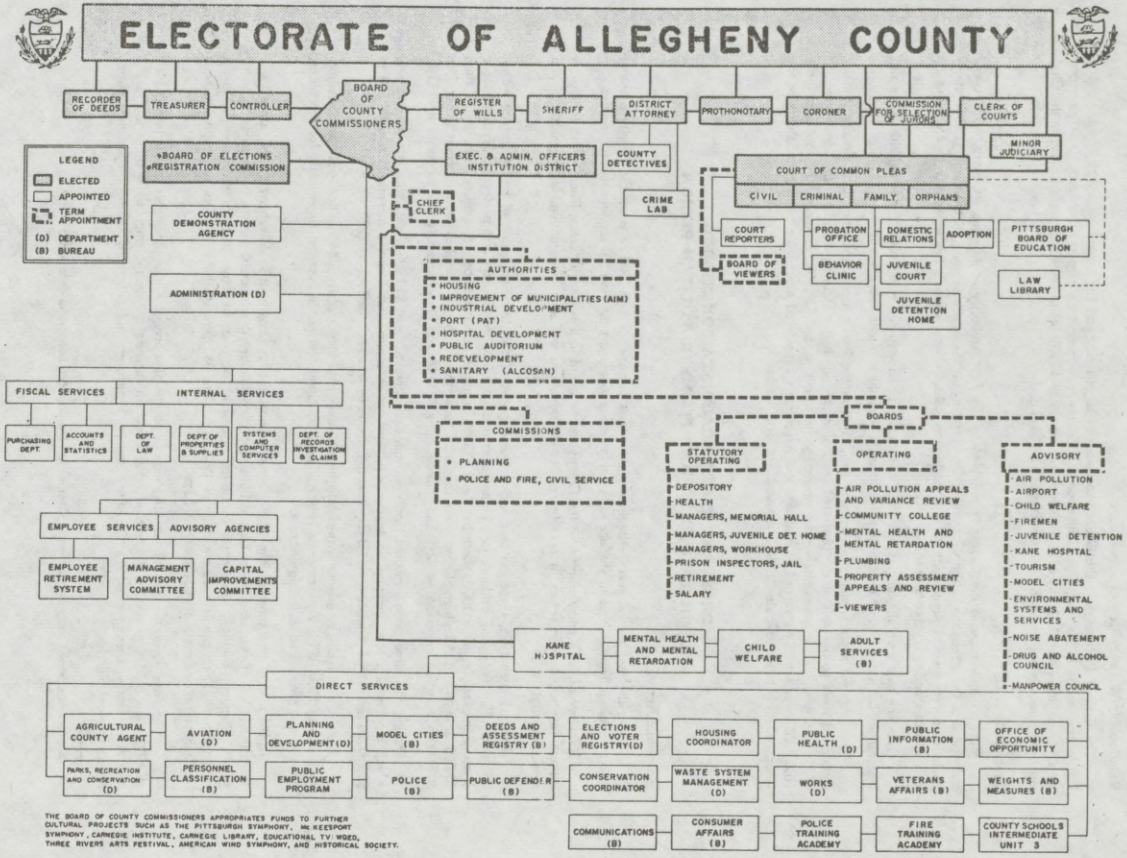
The functions specifically delegated to the county in the code are the administration of elections and registration of voters, assessment of property for taxation purposes, administration of justice, care of prisoners, recording of deeds and probate of wills, construction and maintenance of highways and bridges, construction and administration of aviation facilities, park development and operation and provision of public health services.

The State Constitution provides for eleven elected officials in addition to the Commissioners, who administer the affairs of the county and their duties are prescribed by statutes which are scattered through the county codes and general state laws. These elected officials, as shown on the chart which follows, are independent of the County Commissioners, but their annual budgets are subject to approval by the Commissioners who control the expenditures of all departments in the County.

Chief among the independently elected officials is the County Controller, who has general supervision over all County and Institution District fiscal affairs. He is directed by law to prepare and present the proposed budget and revenue estimates submitted by departments and agencies. The Controller pre-audits and post-audits all accounts and files an annual report of the financial transactions with the Court of Common Pleas.

The County operates on a calendar year. Therefore the 1975 accounts have not yet been certified by the County Controller, although presently available 1975 data is incorporated in this official statement.


ELECTORATE OF ALLEGHENY COUNTY
RECORDER OF DEEDS
TREASURER
CONTROLLER
BOARD OF COUNTY COMMISSIONERS
REGISTER OF WILLS
SHERIFF
DISTRICT ATTORNEY
PROTHONOTARY
CORONER
COMMISSION FOR SELECTION OF JURORS
CLERK OF COURTS
MINOR JUDICIARY
LEGEND
ELECTED
APPOINTED
TERM APPOINTMENT
(D) DEPARTMENT
(B) BUREAU
BOARD OF ELECTIONS
REGISTRATION COMMISSION
EXEC. & ADMIN. OFFICERS INSTITUTION DISTRICT
COUNTY DETECTIVES
CRIME LAB
CHIEF CLERK
COUNTY DEMONSTRATION AGENCY
ADMINISTRATION (D)
COURT OF COMMON PLEAS
CIVIL
CRIMINAL
FAMILY
ORPHANS
COURT REPORTERS
BOARD OF VIEWERS
PROBATION OFFICE
BEHAVIOR CLINIC
DOMESTIC RELATIONS
JUVENILE COURT
JUVENILE DETENTION HOME
ADOPTION
PITTSBURGH BOARD OF EDUCATION
LAW LIBRARY
AUTHORITIES
HOUSING
IMPROVEMENT OF MUNICIPALITIES (AIM)
INDUSTRIAL DEVELOPMENT
PORT (PAT)
HOSPITAL DEVELOPMENT
PUBLIC AUDITORIUM
REDEVELOPMENT
SANITARY (ALCOSAN)
FISCAL SERVICES
INTERNAL SERVICES
PURCHASING DEPT.
ACCOUNTS AND STATISTICS
DEPT. OF LAW
DEPT. OF PROPERTIES & SUPPLIES
SYSTEMS AND COMPUTER SERVICES
DEPT. OF RECORDS INVESTIGATION & CLAIMS
COMMISSIONS
PLANNING
POLICE AND FIRE, CIVIL SERVICE
BOARDS
STATUTORY OPERATING
DEPOSITORY
HEALTH
MANAGERS, MEMORIAL HALL
MANAGERS, JUVENILE DET. HOME
MANAGERS, WORKHOUSE
PRISON INSPECTORS, JAIL
RETIREMENT
SALARY
OPERATING
AIR POLLUTION APPEALS AND VARIANCE REVIEW
COMMUNITY COLLEGE
MENTAL HEALTH AND MENTAL RETARDATION
PLUMBING
PROPERTY ASSESSMENT APPEALS AND REVIEW
VIEWERS
ADVISORY
AIR POLLUTION
AIRPORT
CHILD WELFARE
FIREMEN
JUVENILE DETENTION
KANE HOSPITAL
TOURISM
MODEL CITIES
ENVIRONMENTAL SYSTEMS AND SERVICES
NOISE ABATEMENT
DRUG AND ALCOHOL COUNCIL
MANPOWER COUNCIL
EMPLOYEE SERVICES
ADVISORY AGENCIES
EMPLOYEE RETIREMENT SYSTEM
MANAGEMENT ADVISORY COMMITTEE
CAPITAL IMPROVEMENTS COMMITTEE
KANE HOSPITAL
MENTAL HEALTH AND MENTAL RETARDATION
CHILD WELFARE
ADULT SERVICES (B)
DIRECT SERVICES
AGRICULTURAL COUNTY AGENT
AVIATION (D)
PLANNING AND DEVELOPMENT (D)
MODEL CITIES (B)
DEEDS AND ASSESSMENT REGISTRY (B)
ELECTIONS AND VOTER REGISTRY (D)
HOUSING COORDINATOR
PUBLIC HEALTH (D)
PUBLIC INFORMATION (B)
OFFICE OF ECONOMIC OPPORTUNITY
PARKS, RECREATION AND CONSERVATION (D)
PERSONNEL CLASSIFICATION (B)
PUBLIC EMPLOYMENT PROGRAM
POLICE (B)
PUBLIC DEFENDER (B)
CONSERVATION COORDINATOR
WASTE SYSTEM MANAGEMENT (D)
WORKS (D)
VETERANS AFFAIRS (B)
WEIGHTS AND MEASURES (B)
COMMUNICATIONS (B)
CONSUMER AFFAIRS (B)
POLICE TRAINING ACADEMY
FIRE TRAINING ACADEMY
COUNTY SCHOOLS INTERMEDIATE UNIT 3
THE BOARD OF COUNTY COMMISSIONERS APPROPRIATES FUNDS TO FURTHER CULTURAL PROJECTS SUCH AS THE PITTSBURGH SYMPHONY, MC KEESPORT SYMPHONY, CARNEGIE INSTITUTE, CARNEGIE LIBRARY, EDUCATIONAL TV: WQED, THREE RIVERS ARTS FESTIVAL, AMERICAN WIND SYMPHONY, AND HISTORICAL SOCIETY.

Relationship With the City of Pittsburgh:

The City of Pittsburgh is the County seat and its largest city and the second largest city in the State. Its government is in no way dependent upon the County government for any tax revenues. It is governed by a Mayor and Council. Many of the educational and cultural facilities of the County are located in the City, and approximately one-third of the County population lives in the City.

Transportation:

Mass transportation in the County is provided by the Port Authority of Allegheny County, which owns and operates the streetcars in the City and those operating in the southern areas of the County. Bus transportation covers most of the County, with some limited rail transportation to a few areas such as McKeesport, Pennsylvania, and to areas outside the County.

Over the past several years efforts have been made to construct a rapid transit system with State and Federal aid, but at the present time no positive action is being taken to effectuate this program.

The proposed rapid transit program was designated as the Early Action Program. The County initially committed itself to one-half of the projected cost, of which one-half was to be offset by the Commonwealth of Pennsylvania. This commitment was originally projected at $58,550,165. However, of this sum only $6,201,225 was actually awarded in contracts and is presently considered a probable contingent liability of the County. This is reflected in the "Debt Statement" set forth herein.

RELEVANT STATISTICAL DATA CONCERNING ALLEGHENY COUNTY AND ITS METROPOLITAN REGION

Economic Activity:*

During the past several years, Allegheny County has sustained a high level of economic activity enabling it to maintain a firm tax base to produce sufficient revenues to support the essential services that it provides.

Evidence of the economic health of the County can be found in a number of areas, from growth in various income categories to increases in taxable real estate valuations and new construction, both residential and non-residential.

From 1970 to 1975, there has been a dramatic improvement in the distribution of family income within Allegheny County, giving evidence to a higher concentration of skilled laborers and professionals in the labor force. For example, since 1970, there has been a 30% decrease in the number of families earning less than $5,000 annually in Allegheny County. At the same time, the number of families earning from $15,000 to $25,000 a year has increased by 92% and those earning $25,000 and above annually has increased by 142%.

During this same period, median family income has increased from $10,090 a year to a current $13,695, which represents a total increase of nearly 36%. Per capita income has likewise increased from $4,549 to $5,990, an increase of some 32% and is expected to increase by an additional 39% by 1980.

Taxable real estate valuations within Allegheny County have increased from $4.2 billion to almost $5 billion, a growth of 18%. With a government largely dependent upon real estate taxation to generate local revenue, this increase assumes an added significance.

In the area of new construction, 30,000 units of housing have been built in Allegheny County since 1970. With the influx of vast amounts of federal housing and community development dollars, the housing industry within Allegheny County should enjoy continued success in the years to come. In the area of non-residential construction, during the first nine months of 1975, a total of 313 projects have been started, representing a total capital investment of approximately $153 million.

On the retail level, the outlook for Allegheny County is also bright. Figures available for the period 1967 to 1972 show a 33% growth in the level of retail sales and the establishment during that same period of 382 new retail stores. During the 1975 Christmas season, Pittsburgh and Allegheny County department stores reported record high levels of sales.

*Source: Allegheny County Department of Planning and Development, and various documents.

Even more remarkable than the growth in retail sales has been the expansion of service-related industries within Allegheny County. From 1967 to 1972, a total of 2,573 new service industries were established within Allegheny County, a clear indication that the economy of this County has shed its reliance on heavy industry with its cyclical ups and downs and is moving to a more stable service oriented economy. In recent years only one substantial company, Allis-Chalmers, has moved out of the Pittsburgh market and employment area.

On the employment front, the long-range forecast for Allegheny County is favorable. Unemployment in this area has been on the decline and currently stands at 8.7 (seasonably adjusted) percent for December, 1975. The Southwestern Pennsylvania Regional Planning Commission estimates that total employment within Allegheny County will increase from 653,665 persons in 1967 to nearly 920,000 persons by the year 2000, an increase of more than 41%.

With some 24 major corporations maintaining their corporate headquarters within Allegheny County, including such Fortune 500 giants as United States Steel Corporation, Rockwell International, Alcoa, PPG Industries, Koppers, Mellon Bank and many others, Allegheny County provides a vital link in the economic life of the entire tri-state region and for that matter the nation. It is considered to be the third largest corporate headquarters area in the United States.

County Population:

ALLEGHENY COUNTY
POPULATION

1920	1,185,808
1930	1,374,410
1940	1,411,439
1950	1,515,237
1960	1,628,587
1970	1,605,016

Estimate of Future Population

With the end of the post-war population boom, forecasters are predicting a stable population or a possible slight decline for the county proper. The Southwestern Regional Planning Commission, a multi-county agency, predicts a stable population for the region through the year 2000 with particular stability in the 25-50 age group.

Sources: U. S. Bureau of Census. S. W. Pa. Regional Planning Commission. *(Dimension of Year 2000).*

Family Income Distribution—1970-75:

	1970(1)	1975(2)
Less than $1,000	2%	1%
$1,000—$1,999	2%	2%
$2,000—$2,999	4%	2%
$3,000—$3,999	4%	3%
$4,000—$4,999	4%	3%
$5,000—$5,999	5%	3%
$6,000—$6,999	6%	5%
$7,000—$7,999	7%	4%
$8,000—$8,999	8%	5%
$9,000—$9,999	8%	7%
$10,000—$10,999	14%	8%
$12,000—$14,999	15%	15%
$15,000—$24,999	16%	30%
$25,000—$49,999	4%	10%
More than $50,000	1%	2%
	100%	100%

(1) Source: U. S. Census, 1970.

(2) Source: Allegheny County Department of Planning and Development.

Median Income:

There has been a substantial increase in the median income of family units between 1970 and 1975.

ALLEGHENY COUNTY
MEDIAN INCOME

	1970	1975	% Change
Families	411,172	413,479	6%
Median Income	$ 10,090	$ 13,695	35.7%

Sources: U. S. Census, 1970.
Allegheny County Department of Planning and Development.

EMPLOYMENT RECORDS—SMSA:
Area Employment Statistics[1]
(In Thousands—Rounded)

	Unemployment Data					
	Dec. 1975	April 1975	April 1974	April 1973	April 1972	April 1971
Civilian Labor Force	967.9	959.1	936.0	982.2	1002.8	977.7
Employment(2)	882.5	880.9	881.1	938.2	944.3	946.3
Unemployment	85.4	78.2	54.9	43.0	57.3	41.4
% Unemployment	8.8	8.2	5.9	4.4	5.7	4.2
Unemployment (Seasonally adjusted)	83.9	81.2	58.4	45.7	6.1	N/A
% Unemployment (Seasonally adjusted)	8.7	8.4	6.2	4.6	6.1	N/A

(1) Source: PA Department of Labor, *Labor Market Letter*, January 26, 1976. Figures represent four-county area (Allegheny, Washington, Westmoreland and Beaver).

(2) Because of rounding, totals may have slight variance from sum of employment and unemployment.

Employment Description
(December, 1975)
(In Thousands)

Nonagricultural Wage and Salary	889.8
All Manufacturing Inds.—Total	242.0
Durable Goods	197.4
Lumber & Wood Products	0.7
Furniture & Fixtures	1.1
Stone, Clay & Glass Products	16.0
Primary Metals	95.1
Fabricated Metal Products	20.7
Nonelectrical Machinery	22.9
Electrical Machinery	25.5
Transportation Equipment	8.6
Instruments & Related Products	5.3
Misc. Manufactures & Ordnance	1.5
Nondurable Goods	44.6
Food Products	13.2
Apparel & Related Products	3.3
Paper Products	2.3
Printing & Publishing	8.5
Chemical Products	9.7
Oil & Coal Products	3.9
Other Nondurable Goods	3.7

Employment Description—Continued
(December, 1975)
(In Thousands)

All Nonmanufacturing Inds.—Total	641.4
Mining	13.4
Contract Construction	36.6
Transp. & Public Utilities	55.2
Wholesale Trade	48.2
Retail Trade	147.4
Finance, Ins. & Real Estate	42.4
Service & Miscellaneous	181.1
Government	117.1
Federal Government	16.2
State & Local Government	100.9
Persons Involved in Labor-Management Disputes	6.4

Source: PA Dept. of Labor, *Labor Market Letter*, January 26, 1976.

Largest Area Private Employers

Firms	Approximate Employees
1. United States Steel Co.	26,000
2. Westinghouse Electric Co.	25,000
3. Bell Telephone of Western Pa.	7,200
4. Jones & Laughlin Steel	6,500
5. University of Pgh. (semi-public)	6,000
6. Allegheny Ludlum Steel	6,000
7. Wheeling Pgh. Steel	5,800
8. Mellon Bank, N.A.	4,600
9. Duquesne Light Co.	4,000
10. Pittsburgh Plate Glass	3,800
11. H. J. Heinz	3,000
12. Sears and Roebuck	3,000
13. Dravo	3,000
14. Gulf Oil	2,800
15. Press-Post Gazette	2,500
16. Pittsburgh National Bank	2,300
17. Mine Safety Appliance Co.	2,200
18. Alcoa	2,100
19. Universal Cyclops	2,100
20. Koppers	2,000
21. Kennametal	1,200

Sources: Greater Pittsburgh Chamber of Commerce.
Pa. Department of Labor (Employment Security).

Leading Taxpayers of the County:

The forty leading taxpayers paid approximately 16% of the total taxes levied in 1975, and the top twenty taxpayers paid 13.7% of the 1975 tax levies.

The top twenty taxpayers in 1975 were:

Taxpayer	Total Valuation	Gross 1975 Tax
1. U. S. Steel	$189,783,655	$2,941,646.65
2. Mellon Bank		
Real Estate	24,687,450	382,655.48
Personal Property	95,985,120	383,940.48
Total	120,672,570	766,595.96
3. Equitable Life Assurance	49,439,055	766,305.35
4. Westinghouse	43,769,795	678,431.82
5. Pittsburgh National Bank		
Real Estate	16,236,391	251,644.06
Personal Property	65,001,426	260,005.70
Total	81,237,817	511,669.76
6. Urban Redevelopment Authority of Pittsburgh	32,455,641	503,062.44
7. Jones and Laughlin Steel	29,102,284	451,085.40
8. Oliver Tyrone	17,152,630	265,865.77
9. Harry Soffer, et al (Monroeville Mall)	16,452,085	255,077.32
10. Allegheny Ludlum Steel	15,826,756	245,314.72
11. Carnegie Illinois Steel	15,547,225	240,981.99
12. 525 William Penn Place Corporation, et al	14,652,700	227,116.85
13. Gulf Oil	13,775,070	213,513.59
14. Bell of Pennsylvania	12,512,005	193,936.08
15. May Department Stores	11,164,780	173,054.10
16. Alcoa	9,786,270	151,687.19
17. Allegheny County Industrial Development Authority	9,384,496	145,459.69
18. Joseph Horne Co.	9,048,800	140,256.41
19. Don-Mark Realty	8,693,400	134,747.70
20. H. J. Heinz	8,299,255	128,638.45
TOTAL	$708,756,289	$9,134,447.24

Compiled by the Office of the Allegheny County Treasurer.

Coal:

For many years coal mining was one of the principal industries of Allegheny County. In recent years this has dwindled somewhat but it is still quite extensive.

Allegheny County, Pennsylvania
Coal Reserves

In 1973, the State of Pennsylvania, Department of Commerce published an economic analysis of Allegheny County. Part of the report dealt with energy production and reserves. Quoting from the report:

> "Although iron ore is now obtained from sources outside the county (Allegheny) bituminous coal is still mined quite extensively. "Soft" coal production, about 4.3 million tons in 1973, employed an average of 1,510 persons daily ranking the county ninth in the state (Pennsylvania). About 85 percent was obtained from underground mines. Estimated recoverable reserves, in 1973, were listed as 1 billion tons."

Source: Pennsylvania Department of Commerce.
1973 Pennsylvania Industrial Census Series. Release M 5 73.

The U. S. Bureau of Mines has some of its largest coal research and mining research facilities located in Allegheny County, near Carnegie-Mellon University in Pittsburgh and at the U. S. Bureau of Mines, Bruceton, Pennsylvania. Extensive reasearch and development of gas and possibly oil from coal is conducted by the U. S. Bureau of Mines at Bruceton. Pennsylvania, and by Continental Oil Company and Consolidated Coal Company at the pilot plant in Library, Allegheny County, Pennsylvania.

COUNTY PENSION PROGRAM

Recently, a great deal of public attention has been directed toward an examination of various aspects of the public pension programs.

The County pension program is governed by a Retirement Board, but all its authority is derived from state statutes. In 1973 the Retirement Act was amended by Act 19 to increase the contributions by employees from 7½% on the gross salary up to a maximum of $600, to 5% on the first $750, 7½% on salaries from $750 to $1,500 and 10% on excess of $1,500 to $2,000 per month. This increase resulted in an increase in the possible maximum contribution per member from $45 to a possible maximum of $143.75 per member. The law also requires the County to appropriate an amount sufficient to match the amount contributed by employees and to meet all administrative and legal obligations.

The County retains the services of Babb, Inc. as financial manager. Its latest report to the County Retirement Board, as of July 1, 1974, stated:

"We are pleased to report that:

"1. Your current financing pattern will produce future income in excess of future disbursements and, hence, produce the necessary reserves for benefits provided under the existing plan.

"2. Total contributions (related similarly to future pay levels) should be sufficient to amortize actuarial liabilities over the next 22 years. This is well within the limitations applicable to private employer plans under new legislation.

"3. It is essential that the County at least continue to match the employee contribution."

"The preceding material in this report has examined the history of the Retirement System and projected the future cash flow that will be generated if continued inflation triggers salary increases at a rate of 4% per annum. It was observed that fund expenditures will not exceed contributions plus investment income."

CLOSING CERTIFICATES

The County states that the description and statements herein, incuding financial statements, are true and correct in all material respects and that it will confirm to the underwriters, by certificates signed by its Director of the Bureau of Accounts and Statistics and County Commissioners and delivered at the closing, that such descriptions and statements in this Official Statement, on the date of this Official Statement and at the time of closing, were and are true and correct in all material respects and did not and do not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

CERTAIN LEGAL MATTERS

Certain legal matters incident to the issuance of the Bonds are subject to approval of Bond Counsel, Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, Pittsburgh, Pennsylvania. Copies of the approving legal opinion in the form attached as Appendix "A" will be available at the time of the delivery of the Bonds. The opinion of Bond Counsel is limited to the validity and legality of the Bonds and to present Federal and Pennsylvania and local income tax status of interest on the Bonds.

SALE

As directed on Page 1 of this proposal, bids will be received February 11, 1976, at Room 104, Courthouse, Pittsburgh, Pennsylvania, 15219, up to 10 A.M. and will be opened by County Commissioners in a public meeting immediately thereafter. Closing will take place in New York, New York, on March 31, 1976. Delivery of Bonds to successful bidder will be against payment in immediately available Federal funds in Pittsburgh, plus accrued interest from March 1, 1976. Form of proposal to be used is attached as Appendix "B".

FINANCIAL STATEMENTS

Financial data submitted herein for the years prior to 1975 were adopted from the certified annual reports of the County Controller filed with the Court of Common Pleas each year through 1974.

Also included in this Official Statement and made a part hereof are the Financial Statements of the County as of December 31, 1975, certified by Nicholas Stabile, Director of the Bureau of Accounts and Statistics. The 1975 financial statements have not been certified by the County Controller because the County operates on a calendar year. The statements are believed to accurately reflect the 1975 financial condition. The County is operated on a cash basis, rather than accrual.

MISCELLANEOUS

So far as any statements made in this Official Statement involve matters of opinion or estimates, whether or not expressly stated, they are set forth as such and not as representations of fact, and no representation is made that any of the statements will be realized. Neither this Official Statement nor any statement which may have been made verbally or in writing is to be construed as a contract with the holders of the Bonds.

This Official Statement has been duly executed and delivered by the County Controller of Allegheny County and the County Commissioners.

At the closing, County will deliver a certificate that there is no litigation pending or threatened concerning the validity of these bonds.

COUNTY OF ALLEGHENY

JIM FLAHERTY,
Chairman

THOMAS J. FOERSTER
Commissioner

ROBERT N. PEIRCE, JR.
Commissioner

JOHN P. LYNCH
County Controller

Appendix "A"

BASKIN, BOREMAN, WILNER, SACHS, GONDELMAN & CRAIG
Attorneys at Law
10th Floor Frick Building
Pittsburgh, Pa. 15219
(412) 562-8600

TO THE PURCHASERS OF THE WITHIN DESCRIBED BONDS:

Re: *County of Allegheny, Pennsylvania, General Obligation Bonds, Series C-24, $27,000,000, dated March 1, 1976*

This opinion is furnished to you in connection with the issue and sale today by the County of Allegheny, Pennsylvania, of $27,000,000 principal amount of County of Allegheny, General Obligation Bonds, being Series C-24 in the amount of $27,000,000 (the "Bonds").

The Bonds are dated March 1, 1976 and mature in numerical order on March 1 of the years 1977 through 2006, both inclusive. The Bonds have been issued as coupon bonds, registrable as to principal only, in the denomination of $5,000 each, and will bear interest, at the rate of
payable on September 1, 1976, and semi-annually thereafter on March 1 and September 1 in each year. The Bonds are subject to redemption at the option of the County of Allegheny on and after March 1, 1986 either as a whole at any time, or from time to time in part, on any interest payment date in the inverse order of their stated maturity dates.

The Bonds are authorized by and have been issued and sold pursuant to Section 10, Article IX of the Pennsylvania Constitution; the Local Government Unit Debt Act (Act 185, approved July 12, 1972), as amended; and the Ordinances of the County of Allegheny adopted December 18, 1975, amended January 22, 1976, and February 11, 1976, which, among other things, authorized the issuance and sale of the Bonds, prescribed the form thereof, the manner of bidding therefor and the forms of the bidding documents used in connection with the issue and sale of the Bonds.

The Bonds have been issued to provide funds to retire bond anticipation notes, dated August 28, 1975, in the amount of $14,000,000, and to partially finance the 1975-76 Capital Improvement Program for Allegheny County as needed, which Capital Improvement Program shall include the following: Greater Pittsburgh International Airport for new runway and reconstruction of aprons, taxiways and miscellaneous improvements; for public roads and bridges; County Buildings, including jail rehabilitation, and remodeling of old Juvenile Court Building in Oakland; for County parks and park improvements; to supplement federal grant for housing and human services and flood control; for Port Authority of Allegheny County for transit improvement; or for such other Public Improvement purposes as the Commissioners may from time to time deem necessary, and other improvements as noted in said Ordinances.

We have examined the constitutional and statutory provisions referred to above and certain resolutions and ordinances adopted pursuant thereto by the County Commissioners of Allegheny County, Pennsylvania. We have also examined one fully executed and countersigned bond, the debt statement, and such other certificates and documents as we deem necessary for the purposes of this opinion.

We are of the opinion that:

1. The principal amount of the Bonds is within all debt and other limitations fixed by the Constitution and the laws of the Commonwealth of Pennsylvania.

2. The County Commissioners of the County of Allegheny have, pursuant to the full and adequate legal power conferred upon them by the Constitution and the Local Government Unit Debt Act, validly taken all necessary and proper actions to issue and sell the Bonds, and the Bonds have been validly authorized, issued and sold pursuant to proper and appropriate action of such officials in accordance with the Constitution and the Local Government Unit Debt Act.

3. The Bonds, interest on the Bonds, transfers of the Bonds and gains on the sale thereof, other than the underwriting spread in a distribution thereof, are exempt from taxation for state and local purposes within the Commonwealth of Pennsylvania, except for gift, succession or inheritance taxes or any other

taxes not levied directly on the bonds, the receipt of the income therefrom or the realization of gains on the sale thereof. Interest on the bonds is not subject to present income taxation by the United States of America under existing statutes and decisions.

4. The Bonds are lawful, valid, direct and general obligations of the County of Allegheny, and the full faith and credit of the County has been pledged in accordance with the covenant contained in said bonds and as provided by Section 404 of the Local Government Unit Debt Act, which covenant is specifically enforceable.

5. Under the Probate, Estates and Fiduciaries Code, Act No. 164 of 1972, the Bonds are authorized investments for fiduciaries (as defined in that Act) within the Commonwealth of Pennsylvania, and under the said Act the Bonds are authorized investments for personal representatives.

6. The Bonds are legal investments for Pennsylvania banks, banks and trust companies and insurance companies and are acceptable as security for deposits of public funds.

7. The County of Allegheny has the power to provide for the payment of the principal of and interest on the Bonds and has so covenanted in accordance with the Local Government Unit Debt Act aforesaid, and by the terms of this covenant the County shall budget and appropriate such sums to the payment of such debt services, and shall duly and punctually pay the principal and the interest thereon. The County has power to levy ad valorem taxes on all taxable real property therein for the payment of these Bonds without limitation of rate or amount, and covenants to levy the necessary taxes.

8. If sufficient funds are not appropriated for the timely payment of debt service charges, the covenant contained in the Bonds can be specifically enforced and the appropriate court can direct payment into the sinking fund in sums sufficient to pay such interest and installments of principal, at the suit of the holder of any of the Bonds.

9. These Bonds and all proceedings in connection with the issuance thereof have been approved by the Department of Community Affairs of the Commonwealth of Pennsylvania in accordance with the Local Government Unit Debt Act. The Bonds are exempt from registration under the provisions of the Securities Act of 1933, as amended.

Very truly yours,

BASKIN, BOREMAN, WILNER, SACHS,
GONDELMAN & CRAIG

By /s/ FRANK R. BOLTE

General Partner
Bond Counsel

Appendix "B"

ALLEGHENY COUNTY BONDS

ISSUE OF MARCH 1, 1976

General Obligation Bonds	SERIES C-24	Amount $27,000,000

February . ., 1976

To the County Commissioners and County Controller
of Allegheny County, Pennsylvania.

Gentlemen:

Subject to all the conditions set forth in the offering of bonds hereto attached, we submit the following bid for the above Allegheny County Bonds, aggregating $27,000,000.

This bid is based upon an interest rate of .....%.

The bid for all of the bonds above mentioned is $.....
....., together with accrued interest thereon to date of delivery computed on a basis of 365 days to the year.

We enclose herewith a duly certified check or official bank check, payable to the order of the County of Allegheny, Pennsylvania, for $540,000 to secure the County against any loss resulting from our failure to comply with the terms of this bid. It is understood that no interest will be allowed upon this deposit.

For the information of the County only, and not as part of this proposal, the undersigned calculates that the net interest cost under this proposal, in conformity with the aforesaid public invitation, is $.....
or .....% per annum.

Said bonds are to be duly and legally executed and issued as evidenced by a certified copy of the written legal opinion of Messrs. Baskin, Boreman, Wilner, Sachs, Gondelman & Craig, Pittsburgh, Pennsylvania, and are to be delivered to us on March 31, 1976 at a place agreed upon between ourselves and the authorities of said County, against payment in immediately available federal funds in Pittsburgh.

.....
Signature of Bidder

Senator WILLIAMS. We are most encouraged hearing from two States, Illinois and Pennsylvania. Both States seem to be moving in the direction that would make the guideline provisions of this legislation unnecessary and exempt them if all of these developments that you're talking about are in place or moving in that direction. So your particular concern is probably not addressed to your own State.

But I will say that the policy statement of the National Association which I subscribe to is a fine statement. Here's our situation. What is your title, by the way?

Mr. FLAHERTY. I'm chairman of the county commission.

Senator WILLIAMS. That residual area that becomes the Federal responsibility seems to be ever increasing because we are daily visited by the mayors, the county governments, Governors describing to us what residual areas that they find are necessary in the Federal structure. This week was both Governors and mayors week, I can assure you, here in Washington.

And with that, the ever increasing pressures from local governments, State and local, this modest proposal is being increasingly felt around here as one way to restrict that residual area that we have been exposed to—that is the Federal Government's rescue efforts, as with the biggest city in the country.

I appreciate this, Commissioner Flaherty and Mayor Carver. I would just hope that the specific bill and bills be part of your next association discussions. There are two bills here. One is the full registration requirement that Senator Eagleton has introduced. He testified on our opening day and I got the impression that he is not dogmatic. He feels that Federal legislation is the only way to bring a new atmosphere into this broad area of investment and that provisions of the bill Senator Tower and I introduced were favorably received.

Thank you very much.

Mr. FLAHERTY. We would certainly welcome, Senator, if members of your staff would like to participate in our preparation of the voluntary guidelines which we intend to disseminate so that you would have any input into the establishment of these disclosure requirements that we would hope the National Association of Counties would adopt at its coming annual meeting. My own personal reservation about entry of the Federal Government in this area of local finance—and I have read your disclosure requirements—is that there are requirements for coverage that are capable of being reduced by the Securities and Exchange Commission. I personally fear expanding bureaucracy. Little offices have a tendency to grow into buildings the size of the Pentagon and I think there's a growing feeling in the country that I hope I express to you personally of the intrusion of Federal regulation in that regard. That's my own personal feeling, sir.

Senator WILLIAMS. I know there is this feeling and I have frequently, since introducing this bill, observed that it reflects that national concern because we so clearly limit the bureaucratic overlay by not requiring all statements to be filed with the SEC and instead

it would be someplace else under contract in a repository. The SEC is not to be a swollen bureaucracy because of this requirement. With the State exemption, where just the fundamentals of good investment are part of a State's procedures, that is another way to limit that threat of the swollen bureaucracy. I agree with you. This is a concern. Thank you very much.

Mr. Robert G. Nordling, vice president, and Mr. Gilman C. Gunn, senior municipal bond analyst for the Chubb Corp. Thank you very much, gentlemen, for participating in this hearing.

STATEMENT OF GILMAN C. GUNN, SENIOR MUNICIPAL BOND ANALYST FOR THE CHUBB CORP.

Mr. GUNN. Thank you for inviting us, Senator Williams.

My name is Gilman C. Gunn and I am the municipal bond analyst for the Chubb Corp. With me today is Robert G. Nordling who is a vice president of the corporation and has overall responsibility for fixed income investments. The Chubb Corp. is an insurance holding company with total invested assets of $1.3 billion as of year-end 1975, and a current municipal bond portfolio of $501 million. We are pleased to have the opportunity to voice our general support for the "Municipal Securities Full Disclosure Act of 1976."

As institutional investors, we are convinced that municipal disclosure needs to be improved. Adequate disclosure allows investors to make informed investment decisions and it helps protect investors. If State and local borrowers are to continue to raise money in the municipal marketplace at reasonable cost, a high level of lenders confidence must be maintained. Over the long term, such confidence is fostered by good disclosure.

As a municipal bond analyst, it is my opinion that the voluntary system of disclsure we have now is not working. At the present time levels of disclosure vary widely since there are no standards as such. A great deal of confusion has arisen as to what constitutes "adequate disclosure." Even now, many months after the New York situation gained national headlines, issuers of many general obligation bonds do not provide prospective investors with good credit information. Instead, many issuers still supply a brief offering circular which only describes bidding details. If some of the well-publicized fiscal problems of State and local governments recede into the background in 1976, I am even more skeptical that State and local borrowers will step up their disclosure effort voluntarily.

As an added note, the MFOA is in the process of developing voluntary disclosure guidelines. Since such guidelines would be strictly voluntary, there is no guarantee that better disclosure would result. Voluntary guidelines haven't worked in the past and I don't believe they will in the future.

Without an adequate informational statement, the process of analyzing general obligation bonds is cumbersome for institutional investors and practically impossible for individual investors. As an analyst, without an informational statement, I am forced to rely

on the issuer's budgets, annual reports, fiscal newsletters, Census Bureau data, credit reports of the rating services, special reports prepared for us by municipal bond broker/dealer firms, and other data sources. General obligation bond analysis is further complicated by several other factors. For example, while many municipal governments claim to require balanced budgets, it has become all too apparent that such budgets often are not realistic—that is, revenues are overestimated and expenses are underestimated. Also, accounting policies and accounting changes are often not clearly spelled out although such policies and changes have a major effect on the issuer's financial statements. In addition financial statements are often not independently audited. As we have seen over the past several months, such independent audits are very important, especially in periods of economic stress.

Individual investors are at a much greater disadvantage than us when it comes to obtaining information on issuers of general obligation bonds. They don't have the background to wade through a budget document the size of a Manhattan telephone book. Nor can they generally afford to subscribe to rating service products. Our Moody's bill this year is $2,850—and we have a "no frills" version. Individuals are an important class of municipal bond buyers. Since many people feel that the municipal market already has too few buyers, it is important to maintain a high level of individual investor confidence in the municipal market. One way to help achieve that would be to insure that individual investors have the opportunity to review a document which gives pertinent information in reasonable detail.

The Municipal Securities Full Disclosure Act of 1976 expresses many of our views on improving disclosure. We are in agreement that the SEC is the logical entity to act in the public interest and for the protection of investors. The SEC is independent of issuers and underwriters. Responsibilities spelled out in S. 2969 would fit logically with the SEC because of the Commission's original mandate to protect investors and insure public confidence in the corporate securities markets. We believe it would be consistent to give the Commission a role for municipal securities as well.

We agree philosophically with S. 2574 which would provide for the registration of securities issued by State and local governments. However, as a practical matter, we feel that S. 2969 is a reasonable compromise between investors who would like to see full registration and issuers who want to maintain the status quo.

We are concerned however, about section 13A(c)(1) which states that local governments would be exempt from SEC purview if a State governmental authority indicates that disclosure is adequate for the protection of investors. This clause means that each State could establish different disclosure requirements. In that case, the SEC would be out of the picture. The prospect of each of the 50 States establishing its own disclosure requirements is not an appealing one to us. It would be less efficient and less independent than exclusive SEC involvement. We are particularly concerned that, in the final analysis, the level of disclosure would

not improve, and that we would be right back where we started from. A State agency can be of great help to local governments in assisting them in the disclosure process. However, we believe the authority for establishing rules and regulations should remain exclusively with the SEC.

Another concern is that nothing in the act spells out what happens if an issuer fails to disclose information required by the SEC. What sanctions does the SEC have to insure that items of disclosure are in fact disclosed? It seems logical to us that if the SEC is to actually protect investors, it must have some way of insuring that their items of disclosure are complied with before an issue comes to market.

We also feel that certain additional information would need to be included in annual reports and distribution statements. Both should include a good description of unfunded pension liabilities, accounting policies and changes in accounting, footnotes to the financial statements, status of cash flow and future borrowing plans and the relationship between the issuer and the trustee for bond holders. We would urge you to delete the words "similar and specific" when referring to other information the SEC may require. The sentences (to sec. 1(A)*4) and sec. 13(A)(b)(2)(G)) would then read "Such other information as the Commission may by rules or regulations require as necessary or appropriate in the public interest or for the protection of investors." This change would give the SEC more flexibility and therefore help it to protect investors.

We are in agreement with the need for a distribution statement and an independently audited annual report. Most States have the information needed for such documents. It's just a matter of putting the data in a form meaningful to municipal bond investors. In fact, I just received yesterday in my office a copy of the State of Wisconsin statement which starts out with a letter from the Governor of the State to prospective bidders on the bonds and one of the things he states in his letter, and I quote, is that "It has been prepared simply to consolidate what has in the past been available in several separate publications." So this means to me that many of the larger issuers which your bill focuses on do actually have the information. It's just not in a usable form for investors.

The cost of summarizing such data should be nominal, and the act appropriately excludes public offerings of under $5 million. Now to see how important the $5 and $50 million figures are, we took a look yesterday at the Daily Bond Buyer calendar of sealed bid openings. This list is included in the Daily Bond Buyer which is a trade publication we receive each day and it shows what issues above $750,000 are coming to market over the weeks ahead. This calendar, which was included in the Bond Buyer yesterday, showed that 124 issues are going to be coming to market or at least have announced they are coming to market through May 11. Of these 124 issues, 78 of them were under $5 million in size. That's 63 percent. So most of these issues would be excluded. We

also wanted to check the $50 million figure by looking at the issues that are coming up for sale next week. We found that the Bond Buyer includes 42 issues that are coming to market for competitive sale next week and of those 42 issues only six have amounts outstanding now over $50 million. So we feel that based on the background that I have just described, that the $50 million amount and the $5 million amount both are adequate for protection of investors in the larger issues and also protection for smaller issuers who normally sell their bonds locally.

Some people feel that underwriters should have the primary responsibility for writing a distribution statement. We feel that this responsibility logically belongs to the issuer. The issuer is closest to sources of information, and the 10-40 issues sold weekly on a competitive basis just do not lend themselves to having broker/dealers write detailed distribution statements.

In conclusion, we think S. 2969 represents a sound approach for improving disclosure while at the same time being mindful of the needs of State and local governments. We are pleased to support the act, subject to our concerns noted previously. Thank you for allowing us to express our views today. We'd be happy to answer any questions you might have.

Senator WILLIAMS. Thank you very much for an excellent statement.

First, on our threshold, $5 million and $50 million, you think that the pattern of borrowing is such that those are practical limits and I gather that is true because you feel that those under $5 million—any issue under $5 million and total of under $50—will be issues that will be sold quite close to home. Is that right?

Mr. GUNN. That is right.

Senator WILLIAMS. And is there the circumstantial probability that people that close to the issuer will have that feeling of knowledge that will give him assurance on some of the factors that are important in an investment decision?

Mr. GUNN. That's right. In fact, many local investors know the situation very, very well. Often they know the mayor of the town, members of the council, and are intimately familiar with what's going on in the community.

Senator WILLIAMS. There would be a warning 3,000 miles away, I would think, that on an issue under $5 million that maybe someone better be asked back there because it does not come through with the certification that might be required under this law. There would be a caveat the farther away you go.

Mr. GUNN. That's right.

Senator WILLIAMS. Now on the further authority of the SEC, this moves in the direction of preissue clearance of some kind. Isn't that what is sort of basic to what you're suggesting here?

Mr. GUNN. Well, that's a question that we have been trying to wrestle with ourselves because, on the one hand, we realize the bill as it's written now is certainly not meant to do that. On the other hand, we do feel that investors, particularly individual

investors, need protection before the fact rather than after the damage has been done. Therefore, we are raising the question of trying to insure that the issuer who is coming to market must actually disclose what the SEC has outlined that they should diclose. Unfortunately, I don't have an easy answer for how that process is to occur.

Senator WILLIAMS. It is basic here that if the requirements are clear and the liability question is clear, then these two things together would enforce the provisions and the issuer would conform. If that liability question is to be made very clear, we still have discussion before us. In other words, this is market enforcement, marketplace enforcement, which comes down ultimately to the after-fact situation and liability and damages.

Mr. GUNN. That's what we're concerned about, namely, the after the fact correction of any losses involved in the sense that a small investor—now we are a large investor, of course, speaking as a large investor, and we feel like we can take our lumps. That's really what we're paid to do. On the other hand, the small investor, it's of small solace to him in the intervening months between the time he sees his holdings deteriorate sharply in value and the time, for example, a lawsuit is actually decided in its final form—that can be an awful long time, and during that time an individual whose holdings has deteriorated sharply is severely limited in the options he has.

Senator WILLIAMS. Well, we are very appreciative of the fact that you came here to testify on this legislation and with your eminence in the field it's significantly important to our record that you have made yourselves available to our deliberations. We appreciate it very much.

Mr. GUNN. Thank you for inviting us.

[It was requested that the following appear in the record:]

Excerpted from

Calendar of
Sealed Bid Opening

MAJOR BOND ISSUES SCHEDULED ($ 750,000 up)

These are the official dates as fixed for bond sales reported to **THE DAILY BOND BUYER** with additions and alterations each day.

★ Listings so marked are new today.

(Note—The Moody's and Standard & Poor's ratings shown have been furnished by the rating agencies. Such ratings will be listed only when and if they are received from the agencies following the announcement of an intention to offer a specific issue.)

	Sale Date		$	Ratings Moody's	Ratings S&P's	Bidding Details
	2/25	Fort Worth, Tex.:				
		Various Purpose	20,000,000	Aa	AA	2/11, 13, 17
		Water and Sewer Rev.	3,600,000	A1	AA	2/11, 13, 17
	2/25	Greenfield-Central Community Sch. Corp., Ind.	770,000	†	‡	2/ 3
	2/25	Iowa Co., Iowa	996,000	*A1	‡	2/13
	2/25	Newport Urban Renewal Agency, Ore. (Rev.)	1,000,000	*A	‡	2/17, 19
	2/25	Othello Sch. Dist. No. 147, 163 & 55, Wash.	890,000	A1	‡	2/17, 18
	2/25	Roosevelt Union Free Sch. Dist., N.Y.	2,383,000	†	‡	2/23
	2/25	South Kitsap Sch. Dist. No. 402, Wash.	7,115,000	A	†	2/ 5, 6, 19
	2/25	Texas	18,000,000	Aaa	AAA	1/22, 26; 2/19
	2/26	Albuquerque Metropolitan Arroyo Flood Control Auth., N. Mex.	8,000,000	A1	A+	2/18
	2/26	Buffalo Ind. Sch. Dist. No. 877, Minn.	2,785,000	Baa1	‡	2/19, 20
	2/26	Fairbanks North Star Borough, Alaska	4,500,000	A	A	2/ 6, 11
	2/26	Green Ridge Municipal Utility Dist., Tex. (Waste Disposal Rev. & Water Supply Rev.)	1,000,000	†	‡	2/10
	2/26	Molalla Union High Sch. Dist. No. 4, Ore.	3,500,000	*A	‡	2/ 3, 5
	2/26	Norwich, Conn.	4,900,000	Aa	‡	2/11
	2/26	Norwich, Conn. (MBIA) Qualified)	4,900,000	†	AAA	2/11
	2/26	St. John the Baptish Parish Sch. Dist., La.	4,800,000	Baa	‡	1/26, 29; 2/11
	2/26	Sevier Co., Tenn.	2,000,000	Baa1	§	2/10, 11, 24
	3/ 8	Peoria Unified Sch. Dist. No. 11, Ariz.	6,500,000	§	‡	2/ 6
	3/ 8	Pikeville, Ky. (Natural Gas System Rev.)	2,000,000	†	‡	2/24
★	3/ 8	Wrenshall Ind. Sch. Dist. No. 100, Minn.	1,020,000	..	..	2/25
	3/ 9	Baltimore Co., Md.	30,000,000	§	§	1/15
	3/ 9	Colony Municipal Utility Dist. No. 1, Tex. (Waterworks & Sewer Rev.)	3,725,000	†	‡	2/10, 24
	3/ 9	Cumberland Co., N.C.	9,900,000	§	§	2/24
	3/ 9	Delta Community College, Mich.	3,200,000	§	§	2/17, 19
	3/ 9	Denville Tp. Sch. Dist., N.J.	975,000	§	§	2/23
	3/ 9	Forest City Community Sch. Dist., Iowa	2,818,000	§	‡	2/18
	3/ 9	Georgia	27,310,000	§	§	2/18, 19
	3/ 9	Macomb Co., Mich.	4,300,000	§	§	2/17, 18
	3/ 9	Marshall, Minn. (Medical Facility Rev.)	6,900,000	§	‡	2/24
	3/ 9	Milan, Tenn.	2,500,000	†	‡	2/18, 19
	3/ 9	Minneapolis Special Sch. Dist. No. 1, Minn.	14,475,000	§	‡	2/24
	3/ 9	Ohio Higher Educational Facilities	100,000,000	§	‡	2/17
	3/ 9	Peninsula Sch. Dist. No. 401, Wash.	3,400,000	§	‡	1/21
	3/ 9	Port Neches, Tex.	3,000,000	§	§	2/18
	3/ 9	Washington Co. Sch. Dist., Utah	2,000,000	§	‡	2/10
	3/10	Bernalillo Co., N.M.	5,050,000	§	‡	2/24
	3/10	Closter, N.J.	6,100,000	§	§	2/20
	3/10	Columbus, Ohio	16,000,000	§	§	2/17, 19
	3/10	Jackson Co. Public Water and Supply Dist. No. 15, Mo. (Rev.)	1,376,000	†	‡	2/17, 18
	3/10	Los Angeles Co. Sanitation Dist. No. 19, Calif.	1,000,000	†	‡	2/18, 20
	3/10	Menomonie, Wisc.	3,500,000	§	‡	2/18
	3/10	Pensacola, Fla. (Utility Rev.)	8,750,000	†	§	2/24
	3/10	Port of Portland, Ore.	3,000,000	Aaa	AA	1/27, 2/13
★	3/11	Hinckley Ind. Sch. Dist. No. 573, Minn.	1,040,000	..	..	2/25
	3/11	San Antonio, Tex. (Electric Plant Rev.)	60,000,000	§	§	1/22; 2/24
	3/11	Winnebago Co. Forest Preserve Dist., Ill.	2,000,000	†	‡	2/18
★	3/15	Aitkin Ind. Sch. Dist. No. 1, Minn.	4,385,000	..	..	2/25
	3/15	Beachwood, Ohio	1,000,000	†	‡	2/18
	3/15	Harvey Co., Kan.	2,500,000	§	‡	2/11
	3/15	Pasadena Ind. Sch. Dist., Tex.	6,000,000	§	‡	2/ 3, 24
	3/16	Cherry Creek Sch. Dist. No. 5, Colo.	3,000,000	†	‡	2/23
★ ●	3/16	Pennsylvania	110,000,000	..	..	2/25
	3/16	Wauwatosa, Wisc.	780,000	†	‡	2/24
	3/16	North Gibson Elementary Sch. & Administration Bldg. Corp., Ind. (First Mtg. Lease Rev.)	2,750,000	†	‡	2/23
★	3/17	Connecticut	100,000,000	..	..	2/25
	3/18	Oshkosh, Wisc.	1,750,000	§	‡	2/24
★	3/19	Washtenaw Co., Mich.	800,000	..	..	2/25
	3/22	Akron, Ohio	5,000,000	§	‡	2/18
	3/23	Charlotte, N. C.	8,465,000	§	§	2/ 2, 24
★	3/23	Dakota Co. Area Vocational-Technical Ind. Sch. Dist. No. 917, Minn.	5,355,000	..	..	2/25

Senator WILLIAMS. Mr. Grady Fullerton, Harris County Auditor, Harris County, Tex., member of the executive board and former president, Municipal Finance Officers Association; and Mr. William Reynolds, Director of Finance, Greenwich, Conn., vice chairman, Government Debt Administration Committee for the Municipal Finance Officers Association. We appreciate your being here and helping us in our deliberations on these municipal securities bills.

Senator TOWER. Mr. Chairman, might I note that Harris County, Tex. contains a little country village called Houston, which is the fifth largest city in the United States. It's my pleasure to see Mr. Fullerton here today.

STATEMENT OF S. GRADY FULLERTON, HARRIS COUNTY AUDITOR, HARRIS COUNTY, TEX., MEMBER OF EXECUTIVE BOARD AND FORMER PRESIDENT, MUNICIPAL FINANCE OFFICERS ASSOCIATION; AND WILLIAM J. REYNOLDS, DIRECTOR OF FINANCE, GREENWICH, CONN., VICE CHAIRMAN, GOVERNMENT DEBT ADMINISTRATION COMMITTEE, MUNICIPAL FINANCE OFFICERS ASSOCIATION; AND JOHN PETERSEN

Mr. FULLERTON. Thank you, Senator. We thank you for the opportunity of being invited to participate.

I would like to introduce Mr. William Reynolds who is director of finance in Greenwich, Conn., who will make a statement on behalf of MFOA, and then I will make some remarks. Mr. Petersen of our Washington staff is also present.

Mr. REYNOLDS. Mr. Chairman, Senator Tower: I would also like to express our appreciation of having the opportunity of being here this morning and in addition to that, the appreciation of MFOA and myself as an individual issuer for your continued interest in this area of municipal finance.

I would also comment that, somewhat late in the schedule of witnesses, we are appearing as probably the individuals who are going to be most affected by this legislation. The paperwork has to be gathered and the disclosure requirements met. It's the fellow in the municipal finance department who is going to have to do it. So that as I come here this morning, I do feel a bit like the condemned man being asked if he has any last words.

My understanding of the proposed legislation is that it is to provide for direct regulation under the Federal securities law of the disclosure documents provided by State and local government borrowers. I do not get the impression that it is directed specifically to the question of liability. It appears that these proposals represent essentially a reaction to the turbulent events surrounding the fiscal crisis of New York City and State. They also stem from the recent realization on the part of many market participants today that over time they have become exposed to vague, but palpable legal liabilities under the antifraud provisions of the securities laws. I do not recognize that as a change, but a greater

awareness of this exposure. The range of applicability of these laws is uncertain, primarily because of the lack of precedent of Commission or private actions against governmental issuers. Although the Commission has announced undertaking an investigation of New York City under its existing antifraud powers and although there are approximately 40,000 potential governmental issuers, the SEC has not undertaken enforcement action against any of them.

To address the disclosure question: Rightly or wrongly, in the search for possible dimensions of disclosure liability, some have sought to find guidance in that securities market where fraud actions both by the Commission and private parties have been prevalent: the market for registered corporate securities. Most agree that there are many differences between these two markets, the issuers and their securities. However, until such differences are clarified, it has been necessary to study that area where fraudulent activity has occurred in order to protect against its occurrence in the municipal securities area. Again, this has been necessary because of the absence of any such precedence in the provision of information by municipal issuers.

At the same time, governmental issuers and their advisors, in an effort to meet these newly perceived information needs and increasingly conscious of their own liabilities, have been rapidly developing, with broad industry participation, a comprehensive model for disclosing the information needed by investors and underwriters. Such a model should reflect the differences in the markets and their methods of sale and distribution. The suggested set of guidelines for official statements, that developed by the MFOA in concert with other interested groups, was given wide dissemination starting in late November of last year. This took place only after 6 months of drafting and review and fulfilled a commitment made initially a year ago to this committee, the SEC, and others that rapid progress was being made in this new area of concern. Approximately 3,000 copies of the guidelines have been distributed in a little over 2 months. The guidelines, even though in draft form, have already gained wide acceptance and we have developed a work plan for their continued perfection as we will discuss a little later.

Through a combination of market forces and rapid—but responsible—governmental action, the framework for improved disclosure in this complex market is being put in place. Issuers that do not disclose will not get bids. The discipline will continue whether or not the provision of such information is subject to direct regulation. Incidentally, there's been an extremely valuable ancillary development from all of this communication among the various disciplines in the municipal bond market. We are finally getting to know each other and I think this is important.

I have served on both sides of the table, having worked for a number of years with a dealer bank as a financial advisor to local governments, as mayor of a community, and now as chief fiscal officer in a Connecticut community. Over the years, the issuers

have not really known the problems of the underwriters and the underwriters have not known the problems nor the financial methods, or the bookkeeping procedures of local governments. We have lived, if you will, in somewhat of a dream world. They didn't ask questions and we weren't providing answers. It's a new ball game. There's no question about that. We have come to recognize the fact that, in essence, we are borrowers and they are lenders and if we are going to ask them to lend money to us we're going, just as any other borrower, to have to put our house in order. They are not going to lend us the money if we don't put our house in order. It gets down to that simple basic fact.

I think we have earned the right to an opportunity to put our own house in order and we have demonstrated that we are working in that direction. I think that the underwriters are willing to give us that opportunity and to work together to develop the disclosure guidelines, the things that they need to know in order to make a valid decision both as direct lenders and as sellers of our securities to the ultimate investor.

We do not assert that disclosure documents or procedures in the municipal market met a corporate standard prior to the turmoil of this past fall. Nor is it asserted that in the past 3 months all problems have been resolved. However, it is believed that in a very short period of time, by combining many diverse interests, the municipal market has shown itself capable of developing a workable framework for disclosure. Our policy has been and continues to be to work for improved disclosure, because it makes economic and ethical sense to better inform investors and taxpayers. Doing so in the most efficient manner is also in their interest, and I think it's important for all of us to recognize at the State and local level particularly, that we are responsible to both investors and taxpayers. In many instances this is the same person. That investor is one of our taxpayers and we are aware of that and it is good business for us to protect his interest in the most efficient manner possible.

We do not now favor Federal legislation of the type proposed under S. 2574 and S. 2969. S. 2574 calls for full registration under the 1933 Securities Act of all municipal bonds. This approach would be unwieldy and cause an unnecessary level of involvement by the SEC in the issuing process.

S. 2969 calls for federally imposed standards for annual and new issuance reports under flexible parameters to be set by the SEC. This approach, while less onerous, does share certain other difficulties with the full registration proposal. A question which will be raised and will have to be answered is to the lack of the clear boundaries to the domain of the SEC's rulemaking powers. For example, as already noted, the bill does not address the most pressing problem in disclosure, which is not that of the information items of disclosure, but rather the liability structure among the various market participants involved in the process. It's not the material but the materiality that's disclosed. Now is the time to straighten out these problems of liability. Here, existing practice

in the regulated corporate market provides particularly poor guidance, and I would quote very briefly from a Commission release that recently announced the beginning of a study by the SEC of its disclosure requirements in the corporate market.

> Substantial questions concerning substance and effectiveness of the corporate disclosure system—[this refers to the private corporate system]—as enforced by the SEC, continue to be raised. In some measure these questions reflect the intensification of courses identified by Commissioner Wheat such as the increasing institutionalization of the markets. Moreover, since the time of that report, an increased body of scholarly work examining the economics and structure of information systems has evolved. Increasing consideration has been given to the random work theory and the efficient market hypothesis. New techniques of portfolio management are being utilized and penetrating questions are being asked concerning the cost and benefits of the current system.
>
> In addition, the President and Congressional leaders have urged all units of government to examine their practices and procedures to determine whether they are cost effective, whether they impose inordinate burdens on business and the public, and whether competitive forces, among others, might be substituted for governmental regulation.

If there's one distinct clear difference between the private and the public securities markets it is in this area of competition. Ours is a competitive market with bids being involved in 90 percent, probably, of the issues sold.

Rapid Federal legislation, even though imperfect, perhaps could be justified if the municipal bond market were in a chaotic condition over disclosure. That, however, is not the case. The municipal bond market has many concurrent concerns about credit quality and, in some cases, the implication of the recently reported Federal bankruptcy legislation.

There have been a few instances of postponements attributable to disclosure or of some reduction in the number of bids for the same reason. For the most part, outside of New York City, these were caused by confusion on all sides over what were incorrectly thought to be changed disclosure responsibilities under the 1975 Securities Act Amendments and the need to develop quickly disclosure procedures under the severe emotional and economic pressures of late 1975. As these clear up, there is an emerging consensus that, whatever their method of implementation, disclosure standards will be applied widely throughout the market. The question is really what method of adoption is most efficient and in keeping with our economic and political traditions. We have not waited for additional Federal legislation, regulatory agency or court action to move for designing a workable standard. The records show MFOA anticipated its need, and is moving most rapidly to a solution.

As noted, the major disclosure problem is rapidly becoming less one of getting issuers to "tell all," but rather one of affixing levels of responsibilities in the collection and investigation of information and in its certification. We believe that this problem can be solved by the promulgation of procedural policies by an authoritative body. Some States are already moving in this direction and we are actively working for agreement among all authoritative groups on this question at a national level.

Some Federal legislation may be needed or it may be possible to do this without such legislation. We would stress, though, that this would not be disclosure legislation. This would be liability legislation. We submit, also, that the many alternatives have not been adequately explored. These hearings are most helpful in focusing attention on the fact that such exploration should be diligently and rapidly pursued and we acknowledge and appreciate that.

To be specific as to what we have done, to the end of rapidly designing and disseminating standards of disclosure in this area, we have undertaken many steps. MFOA, along with many private and industry groups, is sponsoring educational seminars on the subject throughout the Nation. We are continuing our commitment to study in depth and dispassionately the provision and use of credit information and its ability to reflect accurately credit quality. We have shared and will continue to share the fruits of this research work with the Congress, the SEC and others. We wish to assist them in their information needs and we need and continue to solicit their assistance. In fact, just last Thursday, I opened my mail before going out to speak before a group on disclosure in Westchester County. There were four notices of seminars or other meetings being held in various parts of our area and nationally on this very topic with multidiscipline groups interested in arriving at a solution.

To this end, MFOA at its executive board meeting in Chicago on February 13 adopted a resolution which has spelled out the process which we intend to adopt at our national meeting in May of this year, a definitive policy for municipal debt guidelines disclosure. I ask that this resolution be introduced in the record.

Senator WILLIAMS. It will be.

[Resolution follows:]

RESOLUTION

The Executive Board of the Municipal Finance Officers Association of the United States and Canada adopted the following resolution at its meeting in Chicago on February 13, 1976:

It is hereby resolved, That the Executive Board of the Municipal Finance Officers Association requests the Governmental Debt Administration Committee of the Association to proceed on a time schedule which would look forward to the adoption at the May, 1976, Annual Conference of the Association of a definitive policy for municipal debt disclosure guidelines. To this end, the Committee is to continue to enlist the comments and suggestions of the Securities Industry Association, the Dealer Bank Association, public interest groups, municipal bond lawyers, the accounting profession, the Municipal Securities Rulemaking Board, the technical staff of the Securities and Exchange Commission, and all other interested parties concerning the draft municipal disclosure guidelines that have been prepared jointly by MFOA staff, consultants, and other groups and have been circulated for comment in accordance with the action of the Board on November 21, 1975.

Adopted February 13, 1976.

Mr. REYNOLDS. Finally, we would not deny that the need to increase the quality and uniformity of government financial reporting and accounting practices is clear. We believe that progress in these practices will be rapid because brand new and extremely effective incentives are now at hand and are pointing the way—

bond market discipline, the requirements for disclosure already on the books, the very occurrence of these hearings. To the extent that States, localities and other market participants are permitted an opportunity to do this for themselves, they will continue to be on the spot to prove their effectiveness as partners in a Federal system. State and local officials are not out to defraud a public they are sworn to serve and if they do they go to jail. By the some token, they have both responsibilities and rights to do their jobs themselves without a Federal checkrein until such time as they have defaulted on their obligations to investors and the public at large.

I would respectfully submit that one New York City does not equal the 40,000 national issuers. Thank you for the opportunity to participate and we would welcome the opportunity to answer any questions.

Senator WILLIAMS. Thank you very much.

Now Mr. Fullerton.

Mr. FULLERTON. Senator, I'd like to affirm everything Mr. Reynolds has said and call to your attention again that a great number of cities and counties throughout the United States have been making fine financial disclosure. Financial disclosure promulgated by MFOA since the 1940's, actually since the 1930's, far exceeds the SEC's requirements in many areas. I would suggest, Senator, in all seriousness, that if this is good for units of city government and county government, that perhaps this same disclosure requirement would be good for the Federal Government. We need Federal disclosure of this type of information and I should suggest that maybe if it's good for one it would be good for the others.

Senator WILLIAMS. An excellent idea.

Senator TOWER. I might point out that we have one advantage over municipalities, and that is we own a printing press.

Mr. FULLERTON. Yes, sir. That's the problem.

Senator WILLIAMS. That came from Senator Tower. That didn't come from me. I agree with you.

Senator TOWER. By the way, I agree with you, too.

Mr. FULLERTON. The golden rule has long prevailed in the investment market and that is "those that have the gold, rule." When underwriters do not get disclosure, they just don't have to bid on the bonds and some of us have found that out. The fact has been elementary in the field of investments for many, many years that an investor should investigate before he invests and if he has nothing to investigate he takes his other options and goes somewhere else. That forces us to give what you wish and I'd like to show you that we have been producing—and in Texas the attorney general of Texas must approve every county bond issue before we can issue it. If we have too much debt outstanding, we can't issue. The differences between the many States causes this problem to be far different from a corporate procedure. Texas has one set of rules. Alabama, another; New York, another; Ohio, Connecticut—trying to work out a procedure within Federal stand-

ards is going to be very difficult because there will be a conflict between States rights and the Federal Government.

We suggest that the guidelines that we're working on, if given enough time—say another year—will provide us with something we think can work and the public interest will be well protected. There seems to be an implication that nothing is being done. There has been a considerable amount done over the years and it is multiplying at a great rate today.

I will be happy to try to answer any questions you might have.

Senator WILLIAMS. Go ahead, John.

Senator TOWER. I think this has been very thoughtful testimony. I think that you may be aware that last year at the request of municipal finance officers I introduced an amendment to the omnibus securities bill which prohibited the Securities Rulemaking Board from imposing standards of disclosure of State and local units.

As has been correctly pointed out, we are all suffering from the New York City syndrome here and this has gotten the underwriters into something of a state and they are concerned that this amendment we adopted last year makes them subject to some unacceptable liability for the municipal securities they underwrite.

Now I notice on page 4 of your testimony you say some Federal legislation may be needed or it may be possible to do this without such legislation. I'm not one of those who want to be stampeded into legislation in some sort of panic situation. I think we do too much of that around here. I think the Congress very often tends to overreact and perhaps finally their reaction sets in after the crisis has already passed. We tend to be fighting yesterday's wars today very often. But you can understand that the New York City situation has sobered everybody up in terms of their responsibilities not only to cause the Government to operate in a responsible and efficient way but protecting investors against the sort of thing that's happened in New York.

The Congress actually refused, of course, to consider any kind of—or I should say a majority of the Congress refused to consider any kind of loan guarantee legislation that would bail New York City paper out. Of course, I think a lot of people who bought that paper probably knew what they were doing in the first place and should be slapped on the wrist for it.

In any case, consistent with what you have said, some Federal legislation may be needed or it may be possible to do this without Federal legislation. Caught as we are in the middle here, what approach do you suggest we take?

Mr. FULLERTON. Wait a year.

Senator TOWER. Wait a year?

Mr. FULLERTON. Yes, sir. Give us a chance. We're working together with the investment dealers, the investment bankers, the bond lawyers, the technical finance officers are all in conversation now much more than we have ever been in the past, and I think we can come forward with voluntary disclosure guidelines that will be acceptable and be enforced by the market.

Senator TOWER. Part of our function here is to make sure that your paper is salable.

Mr. FULLERTON. Yes, sir.

Senator TOWER. In other words, we are not all that concerned about your business because we think you ought to be allowed to run your own affairs the way you want to, but we also have to think in terms of maintaining a viable market for your paper.

Mr. FULLERTON. Yes, sir.

Mr. REYNOLDS. I would comment, sir, that one of the results of this increased communication has been an awareness that the so-called Tower amendment did not impact the liabilities of either party, that it simply states that the Municipal Securities Rulemaking Board shall not directly or indirectly regulate the issuers.

What has happened, as I mentioned in the statement, has been an increased awareness of the underlying liabilities of both parties, both the issuer and the underwriter. The mayors and governors and auditors of Harris County are complaining that they are being requested to sign statements concerning liability that they were never asked for before. We're trying to find our way through this problem of liability. Disclosure may be one part of that, but it's only a small part of it. The ultimate answer is where is the liability to be fixed, and we may not be able to resolve that. It may take court action. But, I do know that there is an awareness at the state level now that was not there just three months ago of this particular problem. Many States are looking at possible legislative solutions at the State level to define the liability and to place the liability and to permit a procedure that will at least shift the burden of proof in any case away from the underwriter. Thus, if he follows certain prescribed procedures and asks for and receives certain information he will not be exposed to the liability that he feels he's exposed to at the present time. I think this is the answer rather than overall Federal legislation.

Senator TOWER. Thank you, Mr. Reynolds.

Mr. Fullerton, would you gentlemen mind waiting a moment? All these disagreeable buzzers you hear indicate that we're having a vote on the Senate floor. The chairman has already gone and I will go and we will be back as soon as we can cast our votes on the floor. It will be roughly 5 to 10 minutes.

[Recess.]

Senator WILLIAMS. One of the factors causing some of our problems is that we are getting divided counsel from the Municipal Finance Officers Association.

Mr. REYNOLDS. Yes, sir.

Senator WILLIAMS. I quoted at length from Mr. Moak.

Mr. REYNOLDS. Yes, sir.

Senator WILLIAMS. And he takes a different approach and concluded from his experience and knowledge in the field the necessity for the establishment of well defined alternative systems of accounting which would be acceptable for application by state and local governments and establishment of standards for disclosure.

Now he's a man of eminence, as you are, in this Association and that's why I say we're getting divided counsel.

Mr. REYNOLDS. I would respond, sir, by a personal comment and then ask John Petersen of our Washington staff, who talked to Mr. Moak yesterday by telephone, to give Mr. Moak's response.

Senator WILLIAMS. Well, that's in the second degree. It's hearsay, but we're not living with the rules of evidence.

Mr. REYNOLDS. I respect Mr. Moak's opinion very much, mainly because he's older than I am. I know that one of the things that I feel Mr. Moak was very careful not to say was that the regulation be Federal agency regulation. I think also that it should be noted that the resolution which I submitted earlier which proposes the alternative plan of developing disclosure guidelines within the industry voluntarily—not so voluntary under Mr. Fullerton's golden rule—but under those standards. It indicates we're really not giving you divided opinions. Mr. Moak supported that resolution. He's vice president of our association and he's a member of our Committee on Debt Administration and he has been very active in the development in this area.

Mr. PETERSEN. I did have occasion to talk to Lennox Moak last night and he's very anxious to receive a copy of the opening statement. No one presumes to talk for Mr. Moak and I won't represent him in any fashion except to say that, of course, he's most concerned about the area, he does subscribe to our position and policy statement, and he's very anxious to talk to you and your staff at your convenience about the general approaches, the variety of approaches, that are available.

Mr. Moak in his statement did go on to catalog certain desiderata that might be formed and one, of course, was to have some municipal council or council of municipal issuers setting the disclosure standards. But I would want him to speak for himself. He's aware of the use of the quotation and is anxious to talk to the committee about it.

Senator WILLIAMS. I appreciate that and we will talk to him. The statement was drawn from his statement at the time of the New York City hearing.

Mr. FULLERTON. Senator, if I might make one comment. I read that statement carefully and I believe he was very careful when he made that statement to say he was speaking for himself and not for MFOA and not even for the City of Philadelphia. I believe that's in the Senate Committee hearing minutes.

Senator WILLIAMS. He has been qualified by Mr. Reynolds as an expert.

Mr. FULLERTON. He's an expert in the field of finance. I believe he disclaims being an expert in the field of accounting.

Senator WILLIAMS. Now, Mr. Fullerton, a document has been given to me that deals with Harris County, Tex., and I would like to read a provision that comes from the February 19 issue. Is that date right? Does that ring a bell with you?

Mr. FULLERTON. Yes; it probably does.

Senator WILLIAMS. This is contained in information accompanying the issue I'm told.

The financial information set forth herein has been obtained from the official financial records of Harris County and is reliable to the best of our knowledge and belief. Statistical information contained herein has been obtained from sources which are believed to be reliable but is not guaranteed as to the accuracy or completness thereof, and its inclusion is not to be construed as a representation on the part of the county to such effect.

Now do you recognize that language?

Mr. FULLERTON. Yes, sir. That's the information published in my notice of sale of $15 million of Harris County flood control bonds that were sold on February 19, and $20 million of Harris County road bonds that were sold on February 19.

Senator WILLIAMS. Is that standard language?

Mr. FULLERTON. No, sir; it is not. Why was it used?

Senator WILLIAMS. It is designed to be exculpatory, I would think, if anything in there is inaccurate. Am I right?

Mr. FULLERTON. Senator, your question is very appropriate and I appreciate the opportunity of responding to it. This language was dictated by the market attorney, the attorney that we hired to represent the purchaser of the bonds. We are in an area that has great confusion. This will not be in our next issue of bonds, I can assure you of that. We are aware of the problem that it created. However, we were able to sell the bonds at a very favorable rate. Harris County, Tex. has a AAA credit rating both by Moody's and Standard and Poor's. We sold the bonds at 4.49 net interest cost and 5.41 net interest cost. One is a tax exempt bond and therefore enjoys a slightly better rate.

The attorneys and the bond dealers, as we said earlier, and the finance officers are now beginning to talk to each other and figure out what is needed. This issue of liability is the main problem and I think if given a little more time we'll be able to get it worked out.

Senator WILLIAMS. Where should liability rest?

Mr. FULLERTON. As to the figures that are in this book, my annual financial report that contains 10-year summaries—not 3 or 5 years as required by the SEC—I am perfectly willing to take full responsibility because these figures have been audited by an international firm of certified public accountants. Harris County has used independent CPAs for more than 20 years. We published this report long before—this is the point, Senator—this type of disclosure, the 10-year disclosure, this much information along with our budget, has been what MFOA has been espousing. This audited statement is where I got the information and this is what a number of the isuers have been issuing.

Now with these guidelines, information may have to be tailored into a different form, but as to financial information I'm perfectly willing to sign it. As to the average age and average educational level of the people of Harris County, Tex., I don't know what it is and I don't want to take the responsibility of saying what it is because I don't know. I don't know what the population is because I haven't counted the people. I'm willing to say that this is the Census population figure and I will take responsibility for that, but the Bureau of Census must accept responsibility for the number of people in the community. Those are the types of problems we're running into.

Senator WILLIAMS. And on the liability question, how do you state the liability that you feel is appropriate upon the issuer?

Mr. FULLERTON. I would want to think about it before I would be completely bound by a statement. I would want the attorneys to help me work out the language, but in essence, my philosophy would say I'm making full disclosure to you of all the financial facts and

I'm the accountant—I'm the chief accountant. I'm the director of finance; the term "county auditor" is an anachronism at this point. Everything here is true and correct to the best of our knowledge and belief and I'm perfectly willing to sign something to that effect.

Senator WILLIAMS. I think you're right, though. We go from that to an evaluation of what that really means in law and we get that from the lawyers.

Mr. FULLERTON. All right. But now we're down to the essence. In a private corporation, a private corporation is very much distinguished from a municipal corporation such as we are. We are the public. Everything we get belongs to the public. There is no profit motive here. We're not trying to hide anything from the public. If we can find out what it is, what exactly the bond dealers need, what exactly the investing public needs, we would be perfectly willing to give it to them within reason. I think reasonable men can work it out.

In the past, I had a bond dealer once tell me, years ago, "Don't worry about the audit: you can't steal city hall." What he was trying to say is that the right to tax is how bonds are going to be paid off and—except for the rare instances of New York City types—a city gets into trouble, but it can eventually pay itself out. The right to levy a tax is a great asset that doesn't show up on financial statements because it's just an inherent characteristic of the entity itself.

Senator WILLIAMS. Now there was quite a head of steam behind changes in bankruptcy law that would apply to municipalities.

Mr. FULLERTON. Senator, in some of the bankruptcy laws there is a provision for what is known as debtor's court where, if I can't handle my finances properly, I pay over to the debtor's court a certain percentage of my salary or it's withheld by my employer and given over to the debtor's court and the debtor's court then pays off my bills. That might not be a bad thing for units of local government who find out they can't manage their affairs.

Mr. REYNOLDS. Senator, if I may, I too would like to respond to that question, wherein lies the liability, and I would support Mr. Fullerton's position. This is my town's official statement which is audited and I would stand behind all of the financial information that's in that statement.

Now the further question is interpretation of that statement by some other party. I don't feel that is the issuer's responsibility and this is the area in which the underwriter is looking for assistance. He's really looking for some hook on which to hang his hat as far as liability is concerned, and we are sympathetic with that. We need him. We are not going to be able to borrow money without a cooperative arrangement with the underwriter. We have established this communication and we are working toward helping him to understand what is in these financial reports.

There have been a series of meetings on municipal accounting. It is drastically different from private corporate accounting. There are a great many things that the underwriter does not understand. He's never had to understand it in the past.

As Mr. Fullerton said, nobody can steal city hall. Another response is that, "It's a Connecticut name; it will sell. Don't bother

us with the details." Those kind of things. Those days are gone now. The underwriter is asking questions and we're having to supply the answers to those questions. Most of the answers are in these annual financial reports, and given the opportunity, I know that we are going to arrive at a solution that will protect the taxpayer, investors, and is going to protect the issuer and the underwriter.

One other comment. I have heard it stated time and again at the hearings here that there are no standard or generally accepted accounting practices as relates to local governments. Now I have gone through two and a half years of torment because in my annual statement 2 years ago there was a comment in the auditor's opinion to the effect that two practices we follow are at variance with generally accepted accounting principles, to wit, I was on a cash instead of a modified accrual basis and I have a parking fund which is an enterprise fund and I wasn't setting up a reserve for depreciation. Now faced with that comment, qualified opinion, I had to go through 2 years of recasting my books to get a clean opinion.

Now if there are no generally accepted accounting principles, what did these people tell me that I'm not complying with and why did I go through this torment? Now this is what is happening in the business. There is a greater awareness that there are generally accepted accounting practices. There's the MFOA handbook on governmental accounting auditing and financial reporting. There's the AICPA audit guidelines that are being enforced by many States. There's a requirement in Connecticut that we conform to this so that we're rapidly moving toward solution and apart from Federal legislation.

Senator WILLIAMS. Now let me ask you. I have a copy here of the "Disclosure Guidelines for Offerings of Securities by State and Local Governments." Your responses are in the big box on the table.

Mr. REYNOLDS. Over 3,000 requests, apparently.

Mr. PETERSEN. Would you like to see them?

Mr. FULLERTON. Senator, please let him show you.

Senator WILLIAMS. As a matter of fact, we had it. May I ask you —the substance of what you provide in here is in this legislation.

Mr. REYNOLDS. But the difference, Senator—and I think it's a critical difference—you have cast them in stone. If this legislation passes, then it's going to take an act of Congress to adjust to a situation that may develop in the market, if these were not acceptable. What you have in your hand are the MFOA's proposed guidelines. It's a draft that was sent out to over 3,000 people and Mr. Petersen has letters from numerous people in the industry suggesting modifications. This is a great concern that I have if this legislation passes: You have taken much of what's in the guidelines and put it into the law when the guidelines are subject to being changed as a result of input. We did not have that input into your legislation, sir.

Senator WILLIAMS. Who formulated the guidelines?

Mr. REYNOLDS. It came from our Committee on Governmental Debt Administration working with staff.

Senator WILLIAMS. It was their best judgment of what the content of the guidelines should be?

Mr. REYNOLDS. As a starting point. I would ask John to comment.

Mr. PETERSEN. Senator, I will try to give you an abbreviated answer to what proved to be a very complex but, nonetheless, rewarding process.

The National Science Foundation, after a 6-month pilot study, gave the Municipal Finance Officers Association a grant to sponsor analysis in the area of municipal credit information and quality. As part of that grant and anticipating by I guess a year, roughly, the events that occurred, we specified that there were questions about the status of municipal securities transactions under the Federal securities laws.

As a result, we did start a long-term study investigating such questions as level of disclosure, levels of negligence, and so on, as they apply in the corporate area and might apply in the municipal area. We also studied what were the substantive differences between the two markets, what were the costs and benefits involved in this area of application of the laws.

In the process of that research, we also stipulated that we would be meeting with other participants in the municipal bond markets—specifically, both bank and nonbank underwriters, bond counsel and other individuals—to try to draft a standard of good practice for municipal disclosure. As a matter of fact, we did start having drafting subcommittee meetings. This was done in conjunction with the disclosure committee that had been formed by a local government law section of the American Bar Association and also by the Securities Industry Association. This was last summer.

Through a period of about 6 months and innumerable drafts—I think probably five to six meetings—we did comprise a project that led to two documents. The first product was a document for disclosure on official statements. You have the November 10 draft of that. That's the one which we finally "went public" within terms of soliciting comments throughout the Nation.

This box contains—I haven't counted them all—I would imagine about 2,500 letters of requests. We didn't send them out. They were requests for the guidelines.

Another document was generated which I have with me today. It's a staff document, a draft. It's disclosure guidelines for current reporting, the current reporting guideline. Meeting with this drafting subcommittee—which was made up of about five individuals, all of them reporting back to the various constituent organizations on an informal basis—we decided it was better to wait before sending out the current reporting disclosure guidelines so they would not become physically confused with the official statement guidelines. We felt that the latter were the most pressing problem at the time.

This is a project that the MFOA has sponsored. By no means is it a unilateral action on our part. We have time and time again asked the assistance of any interested party. As these letters and comments demonstrate—I have 44 letters of specific comment—we have been remarkably successful in getting some of the best minds

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and most interested participants in the market to comment and to help us revise the guidelines. These are in the process of revision. It's a living document but by its mere existence I think it's really helping to set a standard in the market.

Now the standard doesn't have a legal certainty at this time. We realize that. They shouldn't. They are going to need development and improvement. But I might say, as the crowning effort here, March 30 we are having a meeting on the guidelines to which we have invited 18 groups that I know of so far. We certainly would appreciate the participation of your committee and staff at this meeting.

Senator WILLIAMS. Where is this meeting?

Mr. PETERSEN. The meeting will be here in Washington. We sent out the letters of invitation. We have had many people come back and say they plan on being there. At that meeting we will go through two steps. The first will be trying to come out with a second revision of the guidelines as rapidly as possible. But, we are going to take some time. We have to be very careful in drafting proofs of the guidelines. And the second procedure will be to develop a general policy where we can have consensus in terms of the procedural aspects and, particularly, the liability questions.

MFOA and issuers in general can't decide these questions unilaterally at this stage. We want to talk to people throughout the market and that includes the middle men, the underwriters, bond counsel, other fiscal experts, as well as the investors. That's the way we're going to get what we believe will be the most efficient document that meets all of the mutual needs of the participants in this market. It's a devilish complex problem, as the three days of hearings have demonstrated amply.

Senator WILLIAMS. What is your position?

Mr. PETERSEN. I'm the Washington director of the Municipal Finance Officers Association and also the project manager on the overall credit information project.

Senator WILLIAMS. You mentioned in discussion with Senator Tower, Mr. Fullerton, that you needed a year. You know this bill does have an effective date a year away?

Mr. FULLERTON. But it also gives the SEC the right to write regulations and I'd rather——

Senator WILLIAMS. No, not between now and then. And by then, if you put this all in place and your States are in accounting order you're home free as far as the SEC is concerned. Now this is the American Bar Association comment on the Municipal Finance Officers' guidelines—are you a lawyer, Mr. Fullerton?

Mr. FULLERTON. No, sir, I am not.

Senator WILLIAMS. I'm pressed by staff to ask you a question and quite frankly I'm wondering whether it is ultimately the wisest thing to put this question to you. We will see where we go.

I will read the American Bar Association statement of February 5 of this year:

> Under Section 11 of the Securities Act of 1933, an underwriter is not liable as regards any part of a registration statement purporting to be a statement

made by an official person or purporting to be a copy of or extract from an official public document if he has no reasonable ground to believe and did not believe at the time that such part of the registration became effective that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy or extract from the published official document.

Comment? You know what this does. That goes to the underwriter. That's the ABA talking to the underwriter. Now if that is the law, something rests back home where you are, the issuer.

Mr. FULLERTON. We are subject to fraud right now under the SEC.

Senator WILLIAMS. This is a test that's different than fraud. Fraud is where the wrong is clearly known, but there is that other are, "know or should know by reasonable application of due diligence." This puts it right back to you and whether or not this kind of test should apply to you. It's exculpatory, but it puts you to a test. This doesn't really put any burden on the underwriter except to know the official document. Once he's got that, he's home free.

Mr. REYNOLDS. But, Senator, this applies to the private corporate sector and this is the hook that he hangs his hat on. We're saying that the municipal securities underwriter does not have or cannot see that hook at the present time. It may well be that—in our opening statement we recognize the fact—that there have been no cases to determine this liability.

Senator WILLIAMS. The next sentence says, "In this area it's a cloudy picture."

Mr. REYNOLDS. Except that the cases may very well say this exact same test is applicable, that he knew or had reason to know. It's going to come in a court case or you're saying that you want the SEC to make this statement.

Senator WILLIAMS. No, no.

Mr. REYNOLDS. This act doesn't direct itself to this question. This proposed legislation is not directed toward liability. It just says that we must supply information in a format that the law or the SEC will regulate.

Senator WILLIAMS. Well, no. This goes to liability in the private side, damages. Now the question is, if this is applicable to you and your issues, the underwriter has a protection. Now it comes back to you and the liability rests with you. The question becomes whether you can be reached in damage actions.

Mr. REYNOLDS. Both Mr. Fullerton and I say that we have no qualms about being responsible for our financial statements.

Senator WILLIAMS. In other words, if this were law, what I just read in this public area, you would accept it?

Mr. REYNOLDS. I'm not sure that it isn't already law. It just has not been legislated law.

Senator WILLIAMS. It's uncertain because it hasn't been decided yet.

Mr. REYNOLDS. Unlike Mr. Fullerton, I am an attorney, Senator.

Senator WILLIAMS. Very good.

Mr. PETERSEN. I'm not an attorney either. I think there is a possibility some may try a section 11 defense based on the 1933 act concept of using the governmental document as a defense in terms of being able to accept an official statement as a Government document. I think there are other questions involved in terms of the affinity of that issuer to the transaction and the particular document being issued. Also, you do not have the protection, I suppose, of the review and comment process that goes with a filing under the 1933 act. Lawyers can talk to this much better than I, but it doesn't seem as though under existing law this could be relied upon to provide strong protections in municipal transactions. But don't take my opinion; I'm not a lawyer.

Mr. FULLERTON. Senator, rule 10(b)(5) of the SEC carries a definition of fraud that is far more severe than an attempt to deceive or deception with malice. In other words, with intent to deceive. Under rule 10(b)(5), as I understand it, if I put something in here that's purely a mistake, a typographical error, I might well go to jail under the SEC's rule 10(b)(5). There have been people, independent CPAs, who were sued by the SEC and a fraud conviction obtained and a man spent time in jail where it was alleged that was the problem.

I'm perfectly willing to be responsible for what I have in here. These books are audited by independent CPAs not chosen by me. We even go further. Take the management letter—every corporation has its books audited and gets the letter from the independent accounting firm that goes to the president and chairman of the board which says you've got a clean opinion but there are a few things over here you need to do. We publish that management letter. It's a part of the published information in Harris County, Texas and has been for many years.

Senator WILLIAMS. We'll get to this with the next witnesses. Thank you very much.

Mr. PETERSEN. Senator Williams, may I request permission to file additional documents for the record?

Senator WILLIAMS. Certainly.

[Prepared statement and additional information follows:]

OUTLINE OF STATEMENT

by the

MUNICIPAL FINANCE OFFICERS ASSOCIATION

Before the

UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

SUBCOMMITTEE ON SECURITIES

HEARINGS ON S. 2574 and S. 2969

Thursday, February 26, 1976

1. The purpose of the subject legislation is to provide for direct regulation under the federal securities laws of the disclosure documents provided by state and local governmental borrowers.

2. These proposals represent essentially a reaction to the turbulent events surrounding the fiscal crisis of New York City and State. They also stem from the recent realization on the part of many market participants that they over time have become exposed to vague, but palpable legal liabilities under the antifraud provisions of the securities laws. The range of applicability of these laws is uncertain, primarily because of the lack of precedent of Commission or private actions against governmental issuers. The Commission has announced undertaking an investigation of New York City under its existing antifraud powers. While there are approximately 40,000 governmental issuers, the SEC has not undertaken enforcement actions against any of them.

3. Rightly or wrongly, in the search for possible dimensions of disclosure liability, some have sought to find guidance in that securities market where fraud actions both by the Commission and private parties have been prevalent: the market for registered corporate security. Most agree that there are many differences between these two markets, the issuers and their securities. However,

until such differences are clarified, it has been necessary to study that area where fradulent activity has occurred in order to protect against its occurrence in the municipal securities area. Again, this has been necessary because of the absence of any such precedence in the provision of information by municipal issuers.

4. At the same time, governmental issuers and their advisors, in an effort to meet these newly perceived information needs and increasingly conscious of their own liabilities, have been rapidly developing, with broad industry participation, a comprehensive model for disclosing the information needed by investors and underwriters. Such a model should reflect the differences in the markets and their methods of sale and distribution. The suggested set of guidelines for official statements, that developed by the MFOA in concert with other interested groups, was given wide dissemination starting in late November of last year. This took place only after six months of drafting and review and fulfilled a commitment made to this Committee, the SEC, and others that rapid progress was being made in this new area of concern. Approximately 3,000 copies of the guidelines have been distributed in a little over two months. The guidelines, even though in draft form, have already gained wide acceptance. Our work plan for their continued perfection is discussed below.

Through a combination of market forces and rapid -- but responsible -- governmental action, the framework for improved disclosure in this complex market is being put in place. Issuers that do not disclose will not get bids. This discipline will continue whether or not the provision of such information is subject to direct regulation.

5. We do not assert that disclosure documents or procedures in the municipal market met a corporate standard prior to the turmoil of this past fall. Nor is it asserted that in the past three months all problems have been resolved. However, it is believed that in a very short period of time, by combining many diverse interests, the municipal market has shown itself capable of developing a workable

framework for disclosure. Our policy has been and continues to be to work for improved disclosure, because it makes economic and ethical sense to better inform investors and taxpayers. Doing so in the most efficient manner is also in their interest.

6. We do not now favor federal legislation of the type proposed under S.2574 or S.2969.

a. S.2574 calls for full registration under the 1933 Securities Act of all municipal bonds. This approach would be unwieldy and cause an unnecessary level of involvement by the SEC in the issuing process.

b. S.2969 calls for federally imposed standards for annual and new issuance reports under flexible parameters to be set by the SEC. This approach, while less onerous, does share certain other difficulties with the full registration proposal. These range from questions of the power of the federal government to regulate state and local governments in their essential money raising function to a lack of clear boundaries to the domain of the proposed SEC rulemaking powers. For example, the bill does not address the most pressing problem in disclosure which is not that of the information items of disclosure, but rather the liability structure among the various market participants involved in the process. Now is the time to straighten out these problems of liability. Here, existing practice in the regulated corporate market provides particularly poor guidance.

7. Rapid federal legislation, even though imperfect, perhaps could be justified if the municipal bond market were in a chaotic condition over disclosure. That, however, is not the case. The municipal bond market has many concurrent concerns about credit quality and, in some cases, the implications of the recently reported federal bankruptcy legislation.

There has been a few instances of postponements attributable to disclosure or of some reduction in the number of bids for the same reason. In part, these were caused by confusion over what were incorrectly thought to be changed disclosure responsibilities under the 1975 Securities Acts Amendments and the need to develop quickly disclosure procedures under the severe emotional and economic pressures of late 1975. As these clear up, there is an emerging consensus that, whatever their method of implementation, disclosure standards will be applied widely throughout the market. The question is really what method of adoption is most efficient and in keeping with our economic and political traditions. We have not waited for additional federal legislation, regulatory agency or court action to move for designing a workable standard. The records show MFOA anticipated its need.

8. As noted, the major disclosure problem is rapidly becoming less one of getting issuers to "tell all", but rather one of affixing levels of responsibilities in the collection and investigation of information and in its certification. We believe that this problem can be solved by the promulgation of procedural policies by an authoritative body. Some states are already moving in this direction and we are actively working for agreement among all authoritative groups on this question at a national level. Some Federal legislation may be needed or it may be possible to do this without such legislation. We submit that the many alternatives have not been adequately explored. These hearings are most helpful in focusing attention on the fact that such exploration should be diligently and rapidly pursued.

9. To the end of rapidly designing and disseminating standards of disclosure in this area, we have undertaken many steps. MFOA, along with many private and industry groups, is sponsoring educational seminars on the subject throughout the nation. We are continuing our commitment to study in depth and dispassionately the provision and use of credit information and its ability to reflect accurately

credit quality. We have shared and will continue to share the fruits of this research work with the Congress, the SEC and others. We wish to assist them in their information needs and we need and continue to solicit their assistance.

10. The need to increase the quality and uniformity of governmental financial reporting and accounting practices is clear. We believe that progress in these practices will be rapid because brand new and extremely effective incentives are now at hand and pointing the way -- bond market discipline, the requirements for disclosure already on the books, the very occurrence of these hearings. To the extent that states, localities and other market participants are permitted an opportunity to do this for themselves, they will continue to be on the spot to prove their effectiveness as partners in a federal system. State and local officials are not out to defraud a public they are sworn to serve and if they do, they go to jail. By the same token, they have both responsibilities and rights to do their jobs themselves without a federal check rein until such time as they have defaulted on their obligations to investors and the public at large.

THE STATE OF TEXAS I
COUNTY OF HARRIS I

On this the 23rd day of February, 1976, the Commissioners' Court of Harris County, Texas, sitting as the governing body of Harris County, upon motion of Commissioner Eckels, seconded by Commissioner Lyons, duly put and unanimously carried,

IT IS ORDERED that the Harris County Government does not desire any unnecessary Federal control over the Bonded indebtedness of Harris County and Harris County Flood Control District, and that this Resolution be forwarded to the U. S. Senate Committee on Banking, Housing and Urban Affairs.

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THE STATE OF TEXAS)
COUNTY OF HARRIS)

I, R. E. Turrentine, Jr., County Clerk and Ex-Officio Clerk of Commissioners' Court of Harris County, Texas, do hereby certify that the above and foregoing is a true and correct copy of Order made and entered on the 23rd day of February, 1976, as same appears of record in Volume 91 of the Minutes of the Commissioners' Court.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this the 23rd day of February, 1976.

R. E. TURRENTINE, JR., County Clerk
and Ex-Officio Clerk of Commissioners'
Court of Harris County, Texas.

By Nolan J. Gordelon
Deputy.

Senator WILLIAMS. Donald Robinson, Donald Hodgman and Richard B. Smith. The lawyers now should be heard.

STATEMENT OF DONALD ROBINSON, HAWKINS, DELAFIELD, & WOOD

Mr. ROBINSON. Mr. Chairman, I want to thank you for the opportunity to testify on the two bills that are before you.

My name is Donald Robinson. I'm a partner in Hawkins, Delafield and Wood, New York City, a nationally recognized bond counsel. I am also and have been for the last three years chairman of the municipal bond workshops for the Practicing Law Institute. Prior to that, since 1969, I lectured in that program. I was also a participant in the Municipal Finance Officers Association program relating to the preparation of the guidelines. I would like to state that I am appearing today in my individual capacity.

I believe the solution to the problem which you're seeking to address should involve a proper accommodation between the protection of the investors in municipal securities and the continued ability of the municipal issuers to market obligations without any undue impediments. If registration requirements are imposed upon issuers of municipal securities, any benefits which may be derived from substantially greater disclosure for potential investors will undoubtedly be overcome by the detrimental burden of added costs to the general public in the form of increased taxes or increased user charges.

It is my belief that there is adequate statutory authority at the present time for the protection of investors and that additional regulation in the form of either S. 2574 or S. 2969 will not add any further protection to investors but will, in fact, constitute an inappropriate impediment to issuance of municipal securities and add unnecessary costs to such issuance. Therefore, I am of the view that neither bill before you should be enacted into law. There is no need for additional legislation because Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder by the Securities and Exchange Commission provide adequate protection at the present time for members of the investing public who purchase municipal obligations. That section and the rules promulgated thereunder, together with the Securities Acts Amendments of 1975, also give the Securities and Exchange Commission adequate power to police alleged violations of fraud incurred in connection with the offer and sale of municipal securities.

As you know, although municipal securities have been exempt from the registration requirements of the Securities Act of 1933 and the regulatory requirements of the Securities Exchange Act of 1934, the antifraud provisions contained in Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 do not provide any exemption with respect to municipal obligations for fraudulent practices. The Federal securities laws, as interpreted by the courts, also provide for implied rights of action for defrauded purchasers of securities. One of the first cases involv-

ing alleged securities fraud dealing with a purchaser who sought to recover on the basis of an implied right of action, involved the alleged fraud in the sale of municipal securities. That case was *Thiele* v. *Shields* and was decided in 1955. Clearly, the courts have recognized such an implied right of action in connection with alleged fraud in the sale of municipal securities from that date.

The Commission has and continues to recognize its enforcement obligations with respect to the sale of municipal securities. In the 1960s the Commission instituted a proceeding in the matter of Walston & Co., Inc. and issued an order in that proceeding on September 22, 1967, and that involved the sale of municipal securities. Since that date the Commission has taken additional steps and applied additional concern to this field. The Commission has proceeded with at least five civil injunctive actions since that time all of which occurred in the last three years. At no time has the Commission indicated that there was any additional need for legislation.

This committee, in its report dated April 14, 1975 with respect to such legislation stated at page 43: "The Committee believes the municipal securities markets have, in the main, performed their debt financing functions for state and local governments with commendable efficiency and integrity." The Securities Acts Amendments of 1975 were enacted to provide additional enforcement tools to the Commission to help combat those few abuses which did exist. In fact, the committee stated in the report at page 44:

> The Committee is mindful of the historical relationship between the federal securities laws and issuers of municipal securities. Apart from the general antifraud provisions, municipal securities are exempt from all substantive requirements. Most significantly, this means that state and local governments do not have to comply with the registration and disclosure requirements of the Securities Act of 1933. The bill does not in any way change this pattern, for the Committee is not aware of any abuses which would justify such a radical incursion on states' prerogatives.

The antifraud provisions require adequate and full disclosure of all material facts necessary for an investor to make an investment decision with respect to the proposed purchase of municipal securities. Neither of the two bills before you changes that requirement nor does either add to the protection afforded proposed investors from that presently prevailing as aforementioned. Full disclosure is full disclosure without more. The proposed legislation before you accomplishes nothing more than to provide further Federal involvement and governmental decisions with respect to what it considers to be material or adequate disclosure. Also involved in the process is the possibility of substantial redtape and additional costs involved in the registration of or reporting requirements related to municipal securities. The concept of full disclosure which had its foundations in the above-mentioned antifraud provisions is a fair and flexible standard and is now fully adequate for the protection of investors. Therefore, in my opinion there is no need for the enactment of the legislation before you.

There will also be some very practical problems if either piece of legislation is enacted. These problems arise because of the diversity of types of municipal securities and governmental units. The

U.S. Bureau of Census reported in 1972 that there were 78,267 State and local governmental units classified. When working on the Municipal Finance Officers Association guidelines, one of the major problems that was dealt with and why it took so long to at least come out with an exposure draft for something that people could comment on was the diversity of local laws, State and local laws. I understand fully the desire of the chairman in his bill to put together a set of guidelines and he's looked at the exposure draft of the MFOA and there's nothing in there that is dead wrong, but there is nothing in there that we know without comment, without review of all the comments from the 50 States, that is absolutely correct.

The process of evaluation, determining what is material, takes time. It's best done on an ad hoc basis. It's not done by legislation. It's not done by setting one set of standards for all the issuers throughout the country.

As you know, attempts are being made to improve disclosure guidelines. The MFOA project is an outstanding bit of self-regulatory development by the municipal issuers themselves to try to improve with additional minimal cost to taxpayers and the users of public facilities, to reach an accommodation between adequate and full disclosure and keeping the cost of government at the lowest possible rate.

Also, the market has adapted very well to the problems. In any case, municipal issuers are preparing full-disclosure documents which surpass the level of disclosure suggested in S. 2969. In short, the problem this subcommittee is focusing upon is being fully solved by municipal issuers and the securities industry without any Federal supervision.

I would also like to point out to the subcommittee that the sovereign States have constitutionally protected powers and that the Federal Government should be cautious in any approach to limiting these powers.

In conclusion, I recommend that Congress not enact either of the two bills before you. Full disclosure, which we all favor, is presently being provided for by the issuers themselves, as well as by the underwriters of their securities. To require the Commission to set the standards for disclosure in this very complex and sensitive area would be to complicate rather than simplify the problem.

Thank you very much.

Senator WILLIAMS. Thank you very much, Mr. Robinson. It's very appropriate for you to include a statement from our report of last April of the legislation where we did say the bill does not in any way change this pattern of nonapplication, for the committee is not aware of any abuses which would justify such a radical incursion on States' prerogative.

First, I would say I don't consider this bill a radical incursion. With what we knew then that was an accurate statement. One of the reasons we didn't know some of the problems which hit us with such force in November was that the guidelines and the uniform standards and reporting and disclosure weren't in place and with

the information we had all was well on the Hudson, but we found out later, of course, that it wasn't.

So it's fair for you to report what we said then, and I think it's fair for me to comment that one of the reasons we were not aware was that the basic data was not there for us to be made aware. That's a fine statement. We appreciate your appearance and it will be helpful. I will make no further comment at this point.

[Complete statement follows:]

STATEMENT OF DONALD J. ROBINSON

Mr. Chairman and members of the Subcommittee, I thank you for the opportunity to testify with respect to S. 2574 and S. 2969, both of which deal with the treatment of municipal securities under the Federal securities laws. My name is Donald J. Robinson and I am a partner in the law firm of Hawkins, Delafield & Wood, New York City, a nationally recognized bond counsel which renders legal opinions with respect to the valid issuance of municipal obligations throughout the country. In addition, since 1969, I have been a lecturer for the Practising Law Institute programs on Municipal Bonds Workshop and have been Chairman of the Workshop program since 1973. However, today I appear in my individual capacity.

The solution to the problem which Congress is seeking to address should involve a proper accommodation between the protection of investors in municipal securities and the continued ability of municipal issuers to market obligations without any undue impediments to the continued proper operation of state and local governments. If registration requirements are imposed upon issuers of municipal securities, any benefits which may be derived from substantially greater disclosure for potential investors will undoubtedly be overcome by the detrimental burden of added costs to the general public in the form of increased taxes or increased user charges.

It is my belief that there is adequate statutory authority at the present time for the protection of investors and that additional regulation in the form of either S. 2574 or S. 2969 will not add any further protection to investors but will, in fact, constitute an inappropriate impediment to issuance of municipal securities and add unnecessary costs to such issuance. Therefore, I am of the view that neither bill before you should be enacted into law. There is no need for additional legislation because Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder by the Securities and Exchange Commission provide adequate protection at the present time for members of the investing public who purchase municipal obligations. That section and the rules promulgated thereunder, together with the Securities Acts Amendments of 1975, also give the Securities and Exchange Commission adequate power to police alleged violations of fraud incurred in connection with the offer and sale of muncipal securities.

As you know, although municipal securities have been exempt from the registration requirements of the Securities Act of 1933 and the regulatory requirements of the Securities Exchange Act of 1934, the antifraud provisions contained in Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 do not provide any exemption with respect to municipal obligations for fraudulent practices. The Federal securities laws, as interpreted by the courts, also provide for implied rights of action for defrauded purchasers of securities. One of the first cases involving alleged securities fraud dealing with a purchaser who sought to recover on the basis of an implied right of action, involved the alleged fraud in the sale of municipal securities. That case was *Thiele* v. *Shields* and was decided in 1955. Clearly the courts have recognized such an implied right of action in connection with alleged fraud in the sale of municipal securities from that date.

The Commission has and continues to recognize its enforcement obligations with respect to the sale of municipal securities. In the 1960s the Commission instituted a proceeding in the matter of Walston & Co., Inc. and issued an order in that proceeding on September 22, 1967. Since that date, the Commission has also proceeded with civil injunctive actions in connection with fraud in the sale of municipal securities and in the past three years, the

Commission has instituted at least five such actions. At no time has the commission stated a public concern in respect of a lack of power under the Federal securities laws except to the extent that they sought and received additional statutory authority with respect to regulation of brokers and dealers who dealt in municipal securities. Those powers were granted to them in the Securities Acts Amendments of 1975. In addition, this Committee in its report dated April 14, 1975 with respect to such legislation stated at p. 43: "The Committee believes the municipal securities markets have, in the main, performed their debt financing functions for state and local governments with commendable efficiency and integrity". The Securities Acts Amendments of 1975 were enacted to provide additional enforcement tools to the Commission to help combat those few abuses which did exist. In fact the Committee stated in the report at page 44:

"The Committee is mindful of the historical relationship between the federal securities laws and issuers of municipal securities. Apart from the general antifraud provision, municipal securities are exempt from all substantive requirements. Most significantly, this means that state and local governments do not have to comply with the registration and disclosure requirements of the Securities Act of 1933. The bill does not in any way change this pattern, for the Committee is not aware of any abuses which would justify such a radical incursion on states' prerogatives".

The antifraud provisions require adequate and full disclosure of all material facts necessary for an investor to make an investment decision with respect to the proposed purchase of municipal securities. Neither of the two bills before you changes that requirement nor does either add to the protection afforded proposed investors from that presently prevailing as aforementioned. Full disclosure is full disclosure without more. The proposed legislation before you accomplishes nothing more than to provide further Federal involvement and governmental decisions with respect to what it considers to be material or adequate disclosure. Also involved in the process is the possibility of substantial red tape and additional costs involved in the registration of or reporting requirements related to municipal securities. The concept of full disclosure which had its foundations in the above-mentioned antifraud provisions is a fair and flexible standard and is now fully adequate for the protection of investors. Therefore, in my opinion there is no need for the enactment of the legislation before you.

There will also be some very practical problems if either piece of legislation is enacted. These problems arise because of the diversity of types of municipal securities and governmental units. The U.S. Bureau of Census reported in 1972 that there were 78,267 state and local governmental units classified in the following categories:

States	50
Counties	3,044
Townships	16,991
Municipalities	18,516
School districts	15,780
Special districts	23,886
Total	78,267

The number of local governmental units varies considerably from state to state because there is a greater proliferation of units in some jurisdictions than in others. The characteristics of such units and the varied types of municipal securities they are empowered to issue usually differ from state to state and differ from each other within each state. The figures shown and the differing characteristics make unified disclosure requirements extremely difficult if not impossible.

Attempts are being made for improvements in the disclosure made in connection with municipal issuers. As you are aware, a project has been underway for over a year that is designed to assist in satisfying the increased needs for investor information and the increased concern of issuers as to achieving compliance with the antifraud provisions of the Federal securities laws. The project, involving a broad cross section of bond participants and professionals, has been sponsored by the Municipal Finance Officers Association, whose

participation has been financed, in part, by a grant from the National Science Foundation.

A major product of the project has been the preparation and dissemination of suggested guidelines for information documents used in municipal securities offerings. While the guidelines are not intended to be legally binding they are suggestions of information which may be disclosed in offerings of municipal securities. They are not intended to create disclosure requirements or a legal obligation to disclose any or all items of information suggested. The guidelines have been submitted for comment to municipal issuers and other interested parties and comments are being received by the Municipal Finance Officers Association at the present time.

In any case, municipal issuers are preparing full disclosure documents which surpass the level of disclosure suggested in S. 2969. In short, the problem this Subcommittee is focusing upon is being fully solved by municipal issuers and the securities industry without any Federal supervision.

I would also like to point out to the Subcommittee that the sovereign states have Constitutionally protected powers and that the Federal government should be cautious in any approach to limiting these powers.

I suggest that adequate protection for investors can continue to be achieved by (a) the continued enforcement of the antifraud provisions by the Securities and Exchange Commission, which continued enforcement constitutes a substantial inducement for adequate and full disclosure in connection with the offer and sale of municipal securities; and (b) the adoption of the guideline approach proposed by the Municipal Finance Officers Association with the support of the securities industry. Such support would have a prophylactic effect on municipal issuers. The securities industry would refrain from underwriting obligations of municipal issuers where it has been furnished inadequate information on when there has not been full disclosure. Where there is full and fair disclosure of material facts in connection with a municipal issue, the securities industry would fully support and underwrite such an issue.

In conclusion, I recommend that Congress not enact either of the two bills before you. Full disclosure, which we all favor, is presently being provided for by the issuers themselves, as well as by the underwriters of their securities. To require the Commission to set the standards for disclosure in this very complex and sensitive area would be to complicate rather than simplify the problem.

Thank you very much.

Senator WILLIAMS. I would like to turn to a former eminent member of the Securities and Exchange Commission, Mr. Smith.

STATEMENT OF RICHARD B. SMITH, DAVIS, POLK, & WARDWELL, NEW YORK CITY

Mr. SMITH. Good afternoon, Mr. Chairman. My name is Richard B. Smith. I am a lawyer practicing in New York City, a member of the firm of Davis, Polk & Wardwell. I also serve as chairman of the Subcommittee on Municipal and Governmental Obligations of the American Bar Association's Committee on Federal Regulation of Securities, the capacity in which I have been invited to testify. My remarks, however, are my own individually, since I have not had an opportunity to review my testimony with the members of either the committee or the subcommittee and my comments in no way reflect an official position of the American Bar Association.

Because of the short period of time between my being asked to appear on this panel and today's hearing, it was not possible for me to comply with the committee's usual 48-hour procedure. I would, with the permission of the chairman, like to submit for the

record following the hearings my prepared statement and touch on several of the items today.

Senator WILLIAMS. Very well.

[Mr. Smith's prepared statement is not substantially different from his testimony and with his permission is not printed here.]

Mr. SMITH. If time permits, I would also like to canvass my committee members for comments on the legislation for the assistance of the staff.

I should also like to point out that unlike the two witnesses appearing with me, I am not a municipal bond attorney. However, I have had some background and experience on the corporate side of the securities market and in the course of counseling with a major underwriter of municipal securities have been giving thought to municipal securities matters. Perhaps that perspective may be of some assistance to the committee in considering the legislation before it. I should also point out that from 1967 until 1971 I was a Commissioner on the Securities and Exchange Commission, which may account somewhat for some difference in viewpoint among us about the legislation.

I shall address my comments to S. 2969 and hope they will be viewed as constructive for I want to say at the outset that I am strongly in favor of requiring increased disclosure in the municipal securities market and removing a number of the uncertainties now plaguing issuers, underwriters, and investors in that market. Feeling that a framework of Federal legislation is probably necessary to achieve those objectives, I am in sympathy with the legislative effort. The threshold question in considering the desirability of legislation in this area is whether a system for uniform and comparable disclosure about municipal issuers is sufficiently valuable considering its expense. On the heels of that question comes the question whether it is necessary to make such a system mandatory at the Federal level. Somehow, there doesn't seem to me to be an alternative to developing a new system of required disclosure once the market develops a perception of risk from the absence of information, and since the municipal securities market is nationwide, a framework of Federal legislation seems needed to reach across State lines.

First, a subsidiary comment on the bill. S. 2969, in addition to its main purpose of adding a new section 13A to the Securities Exchange Act of 1934 that would require disclosure by municipal issuers, would also effect amendments to existing provisions of the act. I am somewhat perplexed about the need for at least one of those proposed amendments.

The bill would amend section 15B(d)(1) of the 1934 act, the so-called Tower amendment, by deleting the prohibition against the Commission's requiring any issuer of municipal securities to make a filing with the Commission "prior to the sale of such securities." Proposed section 13A, as contained in the bill, however, gives no express power to the Commission to require any filing with it by a municipal issuer either prior to or after a sale. Therefore, the deletion of the prohibition seems ambiguous. It may be that the bill

69-141 O - 76 - 16

intends to confer on the Commission that power by the language in its sections (a)(1) and (b)(1) requiring an issuer of municipal securities to prepare either an annual report or a distribution statement in accordance with such rules and regulations as the Commission may prescribe as being necessary or appropriate in the public interest or for the protection of investors.

Now, if the legislative intention is thereby to empower the Commission to require the filing with it of municipal disclosure documents at any time, this language seems a somewhat disingenuous way to do it. Filing with the Commission does not seem particularly consistent with the issuer document maintenance and central repository concepts contained in paragraph (f)(3) of the bill. Moreover, the 1934 act's only process for preusage filing with the Commission is the review of proxy material, clearly not applicable to municipal issuers. The only other process of preusage filings that have been developed by the SEC exists under the 1933 act which the bill does not touch. If preusage filings are to be required of municipal issuers, or indeed filing at any time with the Commission, this should be provided explicitly in the bill as it is obviously a sensitive issue. If the bill does not intend to empower the Commission to require filings with it, then the proposed change in the Tower amendment seems unnecessary.

Now as to proposed section 13A, which is S. 2969's principal purpose, I shall comment briefly on seven aspects.

First, annual reports provided for in paragraph (a) of section 13A. The bill, in my judgment, properly focuses on systematic annual reporting by municipal issuers. I know of no governmental unit that is not already required to provide an annual accounting of some kind for the unit's financial affairs. So the bill simply recognizes that fact, albeit putting more structure into the process. But the point is, that this should be done anyway and a number of sound governmental purposes, in addition to disclosure to investors, will be enhanced by the development of a comprehensible annual report. [Indeed, so as not to throw bricks, one might be useful at the Federal Government level.] The bill is silent as to the time within which such an annual report is to be provided. This can be a troublesome point. Is the SEC to be guided by the 90-day requirement for corporate issuers? Or the 120-day requirement that preceded it? Should there not be congressional direction in this respect? How is it contemplated that the Commission would enforce noncompliance?

The bill is not explicit on whether the distribution statement can simply incorporate by reference material in the annual report. I trust this is what the bill intends, because every effort should be made to keep down expense and delay of offerings. The distribution statement could well be kept limited to a description of the terms of the security, the underwriting arrangements and an updating of material information since the last annual report. It would be helpful if the statute made clear that an issuer and underwriter would be protected from liability in the use of such an abbreviated distribution statement so long as the last annual report has been

given reasonable prior circulation, complies with the disclosure requirements applicable to it, and is readily available to a prospective purchaser upon request from the issuer and the underwriters.

The second point I'd like to comment on is, while the bill specifies a minimum of $50 million of debt outstanding to trigger the annual report requirement and a $5 million of debt being offered to trigger the distribution statement requirement, it then empowers the Commission to change those amounts, presumably either up or down, with no meaningful standards to guide it in exercising that power. The only basis I can think of for exercising that power is a cost-benefit analysis of the broadest sort, and I wonder whether that is not a decision that the Congress itself should fish or cut bait on.

In terms of investor protection theory, it's difficult to say that 100 institutions purchasing $50 million of municipal debt require disclosure, but 100 individuals purchasing $1 million do not. Yet I appreciate that rough practical judgments may have to be made as to the reach of the statute. These seem to me to be more properly legislative determinations rather than delegated administrative ones. Congress has not heretofore delegated this type of judgment to the Commission. For example, the so-called Reg A exemption of $500,000 is set out in the 1933 act.

The third point I'd like to comment on is the bill's requirements of annual audits by independent public accountants and the application of appropriate generally accepted accounting principles to municipal issuers. They seem like highly desirable provisions. Such requirements would serve to assure that the preparation and presentation of public issued financial statements would be designed for investor usage.

The fourth point I'd like to comment on is the State agency approval provision in paragraph (c)(1). If Congress thinks that the particular disclosures the bill requires for distribution statements are necessary in the public interest—and I agree with Mr. Robinson's comment and the comments of some others that I don't consider that a necessarily adequate or desirable list to be fixed in stone—it's difficult to understand why State approval of something else should be a basis for exemption. (If distribution statements, why not also annual reports which are not referred to in paragraph (c)(1)?)

The bill should make clear that the issuer has the responsibility and liability for disclosure under Federal law, and State agency approval rather than providing an exemption from the disclosure requirements would instead be a process that the state might choose to employ to assure compliance with the requirements. The bill might also provide, in order to encourage states to undertake such approvals, that when issues are so approved underwriters are relieved of any liability for a deficiency in disclosure of which they did not have actual knowledge, thereby improving the price and yield at which issues so approved could be sold. Such state review and approval should be ample protection to investors, and would be a way to assure that underwriters could economically continue

to bid on the many municipal issues being noticed for competitive sale each week.

Fifth, briefly, I would suggest that the language in paragraph (g) of the bill purporting to limit liability of underwriters, could be clarified. I think the language in section 11(e) of the 1933 Act is somewhat more clear and that could also be improved upon. I think the point is that any liability of an underwriter should be limited to the dollar amount of sales actually made by it.

The sixth point I'd like to comment on involves the Municipal Securities Rulemaking Board which is noticeable by its absence from reference in the bill. Since the Congress recently added section 15B to the 1934 act giving the rulemaking Board, with SEC oversight, rulemaking power with respect to practices of municipal securities brokers and dealers, the bill should not the next year forget it. I agree that the Board is probably not the appropriate body to deal with the content of disclosure documents, but it does seem to me to be the logical body to promulgate any rules with respect to delivery of distribution statements and so I would urge the substitution of the Board for the Commission in paragraph (f)(2) of section 13A.

My last comment deals with federal-state relationships. The bill would give the job of determining disclosure standards to the SEC. Given the premises of the bill that mandatory disclosure is desirable for all municipal issues of any size and that the disclosure standards should be uniform and comparable nationwide, with which I agree, it may seem that the existing federal disclosure agency should be assigned to that job. While I personally have no difficulty with that conclusion, I think we should recognize that it is not a necessary conclusion. The SEC has not had occasion to develop as yet an expertise in municipal finance comparable to that which it has in corporate financial matters, even though foreign municipal issuers offering securities in the United States have been required to register with the SEC since 1934. The more important reason to pause is the deference that must be paid to very sensitive aspects of Federal-State relationships, and for that reason alternatives might be considered.

If sovereign States are enormously resistant to their subdivisions being subjected to standards enunciated, and presumably enforced, by a Federal bureaucracy, or if there are sufficient Members of Congress who would find it distasteful as a further step toward central Government power it is at least conceivable that some other mechanism could be created to achieve the salutory objectives of the bill. In other words, I don't think the bill should be scuttled because of concern that the SEC's role would do violence to Federal-State relationships. I repeat, for myself, I don't think it would. After all, we're talking only about disclosure, not what the states can or cannot do in financing themselves. But I am also conscious and respectful of what I know are deeply held feelings on the part of others.

One alternative might be, in effect, a system of state "blue sky" laws hopefully made as uniform as possible, applicable to municipal securities. But I think that would be impractical for national underwriters and a confusing burden on what is essentially a national marketplace. Anyone who has had contact with the com-

plicated system of State securities blue sky laws could hardly be disposed to wish that system upon the municipal securities market.

Another alternative would be to provide a Federal statutory framework—and hence the national jurisdiction—to the States themselves to establish uniform standards. I appreciate this would be a rather innovative approach to federalism, but it would seem to me to be worth trying rather than not to have a bill or having rebellious States. The statute could provide for a national council appointed by the President composed solely of State and local government officials, and possibly a chairman who is a former such official, to implement the general municipal disclosure and accounting standards called for in the statute. The President could be required to consult with appropriate State and local government organizations in making his appointments. The Council could be assisted by advisory committees and the SEC in performing its functions. Thus, the sovereign States could be said to be jointly establishing their own uniform disclosure standards with the benefit of Federal jurisdiction.

Thank you.

Senator WILLIAMS. Thank you very much.

I have not been exposed to this suggestion of a Presidentially appointed council in any other areas of approaching uniformity of State laws. Is this indigenous to—

Mr. SMITH. It was an idea that sprang out of a discussion that I had with some other people interested in the subject of municipal disclosure and I guess I carried it along in my own thinking, beyond this rather brief statement of it. If you're driven to it or interested in it I would be quite prepared to talk to your staff about it as an alternative.

Senator WILLIAMS. Thank you. It's a very helpful statement in its detailed analysis of some of the problems. Of course, the ambiguity problem that you mentioned, preusage filings—there's been no intfient of that authority here and that should be clarified, obviously. Some of the other areas of ambiguity that you have raised we will also be mindful of. We appreciate it, the whole statement.

Mr. Hodgman, do you have a statement?

Mr. HODGMAN. Yes, I do, Senator.

STATEMENT OF DONALD R. HODGMAN, O'MELVENY AND MEYERS, LOS ANGELES, CALIF.

Mr. HODGMAN. I filed a statement. I do not wish to read it.

My name is Don Hodgman of the law firm of O'Melveny and Meyers in Los Angeles. I function primarily as a bond counsel.

I think, Mr. Chairman, if you asked three attorneys, you are liable to get three different points of view. My point of view is colored by two factors. One, I think bond counsel generally have clients on both sides of the fence. In our case, I think about half of our clients are underwriters and about half are municipal issuers. So if I appear to be sitting on the fence, I have good reason. I want to avoid disgruntled clients.

Senator WILLIAMS. That's full disclosure. Very good.

Mr. HODGMAN. There's another point that has been alluded to and is continually lurking in the background in this discussion and you will say, well, why bring it up if it's that apparent, but it's this question of the antifraud sections of the federal securities laws. I think these are all pervasive in any analysis of this problem. I make this point particularly because, like Mr. Smith, I happen to be a chairman of a subcommittee on disclosure of the American Bar Association. This is from a different section, the local government law section. Our conclusions are really not complete as yet. We have circulated a draft position, a comment letter for the MFOA. Our primary focus has been to attempt to respond to their request for comment.

However, in doing that, I think we have tried to grapple with the problem generally of what is the appropriate solution as far as the regulation of municipal issuers, particularly in view of the fact that they are already inserted in the federal securities laws. In my prepared remarks I emphasize the fact that the sinner is already seated in the cathedral and this pervades all of our deliberation on the MFOA guidelines. I think it's also necessary to bear in mind in giving consideration to S. 2969.

You have to have as a focus of your discussion the underlying fact that you're included within the Federal securities laws and that there is a certain amount of liability that is there already. I think it's very important to categorize that liability and one of the issues that I would like to cover in my remarks is this question of liability, but I think it's very important to emphasize that in defining what this liability is and what is the test to determine liability under the anti-fraud sections, the U.S. Supreme Court in its definition of "material" under the federal securities laws, has used a very broad and non-common law definition. It's not common law where you need scienter knowledge and so forth.

Their definition is material items that "might"— (I emphasize that "might") be important to an investor in making his decision to purchase a security.

Well, bearing this in mind, our committee—and I want to point out as Mr. Smith did that I'm not permitted to speak as a member of the Bar Association—we considered four tests in trying to evaluate the disclosure problem. I think I'd like to pass quickly over the first two and emphasize the last two because they haven't received as much discussion in the testimony thus far.

The first test is that issuer compliance should be voluntary if this is possible. Now this is just another way of stating the prerogatives of state and local governments in the federal system. I think the real question here is whether it's possible to recognize this voluntary approach and still have a workable municipal securities market. Certainly, the standards suggested by S. 2969 is an intermediate position. It's carefully articulated in terms of nonreview, nonfiling. Subject to the technical comments that Mr. Smith made in which I concur regarding the amendment of 15B(a)(1), it seems like a position that attempts to make a compromise in this regard.

There is another advantage. Again, I'm on the fence on this one. I applaud the fact that S. 2969 has a definite standard, contrary to Mr. Robinson, who says, well, after all, we have these antifraud sections and they should be sufficient. Senator Williams, you mentioned in your remarks introducing S. 2969 why you go beyond the antifraud sections, and I think our deliberation in our Bar Association Subcommittee points out the necessity to get guidance beyond the antifraud sections and to have some more specific basis for being sure that you have complied with this definition of materiality in the antifraud sections.

This leads to my next test. Although bond counsel traditionally likes to find a safe harbor, after almost a year of deliberations in our subcommittee, we are unable to conclude that a safe harbor would be possible, given the structure of the federal securities laws.

I'd like to move on then to the two really hard questions from the lawyers' standpoint. I think the testimony so far has shown the issues that are really troubling certainly the underwriters and I think, to some extent, the municipal issuers as well are duty and liability. This is really a double-sided coin. I think you can look at one side of the coin and say, well, now that we have inserted municipal issuers into the federal securities laws structure, what duties and what investigation incentives are there? Are they the same as the usual incentives under the Federal securities laws? I think that this has been explored by the testimony, particularly the SIA written testimony goes into this in some detail. They have and others have examined the due diligence defense, the so-called section 11 defense, which if you're talking in terms of a 1933 act registration permits the underwriter who makes the investigation required by the statute to avoid liability.

I think testimony has shown that the difficulty here is that it is not clear in the case of an exempt municipal issuer (although in 1975 we have now expressly required the broker-dealer who deals in municipal securities to register under the 1934 act), how the due diligence defense works. I think even more important and a point that is not made expressly so far is the fact that a municipal issuer may be in quite a different position as far as his incentive for investigation.

Now you can say, well, of course, he has the incentive. He has the incentive of the marketplace. They won't buy his municipal securities unless he adequately provides disclosure material for the investors. But I don't think this is quite the same situation as in the case of the private issuer. He is charged expressly under the 1933 act with a level of responsibility that I would colloquially denominate that of an insurer. I don't want to be misunderstood in this. I don't think he's an insurer in the sense that he writes a policy that the materials in the registration statement are absolutely true, but it approaches that level of liability where his investigation, is inadequate or materials are incorrect. There's no question of establishing negligence or establishing scienter.

Another feature in this investigation incentive that has not been discussed is the question "how does a bond counsel function where municipal underwriters on one side of the equation are now expressly covered by the Federal securities laws.

Suggestions have been made and I think properly that we should give consideration to changing the historical pattern. Historically, the bond counsel has been the only lawyer functioning in the process of marketing and preparing disclosure materials for municipal securities. We should shift from the one-counsel pattern to the two-counsel pattern that is common in private securities. The model that's been suggested is that used in the public utility field where competitive bidding is usually followed as is the rule in the municipal area. I think it's going to be necessary to make some shift in the role of the bond counsel. I think if we don't have additional attorneys, we at least have to add the fact that the bond counsel will have to expand his role to cover the area of disclosure under the Federal securities laws. Whether this is done by having two counsel or having the bond counsel be employed by the underwriter and having the public attorney, who in many cases is already of course on the payroll of the issuer take care of the issuer's problems under the Federal securities laws, only more experience in the marketplace will tell.

I think my final point then would be the hard question of what is the liability of the issuer. Can you reach—and the question has been asked a number of times—can an investor in New York City bonds sue the issuer of the securities? There is a pending suit, the *Abrams* suit, in the Federal courts that raises that very situation. I think this is one of the reasons for the apprehension of whether the present disclosure process is adequate. But I think it's this other side of the coin—does the underwriter now have all the liability and is the municipal issuer exempt from a suit by a private investor for damages because of the usual defenses that are suggested: (1) sovereign immunity; (2) the 11th amendment to the Federal Constitution or other protections that are afforded the State and local governments from liability. I think this is a very difficult constitutional question for the lawyers.

I attended a PLI seminar in New Orleans last week at a number of cases were cited in this area. We received the opinion yesterday from Mr. Rathbun that he felt that properly drawn the Federal statute could reach the municipal issuer even if it was a private investor suing.

I think my conclusion in reviewing these materials since PLI is that of Mr. Rathbun—in fact, I spent part of yesterday afternoon in the Wilmer, Cutler library on the theory that it would provide the proper atmosphere to get the right answer. My authority just to cite one case (that I didn't see in Mr. Doty's materials who lists the other cases), would be the *Edelman* case, 415 U.S. 651 (1974). This is the most recent case. As has been pointed out, the present legislation does not attempt to reach the municipal issuer in a suit of the type mentioned. I think this is, however, a very tricky issue. The *Edelman* case points out that there is an element requiring the municipal issuer consent to the liability. Consent presupposes an activity that is undertaken voluntarily. Social security payments were involved in that case.

Earlier cases had involved different activities. The *Pardon* case, a prior cited case, was a case where Alabama operated a railroad

which was something they did not need to do as a governmental purpose. So I think there's still the possibility that the U.S. Supreme Court would have difficulty in, if you were talking about borrowing money, by means of bonds, assuredly an essential governmental activity. They might have difficulty enforcing this on the municipal issuer, but I think it could be done. Certainly in the State courts, as far as the 11th amendment was concerned. However, these are very tricky issues.

I think the important thing is to recognize the difficult legal problems in the area of liability and attempt to address this in some way that permits the sharing of liability in the situation.

Thank you.

Senator WILLIAMS. Thank you very much, Mr. Hodgman, and all you gentlemen. It's awfully late to begin a continuous discussion of all the things you have raised.

Just as we go into the next group of witnesses with the demands upon the issuer for greater reporting and disclosure and the basis of intelligent investment, where this is required under law, wouldn't that move us in the direction of the underwriter being in a position to be able to rely more on the official materials that would reach him from the issuer?

Mr. HODGMAN. I think that would certainly be the desirable approach.

Senator WILLIAMS. It would seem that way, as a matter of logic. That follows from the clear disclosure demands upon the issuer.

We'll leave for the law professors now and we appreciate very much you, Mr. Hodgman, who are on the fence, and gentlemen, for all your help. Thank you.

[Complete statement of Mr. Hodgman follows:]

STATEMENT OF DONALD R. HODGMAN, OF O'MELVENY & MYERS, LOS ANGELES, CALIF.

This statement is offered in response to an invitation from Senator Williams to testify on S. 2574 and a furnished draft of proposed legislation (the "Williams proposal"), both of which deal with the treatment of issuers of the municipal securities under the federal securities laws.

My remarks are from the standpoint of a municipal bond counsel with a firm that has a fairly long history of rendering so-called municipal bond opinions covering the validity of the issuance of municipal bonds. Such opinions are customarily a requirement of delivery for such bonds. To evaluate the customary relationship of bond counsel to the parties involved in a municipal bond transaction, I wish to point out our clients are split approximately equally between the two sides of the transaction—approximately 50% of our clients are municipal issuers and the remaining 50% are purchasers or underwriters of the municipal bonds involved. Although historically bond counsel was employed by the purchasers of municipal bonds to give an independent opinion assuring the legality of the issuance of the bonds, subsequent practice since the initial use of municipal bond opinions at the turn of the century has resulted in bond counsel being sometimes employed by the municipal issuer and sometimes by the purchaser. Because of this divided allegiance, I would not like one party or the other to have my remarks taken as favoring either one party or the other since in either case I will stand to gain the one thing that lawyers wish to avoid—a disgruntled client.

There is another position that will underlie my remarks in connection with the position of municipal issuers under the federal securities laws. This is the fact that municipal issuers are subject to the so-called anti-fraud sections of the Federal Securities Acts, namely Section 17 of the 1933 Act and Rule 10(b)

(5) as developed under the 1934 Act. There might have been some question of municipal issuers being subject to Rule 10(b)(5) of the 1934 Act prior to the Securities Reform Act of 1975 ("1975 Amendments"). This doubt should now be set at rest because of the change in the definition of "person" as a result of the 1975 Amendments so that municipal issuers are expressly covered. My position is that even if at one time there was a defensible position that exempt securities such as municipal bonds were subject to a different level of "materiality" under the anti-fraud sections than registered securities, this is now a point of view that is not felt to be defensible by experts in federal securities law. Thus, municipal issuers are fairly caught within the web of the federal securities laws under the anti-fraud sections at the present time (and I might add parenthetically that in my view this has always been the case) so that any legislative treatment of current problems of issuers of municipal securities under the federal securities laws must recognize that the sinner is already seated in the cathedral.

Although my testimony is presented on an individual basis or in some cases as a representative of my firm, I function as the chairman of a Subcommittee on Disclosure Problems of the Committee on Liaison with the Securities Industry Association, Local Government Law Section of the American Bar Association. One of our main charges over the past months has been an examination and evaluation of the guidelines proposed by the Municipal Finance Officers Association ("MFOA"). Although we have not submitted our final comment letter to the MFOA, a proposed final draft has been circulated among our membership for comment and approval. In the proposed comment letter, we had four main areas of concern in evaluating the MFOA guidelines and I would like to use the same four areas of concern as a basis for the general evaluation of the Williams proposal.

1. ISSUER COMPLIANCE VOLUNTARY

Bearing in mind the caution given above that we are excluding the presence of the anti-fraud sections of the federal securities laws, an important position of municipal issuers as indicated in the MFOA guidelines is that compliance with disclosure requirements should be on a voluntary basis. I am speaking here of "voluntary" in the sense that the method of disclosure should involve the smallest amount of federal regulation possible. The legal requirement that disclosure must take place is not in question under the federal securities laws. If a spectrum were constructed of the various stages from voluntary disclosure to required disclosure, the Eagleton Bill S2574 would be at the extreme side of the spectrum requiring mandatory disclosure. This would mandate the filing of a registration statement (which under SEC practice would include a thorough review of the statement) before solicitation of offers to purchase would be permitted. Requiring registration in compliance with the terms of the 1933 Act was a step that was clearly foreign to all of the drafts and discussion in connection with the 1975 Amendments. This is recognized by a Section 15B(d)(1) of the 1975 Amendments to the 1934 Act which clearly states that neither the Commissioner nor the Board is authorized to require any issuer of municipal securities, directly or indirectly, to file prior to the sale of such securities any document in connection with such sale. Reasons for not using the 1933 Act registration approach are in part of a historical nature and may be based upon considerations of political philosophy inherent in the federal system. The review by the one level of government of the ability of a different level to borrow money by the marketing of its securities is a significant feature in the balance of power that needs to be achieved if the federal system is to be workable. Additional reasons for not adopting registration under S2574 will be covered in the third and fourth concerns.

On the opposite end of the spectrum, the MFOA guidelines propose a purely voluntary method of complying with disclosure. There are several intermediate possibilities and one of these is offered by the Williams proposal. The Williams proposal would require in Section 13A(f)(3) the filing of reports and distribution statements required by the Section either at a designated location as prescribed by rules and regulations of the Commission or at a central repository provided under contract by the Commission. The Williams proposal would provide no review, but the reports and distribution statements would comply with criteria as to their content as set forth in general guide-

line requirements contained in the legislation. Such a filing requirement of annual reports and disclosure statements in connection with the sale and distribution of municipal issues would constitute a much milder form of federal regulation and would appear to be only a small step along the spectrum to mandatory requirements from the MFOA position of voluntary compliance as indicated.

The Williams proposal achieves another goal of both the municipal issuer and the purchaser as well as other interested persons connected with the transaction —the provision of a definite legal standard to follow in preparing the disclosure material. Although there may be quibbling about the specific disclosure requirements in the Williams proposal both as to the annual reports and the distribution statements, based upon our Subcommittee work in connection with the MFOA guidelines and bearing in mind the comments of other interested groups such as the DBA, the SIA and others, I believe it is fair to say that the Williams proposal requirements, although sufficiently comprehensive for disclosure purposes, do not appear to be onerous or unduly extensive.

At this point I would like to draw attention to what in my view is one of the most significant improvements in the current status that would be achieved by the Williams proposal. I refer to the requirement in proposed Section 13A(a)(2)(J) that requires financial statements of the issuer for any fiscal year commencing on or after December 31, 1978 to be audited and reported on by an independent public or certified accountant ("private financial statements") in such manner as the Commission may prescribe. Although it may not be the proper function of bond counsel to comment on the desirability of requiring private financial statements, we believe that the experience of our firm in its private securities law practice would definitely permit us to make the comment that such a requirement would go a long way in redressing the differences and difficulties that separate public and private issuers of securities.

2. NO SAFE HARBOR

There is a tradition that has grown up in connection with the issuance and sale of municipal bonds that is in conflict with the practice in private securities work. Historically, municipal bond practice both from a legal and marketing standpoint, has required a degree of legal certainty that is on a different and higher level than the private securities practice. The best example would be the standard for rendering a municipal bond opinion, i.e. bond counsel must not issue an approving opinion if there is a reasonable argument to the contrary. This should be contrasted with a private securities opinion where the securities lawyer should not give his opinion if he doesn't believe it will prevail in the courts. Regardless of how this difference is categorized, whether as qualitative or quantitative, it is reflected in other areas of public law pertaining to municipal issuers. One corollary of the higher standard opinion is the search for and the desirability of safe harbors in connection with regulatory requirements. Thus, in the area of arbitrage of municipal bonds, the IRS was beseeched by issuers and their bond counsel to provide tests that would give a safe harbor from the arbitrage sanctions of the loss of income tax exemption. As a result of this demand, the IRS regulations in their various proposed formats have all evidenced an attempt to comply with the issuer's request so that upon the preparation and execution of an appropriate certificate covering the specific items required by the IRS regulations, the issuer would be able to avail itself of a safe harbor.

Alas, as our Subcommittee was to discover after a number of months of searching for satisfactory guidelines that would produce something approaching a safe harbor, such a goal seems clearly unattainable under the structure of the federal securities laws. Given the municipal issuer is subject to the anti-fraud sections as set forth above and given further the present view of the scope of "materiality" as defined by the most recent pronouncement of the United States Supreme Court in the Ute Indians case, i.e. anything that "might" be important to a reasonable investor in making his decision, the search for a safe harbor in disclosure guidelines seems unattainable. On the other hand, the presence of the Williams proposed guidelines in the 1934 Act will have definite legal and practical benefits not directly attainable by voluntary guidelines such as those of the MFOA. Although a strict compliance with the stated requirements of either the report in Section 13A(a) or the distribu-

tion statement in Section 13A(b), together with any further requirements as prescribed by rules and regulations of the Commission will not constitute a safe harbor, such compliance will permit the issuer to provide specific information mandated by the governing law instead of having to determine in each case the disclosure that would be "material" based upon the broad applicable definition. In addition, since the requirements of the Williams proposal would be administered by the SEC, there would be a body of rulings and legal administrative practice that would be available for guidance. It should be pointed out that there is a loss in moving towards the voluntary approach by requiring only a neutral filing without any registration or review by the SEC. As a result of this departure, the parties lose the benefits that come from discussion and dialogue with the SEC in the preparation and registering of the appropriate statement.

3. INVESTIGATION INCENTIVES

A key area of concern in examing any solution to the treatment of municipal issuers is the question of whether the incentives to investigation by the parties to the transaction under a proposal are similar to the incentives on private issuers under the federal securities laws. It is my belief that there are some key differences in the resulting relationships and that for any amendatory legislation to be appropriate, it must take into consideration these differences. In the first place, one of the parties to the transaction is not directly under and subject to the direct enforcement powers of the SEC, namely, the municipal issuer. In the standard 1933 Act registration situation, the issuer under Section 11 has the liability of an issuer with respect to full disclosure. The liability of a municipal issuer (where even after the 1975 Securities Act Amendments the municipal issuer is still exempt) is unclear, whereas the broker or dealer following the 1975 Amendments is required to register with the SEC to be able to act as such and is subject to direct sanctions by the SEC. Thus, in a private securities transaction, the issuer has the incentive to investigation that is thrust upon him by his status as an issuer. This difference in the incentive position of the municipal issuers is felt by the underwriter to markedly increase his exposure. Often in a private underwriting, the underwriter will insist that a corporate issuer have experienced corporate securities counsel so that the issuer will be aware of his status as an insurer under the 1933 Act. This is felt to furnish protection to the underwriter even if he remains subject to exactly the same disclosure obligations he possessed before.

The so-called "due diligence" defense of the underwriter or purchaser in a pure 1933 Act transaction may not be available in the case of municipal issues. The registered offering under the 1933 Act presupposes a procedure under which the underwriter will have experienced corporate counsel, who will participate in the preparation of the registration statement and have an opportunity to question and to contemporaneously investigate the truth and adequacy of the disclosures in the registration statement for his underwriter client. Where no registration statement is required, the opportunity for investigation is not present in the same way. Even in a municipal transaction where a substantial official statement is prepared, the opportunity for investigation by the underwriter is not the same unless the underwriter is selected well in advance of the sale and he has an opportunity to participate through his own corporation securities counsel in the preparation of the official statement. Historically, this is contrary to the practice in the issuance of municipal bonds except in some negotiated sales. An added complication is the fact that a large majority of municipal bond issues (on the basis of number of transactions) are marketed through competitive bidding. Once again, in order to obtain the same opportunity for investigation by the underwriter, it would be necessary to utilize a transactional format that is presently used only for certain private utility issues which are traditionally subjected to competitive bidding. In such a case, the opportunity for investigation by the underwriter can be supplied by the appointment of an experienced private securities counsel for the underwriter by the issuer where the selected counsel has a sufficient reputation so that his participation in the transaction will be acceptable to the various prospective purchasers at competitive bidding.

This discussion points up a further essential difference in municipal transactions from those under the private sector; traditionally in municipal issues the underwriter has not engaged separate counsel to look after his interest and conduct an investigation under the federal securities laws. Recent events in the municipal bond market in early 1976 have indicated a growing awareness among underwriters that counsel who will consider their interests under the federal securities laws may be an essential ingredient of any transaction. In the case of the Williams proposal, the preparation of the disclosure statement in the traditional way by the issuer and his financial consultant with a review of the document for legality by bond counsel would not satisfy the underwriters' requirements. On the other hand, it would be possible regardless of whether the transaction were negotiated or competitively bid to provide an additional corporate securities counsel for the underwriter under the Williams proposal. For any investigation to be effective, the practice followed in private corporate securities would need to be instituted in some form so that an underwriter's counsel would participate in the preparation of the distribution statement. This would require significant changes in the procedures attendant upon the preparation of official statements offered in connection with the sale of municipal issues. It may be that in the case of firms with existing corporate practices, the role of bond counsel would be expanded or that bond counsel would increase his expertise in the federal securities area.

The objections of expense and added burdens on the municipal issuer because of the provisions of the Williams proposal if additional underwriter's counsel is utilized will not be directly met by the argument that the proposal applies only to large issuers where the size of the issue and the danger to investors merits the level of expense. It is submitted that although one may not have faith in the ability of the market to be a sufficient force so that its demands without federal law will force municipal issuers to provide private financial statements, nonetheless, if a federal statute requires only six percent of the municipal issuers to provide annual reports and distribution statements with private financial statements, the result will be to force the non-covered issuers, the remaining 94 percent, to meet the higher standards of the 6 percent or be penalized with higher interest costs of inferior securities.

4. ISSUER SANCTIONS

The other side of the coin to incentives for investigation is the question of sanctions against the municipal issuer or the possible liability of the municipal issuer for false or incomplete information in either the annual report or the distribution statement required under the Williams proposal. It is believed that one of the causes of the increased demand for disclosure by the underwriters in the January 1976 market was the spectre of the potential liability that might be visited upon underwriters as illustrated by the *Abrams* case, a civil suit against the City of New York, its Mayor, Controller and several of the underwriting banks filed in the Southern Federal District Court of New York August 13, 1975. The *Abrams* suit is a class action which uses the established theory that a purchaser may recover the loss in market value of his securities by a direct 10(b)(5) action against the issuer and others connected with the transaction. The fear of the underwriters in *Abrams* is that on analysis it may well turn out that the public issuer or the public officers named in the action have no real liability to the purchasers. The legal grounds for such a lack of liability are easy to suggest in general terms, i.e. depending upon the facts of the case, avoidance of liability under both the Eleventh Amendment and the sovereign immunity doctrine, would clearly be raised.[1] Because of the

[1] The question of the liability of a municipal issuer was discussed at a just-completed Practising Law Institute seminar at New Orleans titled "Municipal Bond Workshop 12th" held on February 18-20, 1976. At the workshop it was indicated by a bond counsel from Connecticut that the official statement for bonds of that State carried on the front cover an express indication that neither the State or State officials were liable for inadequate disclosures in connection with the official statement. In addition, a number of authorities were cited by members of the panel that would offer legal theories under which either a municipal issuer or a public officer of the issuer could be held liable in spite of the presence of the 11th amendment or sovereign immunity. The shortness of time before this appearance has not permitted an examination of these authorities but they can be made available to this committee.

diversity of possible fact situations that may be involved as far as parties to the suit are concerned under the Eleventh Amendment, because of differences in state laws as to the extent to which sovereign immunity applies in a given state, in the case of torts or contracts or both and the extent to which it may be waived by statute, by implied consent or by other means in a given situation and because of difficult questions of the relation of federal laws versus state laws, any general statement beyond a clear indication that a serious question of whether legal liability exists, is not possible.[2]

A more satisfactory alternative solution that might be utilized by the Williams proposal that has been used in the municipal sections of the Federal Bankruptcy laws, would be a procedure utilizing the "carrot and stock" approach. Although the first Federal Bankruptcy Law for municipalities was held invalid because of its violation of the reserved powers of the states under the Tenth Amendment (*see Ashton v. Cameron County*, 298 U.S. 513 (1935), the second municipal bankruptcy law enacted by Congress was upheld on the basis that its acceptance by the states was purely voluntary. *See U.S. v. Bekins*, 304 U.S. 27 (1937). In all subsequent federal legislation on the subject, the same approach has been consistently followed. The underlying practical compulsion of this approach in the bankruptcy situation is based on the fact that the states are powerless acting at the state level to effect a composition of the various creditors' claims since a state legislature cannot, because of the contract clause of the Federal Constitution, directly require a composition. On the other hand, at the federal level, utilizing the bankruptcy clause in the Federal Constitution, Congress has the power to order a composition under Federal Bankruptcy Laws that is binding on creditors of municipalities since the contract clause does not bind the Federal Government. Thus, using the carrot and stick approach, in return for a forced composition of private creditors' bonds liens, the states voluntarily permit the municipalities to invoke federal bankruptcy jurisdiction. A similar approach could be used in disclosure under which, in return for having a workable set of disclosure standards under the federal securities laws, the states would set up some form of state or local certification or approval of disclosure reports or statements, one feature of which would be placing liability on the municipal issuer for defects or provide an indemnity for the underwriter who has been held liable for the defective information furnished by the issuer.

Although the Williams proposal does not directly invite the creation of authorities or agencies that will provide sanctions to assure that the reports and distribution statements under the Williams proposal are true and complete, the Williams proposal does contain at least two provisions that offer similar or substitute sanctions. The provision in Section 13A(c)(1) which exempts the issuer from the requirement of a distribution statement where the state governmental authority (other than the issuer) is expressly authorized by law to grant approval to a statement of disclosure after appropriate hearing is a provision that has a similar approach. The difficulty with the proposed provision is the requirement that the law expressly indicate that the disclosure at the hearing has been "adequate." Most state corporate securities laws do not provide provisions and procedures under which the state agency would be in a position to assure the adequacy of the disclosure in the given transaction. In this connection, the suggestion can be offered that perhaps an amendment should be considered that would expand the provisions in Section 11 of the 1933 Act that permit reliance upon certificates or statements of public officials. Once again, if the underwriter were relieved of liability, his place should be taken by the public official and this raises the Eleventh Amendment and sovereign immunity problem once again.

The requirement in the Williams proposal that after fiscal years commencing on or after December 31, 1978, private financial statements be furnished will in some respects eliminate the requirement that sanctions against the issuer for accurate and complete financial statements would be necessary. This represents a significant difference from the solution in the MFOA guidelines. The provisions of the MFOA guidelines requiring financial statements permits the

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[2] A fact situation that seems clear would be that municipal issuers are presently subject to suit by the SEC directly. However, such a suit has never been brought by the SEC.

statements to be satisfied by an alternative standard. Either these statements may be prepared by an independent certified or public accountant[3] or the financial statements may be those of public officials who use recognized uniform accounting standards applied to governmental bodies.[4] To the extent the alternative requirement is eliminated and a requirement of financial statements from private accounting sources is the sole requirement, the need for sanctions on the public issuer and the public officials is significantly reduced. It has been demonstrated by the experience in private corporate securities sector under the federal securities law that private accountants can be held liable under the federal securities laws to an extent that other parties to the transaction may be relieved of liabiliy and the resulting creation of better accounting practices has resulted in removing the basis of liability.[5]

Senator WILLIAMS. Mr. Ronald Forbes, associate professor of finance, State University of New York; and Mr. Robert W. Doty, professor of law, Creighton Law School.

STATEMENT OF RONALD W. FORBES, ASSOCIATE PROFESSOR OF FINANCE, STATE UNIVERSITY OF NEW YORK

Mr. FORBES. My name is Ronald Forbes. I'm associate professor finance, State University of New York. We have a fairly lengthy prepared statement. I won't bother to read it.

Senator WILLIAMS. I would appreciate it if you didn't. I will promise that it will be read in full before this day is over.

Mr. FORBES. Thank you.

I would like to highlight some of the research that we have been doing. I have been working under a grant from the National Science Foundation and the Municipal Finance Officers Association is the sponsoring organization, on problems of municipal credit quality and credit information. The views in this statement represent my own views and a report of some of the results of that research to date.

I think if we consider the economic and legal factors of the marketplace now it would seem that all participants have sufficient incentives to provide just the right amount of disclosure. Investors should demand it to reduce the risks. Issuers should be willing to comply to achieve lower borrowing costs and underwriters and other intermediaries have the added burden of compliance with securities laws. There have been no systematic studies of the extent of disclosure in the municipal securities markets. Therefore, we initiated a project designed to measure the extensiveness of the credit information reported in the documents, notices of sale, official statements and prospectuses that are provided by issuer or their advisors.

The first phase of this project was begun September 1975. We requested copies of the offering documents furnished in conjunction with new bond sales for all issues listed in the sealed bids invited section of the daily bond buyer. We have received 174 offering

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[3] The Disclosure Guidelines for Offerings of Securities by State and Local Governments of the Municipal Finance Officers Association, Disclosure Draft dated November 10, 1975, indicate under footnote 3 on page 7 that the recommended guidelines are those obtained in *Governmental Accounting, Auditing, and Financial Reporting*, 1968 as presented and recommended by the National Committee on Governmental Accounting which has been reconstituted as the National Council on Governmental Accounting.

[4] *Audits of State and Local Governmental Units*, 1974 prepared by the Committee on Governmental Accounting and Auditing of the American Institute of Certified Public Accounts.

[5] This approach offers no panacea. See the recent case of *Saunders v. John Nuveen & Co., Inc.*, CCCH ¶ 95,347 decided October 30, 1975, where reliance on financial statements of private accountants by the underwriter was held not to prevent liability.

statements covering as many general obligation bond issues and we are presently in the process of analyzing the content of those statements. Each of these offering statements is being analyzed to determine whether sufficient information has been provided to enable an experienced analyst to arrive at a judgment of the relative credit strengths and weaknesses of the issue. Quite clearly, a good deal of the subjective judgment must enter this process.

Without going into elaborate detail, we have focused on three broad classes of credit information, including: (1) the timely and comprehensive statement of outstanding indebtedness; (2) a detailed financial report including the revenues and expenditures and the balance sheet of the borrower; and (3) a thorough report of the economic and demographic characteristics of the population served by the governmental unit.

In our prepared statement we summarize some of the official results of this survey and we provide a lengthy list of detailed items that we evaluate on these official statements. I would only like to summarize a couple of points which are in our table 3.

We have heard a good deal of discussion—indeed, the main feature of the legislation that is proposed has been the inclusion of an independent or certified financial report by an auditing firm. As noted in our table 3, only 17 or 10 percent of the offering statements in our survey supplied copies of certified financial reports. Only 7 of these described the accounting methods used in these reports. Only 44 of the 174, or slightly more than one-quarter, provided current year operating statements of revenues and expenditures. Of these, only 25 reported in detail the sources of revenues and the purposes for expenditures, and only 5 provided detailed statements of actual cash flows.

As a specific example of the lack of detail, only four documents provided any detailed discussion of the pension arrangements covering government employees, even in light of the heightened concern over the potential liabilities of unfunded municipal pension plans.

Although our analysis of reporting practices is not yet complete, these observations drawn from a survey of 174 issues provide very strong cases that issuers of municipal securities do not generally supply the market with many of the types of information that credit analysts perceive as important disclosures. We feel that these results, even though based on a survey, are very likely representative of the practices that were followed in the past by most issuers. However, before drawing the conclusion that such evidence represents a strong case of the need for Federal rules and regulations governing municipal disclosure practices, certain other observations should be noted.

First, the offering statement may not be the sole source of credit information available to the investment market. In fact, a good deal of credit related information is available to investors through only the cost of a newspaper and governmental agencies at the state and Federal level disseminate a substantial volume of local govern-

ment statistics. We cannot measure the extent to which these other sources of information are generally available nor how complete these sources are, nor even whether these sources are widely used.

In addition to this unknown quantity of free information, the investment market has always been free to purchase additional information. If municipal credit information was valued highly we could expect to observe high prices paid for analysts and we should observe active competition by firms specializing in credit analysis. Such does not appear to have been the case. While precise data is not readily available, it is common knowledge that credit analysts did not at least until 1975 command the high salaries and bonuses that were more characteristic of underwriting managers and sales personnel. Indeed, there appeared to be very few analysts around.

In a continuing study of investors' needs and uses for credit information, we have surveyed some 87 major institutions and among the questions asked of each institution was an indication of the number of employees who devoted full time to municipal credit analysis. The results are tabulated in our table 4. Perhaps the most striking result is the fact that 53 of the 87 institutions did not employ a single full-time munincipal credit analyst. The absence of credit analysts is one suggestion of the low priority that has been assigned to municipal credit evaluation in the past. Expressed most simply, indepth credit analyses costs money and these costs must be weighed against the benefits that can accrue from the production of information and analysis. For the past three decades, until 1975, municipal securities have been regarded as second in safety only to the securities of the Federal Government and its agencies. Indeed, defaults were extremely rare and generally confined to the more speculative tax-exempt revenue bonds. Since 1975, since January 1975, this trend has been completely reversed and as evidenced by trends in interest rates and other problems, the erosion of investor confidence, evidenced by the relative changes in interest rates and the renewed and heightened perceptions of credit risks have been associated with a number of developments, including the 1974 abrogation by New York and New Jersey of covenants adopted in 1962 prohibiting the application of the pledge revenues of the Port of New York Authority for rail mass transit, the recent passage of municipal bankruptcy legislation by the Senate and the House, decline and fall of the New York State Urban Development Corp., the long and tortuous still continuing situation of New York City and its cash flow problems, and the moratorium by New York City and its note applications. These recent developments have been interpreted by the market as evidence that issuers when faced with difficult choices may be willing to ignore earlier promises to bond holders.

The combined effect of these events has been a tremendous shock to the entire capital market. One fallout has been to dramatically increase the market's demand for information. Although we are just now preparing to continue our survey and cover issues sold

69-141 O - 76 - 17

this spring, our casual observations suggest that heightened demand for credit information is already being reflected in prospectuses accompanying new issues. If our survey supports this, then it will be clear that the market can make and may have made extremely rapid adjustments to meet these demands for added disclosure. If this view of the market is correct, then it is not at all clear that imposing Federal rules and regulations will add any net benefits. Moreover, disclosure rules address themselves to a limited body of information. These rules do not insure that public finance officials develop the management information systems that can improve the decision process in government. Indeed, it should be apparent by now that one of the symptoms of New York City's problems is that the city does not have and has not had the type of internal accounting and information systems that are necessary.

In this context, we believe that it makes more sense to allocate the resources to the general improvement of all municipal information systems so that taxpayers as well as bond holders and underwriters can better understand the choices that are available, the funds that are needed and the resources that are to be applied.

Thank you.

Senator WILLIAMS. Thank you very much, Mr. Forbes.

[Complete statement of Mr. Forbes follows:]

STATEMENT OF THE MUNICIPAL FINANCE STUDY GROUP*

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

of the

UNITED STATES SENATE

February 26, 1976

*The research that is discussed in this statement has been supported by a research grant from the National Science Foundation, Program of Research Applied to National Needs, entitled Reporting, Evaluating and Improving Municipal Credit Condition.

Statement of the Municipal Finance Study Group
Before the
Committee on Banking, Housing and Urban Affairs
of the
United States Senate

February 26, 1976

Mr. Chairman, I am Ronald W. Forbes, Associate Professor of Finance at the School of Business, University Center at Albany, Albany, New York. I am appearing today as a member of the Municipal Finance Study Group, which is an ad hoc association of faculty and graduate students that are carrying out research projects on policy issues of concern to the municipal bond market.

I would like to acknowledge the very substantial assistance of Christopher Carter, Steven Chilton, Harold Kreitzman, Paul Leonard and David Whitford in the preparation of this statement. We appreciate this opportunity to address the Committee on the matter of disclosure in the municipal securities markets.

State and local governments depend heavily on continued access to financial markets in order to raise the necessary funds for needed capital investments in schools, hospitals and water and sewer treatment facilities. Capital markets also provide the short-term funds needed in many jurisdictions to even out seasonal patterns of receipts and expenditures. To this point, the capital market has been able to accomodate many if not most of these needs; the market has even been willing to supply funds for somewhat more dubious purposes such as the use of public financing in support of private enterprises such as football stadiums and racetracks.

In 1974, some 7,701 new issues of long-term bonds and short-term notes were sold by state and local governments, amounting to $51.9 billions. In 1975, there were 8,080 new issues amounting to $58.2 billions. Indeed, the

municipal securities market far surpasses any other public securities market in terms of the number of issues and issuers that have been accomodated (see Table 1) and is second only to the market for U.S. Treasury and governmental agency securities in terms of the amounts of funds raised.

The importance to state and local governments of continued access to the public market is attested to by the fact that over 50 percent of all state and local capital investment is financed through offerings of debt securities. In particular, the ability to market long-term debt permits governmental units to align the costs (of debt service) with the useful life of such capital projects and thereby avoid the sizeable tax burdens that would otherwise be required to fund, immediately and in full, outlays for new investment.

State and local borrowing is carried out in the context of the larger capital market where numerous alternative financial instruments are also competing for the available supply of funds. The exemption of interest payments from federal taxation generally permits municipalities to market their securities at lower interest rates, even when the marked cyclical volatility of the tax-exempt market is considered. Since 1955, for example, the interest rate on the highest quality of long-term municipal bonds (rated AAA) has averaged 72 percent of the rate on corporate bonds of comparable quality. (See Chart 1.)

Many factors other than the value of tax-exempt income are weighed by investors, but foremost among these factors is, perhaps, an assessment of relative risks and required returns on different securities.

The risk arises from the fact that investors in municipal securities (or in other securities) are purchasing claims on the <u>future</u> revenues of the borrower. One way to identify and perhaps reduce this risk and uncertainty

is to seek out all relevant information on the borrower. In this regard, any information that allows investors to better estimate the likelihood that they will in fact receive the promised payments can be viewed as relevant information. Moreover, several facets of existing securities laws are addressed to the importance of information to the investment market. Rule 10b-5 of the Securities and Exchange Commission, which covers all securities transactions, states, in part, that it is unlawful for any person

> "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, misleading."
>
> (17 C.F.R. §240-10b-5(1974))

Moreover, the thrust of judicial decisions on such questions has been to reinforce the need for full disclosure. As summarized by Professor Robert Doty, these decisions widen the scope of relevant information that should be disclosed:

> The "basic test" of materiality has been said to refer to "whether 'a reasonable man would attach importance [to the fact . . .] in determining his choice of action in the transaction in question.'" . . . Whatever the boundaries of even this vague definition, with its ties to the judgment of the market or to what reasonable investors would do, the Supreme Court in a recent case constructed even a more elusive definition: "All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of [his] decision."
>
> (Robert W. Doty, "Application of the Antifraud Provisions of the Federal Securities Laws to Exempt Offerings: Duties of Underwriters and Counsel," Boston College Industrial and Commercial Law Review, Summer 1974, p. 403)

It would seem, then, that all participants in the tax-exempt market have sufficient economic and legal incentives to provide just the "right" amount of

disclosure. Investors should demand it, to reduce their risks. Issuers should be willing to comply, to achieve lower borrowing costs. And, underwriters and other intermediaries have the added burdens of compliance with the securities laws.

Yet, the recent and frequent reports highlighting the difficulties of several well-known governmental borrowers, including the state of New York, New Jersey and Ohio, have cited alleged lapses in disclosure. Since there have been no systematic studies of the extent of disclosure in the municipal securities market, we have initiated a project designed to measure the extensiveness of the credit information reported in the documents (notices of sale, offering statements, or prospectuses) that are provided by issuers or their advisors. The first phase of this project was begun in September 1975: we requested copies of the offering documents furnished in conjunction with new bond sales for all issues listed on the "Sealed Bids Invited" section of The Daily Bond Buyer (Thursday and Friday editions) from September through November. We have received 174 offering statements covering as many general obligation bond issues and we are presently in the process of analyzing the content of these statements. As noted in Table 2, the bond issues associated with these statements cover all size categories; individual issues ranged in size from the very small $90,000 issue of general obligation street improvement bonds of Albert City, Iowa to the $50,000,000 capital improvement general obligation bond issue sold by the State of Delaware.

Each of these offering statements is being analyzed to determine whether sufficient information has been provided to enable an experienced analyst to arrive at a judgment of the relative credit strengths and weaknesses of the issue. Clearly, a good deal of subjective judgment must enter this process.

Each credit analyst has his own perspective and assigns his own weights to the different measures of creditworthiness; and there is no fixed, quantifiable formula that guarantees a precise measure of risk. However, most analysts would readily agree that at least three broad classes of credit information are important:

1) a timely and comprehensive statement of outstanding indebtedness;

2) a detailed financial report, including the revenues and expenditures and the balance sheet of the borrower; and

3) a thorough report of the economic and demographic characteristics of the population served by the governmental unit.

A more extensive rationale for these broad classes of credit-related information is provided in Appendix A to this statement. It should also be noted that the specific types of information selected for our survey are drawn also from the draft Disclosure Guidelines for Offerings of Securities by State and Local Governments, published by the Municipal Finance Officers Association, and attached as Appendix B to this statement.

While our analysis of the sample issues is not yet complete, certain observations are reported in summary form in Table 3.

Credit analysis focuses on an evaluation of cash flows--more specifically, on determining whether sufficient cash will be available for the timely repayment of obligations. One starting point, then, is to assay the required cash flow by analyzing the burden of outstanding indebtedness. As noted in Appendix A, since much of the burden of carrying a given level of indebtedness falls on the taxpayers residing in a governmental jurisdiction, and since

taxpayers fall under the jurisdictions of several governmental units, such as school districts, towns and counties, an inclusive measure of indebtedness should report the outstanding long and short-term debt of the borrowing unit and all other overlapping governmental units. As noted in Table 3, most offering statements did report such information; but 25 statements, or 14 percent, did not report the amount of direct debt outstanding as of a date within three months of the bond sale, and 9 statements provided no information at all on the amount of outstanding debt. Again, 20 statements did not report on the overlapping indebtedness of other governmental units. (This category was viewed as not relevant for 16 issues in our survey; several of these issues were sold by states.)

As suggested in the draft Disclosure Guidelines, the statement of current indebtedness should be supplemented by a report of the outstanding indebtedness for the past five fiscal years. Only 3 statements provided this information for the prior five years; 7 other statements provided some prior data (generally the prior 4 years); and 160 provided no information on past indebtedness. The amount of debt outstanding is only an indirect measure of the required cash flows of concern to investors. Most bonded debt matures serially over as long as 25 or 30 years, and the total annual debt service, which includes interest payments, is a more direct measure of the future debt burden. It is of interest to note that only 36 offering statements, or 21 percent of those surveyed, contained a schedule of the annual debt service requirements, and only 66 statements supplied annual schedules of maturing principal payments.

Measuring the required cash flows to meet debt obligations represents only one dimension of the credit analysis; having ascertained these required flows, the analyst must then relate the future promises to pay to the ability of the issuer to meet these payments. Unfortunately, there are no crystal balls, nor

even any satisfactory econometric models, that are or can be used to predict the receipts and expenditures of specific local governmental units. Instead, most analysts would turn to the current and prior financial reports to derive estimates of the revenue capacity and the competing expenditure needs of the borrower. Moreover, these financial reports can provide some indications of the quality of the stewardship of public officials. And, as research in the corporate markets has demonstrated, current financial reports, even though they relate past developments, are used to revise previously-held expectations for future returns. Most publicly-held corporations issue annual financial reports that are certified by independent public accountants. As noted in Table 3, only 17, or 10 percent, of the offering statements in our survey supplied copies of certified financial reports and only 7 of these described the accounting methods used in the reports. Only 44, or slightly more than one-quarter of the issues surveyed provided current year operating statements of revenues and expenditures; of these, only 25 reported in detail the sources of revenues and the purposes for expenditures; and, only 5 provided detailed statements of actual cash flows.

As a specific example of the lack of detail, only 4 documents provided any detailed discussion of the pension arrangements covering government employees, even in light of the heightened concern over the potential liabilities of unfunded municipal pension plans.

Most general obligation bond issues are backed ultimately by the unlimited authority to levy ad valorem taxes on properties located in the governmental boundaries and most credit analysts would seek to evaluate the "carrying capacity" of this economic base. A fundamental statistic is the valuation base. Interestingly, some 32 issues did not report the current assessed property

valuations for prior years. Property tax rates are a major source of revenue for local governments and are generally expressed in terms of assessed valuations. Although most property owners bemoan the high level of taxes, credit analysts do evaluate comparative tax rates to arrive at some perspective on the actual tax burden. However, for 60 issues, or 34 percent of the survey, data on current tax rates were not reported.

Other economic and demographic data are used by credit analysts in subjectively evaluating the longer-run prospects that a given community will retain sufficient economic potential and generate the required revenues to meet all expenditure demands. Population trends, for example, can provide a measure of the economic trends in an area. But, as noted in Table 3, 64 issues did not report current population estimates; and 60 issues did not provide population figures from the 1970 census. And, as summarized in Table 3, there were very few examples of offering statements that provided any detail on current employment and/or unemployment, on major industries, or on incomes of residents in the governmental jurisdiction.

Although our analysis of reporting practices is not yet complete, these observations drawn from the survey of 174 issues provide very strong indications that issuers of municipal securities do not generally supply the market with many of the types of information that credit analysts perceive as important disclosures. Even though our survey represents only a sample of all issues sold last year, the results are very likely representative of the practices that were followed in the past by most issuers. (By September, the hue and cry over disclosure omissions associated with the New York debacle had been widely discussed in the press.) Indeed, by comparison with the corporate securities market, these observations suggest that the information provided in municipal

bond offering statements is most notable for the lack of disclosure of possibly material information. However, before drawing the conclusion that such evidence represents a strong prima facie case of the need for federal rules and regulations governing municipal disclosure practices, certain other observations should be noted. First, the offering statement may not be the sole source of credit information available to the investment market. In fact, a good deal of credit-related information is available to investors for only the cost of a newspaper. And, governmental agencies at the state and federal level collect and disseminate a substantial volume of local government statistics. We cannot measure the extent to which these other sources of information are generally available; nor how complete these sources are; nor even whether these sources are widely used.

In addition to this unknown quantity of "free" information, the investment market has always been free to purchase additional information.

If municipal credit information was valued highly, we could expect to observe high prices paid for analysts and we should observe active competition by firms specializing in credit analysis. Such does not appear to have been the case: while precise data is not readily available, it is common knowledge that credit analysts did not, at least until 1975, command the high salaries and bonuses that were more characteristic of underwriting managers, bond traders, and sales personnel. Indeed, there appear to be very few analysts around. In a continuing study of investor needs and uses for credit information, we have surveyed some 87 major institutions, and among the questions asked of each institution was an indication of the number of employees who devoted full time to municipal credit analysis. The results are tabulated in Table 4. Perhaps the most striking result is the fact that 53 of the 87 institutions did not employ a single full-time municipal credit analyst.

The absence of credit analysts at investing institutions is one suggestion of the low priority that has been assigned to municipal credit evaluation. In-house analysis has been largely replaced by ready acceptance of the credit ratings supplied by the independent credit rating agencies. Ironically, these agencies are now castigated for failing to sound the siren loud and strong over the recent New York debacle whereas not so long ago, Congressional hearings and other vociferous complaints were directed at these same agencies for their failures to recognize the unquestioned strengths of municipal credits. Somewhat lost in the rush to make "whipping boys" of the rating agencies is a more fundamental observation that the inadequacies, if any, of the current rating system may simply be additional examples of the low value assigned to credit analysis by the market as a whole.

Expressed most simply, in-depth credit analysis costs money and these costs weighed against the benefits that can accrue from the production of information and analysis. For the past three decades, until 1975, municipal securities have been regarded as second in safety only to the securities of the federal government and its agencies. Indeed, defaults were extremely rare and generally confined to the more speculative tax-exempt revenue bonds, used to finance private enterprise-type functions and backed by prospective user charges. As noted in a recent study by the Advisory Commission on Intergovernmental Relations, the total dollar amount of municipal debt that was declared in default over the period from 1945 to early 1970 was only $450 million or 0.4 percent of all tax-exempt debt outstanding in 1970. Moreover, only 2 of the 24 major defaults involved general obligation bonds (see City Financial Emergencies, p. 16.)

With this record of safety, reinforced by the exhortations of public officials, the value of independent credit analysis-in-depth must have seemed marginal at best.

This view of history is reflected in the trend of interest rates on municipal securities relative to corporate securities. For example, the ratio of interest rates on the lowest investment-grade municipals (rated BAA by Moody's Investors' Service) relative to rates on like-rated corporate bonds exhibited a pronounced downward trend over the period 1955-1974. From 1955 to 1960, the BAA municipal interest rate averaged 86 percent of the corporate bond rate, but this ratio had dropped to only 68 percent for the period 1970-1974. (See Chart 2.)

Since January 1975, however, this trend has completely reversed. Interest rates on the lowest investment-grade municipal bonds in particular have risen sharply relative to the corporate bond rate. The ratio of tax-exempt to taxable interest rates on BAA-rated bonds climbed from 67 percent in February 1975 to 78 percent in November.

Over the same period, investors were making equally significant distinctions in the relative credit strengths within the municipal market. Differences in yields between municipal bonds carrying the highest credit ratings and those with the lowest investment-grade ratings widened by 50 basis points between January and December.

The erosion of investor confidence evidenced by the relative changes in interest rates on municipal securities during 1975 and the renewed and heightened perceptions of credit risk have been associated with a number of developments, including:

- The 1974 abrogation by New York and New Jersey of covenants adopted in 1962 prohibiting the applications of pledged revenues of the Port of New York Authority for rail mass transit.
- The recent passage of municipal bankruptcy legislation by the Senate (S. 2597) and the House (H.R. 10625)

- The decline and fall of the New York State Urban Development Corporation in the winter of 1975.
- The long and tortuous, still-continuing saga of New York City, its cash flow problems (and its difficulties in measuring its cash flow problems);
- And, the moratorium or "de facto" default by New York City on its note obligations.

These events, which must be considered together, have acted to weaken a fundamental underpinning of the municipal market and that is the protection that investors perceived as inherent in the widely used statement that:

> the full faith and credit of this government are pledged to the payment of principal and interest on these bonds and the government is obligated to levy ad valorem taxes without limitations as to rate or amount upon all the taxable property, sufficient to pay the principal of and interest on the bonds.

These recent developments have been interpreted by the market as evidence that issuers, when faced with difficult choices, may be willing to ignore earlier promises to bondholders.

The combined effect of these events has been a tremendous shock to the entire capital market, and one fallout has been to dramatically increase the market's demand for information. Although we are just now preparing to collect and subsequently evaluate the offering circulars provided with bond issues sold this spring, our casual observations suggest that this heightened demand for credit information is already being reflected in the prospectuses accompanying new issues. If our survey supports this, then it will be clear that the market can make and may have made extremely rapid adjustments to meet these demands for added disclosure.

If this view of the market is correct, then it is not at all clear that imposing federal rules and regulations will add any net new benefits, even though it will almost surely add net new costs. Disclosure rules will not by themselves remove the shortage of trained credit analysts. Moreover, disclosure rules address themselves to a limited body of information; these rules do not ensure that public finance officials develop the management information systems that can improve the decision process in government. Indeed, it should be apparent by now that one of the symptoms of New York City's problems is that the City does not have and has not had the type of internal accounting and information systems that are necessary. But the New York problem is not new or unique. As noted in the Advisory Commission on Intergovernmental Relations study of City Financial Emergencies, in 1973,

> Improper financial management practices are frequently a cause of or a primary factor contributing to financial emergencies. As a consequence of inadequate accounting and reporting, some cities have drifted into financial emergencies without realizing how serious their problems have become . . .

In this context, we believe that it makes more sense to allocate resources to the general improvement of all municipal information systems, so that taxpayers as well as bondholders and underwriters can better understand the choices that are available, the funds that are needed and the resources that can be applied.

TABLE 1

Summary Measures of
New Issue Volume in Municipal
and Corporate Securities Markets
1970 - 1975

New Issues of:[1]	1970	1971	1972	1973	1974	1975
Municipal Securities:						
Long-Term No of Issues	4701	5461	5103	4741	4287	4697
Dollar Volume[2]	$17.762	$24.370	$22.941	$22.953	$22.824	$29.224
Short-Term No of Issues	2903	3350	3317	3406	3414	3383
Dollar Volume	$17.880	$26.281	$25.222	$24.667	$29.041	$28.973
Total No of Issues	7604	8811	8420	8147	7701	8080
Dollar Volume	$35.642	$50.651	$48.162	$47.620	$51.865	$58.197
Corporate Financing:						
Bonds-						
No of Issues	549	598	469	264	376	486
Dollar Volume	$24.349	$25.636	$18.916	$13.442	$27.306	$34.280
Preferred Stock-						
No of Issues	55	77	78	54	57	78
Dollar Volume	$1.317	$2.168	$2.346	$2.360	$1.675	$2.616
Common Stock-						
No of Issues	778	1128	1383	411	154	217
Dollar Volume	$5.463	$11.344	$12.979	$6.899	$2.646	$6.439
Total No of Issues	1382	1803	1930	729	587	781
Total Dollar Volume	$31.130	$39.148	$34.241	$22.701	$31.627	$43.335

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1 Source of Data - "A Decard of Municipal Financing," The Daily Bond Buyer, January 7, 1976, p. 5.

2 All dollar figures are in billions.

3 These figures are taken from "Total Underwritten Public Financing" tables compiled by the Investment Dealers Digest, various issues. Corporate data for 1975 are through November.

TABLE 2

Size Distribution of
General Obligation Bonds
in Survey of Official Statements

Size of Issue	Number of Observations
Less than $500,000	42
$500,000 - $999,999	29
$1 million - $2.49 million	42
$2.5 million - $4.99 million	20
$5.0 million - $9.99 million	22
$10.0 million - $24.99 million	10
$25.0 million - $49.99 million	3
$50 million and over	6
Total	174

TABLE 3

Summary of Reporting Practices
in Survey of Official Statements

Type of Information	Number of Statements Reporting	Not Reporting	Not Relevant
1. Statement of Direct Debt Outstanding Dated within 120 days of sale date	149	25	-
2. Direct Debt Statement dated in 1975	165	9	-
3. Statement of Overlapping Debt dated in 1975	138	20	16
4. Statement of Direct Debt for Prior 5 year Period	7	167	-
5. Statement of Annual Debt Service Requirements for all Direct Debt:			
a) Principal Only	66	108	-
b) Principal and Interest	36	138	-
6. Audited Financial Reports	17	157	-
7. Accounting Methods Identified	7	167	-
8. Operating Statements of Revenues and Expenditures for Most Recent Completed Fiscal Year	44	130	-
9. Detailed Statement or Explanation of Sources of Revenues and Expenditures	25	149	-
10. Current Year Assessed Valuation of Taxable Property	139	22	3
11. Current Property Tax Rate	109	60	5
12. 1975 Population	110	64	-
13. 1970 Population	114	60	-
14. Data on Number of Employed Persons in Major Employment Categories	10	164	-
15. Data on Level or Rate of Unemployment	4	170	-
16. List of Major Industrial Firms Located in Area (with Employment figures)	50	119	5
17. Personal Income Data			
a) Median Family Income - Own Unit	20	154	-
b) Median Family Incomes - Standard Metropolitan Statistical Area	3	168	3
c) Total Personal Income of Residents	14	160	-

TABLE 4

Number of Institutions with
Full-Time Municipal Credit Analysts

Type of Institution	Number of Analysts per Institution					
	0	1	2	3	4	5 or more
Investment Banking Firms with Annual Municipal Underwriting Volume of:						
Less than $10 million	4	-	1	-	-	-
$10 - $50 million	9	1	2	-	-	-
$50 - $100 million	4	-	1	-	-	-
$100 - $500 million	9	-	4	-	-	-
Over $500 million	2	-	1	1	-	1
Commercial Banks with Municipal Portfolio Holdings of:						
Less than $10 million	-	-	-	-	-	-
$10 - $50 million	2	2	-	-	-	-
$50 - $100 million	7	1	1	-	-	-
$100 - $500 million	10	7	-	-	-	-
Over $500 million	-	1	2	-	1	-
Property and Casualty Insurance Companies with Municipal Portfolio Holdings of:						
Less than $10 million	1	-	-	-	-	-
$10 - $50 million	3	-	-	-	-	-
$50 - $100 million	1	-	-	-	-	-
$100 - $500 million	-	-	-	-	-	-
Over $500 million	1	2	3	1	-	1
Total Number of Institutions	53	14	15	2	1	2
Total Number of Analysts	0	14	30	6	4	10

CHART 1

Average Annual Interest Rates on
Long-Term Municipal and Corporate Bonds
Rated AAA by Moody's

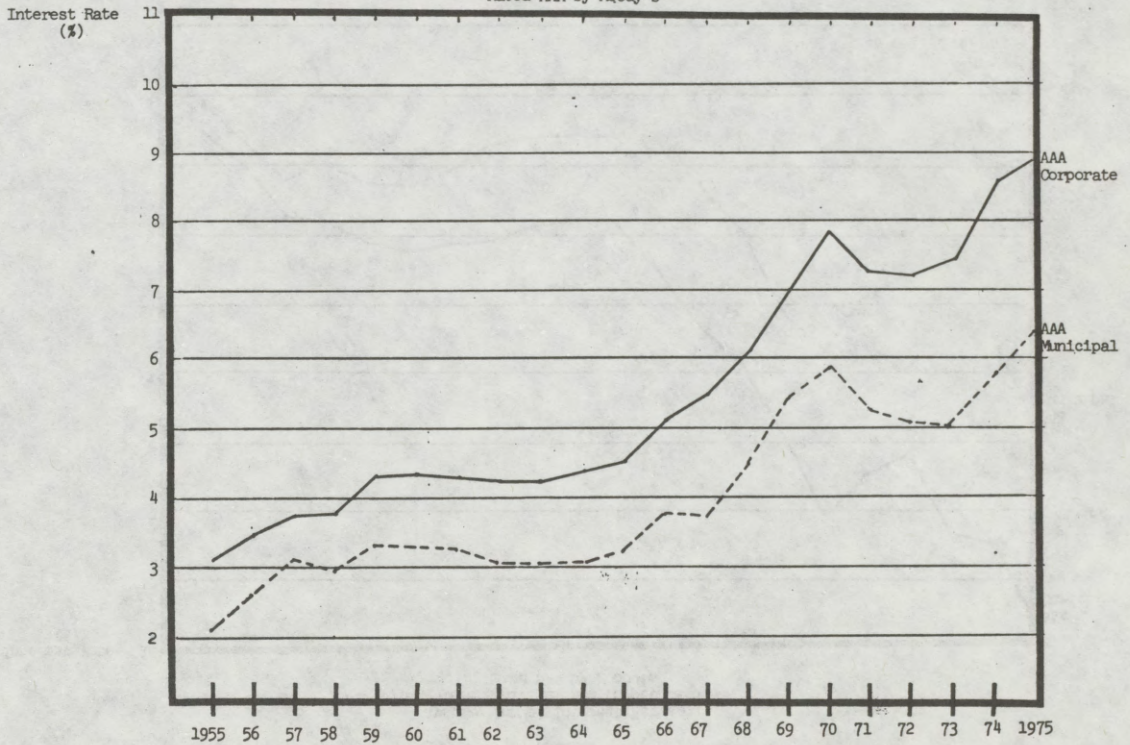


CHART 2

Average Annual Interest Rates on
Long-Term Municipal and Corporate Bonds
Rated BAA by Moody's

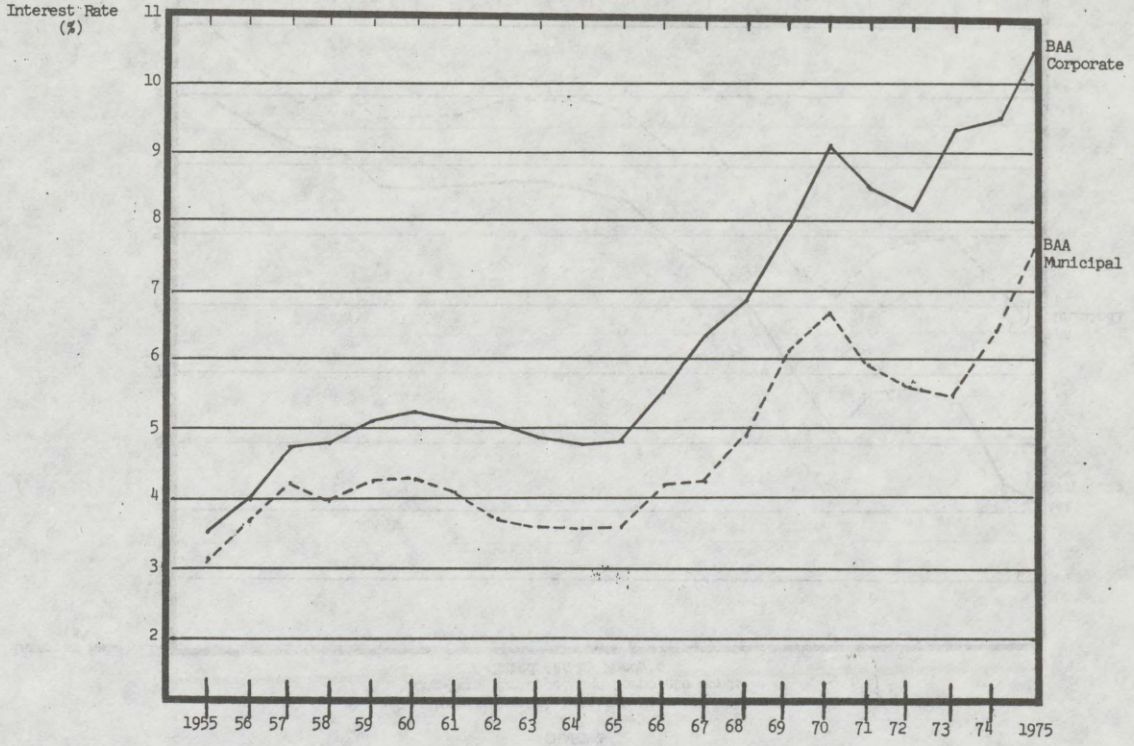
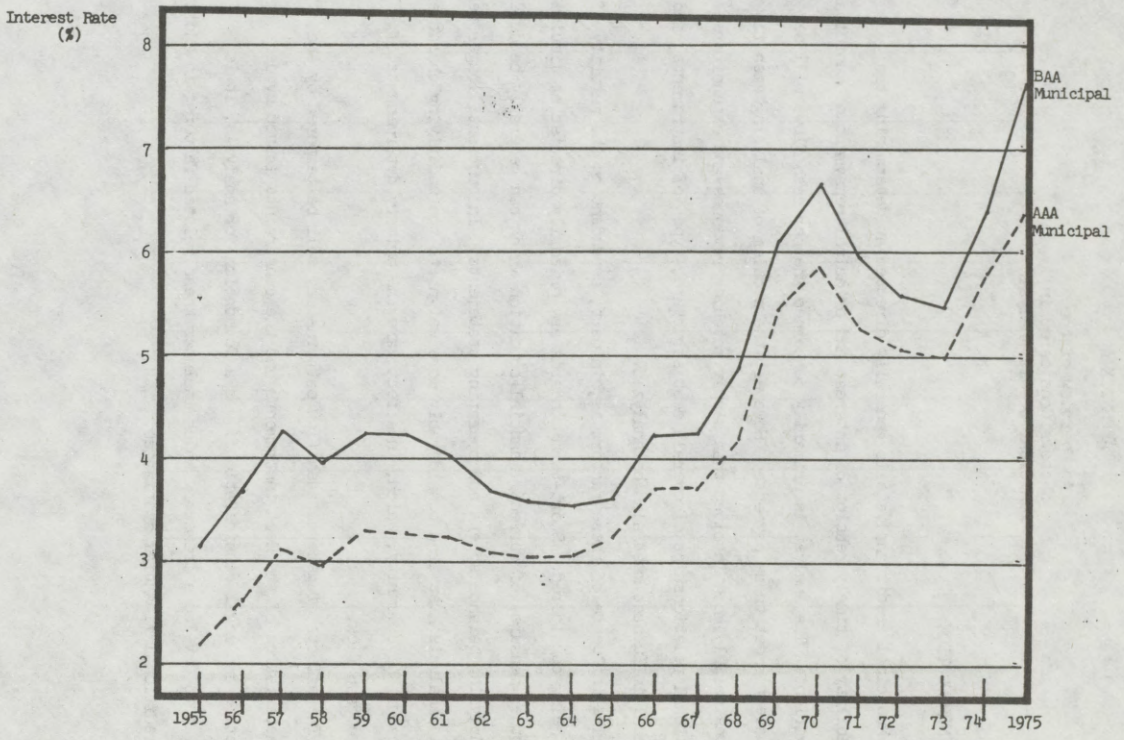


CHART 3
Average Annual Interest Rates on
AAA and BAA - Rated Municipal Bonds



APPENDIX A

An Overview of the Factors Considered in Municipal Credit Analysis

I. INTRODUCTION

Municipal credit analysis is generally directed at determining the probability of timely receipt of interest and principal repayment of municipal obligations. The analyst is primarily concerned whether cash flows will be adequate to meet these payments. However, the problem of analyzing cash flows is considerably more involved than simply matching revenues and expenditures. Functional relationships of overall debt structure, types of instruments, and external influences must also be analyzed.

The influence of these factors is, in part, dependent on the maturity of debt being considered. Short-term concerns are primarily directed at liquidity and other measures of current financial condition which can generally be determined by analyzing balance sheets and operating statements. In contrast, longer term credit analysis must lend considerably more weight to the underlying characteristics of the community, which, in effect, are the primary determinants of future cash flow.

The effects of general cash flow patterns may well be tempered by the characteristics of the debt instruments and the constraints issued by debt structure and legal considerations. As a foundation for analysis, it is crucial to develop a framework which includes these related factors, in addition to traditional financial statistics.

APPENDIX A

II. DEBT INSTRUMENTS

Municipal debt instruments are classified into various categories of short and long-term debt, which differ in purpose, security, sources of repayment and average maturity.

Note obligations may be issued in connection with both operating and capital expenditures. The primary instruments which are used are Bond Anticipation Notes (BAN), Tax Anticipation Notes (TAN), and Revenue Anticipation Notes (RAN).

BAN's are issued in anticipation of the issuance of bonds and, thus, are associated with capital expenditures. Repayment is generally associated with the issuance of bonds. Maturities may be extended to run several years, depending on the nature of the project associated with the notes.

In contrast, TAN's and RAN's should only be issued in connection with operating expenditures. TAN's are issued in anticipation of the receipt of taxes. In local governments, they are specifically associated with property taxes. RAN's are issued in anticipation of other revenue receipts; in local governments, this may include non-property revenues such as sales taxes. The function of these instruments is to temporarily support inadequate cash flows, which may result from irregular revenue receipts and tax collections. By the nature of their function, they must be of maturities less than one year.

Security for short-term debt obligations is primarily dependent on the receipt of the associated revenues. In event of default, bondholders generally have priority of claims over noteholders.

Bond obligations should only be issued in connection with capital expenditures. The primary instruments used are General Obligations and Revenue Bonds; however, these instruments may be further classified with respect to various degrees of security associated with them.

APPENDIX A

General Obligations are issued by municipalities with taxing authority and are secured by the full faith and credit of the issuer, being payable from general revenues. They may be classified as "Unlimited Tax" or "Limited Tax," depending on the taxing authority of the issuer.

Revenue Bonds are issued in connection with specific projects, and are payable only from taxes or user charges associated with the project. "Special Tax" obligations are supported by special taxes, generally associated with users, e.g. highway bonds which are supported by gasoline taxes. "Special Assessment" bonds are repayable from assessments against persons who benefit from the facilities being financed. Other revenue bonds may be associated with direct user charges, such as Water and Sewer Bonds. Lease-Rental obligations involve contractual arrangements by which the facility being financed by the debt obligation is leased to the municipality, with lease payments being used to pay debt service.

The only restrictions on bond maturities are those established by the individual municipality. Rarely will a bond run more than 35 to 40 years and, in no case, should the maturity extend beyond the useful life of the project being financed.

In addition to considering the characteristics of the various types of instruments, the analyst is also concerned with the general provisions of the debt instruments, structure of debt repayment, and the overall composition of debt.

APPENDIX A

III. DEBT REPAYMENT STRUCTURES

An important consideration, with respect to longer term debt, is the timing and structure of debt service repayment.

The rate at which debt principal is amortized can cause debt service to become unmanageable if it is too rapid. If the rate is too slow, excessive interest costs will be incurred and future generations may be faced with excessive tax burdens.

The structure of repayment arrangements also has implications for debt service manageability.

The Straight Serial bond has equal principal repayments and, consequently, declining debt service. Greater cash inflows are required in earlier years. If revenues are available, earlier retirement will result in lower interest rates. Another advantage is that more principal is repaid during the more predictable earlier years.

Level Debt Service bonds have repayment schedules which result in approximately equal annual debt service requirements. The total cost is greater than that of the straight serial bonds but less revenue is required during the earlier years. In addition, excesses and deficiencies of revenues are minimized, which makes this type of bond more preferable where revenues are unstable.

Deferred Serial bonds may have irregular maturities or amounts. Use should be limited to smoothing of prior debt service schedules or matching of debt service to irregular inflows of revenues.

APPENDIX A

IV. DEBT PROVISIONS

The security of bond instruments can be enhanced by the establishment of various funds or accounts.

Bond Interest and Principal Redemption Funds are established for debt service accounting. Revenues allocated for interest and principal repayment are appropriated to these funds. As added security, the following year's principal and interest due may be required to be placed in the account in advance.

Sinking funds are generally associated with term bonds and provide for periodic allocation of redemption funds. Thus, funds are made available on an orderly basis, preventing the municipality from postponing the inevitable allocation of funds to the distant maturity date. Often, these funds are used for earlier redemption of term bonds, if market conditions are favorable. It is important that sinking fund requirements are met, since chronic failure implies inevitable default in repayment, and technical default in the bond provisions.

Various reserve funds may be attached to bonds. The most common type of reserve fund is the Debt Reserve Fund, which provides that reserves be maintained for future payments, usually equivalent to at least the maximum principal and interest payable within a year. Reserve funds can only provide temporary cushions against default, i.e. to meet problems caused by temporary cash flow irregularities.

APPENDIX A

V. ANALYTICAL FACTORS IN DEBT EVALUATION

The debt statement presents a summary of the municipality's debt composition and burden. It should indicate all potential sources of debt liability, and should derive the overall debt burden of the municipality. The latter item can be indicative of the municipality's ability to accomodate additional debt burden. Historical data can be used to detect unfavorable trends in debt components. Such trends are extremely important in considering future cash flows, but may not be evident from a single year's statement. In addition, the statement should, ideally, be prepared fairly recently, in order to disclose the current debt burden accurately.

Direct Debt consists of obligations of the issuer. It can further be delineated into long-term debt (bonds) and short-term debt (notes). It not only represents a portion of the community's total debt burden but also is a primary factor in the financial stability of the municipality under consideration.

Debt which has already been funded does not represent a burden to the municipality. Thus, in determining net direct debt, Self-Supporting Debt and Interest and Sinking Funds should be deducted. Self-Supporting Debt reflects debt which is repaid from other sources such as user charges. Interest and Sinking Funds consist of funds already allocated toward debt repayment.

The final component of the debt burden is overlapping debt. Overlapping debt recognizes the simultaneous impact of debt burdens of overlapping governmental units, which must be combined to determine the total debt burden to the taxpayers. The financial stability of a municipality can be substantially undermined by the impact of these indirect, external overlapping debt burdens.

APPENDIX A

The actual burden to the municipality is the overall debt, which consists of all obligations not already allocated for or not payable from other sources.

In considering items on the debt statement, the analyst may require additional information, with respect to sources. Self-Supporting debt can become a burden if revenue generating capacity becomes insufficient. Problems of overlapping municipalities can jeopardize revenue collections by excessively draining the economic base. The debt statement alone may not provide this information. Consequently, analysis of trends in the financial statements of sources may be desirable.

Other types of debt-related information are useful in analysis. Debt limits suggest a degree of protection from unmanageable debt burdens. The debt service schedule is useful in cash flow analysis.

Various measures can be used as indicators of debt capability. Per capita debt, particularly net per capita, is indicative of the average debt burden on the individual taxpayer. Debt: true value measures asset coverage and provides a means to compare debt burdens of municipalities, in relation to their respective tax bases.

The most serious problem that the analyst wishes to detect is default. In addition to measures of current financial condition and factors affecting future cash flows, default history should be considered, where applicable:

Were defaults temporary?
Were amounts due compromised?
Was bankruptcy declared?
Was default caused by internal problems or external factors?
Have the problems been corrected?

Any default, whether actual or technical, is an indication of inherent financial weakness and potential problems and should therefore be reviewed carefully.

APPENDIX A

VI. FINANCIAL ANALYSIS

Equally important to debt information and analysis are the cash inflows which are the basis for debt repayments, and the influences of other financial activities. While the predictability of financial analysis is greatest in the short run, statement analysis is crucial to any credit report.

Sources of revenues include taxes, transfer payments, user charges and other fees.

Property taxes are based on assessed valuations. Trends in assessed and true values can provide an indication of trends in the tax burden and economic base. Tax collection rates can be indicative of the ability or willingness of the municipality to support additional debt. It must be realized that poor collection rates will imply necessarily higher individual tax burdens and a greater probability of revenue deficiencies. Consequently, trends in these statistics have highly significant implications for analysis.

Another major revenue source for many municipalities is the sales tax. Consideration should be given to the overlapping districts as well as the issuing municipality. Overlapping taxes are of interest because they tend to reduce the taxpayer's total available income. Data should be analyzed to determine the stability of such revenues, on the basis of trends, and the probable impact of changing economic conditions.

Other revenue sources, such as income taxes, should similarly be analyzed, where contributions are significant.

Another type of cash inflow is the receipt of assistance from other levels of government, in the form of fiscal aid. Here, consideration must be given to several factors:

APPENDIX A

- The method of aid determination
- Trends in factors affecting these determinants
- The financial strength of the unit providing assistance

The receipt of aid is contingent on the financial well-being of the assisting government. This is critically important for municipalities which depend upon assistance for significant portions of non-postponeable operating expenditures.

An important consideration, with respect to short-term needs, is that of liquidity. This can be measured by a ratio of liquid assets to current liabilities. Cash, or items easily converted into cash without significant loss, should be sufficient to cover current liabilities, with a reasonable margin for fluctuations in revenues and expenditures.

Cash deposits should be backed by pledged securities of depository banks. Investments must be of sufficient liquidity, quality, and marketability to prevent significant loss due to default or capital loss. This is particularly important in unfavorable markets.

Receivables should be analyzed to determine collectibility. It is also important to determine if excessive collection periods are being permitted or encouraged, e.g. by low penalties for delinquent taxes.

Deferred items reflect transactions related to future periods--prepaid revenues or expenditures. Since they represent reductions in future revenues and expenditures, it is important to recognize the implications of any large net reduction in revenues.

APPENDIX A

VII. SOCIAL - ECONOMIC - LEGAL ASPECTS

The effect of external factors on future cash flows can be considered from several perspectives:

- current level
- trends
- stability
- interactions
- controllability

The population is closely interrelated with various other factors. Declining population trends may suggest an impending erosion of the economic and tax bases. The impact of population changes is, to some extent, dependent on the extent by which demographic composition is altered.

Trends in income levels and income distributions are primary influences on the economic base. Lower income families tend to utilize more services of the municipality, such as municipal hospitals and welfare services, and, at the same time, generate less revenues through taxes and user charges. Thus, population increases can have a negative effect when there is a shift toward families with decreasing income levels.

The level of services provided by a municipality, and the extent to which they are utilized, is a critical input to financial stability. It is unusual to see services withdrawn; consequently, during economic downturns, the municipality may face unusual difficulties in meeting operating budgets. Increasing demand for services, as indicated by trends, must be considered with a perspective on corresponding changes in revenue-generating capacity.

69-141 O - 76 - 19

APPENDIX A

Industry affects the municipality's financial condition through its activity in both the employment and tax sectors. In the employment sector, a strong industrial base will generally result in a stronger economic base by increased employment and higher total income. Consequently, greater receipts of taxes and other revenues will be realized. In addition, industries are generally the largest taxpayers within the municipality. The extent that diversification among industries exists will influence the impact of the loss of any individual employer. A municipality which is primarily dependent on a single employer for revenues could suffer considerably if the employer transfered operations elsewhere.

Housing trends, with respect to construction and value, provide an indicator of the general economic level of the municipality. Declining values would clearly indicate a weakening of the economic base.

There are numerous other factors which can directly affect costs of operating expenditures. The influence of unions may have strong implications for rising wages and pensions; this could impose severe strains on future operations. In addition, inflation tends to increase the cost of providing services, general operations, and capital expenditures. This is of particular importance in cases where tax restrictions prevent sufficient adjustment of the tax rate in order to meet revenues.

The stability of these factors, as with any predictive variable, greatly determines the validity of the relationships and, consequently, the associated risk. While the municipality probably will not have absolute control over the direction of these variables, it can influence many of them. Industry can be attracted by tax and other incentives, resulting in increased employment and tax revenues. Tax collections can be improved by installing sufficient audit

procedures and higher penalties for delinquencies. To a large extent, the capabilities and intentions of the respective municipal government will influence the impact of these external factors.

VIII. FACTORS AFFECTING CASH FLOW (SHORT-TERM DEBT)

In addition to the traditional debt and financial statistics, which are used to measure municipal credit quality, there are various considerations particularly relevant to the type of instrument being considered.

With short-term obligations, the primary concerns should be the issuer's liquidity and current capital adequacy. The investor is not concerned about cash flows ten years hence, but rather that sufficient cash will be available in the near future for repayment of principal and that sufficient funds are currently available for interest payments. In addition, the sources of repayment are of particular importance.

Bond Anticipation Notes are especially dependent on general market conditions for their repayment. In a tight credit market, weaker obligations may not be able to roll over or convert to longer term bonds. Consequently, analysis must consider short run market tendencies.

Tax Anticipation Notes must rely on sufficiency of tax collections, which is somewhat dependent on tax limits and delinquency rates. However, generally, a cushion exists in the form of restrictions on the volume of taxes that may be borrowed against.

Revenue Anticipation Notes are dependent on the receipt of various revenues, such as receivables or fiscal aid. An evaluation of these sources may be warranted.

APPENDIX A

IX. FACTORS AFFECTING CASH FLOW (LONG-TERM DEBT)

Long-term debt analysis must concern itself with short run considerations to the extent that interest receipts occur throughout the life of the instrument. However, the larger principal and the majority of the interest payments will occur in the distant future. Consequently, current financial trends and statistics need not be indicative of longer term credit quality. Thus, analysis must look further and consider the factors that will influence the municipality's future revenue-generating capacity, by considering the social, economic and demographic variables. As with short-term obligations, the various types of instruments also influence the cash flow structure.

Unlimited Tax General Obligations should generally be the strongest type of debt instrument. The only concern with these instruments is that debt does not become excessive and that the economic base remains sufficiently strong.

With Limited Tax General Obligations, consideration must also be given as to the extent which taxes could be raised, i.e. to cover delinquencies.

In considering revenue bonds, some determination must be made as to the necessity of the facilities financed and the extent to which substitutes can be found.



MUNICIPAL FINANCE
OFFICERS ASSOCIATION

DISCLOSURE GUIDELINES FOR OFFERINGS OF SECURITIES BY STATE AND LOCAL GOVERNMENTS

INTRODUCTION

A project has been underway for the past year that is designed to assist in satisfying the increased needs for investor information and the increased concern of issuers as to achieving compliance with the antifraud requirements of the Federal securities laws. The project, involving a broad cross-section of bond participants and professionals, has been sponsored by the MFOA, whose participation has been financed, in part, by a grant from the National Science Foundation.

A major product of the project has been to prepare suggested guidelines for informational documents used in municipal securities offerings. These documents are usually referred to as official statements or, sometimes, as prospectuses.

The proposed Guidelines are suggestions of information which may be disclosed in offerings of municipal securities. The Guidelines are not intended to be legally binding. Rather, they are suggestions of information that usually should be included in official statements because it will be relevant to investors on most occasions for most issuers.

All persons interested in these matters should review the Guidelines and should send their comments by January 31, 1976 to John E. Petersen, Director, MFOA Washington Office, Suite 512, 1730 Rhode Island Avenue, N.W., Washington, D. C. 20036.

GENERAL INSTRUCTIONS

A. USE OF GUIDELINES

These Guidelines are designed for use in providing information to investors in connection with offerings of securities to state and local governments.

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* Exposure Draft, November 10, 1975. An MFOA *Analysis* "Regulation of the Municipal Securities Market and its Relationship to the Governmental Issuer" that discusses both the use of the Guidelines and the new Federal regulation framework for the municipal securities industry is available from the MFOA at 1313 East 60th St., Chicago, IL 60637 at $1.50 per copy.

As Guidelines, they are intended to suggest information which may be considered of importance by investors. They are not intended to create disclosure requirements or a legal obligation to disclose any or all items of information suggested.

Information such as that suggested has often been published in official statements, whether following prior guidelines[1] or market practice. It has also been given to rating agencies. Such information is commonly found in budget documents, audited financial statements and other easily accessible records. It is suggested that as much accurate information as possible should be furnished so that investors may make informed investment judgments.

Due to the breadth and vagueness of the definitions relied upon by various authorities as to what may be considered to be "material" information, no full statement is possible of all information which should be considered for disclosure in all offerings. The Supreme Court has stated that "material" information includes all information which "a reasonable investor might [consider] important in the making of [a] decision."[2] These Guidelines, therefore, are only a general indication of information which may be provided.

B. ADDITIONAL INFORMATION

These Guidelines suggest disclosure of information that is most likely to be material to investors. It is possible that other information, not suggested herein, may at times be material and in such cases should be provided.

In addition to the information suggested, there should be added such further material information as may be necessary so as to make any statements made not misleading under the circumstances. Care should be taken to review the financial, historical and other factual information as given so as to determine whether qualifications or additional information should be stated. If reliable information is available which indicates material changes in trends or other disclosures, such information should be presented.

Some sections of these Guidelines are more appropriate for offerings of general obligation securities. Others are more appropriate for offerings of revenue securities or of special obligation securities. In some cases, a particular security may have characteristics both of a general obligation security and of a revenue security or of a special obligation security. For example, revenue sources from a project or projects or a specific tax may be the primary source of payment and security for an issue of bonds, while additional security is furnished by the general taxing power of the issuer. Under these circumstances, consideration should be given to making the appropriate disclosures suggested as to both types of securities.

C. OMISSION OF INFORMATION

In some cases certain specific suggested information will not be material under the circumstances. In such instances, there is no need to report the information. As the size of the offering decreases, and as the sophistication of purchasers increases, it is possible to decrease the amount of detail in

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1. See Advisory Commission on Intergovernmental Relations, *State Technical Assistance to Local Debt Management*, 64-70 (1965).

2. See Appendix B for a brief discussion of the concept of materiality and of the relevant sections of the federal securities acts.

the official statement. The degree of detail may also be related to the term of the obligations. For instance, matters bearing principally on the long-term prospects of the issuer, such as demographic or economic data, would normally not be material and in such cases may be omitted in the sale of short-term obligations. Where information is omitted, however, careful consideration should be given to each omitted category of information to insure that there is no omission of information material to investors under the circumstances. In the case of direct negotiations with sophisticated purchasers, an official statement should not be necessary where the purchasers acknowledge that they have sufficient access to facts and have made such investigation as they deem necessary to decide whether to purchase the obligations.

Information need be given only insofar as it is known or reasonably available on a reliable basis. If reliable information is unknown and not reasonably available, the information may be omitted. However, nondisclosure of information on grounds that it is not "reasonably" available should only occur in very unusual circumstances. Normally, disclosure should be made of all material information suggested in these Guidelines or of information of a similar nature which reflects adequately the risk of investment in the securities being offered. Information which is available in the issuer's records or which can be obtained from another source, such as U.S. Government census reports, normally should be obtained, compiled and reported. There should be an appropriate indication of the source of the information, if the source is other than the issuer. Where relevant material information is omitted as not reasonably available, a statement to such effect should be made in the official statement, together with the reasons for the omission.

In many cases, these Guidelines suggest disclosure over a five-year period. Where the information for the fourth and fifth previous years does not reflect trends different from those reflected in information for three years, or is not otherwise of special informational value, information for that category of disclosures need only be presented for a three-year period.

D. CONTENTS OF OFFICIAL STATEMENT

The purpose of the official statement is to inform prospective investors of the investment merits of the securities being offered and of other matters which an informed investor might consider prior to making his investment decision. Hence, the information set forth in the official statement should be presented in a concise, understandable fashion. Material should be set forth in the manner which will give appropriate emphasis to such material in view of its relative importance. Avoid unnecessary and irrelevant details, repetition and unnecessary technical language. Material suggested in particular sections of these Guidelines and appearing elsewhere in the official statement need not be duplicated. However, appropriate cross-references should be used. No reference need be made in the official statement to inapplicable sections of these Guidelines, and unless a section specifically suggests them, negative answers may be omitted.

E. FINANCIAL AND ACCOUNTING STANDARDS

Financial and accounting information should be prepared and presented in accordance with generally accepted accounting principles, as presented and recommended in National Committee on Governmental Accounting,[3] *Governmental*

3. The National Committee on Governmental Accounting has been reconstituted as the National Council on Governmental Accounting.

Accounting, Auditing, and Financial Reporting (1968) and the Industry Audit Guide of the Committee on Governmental Accounting and Auditing of the American Institute of Certified Public Accountants, entitled *Audits of State and Local Governmental Units* (1974), as such generally accepted accounting principles are supplemented and modified from time to time.[4] These sources make appropriate allowance for state legal requirements on presentation of financial information. The financial statements should be accompanied by an opinion of independent certified or public accountants or, where appropriate, of state authorities performing procedures and issuing opinions equivalent to those of independent accountants.

F. PROVISION OF INFORMATION; TRANSMITTAL OF OFFICIAL STATEMENT TO INVESTORS

These Guidelines are divided into three parts. Part I relates to information of a financial nature about the issuer or enterprise. Part II relates to general information concerning the issuer or enterprise and the securities being offered. Parts I and II should be furnished by the issuer to potential underwriters or underwriting syndicates at the time of publication of the invitation for bids. This portion of the official statement should then be provided by such underwriters or syndicates to prospective investors who are offered the securities.

Part III (found in Appendix A) suggests information which should be furnished by the purchasing underwriters or syndicate. This information may be attached (as a "sticker", "wraparound", cover sheet or otherwise) to the portion of the official statement furnished to the underwriters or syndicate by the issuer. The underwriters' information should then be sent to the underwriters' or syndicate's purchasers with the confirmation of sale, if it has not been previously furnished to the purchasers.

G. POLLUTION CONTROL AND OTHER INDUSTRIAL DEVELOPMENT OR INDUSTRIAL REVENUE BONDS

These Guidelines are not appropriate for disclosure in official statements for offerings of pollution control or other industrial development or industrial revenue bonds. The investment risk of such securities is in most instances dependent upon the financial success of the private entity involved in the offering. Consequently, disclosures substantially similar to those prescribed by Form S-1 promulgated by the Securities and Exchange Commission under the Securities Act of 1933 should be considered regarding the private entity in such cases. Where additional security is provided by the issuer, disclosures suggested by these Guidelines should also be made.

H. DEFINITIONS

Unless the context otherwise indicates, the following terms have the stated meanings for purposes of these Guidelines:

(1) "Issuer" means the issuer of the securities being offered, including all departments, divisions and organizations under its operating control.

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4. Copies of the NCGA publication are available from the Municipal Finance Officers Association, 1313 East 60th Street, Chicago, Illinois 60637. The AICPA Industry Audit Guide is available from the AICPA, 1211 Avenue of the Americas, New York, New York 10036.

(2) "Enterprise" means any undertaking or group of undertakings expected to generate revenues which are to be a material source of payment for the principal of and interest or premium on the securities.

(3) "Default" means a default as provided in the laws or authorizing or governing instruments with respect to the securities.

(4) "Payments of principal" of securities and similar references include, but are not limited to, sinking fund payments.

SUGGESTED DISCLOSURES

PART I. FINANCIAL, DEBT AND TAX INFORMATION

The information suggested in this Part I is to be provided by the issuer. See General Instruction F.

SECTION 1. FINANCIAL INFORMATION

In providing information suggested in this Section 1, refer to General Instructions B and E.

(a) Furnish appropriate financial statements of the issuer, or in the case of an offering of revenue securities, the enterprise, to indicate the issuer's financial ability to fulfill its obligations to the holders of the securities being offered. The financial statements selected for presentation should be selected in accordance with generally accepted accounting principles as presented and recommended in the sources referred to in General Instruction E, as such generally accepted accounting principles are supplemented and modified from time to time. Those financial statements reflecting assets and liabilities should be presented as of the end of each of the last two fiscal years, and those financial statements relating to operations should be presented for each of the last five fiscal years. In the case of an offering of revenue securities, interim financial statements reflecting assets and liabilities should also be presented as of a date within the last 120 days and as of the comparable date in the preceding fiscal year, and those financial statements relating to operations should be presented for the interim period between the end of the last fiscal year and the date of the interim financial statements reflecting assets and liabilities and for the comparable period of the preceding fiscal year. Receipts and assets which cannot be used to discharge the issuer's obligations to the holders of the securities being offered and expenditures chargeable against such receipts should be clearly indicated.

Explanation of Section 1(a):

(1) The financial information should reflect the retroactive adjustment of any material items affecting the comparability of the results. State the basis on which the financial statements have been prepared, such as a cash, accrual or modified accrual basis. Data for all undertakings which individually or together are material sources of payment for the principal of or interest on the securities being offered should be shown on a consolidated basis, and where informative, may also be shown separately for specific undertakings or groups of undertakings.

(2) Disclose the effects in dollar amounts of extraordinary receipts or expenditures and describe the nature and purpose of the receipts or expenditures.

(3) Subject to appropriate variation to conform to the nature of the enterprise or the purpose of the offering, the following items should be included in the operational statements for enterprises: net sales or operating revenues; cost of goods sold or operating expenses (or gross profit); interest charges; net income; and special items.

(4) In connection with the financial statements, whenever necessary, reflect information or explanations of material significance to investors in appraising the results shown, including analyses of material increases or decreases in significant categories during the last two fiscal years and any comparative interim periods.

(b) In an offering of general obligation securities, if more than 15 percent of the receipts of the issuer in either of its two most recent fiscal years comes from

(i) a single enterprise owned or operated by the issuer (such as a public utility or transportation system), or

(ii) a number of such enterprises engaging in essentially similar functions or operating as a integrated enterprise,

and if the receipts from such enterprise(s) may be used for payment of principal of or interest or premium on the securities being offered, provide an appropriate financial summary regarding such enterprise(s).

(c) If payment of principal of or interest or premium on the securities being offered is guaranteed or insured in any respect, furnish appropriate financial or other information as to the guarantor or insurer. Under normal circumstances, it is unnecessary to include more than a very brief financial summary as to a state guarantor.

SECTION 2. DEBT AND REVENUE STRUCTURE

In many offerings of revenue securities, information suggested for disclosure generally regarding the issuer need not be provided except to the extent it relates specifically to the enterprise or is relevant to its revenues, expenses or operations. For example, a response in such an offering to Section 2(a) and (b) need only disclose information as to indebtedness payable from revenues of the enterprise. Similarly, in such an offering, a response to Section 2(d) need only be given where a debt limit of the issuer or legal requirements for debt issuance could affect the enterprise's ability to obtain future financing. Such considerations are applicable throughout these Guidelines, but they are particularly applicable with respect to information suggested in this Section 2. See General Instruction B.

(a) Furnish the information called for by the following table as to appropriate categories of long-term and short-term securities and other indebtedness of the issuer (other than unpaid bills fewer than 90 days past due):

Category of indebtedness	Amount authorized	Amount outstanding as of [date] (less sinking fund installments paid to such date)	Amount to be outstanding

Explanation of Section 2(a):

(1) The "appropriate" categories of indebtedness will vary from issuer to issuer. Generally, the purpose of the indebtedness, for example, School Debt or Tax Anticipation Notes, or the maturity of the indebtedness, for example, Sundry Short-term Debt, may be used as a basis for categorization.

(2) Debt should be regarded as "authorized" when all material discretionary legal steps have been taken by the issuer for its authorization for issuance, such as required approval of the city council or the voters. Actions tending to be of a ministerial or judicial nature, such as validation in some jurisdictions, should not be regarded as discretionary for this purpose.

(3) The amount of indebtedness outstanding should be as of a specified date within the previous 120 days. In reflecting the amount to be outstanding, include the securities being offered and the effects of payments to be made of outstanding indebtedness.

(b) Furnish a debt service schedule for total principal, interest and premium requirements of the issuer under outstanding indebtedness, and where appropriate, under authorized indebtedness, to the final maturity date of all outstanding securities. Include debt service on the securities being offered. Indicate in footnotes to the schedule any assumptions, such as interest rates on authorized but unissued debt, on which information in the schedule is based. The schedule may be presented in substantially the following tabular form:

Fiscal year ending [date]	General obligation indebtedness	Special assessment indebtedness	Utility revenue indebtedness	Other indebtedness (describe)	Total
19	$	$	$	$	$
19	$	$	$	$	$
19	$	$	$	$	$
.	.	.	.	.	.
.	.	.	.	.	.
.	.	.	.	.	.
(year)	$	$	$	$	$

(c) State the total amounts of indebtedness of the issuer outstanding as of the end of each of its last five fiscal years.

(d) Describe any legal debt or tax limit of the issuer, the legal source of the limit, the indebtedness or tax rates of the issuer chargeable to the limit, and the unused borrowing or taxation margin. Describe legal requirements, such as voter approval, which must be met in connection with debt issuance.

(e) If any refunding securities have been issued by the issuer within the last 25 years for the purpose of preventing a default in principal or interest payments on securities then outstanding, describe the circumstances giving rise to the issuance, including the amounts involved.

(f) If any securities of the issuer have been in default as to principal or interest payments or in other material respects at any time in the last 25 years, state the circumstances giving rise to such default, including descriptions of the relevant provisions of the securities and authorizing and governing instruments and the amounts involved. State whether such default has been terminated or waived, and if so, the manner of such termination or waiver.

(g) If any outstanding revenue, special assessment or limited obligation securities have not been fully supported by earnings of the relevant facilities or by other relevant receipts at any time in the last ten years, state for each such year in which additional general receipts of the issuer were used or required to be used for payments on such securities, the amount due on such securities and the amount of such additional funds. Describe any contract or arrangement, such as a lease, services contract or deficiency subsidy agreement, requiring application of general tax or other receipts of the issuer for the benefit of other governmental entities.

(h) If the proceeds from the sale of any securities (other than tax anticipation notes issued against revenues of a current fiscal year) have been used for current operating expenses at any time in the last ten years, describe the circumstances giving rise to such use, including the amount used in each of such years.

(i) Describe briefly the issuer's or the enterprise's pension and other employee retirement plans and the methods by and basis (e.g., actuarial or "pay-as-you-go") on which the plans are funded. State the issuer's or the enterprise's contributions to the plans for, and the unfunded accrued liabilities as of the end of, each of the last five years. State the annual benefit payments, net of employee contributions and interest earnings of the plans, for each of the last five fiscal years, unless the plans are fully funded. State the date of the most recent actuarial study, if any, and describe briefly the assumptions upon which the study was based. If contributions are made on an actuarial basis, state the year in which such basis was first used to determine contributions and the extent to which any deficiencies in contributions prior to such time have been eliminated.

(j) Describe briefly the manner in which property valuations and assessments are determined and principal taxes are levied and collected. Include descriptions of (i) the manner in which delinquent taxes are collected; (ii) the interest charged on delinquent taxes; (iii) important changes during the last five years in tax assessment, levy or collection practices; and (iv) the reasons for such changes. State the value of total tax title liens owned by the issuer as of the end of each of its last five fiscal years and as of a recent date. Describe briefly the procedures followed in foreclosure, including extension of foreclosure dates. Describe the priority of tax claims of the issuer over other indebtedness of taxpayers.

(k) Give in tabular or other appropriate form with respect to the issuer, as of the end of each of its last five fiscal years and as of a recent date, information as to (i) its assessed valuation of taxable real property; (ii) its estimated true valuation of taxable real property; (iii) its assessed valuation of taxable personal property; and (iv) the assessed valuation of taxable real property expressed as a percentage of the estimated true valuation thereof. Segregate such information as to industrial, commercial, utility and residential properties.

(l) Give information as of the end of each of the issuer's last five fiscal years and as of a recent date in respect of the issuer's (i) debt per capita; (ii) debt expressed as a percentage of total assessed valuation of taxable real and personal property; (iii) debt expressed as a percentage of total estimated true valuation of taxable real property; and (iv) debt per capita expressed as percentage of estimated per capita income of individual taxpayers residing in the jurisdiction.

(m) State whether real estate, sales, income or other taxes are levied in excess of actual requirements to provide a margin against delinquencies and, if so, give the amount of such excess taxes expressed as a percentage of total taxes levied for the issuer's last fiscal year. State in tabular or other appropriate form the total tax levy and the accumulated amount of delinquent taxes as of the end of each of the issuer's last five fiscal years and as of a recent date and the tax delinquency rate for each of such fiscal years and for the current fiscal year to date. Describe any anticipation of collection of delinquent taxes in budgets for current or future years. State whether borrowing is made against delinquent taxes, and if so, state the percentage of delinquent taxes so financed as of the end of such prior fiscal years and as of a recent date. Describe the accounting principles applied in writing-off delinquent taxes, and state the period for which delinquent taxes are reflected on the issuer's books before they are written off.

(n) Name every taxpayer providing through tax payments more than 10% of the tax receipts of the issuer in the issuer's most recent fiscal year. State the amount of taxes levied against each such taxpayer and the percentage of the total tax levy represented by such amount.

(o) Furnish the information called for by the following table as to indebtedness of overlapping governmental entities:

Name of overlapping entity	Amount of authorized debt as of [date]	Amount of outstanding debt (less sinking fund) as of [date]	Percent of outstanding debt chargeable to persons or property in issuer's boundaries

Explanation of Section 2(o):

See Explanation 2 of Section 2(a) as to the definition of "authorized" debt. The information should be as of a specified date within the previous 120 days. Unless inappropriate, the information in the last column should be based upon the estimated true valuation of real property in the respective jurisdictions.

PART II. GENERAL INFORMATION

The information suggested in this Part II is to be provided by the issuer. See General Instruction F.

SECTION 3. ISSUER AND PROJECT

(a) State the year in which the issuer was established, give the name of the state or other jurisdiction under the laws of which it was established,

describe its form of government, such as mayor-council or city manager, and if the issuer is a municipality, state the county in which it is located.

(b) In the case of an offering of revenue securities, state the year in which the enterprise was organized, its form of organization (such as "a corporation", "an unincorporated association", "a department of the issuer" or other appropriate statement) and the name of the state or other jurisdiction under the laws of which it was organized. Name the municipality, county and state in which the enterprise is located.

SECTION 4. USE OF PROCEEDS TO ISSUER

(a) State the principal purposes for which the net proceeds of the offering are authorized or proposed to be used and the approximate amount authorized or proposed for each purpose.

Explanation of Section 4(a):

(1) Details of proposed expenditures should not be given; for example, there need be furnished only a brief outline of any program of construction or addition of equipment. In the event of construction of all or part of an enterprise, see Section 6(a). If 15% or more of the proceeds has not been allocated for particular purposes, a statement to that effect should be made together with a statement of the amount of proceeds not so allocated.

(2) If any material amounts of other funds are to be used in conjunction with the proceeds, state the amounts and sources of such other funds.

(b) If the aggregate expenses of the offering to be paid by the issuer, other than underwriting commissions, are 5% or more of the net proceeds of the offering, state the aggregate amount of all such expenses in connection with the issuance and distribution of the securities.

Explanation of Section 4(b):

(1) Only an aggregate figure need be given. The information may be given as subject to future contingencies. If any amounts are not known, reasonable estimates designated as such should be given, together with a statement of the assumptions upon which they are based.

(2) The term "net proceeds of the offering" means the proceeds paid to the issuer from the sale of the securities being offered after deduction of underwriting commissions and discounts.

SECTION 5. DESCRIPTION OF ISSUER

The information suggested in this Section 5 normally should be disclosed only in offerings of general obligation securities. See General Instruction B.

Sufficient information should be given to provide background and general information concerning the issuer. At times, data on other population areas in the issuer's vicinity may be informative, either in addition to or, where information on the issuer is unavailable, in substitution for information on the issuer. Investors should be informed of factors which indicate the ability

of the issuer to impose and collect, and the ability of its citizens to pay, taxes and other receipts which can be used to discharge the issuer's obligations. Certain trends provide useful indications in these regards. Factors which may have a significant, though indirect, effect on these trends, such as the types and levels of services provided by the issuer and demands for services, may also be helpful. In many cases, information suggested in this Section is available in reports of the U. S. Government. Indicate information obtained from sources other than the issuer. Examples of the types of information which may be appropriate when reliable and reasonably available are:[5]

(1) The last official estimate, and the most recent estimate, of the issuer's population, school enrollment, per capita income, median age, and unemployment rate, and the number and value of residential and nonresidential construction permits issued during each of the issuer's last five fiscal years and the current fiscal year to date.

(2) A brief statement or description of (i) the principal industries and commercial entities in the issuer's immediate geographical area; (ii) the number of persons employed by such industries or entities; (iii) the economic stability of such industries or entities; and (iv) the economic effects of any addition or loss of major industrial or commerical entites in the last five years.

(3) A brief description of (i) the principal governmental services performed by the issuer; (ii) the extent to which similar or differing governmental services are performed by overlapping governmental entities; and (iii) major changes in such services in the last five years.

SECTION 6. DESCRIPTION OF ENTERPRISE

The information suggested in this Section 6 normally should be disclosed only in offerings of revenue securities. See General Instruction B.

(a) Where proceeds of the offering will be used for the construction of all or part of the enterprise, briefly describe the new facilities, including their proposed purposes, productive capacity, anticipated life, and nature of construction. State the dates proposed for the commencement and completion of the construction; the dates proposed for the commencement of operations in the new facilities; the construction arrangements and principal contractors, engineers or other parties participating in the construction; the amount and location of the land on which the facilities are to be located; and the rights of the issuer or the enterprise in relation to the land, such as whether the land is held in fee, is leased, is held subject to encumbrances, or must be condemned or otherwise acquired before use.

(b) Where proceeds of the offering will be used for construction of all or part of the enterprise, reference should be made to any relevant engineer's or financial feasibility reports or studies on the feasibility of such construction as a part of the enterprise's operations. Name the parties preparing the reports or studies. Reference should also be made to any other reports or studies which may have a bearing on the conclusion of feasibility. All refer-

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5. Additional examples are indicated by the National Committee on Governmental Accounting in the volume cited in General Instruction E.

should describe the material conclusions of the reports or studies, insofar as such conclusions relate to the use of proceeds as set forth in the official statement. If no such report or study has been obtained, a statement should be made to that effect, together with an explanation of the reasons therefor.

(c) Describe the operations performed and intended to be performed by any new or existing enterprise and the general development of such operations during the past five years, or such shorter period as the enterprise may have been engaged in operations. The description should include, but not be limited to, information as to matters such as the following:

(1) The principal products produced or to be produced and services rendered or to be rendered by the enterprise, and the principal markets for, and methods of distribution of, such products and services. Include a description of significant changes in the kinds of products produced or services rendered, or in the markets or methods of distribution, during the past five fiscal years.

(2) Whether the enterprise has or will have an exclusive position in its market area, and if not, a description of the competitive conditions in the industry or industries involved and the present and proposed competitive position of the enterprise, if known or reasonably available to the issuer.

(3) The number of customers of the enterprise at present and as proposed after the completion of construction, in residential, commercial, industrial and utility categories; and an appropriate categorization of ranges reflecting amounts paid or to be paid by customers for the enterprise's products and services. If a material part of the operations is or will be dependent upon a single customer or a few customers, the loss of any one or more of whom would have an adverse effect on the operations or financial condition of the enterprise, give the names of the customer(s), their relationship, if any, to the enterprise, and material facts regarding their importance to the operations of the enterprise.

(4) The sources and availability of raw materials essential to the enterprise's present and proposed operations.

(5) The importance to the enterprise and the duration and effect of licenses, permits and franchises held or required to be held.

(6) The numbers of employees employed at present and to be employed after the completion of construction, by nonsupervisory, supervisory and executive categories; and the percentage of employees of the enterprise who belong to unions or other collective bargaining groups. Disclose general serious problems with employee relations.

(7) The extent to which the operations of the enterprise or a material portion thereof are or may be seasonal.

(8) Any federal, state or local governmental regulation of the operations of the enterprise, and the effects thereof on the enterprise's present and proposed operations and on new construction.

(9) The effects of compliance with federal, state and local provisions relating to the protection of the environment on the enterprise's present and proposed operations, revenues and expenditures and on new construction.

(10) Any federal, state or local governmental program which provides any or all of the enterprise's revenues.

(d) If the enterprise has not received revenues from operations for the fiscal year prior to the date of the sale of the securities being offered, state the enterprise's plan of operation for the remainder of the current fiscal year, if the sale is made prior to the end of the second fiscal quarter, and the enterprise's plan of operation for the remainder of the current fiscal year and for the first six months of the next fiscal year, if the sale is made subsequent to the end of the second fiscal quarter. If such information is not available, the reasons for its not being available should be stated. Disclosure relating to any plan should include such matters as:

(i) A statement in narrative form indicating the issuer's opinion as to the period of time that the proceeds from the offering will satisfy cash requirements and whether in the next six months it will be necessary to raise additional funds to meet the expenditures required for operations of the enterprise. The basis for such opinion should be set forth with specificity, and categories of expenditures and sources of cash resources should be identified.

(ii) Any anticipated material acquisition of plant and equipment and the capacity thereof.

(iii) Other material areas which may be peculiar to the enterprise's construction and operations.

(e) If the enterprise is engaged or will engage in more than one line of business, or has or will have more than one class of products or services, provide appropriate information of the nature suggested in paragraph (c) as to the principal lines of business and classes of products and services.

SECTION 7. DESCRIPTION OF PROPERTY.

State briefly the general character of the principal facilities of the issuer, or in the case of an offering of revenue securities, the location and general character of the principal plants and other principal facilities of the enterprise. If any such property is leased or otherwise not held in fee or is held subject to any major encumbrance, so state and briefly describe how held.

Explanation of Section 7:

What is suggested is information essential to an investor's appraisal of the suitability and adequacy of the issuer's or the enterprise's principal facilities for its needs so as to permit evaluation of the issuer's or the enterprise's abilities to continue to perform its services or operations and of the need for additional financings. Such information should be furnished as will reasonably inform investors as to the extent of utilization of the facilities, and as to the productive capacity of the enterprise's facilities. Itemization of facilities and detailed descriptions should not be given.

SECTION 8. LEGAL PROCEEDINGS

Briefly describe any pending legal proceedings to which the issuer or the enterprise is a party or to which any of its property is subject and which

may materially affect the issuer's ability to perform its obligations to the holders of the securities being offered, or in the case of an offering of revenue securities, the ability of the enterprise to perform its functions, including, but not limited to, proceedings which challenge the validity of the securities being offered. Include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceedings, and the relief sought. Include similar information as to legal proceedings which have been threatened to a degree which constitutes a material possibility that they will be instigated. An opinion of counsel with respect to such legal proceedings may, with the consent of counsel, be included or summarized in the official statement. State the name and address of such counsel.

SECTION 9. GOVERNING BODY AND EXECUTIVE OFFICIALS

Describe the manner in which the governing body and executive officials of the issuer or the enterprise are chosen, their respective terms, the general means by which policy and executive decisions are made on behalf of the issuer or the enterprise, and the parties possessing the authority to make such decisions. Name each executive official. In the case of an offering of revenue securities, briefly describe the principal employment for the past five years of each such executive official of the enterprise.

Explanation of Section 9:

> The term "governing body" means the city council, legislature, board of directors, trustees or other body performing legislative or policy-making functions on behalf of the issuer or the enterprise. The term "executive officials" means the mayor, manager, department head, president, vice president, comptroller, tax assessor-collector, treasurer, secretary, and other officials performing essential executive functions on behalf of the issuer or the enterprise.

SECTION 10. SECURITIES BEING OFFERED

Provide briefly the following information to the extent relevant regarding the securities being offered and regarding the authorizing and governing instruments:

(a) Describe any provisions with respect to maturity, redemption, amortization, sinking fund, callability, conversion, retirement, registration or exchange.

(b) Describe any provisions with respect to the priority of payment of such securities in relation to any outstanding securities or other obligations of the issuer. Where the payment of obligations evidenced by the securities is secured by a lien on physical properties, describe the kind and priority of such lien and briefly identify the properties. If the securities are payable only from particular receipts of the issuer, such as a particular tax or assessment, describe the receipts and refer to the information given in response to Section 1 which indicates the amount of such receipts and expenditures related thereto for the past five fiscal years.

(c) Describe provisions regarding the creation or maintenance of reserves or the maintenance of properties.

(d) Describe provisions permitting or restricting the issuance of additional securities, the withdrawal of cash deposited against such issuance, the incurring of additional debt, the release or substitution of assets securing the issue, the modification of the terms of the securities, and similar provisions.

Explanation of Section 10(d):

In the case of debt secured by liens on physical properties, there should be stated (i) the approximate amount of unbonded bondable property available for use against the issuance of bonds as of the most recent practicable date and (ii) whether the securities being offered are to be issued against such property, against the deposit of cash, or otherwise.

(e) State the name of the trustee or fiscal agent, if any, and the percentage of securities of the class necessary to require the trustee or fiscal agent to take action. Describe any indemnification the trustee or fiscal agent may require before proceeding to enforce the rights of holders of the securities. Describe any business relationship of the trustee or fiscal agent with the issuer as security holder, depositary or otherwise. If the trustee or fiscal agent acts in the capacity of trustee or fiscal agent for the holders of other securities of the issuer, describe such relationship or capacity.

(f) Describe the events which constitute defaults under the securities being offered and whether any periodic evidence is required to be furnished as to the absence of default or as to compliance with the terms of the securities, the indenture or other authorizing or governing instruments.

(g) With the consent of bond counsel, include or summarize the approving legal opinion of bond counsel regarding the issue of the securities, or state that such an opinion will be furnished with the securities. State the name and address of such bond counsel.

(h) Describe the tax-exempt nature of the securities. With the consent of counsel, include or summarize an opinion of counsel as to such tax-exempt nature. State the name and address of such counsel.

(i) Describe briefly any priority of claims available to citizens in respect of services performed by the issuer, to employees in respect of wages, or to any other party which would require expenditure of funds of the issuer prior to payment of principal of or interest or premium on the securities.

(j) State whether the issuer can be sued for failure to perform its obligations to the holders of the securities and whether any judgments resulting from such a suit are enforceable against the issuer.

(k) If payment of the principal of or interest or premium on the securities being offered is guaranteed or insured in any respect, name the guarantor or insurer and state the terms and conditions of the guaranty or insurance. Refer to the information given in response to Section 1(d). Describe any known claim of the guarantor or insurer which may be asserted as a defense in a suit on the guaranty or insurance.

(1) Describe briefly any specific federal, state or other program or procedure which is designed to assist the issuer as to the payment of the securities in times of financial emergency.

Explanation of Section 10:

If rights of holders of the securities being offered are or will be limited or qualified by the terms or conditions of any other indebtedness, include such information regarding such other indebtedness as will enable investors to understand the terms and conditions of the securities being offered.

SECTION 11. INTEREST OF EXPERTS NAMED IN OFFICIAL STATEMENT

(a) If any expert named in the official statement as having prepared or certified any part thereof or any document referred to therein was employed for such purpose on a contingent basis, furnish a brief statement of the nature of such contingent basis.

(b) If any such expert was or is connected with the issuer as an underwriter, financial advisor, security holder, member of the governing body, executive official or employee, describe such connection.

SECTION 12. ADDITIONAL INFORMATION

Efforts should be made to make available to offerees and investors specimens or copies of any indenture and other authorizing or governing instruments defining the rights of holders of the securities being offered, or preliminary forms thereof. The availability may be upon request or upon payment by the offerees or investors of a reasonable copying, mailing and handling charge. The official statement may inform offerees and investors of the availability of the information and the means of obtaining it. Where this is done, the description in response to Section 10 of the terms of the securities being offered may be qualified by reference to such additional information.

APPENDIX A

PART III. INFORMATION TO BE PROVIDED BY UNDERWRITERS

The information suggested in this Part III is to be provided by the purchasing underwriters or syndicate. See General Instruction F.

SECTION A-1. DISTRIBUTION SPREAD

(a) State the maximum aggregate commissions which may be received by the purchasing underwriters or syndicate and the aggregate proceeds to the issuer, in both cases unless such commissions are less than 3% of the net proceeds of the offering. If such commissions are subject to change, a statement to that effect should be made.

Explanation of Section A-1(a):

(1) The term "commissions" means all commissions or discounts paid or to be paid, directly or indirectly, by the issuer or the investors to

the purchasing underwriters or syndicate in respect of the sale of the securities being offered, and includes all cash, securities, contracts, or anything else of value, paid, to be set aside or disposed of for, or understandings with or for the benefit of, any parties in which any purchasing underwriter or syndicate is interested in connection with the sale of such securities.

(2) If it is impracticable to state the price to the public or to state the commissions, the method by which these amounts are to be determined should be explained.

(3) See Explanation 2 to Section 4(b) as to the meaning of the term "net proceeds of the offering".

(b) If there are arrangements for indemnification by the issuer of the purchasing underwriters or syndicate or their controlling persons against liabilities arising under the federal securities laws, a brief description of such indemnification arrangements should be furnished.

SECTION A-2. PLAN OF DISTRIBUTION

Give the names and addresses of the managing underwriters. State briefly the nature of the purchasing underwriters' or syndicate's obligation to take the securities if it is other than on a firm commitment basis.

Explanation of Section A-2:

All that is suggested in the last sentence as to the nature of the purchasing underwriters' or syndicate's obligation is disclosure where they are not or will not be committed to take and to pay for all of the securities if any are taken; that is, where it is merely an agency or "best efforts" arrangement under which they are required to take and pay for only those securities as they may sell to the public. Conditions precedent to their taking the securities need not be described except in the case of any agency or "best efforts" arrangement.

SECTION A-3. INTEREST COUPONS

State in tabular or other appropriate form the rates of interest payable on differing coupons of securities being offered. This should be expressed as the yield to the first call date and to the final maturity date (i) on each such coupon and (ii) on each series of the securities being offered.

SECTION A-4. RATINGS

State all ratings of the securities being offered and the names of the rating agencies. If the ratings are provisional, that should be stated. In addition, there should be stated ratings of any other outstanding securities of the issuer secured similarly to the securities being offered. If no ratings have been obtained on any such securities, a statement should be made to such effect. Changes in any ratings of any securities of the issuer during the preceding two years should be described.

APPENDIX B

The disclosure of information in the securities markets is governed by federal regulations that are designed to protect investors against misleading statements or omissions of important facts. Rule 10b-5 promulgated by the Securities and Exchange Commission under 10(b) of the Securities Act of 1934 provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. Section 17(a) of the Securities Act of 1933 contains similar provisions requiring full disclosure.

"Full" disclosure for this purpose means disclosure of all information material to investors. The Supreme Court has stated that "material" information includes all information which "a reasonable investor might [consider] important in the making of [a] decision." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) [emphasis added]. The antifraud provisions have been held to protect "speculators and chartists" as well as "conservative" investors. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968). Consequently, the requirement of full disclosure of material information means a considerable amount of information must be disclosed to prevent liability of parties involved in an offering and to prevent the possibility of injunctions or other legal remedies which may arise as a result of violations of these provisions. In addition to civil remedies for violation of the federal antifraud provisions, Section 24 of the Securities Act of 1933 and Section 32 of the Securities Exchange Act of 1934 provide for criminal penalties in the event of a "willful" violation of any of the provisions, including the antifraud provisions, contained in those Acts.

STATEMENT OF ROBERT W. DOTY, PROFESSOR OF LAW, CREIGHTON LAW SCHOOL

Mr. DOTY. Mr. Chairman, I appreciate the opportunity to appear before you. I am Robert Doty, associate professor of Law at Creighton University School of Law.

I have worked in the securities law area since 1967. About two years ago, I began working on municipal securities law problems of a private firm, Kutak Rock, in Omaha, primarily regarding industrial development bonds. Since then I have worked on the proposed Disclosure Guidelines and a number of papers and acticles listed in my written testimony, as well as the Current Disclosure Work Paper submitted to you this morning.

My written testimony covers a broad range of issues to which I can only refer to for our present purposes. Since I was unable to discuss S. 2969 in my written testimony, I will make a number of suggestions on it in my oral statement.

Incidentally, there is a correction in my written testimony. On page 16, at the fourth line in the second full paragraph, the word "nonpublic" should be "public".

Mr. Chairman, during recent months, it has become increasingly obvious that there are serious disclosure problems in the municipal securities market. There is a need for greater investor protection, particularly through increased disclosure by issuers.

There is also a great deal of confusion and ambiguity. Many questions are unanswered and additional questions are appearing. There are important differences between the municipal and corporate markets. These deserve careful analysis.

In my experience, there has been a drastic shift toward increased disclosure, particularly during the last few months. A number of private suits have been filed, and my information is that more suits are in preparation. These developments underscore the vitality of the antifraud provisions and the concerns of issuers regarding disclosure.

Apart from the MFOA, until last spring and summer, no one in or out of government had a serious interest in assuming an active role ragarding municipal disclosure. It is evident to me, and I want to emphasize this to you, that, in addition to MFOA, issuers and other market participants are now actively working on and care about disclosure. They care about investor protection. The Guidelines project to which several witnesses have referred is important evidence of this. The project has moved rapidly and is near completion. There is no need to create a wholly new regulatory scheme or to design new regulatory powers. I urge you to permit these private parties to continue their work.

At the same time, there are several identifiable problem areas, noted in my written testimony, which I suggest for your attention: sovereign immunity, accounting matters, due diligence, and informational delivery. These are all serious issues, and they are very complex. For that reason I will not attempt even to summarize them at this time but instead refer you to my written statement.

As to legislative alternatives, S. 2574 is unwarranted. The significant differences between the corporate and municipal markets leading me to this conclusion are outlined in my written statement. Instead, the concept of self-regulation establishing national uniform standards is important and valid if we are to have a new regulatory pattern.

My first comment on S. 2969 is that it is unnecessary to give the Commission the breadth of authority contemplated. Instead, self-regulatory alternatives are advisable.

It is desirable that we have a nationally uniform standard. The enumeration of disclosure categories, as is done in the bill is valuable. The process of State hearings is also useful, but this would not necessarily result in uniformity. In the corporate area, the State blue sky laws often cause serious problems, particularly due to the absence of uniform approaches to various problems. State authorities, then, are closer to municipal issuers than are Federal regulators, but a national board is preferable.

If regulation must be through the Commission, I suggest establishment of an advisory board of municipal issuers, dealers, and investors, and a requirement that the Commission meet with these advisers in prescribing specific disclosure requirements, forms, accounting rules, and procedures for informational delivery.

Further, it would be very helpful if the Commission were required to hold formal hearings before prescribing the initial set of rules on these matters and before making material changes therein. Informational delivery requirements should not be permitted to interfere unduly with competitive bidding.

In any case, the existing Board is really the ideal body to consider informational delivery problems.

Second, the most serious problem, in my opinion, is not disclosure. Disclosure problems, while not small, are being solved. The most serious problem, instead, is the allocation of responsibility for disclosure and due diligence. S. 2969 does not speak to that issue sufficiently.

Third, it is advisable that there be disclosure requirements for smaller issuers, and that the proper authorities be given power to prescribe reduced requirements in this area. The emphasis is best placed upon the financial statements of these issuers. Under proposed section 13A(d), I suggest that reductions in the minimum dollar amounts to require disclosure by smaller issuers be accompanied by consideration of reduced disclosure. This would facilitate dollar reductions, since smaller issuers would not then be subject to the broader requirements which are really designed for the larger issuers.

Fourth, I have a series of comments on specific sections. In section 2 (b) of the bill, the definition of securities is to be amended to add "guarantees". This is commendable. At the same time, I question whether it is necessary for State guarantors and particularly for municipal insurance companies to be required to make a filing for each offering. Instead, an annual filing with appropriate supplemental filings for material changes should be sufficient. This could be attached to the distribution statements by the primary issuers.

Section (e) of the bill, and subsections (a) and (b) of proposed section 13A, relate to specific disclosures. You may wish to consider certain additional disclosure items. For instance, many enterprises generating funds for payment of revenue securities are much like profit-making entities; you may wish to require more information on the businesses and activities of these enterprises.

Further, disclosure for industrial development bonds has not been discussed in the bill, and you may wish to do so. For general obligation issuers, overlapping debt is important, as well as economic and demographic information. The former is a traditional disclosure, and the latter has many aspects found to be relevant in economic studies of risk. Pension plan information is very informative, particularly where plans are not fully funded. Especially for revenue enterprises, information on property and management experience is useful. Additional items include information on bond trustees; a statement of the opinion of counsel on tax matters; and ratings, if any, and recent changes therein.

With respect to subsection (a) of proposed section 13A, there is a need for a definition of "event of default." This is a very ambiguous term in the municipal area, where statutory as well as contractual provisions bear relevance.

In subsection (c)(1), from a comment you made yesterday, I received the impression that States are to apply the SEC standards. The bill in its present form, however, appears to make paragraph (b) wholly inapplicable where State hearings are held. Each State could thus set its own standards. This would seriously undermine uniformity in disclosure. Additionally, where State hearings are to be held, there is a need for clarification that the bill is referring to approval by the State under the laws of which the issuer is organized, not where offers or sales are being made. Further, the word "solely" in the second line of subsection (c) is confusing. Perhaps that could be expanded. In subsection (c)(2), I suggest an exemption for intrastate offerings such as that in section 3(a)(11) of the Securities Act of 1933.

In section (f) of the act and also in section 2(d) of the bill, limitations on the Commission's power, if any, to require filing could be explicitly expressed so as to permit only requirements of filing with the repository. A negative implication is created by the amendment to section 15B of the Exchange Act, and the explict limitation would correct that. Formal and informal stop order powers could be explicitly denied, as opposed to powers to undertake injunctive actions in the courts. Commission review and comment powers, such as those under the Securities Act, could be explicitly denied. I have in mind here the effective means by which the SEC extends the 20-day period in the Securities Act by threatening to use its powers if issuers do not accept a review period not created by Congress. Powers to require filing with the repository before offers, as opposed to sales, could also be denied. All these changes would clarify the effects of the bill.

In subsection (f)(3), I have the impression that the second sentence is intended to apply to distribution statements as well as to reports, but the phrase "distribution statements" does not appear therein.

Finally, I have several general comments on the bill. These are based upon the analyses contained in my written statement. There is

a need to provide explicitly for private rights of actions against issuers under Supreme Court decisions. These rights are desirable. I believe these actions may be maintained, if there is such an explicit provision.

It would be useful to set due diligence responsbilities of underwriters and of issuer officials participating in the offering at a knowing or reckless level. The stricter standards required by some courts under rule 106–5 impose costs which are unnecessary in the municipal market. Due diligence responsibilities of issuer officials not participating in the conduct of the offering and not knowing of misrepresentations or omissions could then be denied, as could due diligence responsibilities of other offering participants. This would provide for adequate due diligence without duplicative efforts.

In conclusion, the many problems you face are difficult and multifaceted. As one with primary experience in corporate securities law, I can sympathize with you. Municipal securities are securities, but they are not corporate securities. The municipal securities market is a securities market, but it is not the corporate securities market. After 2 years, I am still making adjustments. I urge you to bear this in mind and to exercise caution as you consider new legislation. It is important to avoid undue disruption in the flow of funds in State and local financing. It is also important to encourage increased disclosure and improved disclosure practices.

Senator WILLIAMS. Thank you very much, professor.

[Complete statement and additional material received for the record follows:]

STATEMENT OF ROBERT W. DOTY[1]

I. INTRODUCTION

During recent months, it has become increasingly obvious that there are serious disclosure problems in the municipal securities markets. There is a need for greater investor protection, particularly through increased disclosure by issuers. The industry has focused upon the issues due to the financial difficulties of New York City, various agencies of New York State and other large Eastern cities. Few other state or local governmental issuers are directly involved, although the repercussions have affected disclosure practices throughout the nation.

As often happens, the recognition of a problem area brings with it rapid calls for regulation and some degree of emotionalism. This situation is no exception, although one can perceive that a steadying influence is now pervading the deliberations.

Still, there is a great deal of confusion and ambiguity. Many questions are unanswered, and additional questions are appearing. For this reason, it is important first to identify the issues before hastily designing a totally new statutory and regulatory scheme. If there is a need for federal regulation, it should be the consequence of well-considered analysis.

The problems you and the Securities and Exchange Commission face are difficult and multi-faceted. As one with primary experience in corporate securities law, I can sympathize with you. Municipal securities are securities, but they are not corporate securities. The municipal securities market is a securities market, but it is not the corporate securities market. After almost two years of working in the area, I am still making adjustments. I urge you to bear this problem in mind and to exercise caution as you consider new legislation. It is important to avoid undue disruption in the flow of funds in

[1] Associate Professor of Law, Creighton University School of Law, Omaha, Nebraska. Thanks is expressed to Bruce Aubin for research assistance on the Uniform Commercial Code.

state and local financing. It is also important that increased disclosure and improved disclosure practices be encouraged.

A number of papers and other documents have been submitted to the Subcommittee. Among these are the following documents with which I have some association:

(1) A draft of an article, as yet in preliminary form, entitled "The Federal Securities Laws and Transactions in Municipal Securties," by myself and Dr. John E. Petersen.

(2) The "Disclosure Guidelines for Offerings of Securities by State and Local Governments" (Exposure Draft of November 10, 1975) prepared with participation by a number of persons with experience as issuer officials, investment bankers, commercial bank investors, bond counsel, securities counsel, and accountants under a grant from the National Science Foundation in a project sponsored by the Municipal Finance Officers Association.

(3) An article by myself entitled "Application of the Antifraud Provisions of the Federal Securities Laws to Exempt Offerings: Duties of Underwriters and Counsel," published at 16 Boston College Industrial and Commercial Law Review 393 (1975).

(4) An article entitled "The Case for Self Regulation in Tax-Exempt Bond Financing" appearing in The Daily Bond Buyer on January 29, 1976.

(5) An "Analysis" by Dr. Petersen and myself entitled "Regulation of the Municipal Securities Market and Its Relationship to the Governmental Issuer," published by the Municipal Finance Officers Association.

(6) An article by myself entitled "Disclosure Guidelines for Municipal Securities Transactions Proposed," appearing on December 10, 1975, in the Securities Regulation and Law Report, published by The Bureau of National Affairs, Inc.

A review of these documents will indicate many of the difficult and complex issues. There is a genuine need for caution. The differences between the corporate and municipal securities markets are numerous and, frequently, great. Some differences are apparent only, and disappear under close analyses. Others are evident only after thorough analysis. There is much misinformation existent, and a need for additional current information.

With this fluid situation in mind, I will discuss the protections and the weaknesses of present law and practices. I will then discuss specific problem areas and legislative alternatives.

II. THE PRESENT CONTEXT

A. APPLICABILITY OF THE FEDERAL ANTIFRAUD PROVISIONS

The outstanding feature of the present statutory and regulatory context is the applicability of the federal securities law antifraud provisions. The principle provision is Rule 10b-5 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934. An additional provision is found in Section 17 of the Securities Act of 1933. It is important to realize that Rule 10b-5 became explicitly applicable to municipal securities issuers only last year. The Securities Acts Amendments of 1975 added to the definition of "person" a "government, or political subdivision, agency, or instrumentality of a government." This definition is incorporated into Rule 10b-5 by Commission Rule 0-1(b). The Commission evidently takes the position that this amendment was only for clarifying purposes, since it was ignored in Securities Exchange Act Release No. 11876 (November 26, 1975), in which the Commission referred to past applicability of Rule 10b-5.

This position may or may not be accurate. The Committee Report on S. 249 mentions the change as an amendment, but does not say it is only for clarification. S. Rep. No. 75, 94th Cong., 1st Sess. 90 (1975). For years, the definition of "person" included corporations," but said nothing of "municipal corporations." This is significant. As indicated below in the discussion of sovereign immunity issues, the Supreme Court has required specific references to state and local governments before holding them subject to other legislation.

Meanwhile, the Securities Act of 1933 included in its own definition of "person" these same governments and their agencies and instrumentalities at an explicit level. The strong negative implication thus arising has very practical consequences, for private rights of action are more widely accepted by the courts under Rule 10b-5 than under Section 17.

Regardless of the technical consequences of these differences, it is important to realize that the principal antifraud provision. Rule 10b-5, has only explicitly applied to states and municipalities during the last few months. There has not been sufficient time to test its effectiveness, for securities litigation requires years to resolve.

It should be emphasized, however, that in my experience, there has been a drastic shift toward increased disclosure during this period. In addition, shortly before and during the period, a number of private suits were filed against issuers, underwriters, issuer officials, bond counsel, trustees, and other parties involved in municipal securities offerings, principally offerings of industrial development bonds. My information is that several additional cases are in preparation for filing in Oklahoma. It is evident that the antifraud provisions are working in the municipal securities market.

Another, and far more important point, is the consequences of antifraud applicability. These provisions are far-reaching. They require considerable disclosure in offerings, and probably in the trading markets. The concepts of "fraud" in these provisions are not those of common law fraud, with its elements of intent to defraud, privity, reliance, and the like. Rather, notions of unfairness predominate in the enforcement of the federal antifraud provisions, and many courts indicate a willingness to impose large liabilities at a negligence level of culpability. Indeed, in many respects, there is almost an absolute liability standard imposed on some parties.

It is also important to comprehend the nature of the materiality concept in the antifraud provisions. This is the key to an understanding of the disclosures required. The Supreme Court has stated that the provisions require disclosure of all information which "a reasonable investor *might* [consider] important in the making of [a] decision." *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972) [emphasis added]. The antifraud provisions have been held to protect "speculators" and "chartists" as well as "conservative investors." *SEC v. Texas Gulf Sulfur Co.*, 401 F.2d 833, 849 (2d Cir. 1968). Consequently, the provisions require the disclosure of a large volume of information and the exercise of considerable care in the development and presentation of that information for the protection of investors, if participants in a securities transaction are to avoid liability.

Underwriters are, to their credit, increasingly requiring improved disclosure for the offerings in which they participate. This must happen regardless of whether there is a new legislative scheme, for the antifraud provisions have been held to require it. Issuers likewise must develop a more complete understanding of their own legal obligations and the means of satisfying them. Indeed, just as responsible underwriters are responding, so are responsible issuers actively working to resolve the many difficult disclosure questions which are coming to be recognized by all market participants. I personally have worked with many issuer officials who are genuinely desirous of presenting information to investors, even though in their cases there have been no underwriting difficulties. The discipline which the market thus is now enforceing with respect to disclosure demonstrates both the need for the information and a method of obtaining it.

B. THE TOWER AMENDMENT

A second set of provisions in the Securities Exchange Act are important to the municipal securities market. These are contained in Section 15B(d), and are known popularly as the "Tower Amendment". There has been much misunderstanding of these provisions, with some persons asserting that they relieve issuers of disclosure obligations. This is inaccurate.

The 1975 amendments to the federal securities laws constitute a complex piece of legislation. Under this Act, the new Municipal Securities Rulemaking Board was established for the self-regulation of municipal securities dealers and their activities. This is a consequence of a very few highly unusual frauds committed by a dealer fringe.

Due to the strongly competing and investment banking interests, a subtle legislative scheme was designed. The membership of the Board was set at 15, with five representatives of commercial banks, five representatives of investment bankers, and five public representatives Only one public member must represent state and local governmental issuers. Because of the Board's structure

and its narrow functions, it was never intended that it have authority to prescribe issuer disclosure rules. For that reason, the Tower Amendment prohibits regulation of issuers by the Board.

Certainly, as noted above, it does not follow that issuers do not have disclosure obligations. It is imperative to comprehend the breadth of the requirements of Rule 10b-5 and the other antifraud provisions of the federal securities laws. They apply to issuers. They require very strict and comprehensive disclosure. Without this disclosure, issuers and probably their officials are subject to a broad range of legal remedies.

It is unfortunate that misundersandings have developed regarding the intent and effect of the Tower Amendment. As can now be seen, the Amendment does not erect a protective fortress against issuer disclosure. It does not prohibit the promulgation of disclosure rules by the Securities and Exchange Commission under the antifraud provisions. It does not stand as an obstacle to Commission enforcement actions or to investor litigation. It does not prohibit the Commission from imposing post-offering filing requirements or from requiring delivery of information to investors in connection with offerings or even in the trading markets. Rather, it simply prevents the Rulemaking Board, composed largely of underwriters and dealers, from setting rules that apply to governmental issuers and prohibits the Commission from imposing pre-offering filing requirements, a power it probably does not have in any event.

C. DISCLOSURE GUIDELINES PROJECT

In 1974, months before the commencement of the current debate and before the explicit applicability of Rule 10b-5 to municipal securities issuers, the Municipal Finance Officers Association recognized the need for increased disclosure in the market. In this connection, it applied for and received a National Science Foundation grant to study disclosure needs and the means for improving disclosure.

At that time, the emphasis was not so much upon the satisfaction of the antifraud provisions, but rather upon the desires and needs of investors. Of course, protection of these same interests is coincidentally the goal of the antifraud provisions themselves. The project is much larger than the portion discussed herein, which is that for the preparation of Disclosure Guidelines. Nevertheless, due to the widespread industry participation and interest, the Guidelines aspect of the project has assumed considerable importance.

The Guidelines have been submitted to you and are discussed in the draft article, the Analysis, and the Bureau of National Affairs article also submitted to you. In addition to the discussions of the Guidelines in these documents, it would be very useful in analyzing risk in municipal issues. This information, as well as the wealth of experience of those persons participating in the Guidelines project, provided a solid foundation for designing the specific suggestions.

It is evident to me, and I want to emphasize this to you, that issuers and other market participants care about disclosure. They care about investor protection. The Guidelines are important evidence of this. There is no need to create a new regulatory scheme or to design new regulatory powers. I urge you to permit these private parties to continue their work.

III. IDENTIFIABLE PROBLEM AREAS

A. ACCOUNTING STANDARDS AND CERTIFICATION

1. Accounting standards

One of the principal areas deserving careful analysis is the need for improved governmental accounting standards. Accounting standards do exist. These may be found in National Council on Governmental Accounting (formerly, National Committee on Governmental Accounting), *Governmental Accounting, Auditing, and Financing Reporting* (1968), available from the Municipal Finance Officers Association, 1313 East 60th Street, Chicago, Illinois 60637, and the Committee on Governmental Accounting and Auditing of the American Institute of Certified Public Accountants, *Audits of State and Local Governmental Units* (1974), available from the AICPA, 1211 Avenue of the Americas, New York, New York 10036.

It is not likely, however, that the NCGA or the AICPA would assert that existing standards are sufficient. The field of governmental accounting is not

as well-developed or as uniform as the field of corporate accounting. Many governmental entities do not conform to these or other standards that may be recognized as "generally accepted." As a consequence, financial statements of varying governmental entities often lack a comparative basis. Words of art and other terminology in financial statements for one issuer entail much different definitional considerations than substantially the same words and terminology in financial statements for other issuers. Disclosure of these and similar differences or their effects on the disclosures do not necessarily appear in the notes to the financial statements.

It is inevitable, in the face of such serious interpretive obstacles, that investors do not receive adequate information. Consequently, the Guidelines suggest conformity to the accounting principles of the NCGA and the AICPA as a means of establishing greater uniformity in the field of municipal financial reporting.

The NCGA is undertaking a thorough revision of its publication. It would be wise to take advantage of this existing expertise and activity. This is a serious problem, and the most expeditious means of solving it should be followed.

There are dangers in the promulgation of state and local governmental accounting standards through federal proclamation. First, considerable differences exist between municipal and corporate accounting procedures. Municipalities are not profit corporations. Balance sheets do not have the same meaning for investors in municipal securities that they possess for investors in corporate securities. Municipal assets cannot be sold for the benefit of investors. Many typical corporate adjustments, such as depreciation or amortization, do not have the same significance. Profit and loss or income statements are not usually relevant, except in some cases for enterprises generating funds for the payment of revenue securities. Instead, cash flow analyses generally are crucial and relevant.

But the problem is much more complicated. Municipalities operate on the basis of "fund" statements, with only certain funds pledged to the payment of various issues of securities. This is true even of general obligation securities, as well as special obligation and revenue securities. The resulting problems are not fully comprehended by persons who lack expertise in the area.

There is a role, however, for federal participation in the projects. The most useful course would be that of funding the existing projects so that the participants may employ additional staff, have access to additional expertise, and consider more far-reaching revisions and problems. Participation in the projects by regulators could be advantageous. It would be very educational for regulatory personnel with a corporate orientation, and it would entail many fewer and less severe consequences than would governmental promulgation in an area not readily understood.

2. Certification

A related problem is that regarding certification of financial statements. The certification issue is much broader than that of obtaining increased uniformity. Where offerings are made to the public, certification is necessary. My own experience in the corporate area establishes firmly in my mind the utility for all concerned of the participation of independent accountants.

This is an expensive process. If the requirement were imposed upon small issuers, however, it may well price them completely out of the securities market. Yet, many officials of these communities do not have sufficient expert accounting expertise or advice to prepare sufficient financial information.

Some middle ground is necessary to satisfy the conflicting needs for preservation of our federal system, efficiency, and disclosure. One means would be a federally funded educational program for financial officers of small communities so that they may better understand their antifraud obligations and the means of satisfying them.

These small communities often sell in local or "private" offerings, but even there, antifraud obligations exist. They are not, however, as heavy as those for larger issuers. Those issuers in larger, nonpublic offerings have antifraud obligations not unlike those imposed upon corporate issuers in registered offerings.

An example, is the due diligence defense (or obligation, depending upon one's orientation). Under the scheme of the Scurities Act of 1933, various

parties have a due diligence defense and can avoid liability to investors if they perform the steps necessary to establish it. Parties who may rely upon this defense include the underwriters and the directors and municipal officers of the issuer. Particularly for individuals, securities law liabilities can be ruinous, so there is a considerable motivation to avoid liability by investigating and verifying the adequacy and accuracy of the information disclosed. This must be accomplished to the extent to which the information would be investigated by a reasonably prudent person in the management of his or her own property. Where information purports to be provided on the authority of an expert, however, these parties may escape liability if they have no reason to believe and do not believe the information to be incomplete or incorrect.

The due diligence defense is also relevant, perhaps even for issuers, under the antifraud provisions, although the defense is not explicitly stated therein. As yet, the courts have taken widely varying positions so that there is no definitive word on the standard of investigation required to establish the defense. Yet, regardless of the applicable standard, there is some obligation on the part of certain participants in offerings of municipal securities to verify the adequacy and accuracy of information disclosed.

One of the basic due diligence activities is the investigation of financial information. In the corporate context, this is done through reliance upon opinions of independent public or certified accountants. The other nonissuer offering participants then have the lower responsibility noted above for "expertized" material, while the issuer and the accountants bear the primary responsibility for the financial disclosures.

In the municipal context, however, this has not been the usual procedure. Many of the larger issuers do not utilize independent accountants at present, although more are coming to do so. Even fewer of the smaller and medium-sized issuers do so in their financial reporting processes. This is extremely risky to say the least. Attorneys and accountants experienced in the preparation of disclosures for corporate offerings are accustomed to frequent discussion and revision of financial disclosures as a result of issues posed by the independent accountants. Other revisions are avoided only through anticipation of the position of these accountants.

With the present state of affairs, it is inevitable that misstatements and omissions will occur in municipal financial information reported in official statements. The officials of the issuer are not as likely to raise difficult questions concerning the adequacy and accuracy of the financial statements as are independent parties. This is not at all to cast aspersions upon the integrity or ability of these officials or to question their desire for full and accurate reporting. Rather, it is a recognition of their human qualities in a complex and subtle context.

When adequate due diligence procedures are not performed on the financial disclosures, and a government defaults, issuer officials and other offering participants must view themselves in effect as potentially liable on the securities and even as liable for certain market losses of investors. These participants are, therefore, in serious need of due diligence protection.

The parties preparing the Guidelines recognized the importance of these considerations. Consequently, the Guidelines suggest that the financial statements contained in official statements be reviewed by independent accountants or by independent state authorities performing equivalent procedures and giving equivalent opinions. Any new legislative and regulatory pattern also should do so, except for private or local offerings.

B. SOVEREIGN IMMUNITY ISSUES

A second problem area is that created by the Eleventh Amendment to the United States Constitution and by the common law sovereign immunity doctrine. The draft article by John Petersen and myself contains a lengthy analysis of the sovereign immunity doctrine as applied in various legislative areas including civil rights, labor, antitrust, and securities. Consequently, this statement contains only a brief summary.

The Eleventh Amendment provides,

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or Subjects of any Foreign State.

The Amendment does not explicitly bar suits in federal court against a state by one of its own citizens, but the Supreme Court has held that such suits may not be maintained. *Hans v. Louisiana*, 134 U.S. 1 (1890). The Supreme Court has also held that the Amendment does not protect local governmental entities. *Lincoln County v. Luning*, 133 U.S. 529 (1890). Consequently, counties, towns, and cities and their agencies and instrumentalities must rely upon the sovereign immunity doctrine for protection.

One area in which the Supreme Court has considered municipal and state liability is Section 1983 of the Civil Rights Act. In an early decision, the Supreme Court held that the term "person" did not include a municipality, absent explicit congressional regulatory intent. *Monroe v. Pape*, 365 U.S. 167, 189 (1961).

A second legislative area is that of antitrust laws. Again, here, the court has stated its desire for explicit indications of regulatory intent. *Parker v. Brown*, 317 U.S. 341 (1943). A third area is that of labor legislation. The themes from the civil rights and antitrust laws are continued here. My conclusion is that, although there is no certainty on the question, it is important that there be explicit indications of congressional intent to regulate municipalities and to impose private rights of action if they are to exist. See *United States v. California*, 297 U.S. 175 (1936) (Safety Appliance Act—regulation for employee safety); *California v. Taylor*, 353 U.S. 553 (1957) (Railway Labor Act—prescribed methods of dispute settlement); *Petty v. Tennessee-Missouri Bridge Comm.*, 359 U.S. 275 (1959) (Jones Act—negligently caused wrongful death in boat collision); *Parden v. Terminal Railway*, 377 U.S. 184 (1964) (Federal Employer's Liability Act—liability for injuries to employees); *Maryland v. Wirtz*, 392 U.S. 183 (1968) (Fair Labor Standards Act—minimum wage for certain specific governmental institutions); *Employees of the Department v. Department of Public Health & Welfare*, 411 U.S. 279 (1973). The most recent case, Employees indicates a lower degree of readiness to accept regulation than is indicated in some of the earlier cases.

Of course, in 1975, Congress gave an explicit indication that Rule 10b-5 is to apply to municipalities. Section 17 has always applied through the definition of "person" in the Securities Act. But the securities law implied private rights of action with which we are all so familiar have been recognized by the Supreme Court to date only against corporations. It is not clear that they would be extended to municipal issuers.

The Second and Sixth Circuits have reached conflicting results as to private rights of actions against state agencies in aider and abettor cases under Rule 10b-5. *Forman v. Community Services, Inc.*, 500 F.2d 1246 (2d Cir. 1974), rev'd. on other grounds, sub. nom. *United Housing Foundation v. Forman*, 95 S.Ct. 2051 (1975); *Yeomans v. Kentucky*, 514 F.2d 993 (6th Cir. 1975), cert. denied, 44 U.S.L.W. 3297 (Nov. 18, 1975); *Brown v. Kentucky*, 513 F.2d 333 (6th Cir. 1975), cert. denied, 44 U.S.L.W. 3202 (Oct. 7, 1975).

Perhaps the policies of the securities laws are so strong and clear that the Supreme Court would override considerations it has viewed as governing in these other legislative areas and would accept implied, as opposed to explicit, private rights of action. But the policies supporting the Court's approach in the other areas are themselves quite important. We are dealing with the separation of powers in our constitutional system; extensive regulation of state and local governments by the federal government should not lightly be implied. Consequently, if the private rights of action are intended, it is advisable that the antifraud provisions be amended to create them explicitly.

C. DELIVERY OF INFORMATION

Another serious problem relates to the delivery of information in municipal securities offerings. In the past, official statements have often been provided only to underwriters. Information in an official statement frequently has been furnished to the ultimate investors in a summary form. In some cases, the summaries have not been furnished until the confirmations of the sale have been mailed. In yet other cases, no information at all has been sent to investors. One consequence is that investors, the parties most interested in receiving information, often do not receive adequate disclosures on which they may base their investment judgments. Instead, bond ratings have assumed a strong role in investor decisions.

Other issuers and underwriters have chosen to follow good market practice. They have made copies of the official statement available to investors at the time of the offers. Investors then have been able to review the information and make informed investment judgments. The Disclosure Guidelines suggest that issuers follow this practice and that the full official statements be provided to investors, either directly or through the underwriters.

Indeed, this is the point of the Guidelines. The Guidelines do not speak simply to the question of information to be furnished to the underwriters. Short of compliance with these suggestions, it is difficult to comprehend how there can be satisfaction of the requirements of the federal antifraud provisions with respect to furnishing information to investors.

It is desirable that modifications in methods of offering the securities mesh with other traditional marketing procedures. Municipal securities are usually sold through competitive bidding, as is often required by state law, rather than through negotiated sales with a specific underwriter. When the competitive bids are opened and the winning syndicate is determined, the municipal securities are sold within a very short period of time, if the syndicate is purchasing for resale to others. Normally this is only a matter of hours. If official statements are to be furnished to the ultimate investors prior to sale, problems can arise under these traditional procedures.

There should be careful consideration of informational delivery requirements in any legislation or regulation. Competitive bidding procedures should be preserved, if possible, to avoid additional issuer costs through the loss of the benefits furnished by that financing pattern.

There are several alternative courses of action. Under the first and most workable variation, the potential underwriters would, prior to the opening of the bids, make copies of the official statement available to the customers to whom they make offers. At this point, much of the underwriting information cannnot be provided. Then, when the syndicate is determined, the sales may be quickly completed. Full underwriting information can be provided with the confirmations.

This procedure is not fully satisfactory. Since several syndicates may bid, a large number of official statements may be required, most of them ultimately unnecessary, since only one syndicate can win the competition. Further, offering procedures would be complicated by the procedure, and those investors contacted at the last minute could not feasibly receive the material before sale.

The increased printing expenses would not, however, be great in relation to the total amount or expenses of most offerings. The additional complexities in the offering process would be overcome as new procedures become standardized. And my information is that the numbers of last minute contacts, while a problem, is not overwhelming.

The second alternative entails disadvantages that are greater. By following this alternative, the successful syndicate, after it is determined, would distribute copies of the full official statement to its offerees prior to sale. The delay involved and the consequent uncertainty and exposure to market risks would be unacceptable to many, if not most, underwriters.

The third alternative is a variation on the second. Under this alternative, the successful underwriters would send the official statements with confirmations immediately after the bids are opened. Investors would then have a period, perhaps one week, within which to rescind. This also would usually be unacceptable due to the resultant exposures. By a process of elimination, then, the first alternative appears preferable, if competitive bidding procedures are to continue to be followed and if investors are to receive disclosures at a relevant time.

The final alternative is the elimination of reliance upon competitive bidding procedures. Negotiated underwritings are often utilized for offerings of revenue securities. While it is desirable to retain competitive bidding, some issuers may elect to rely, where legally permitted, upon negotiated underwritings on the theory that the cost benefits of competitive bidding are outweighed by the procedural difficulties.

The conclusion as to the superiority of the first alternative is strengthened by Article 8 of the Uniform Commercial Code. This establishes the conditions under which a buyer of securities becomes liable for the purchase price. In an action for price under Section 8–107, a prerequisite for recovery is that an

69-141 O - 76 - 21

enforceable contract of sale exist. Whether there is an enforceable contract is determined in part by Section 8–319, the statute of frauds section. Section 8–319 reads as follows:

A contract for the sale of securities is not enforceable by way of action or defense unless:

(a) there is some writing signed by the party against whom enforcement is sought or by his authorized agent or broker sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price; or

(b) delivery of the security has been accepted or payment has been made but the contract is enforceable under this provision only to the extent of such delivery or payment; or

(c) within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt; or

(d) the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price.

When dealing with actions for price for corporate and municipal securities, the occurrence of conditions necessary to satisfy Section 8–319(a) or (d) is unlikely. In most circumstances, Section 8–319(c) establishes the outer limits on the period within which a buyer may properly reject the securities tendered. The underwriter normally sends the buyer written confirmation soon after the registration becomes effective in a corporate offering or after the syndicate is awarded the bid in a municipal offering. The buyer then has ten days after receipt of the confirmation within which to send a written rejection. If no such rejection is sent, the contract for sale is enforceable, and the seller may maintain an action for the price under Section 8–107. *Weiss v. Dempsey-Tegler & Co., Inc.*, 443 S.W.2d 934, 936 (Tex. 1969).

The purchaser, however, may become liable for the price at an earlier time. Under Section 8–319(b), the contract for sale becomes enforceable upon payment or upon delivery and "acceptance" of the securities. Underwriters do not wish to remain at market risk until the settlement date. Therefore, so that there may be an enforceable contract from the time of the customer's agreement to buy, the focus must be upon delivery and "acceptance". Delivery occurs when the underwriter sends the purchaser "confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser." U.C.C. Section 8–313(1)(c); *Fine v. Bradford*, 100 Ga. App. 380, 136 S.E.2d 147 (1964). Section 2–206 designates when the purchaser is held to have accepted "goods". Although Section 2–105(1) excludes investment securities from the scope of Article 2, the application of Section 2–606 by analogy is permissible. Section 2–105, comment 1. *See also*, U.C.C. Section 8–107, comment 2; *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934). Section 2–606(1)(a) provides that "acceptance" occurs after the buyer is given a "reasonable opportunity to inspect" the goods and signifies to the seller that they conform to the contract.

Placing these provisions in the context of a corporate underwriting, the buyer accepts the corporate securities when he or she signifies to the seller an agreement to purchase the scurities after there has been a "reasonable opportunity to inspect". The emphasis here is upon the reasonable opportunity.

The security instrument itself will not physically provide the buyer with much information for inspection. The availability of the preliminary disclosures, though, after oral disclosure of the underwriter's analysis, followed by or simultaneous with a phone call between the underwriter and the customer in which the customer agrees to purchase should constitute acceptance under Section 2–606. And since delivery will occur when the underwriter sends confirmation and designates a particular security as belonging to the buyer, the contract is enforceable under Section 8–319 and the buyer will be liable for the price. The ten-day limit of Section 8–319(c) will have been superseded by subsection (b).

Under some present practices, underwriters of municipal securities may not be able to rely upon the protections of Section 8–319(b). Acceptance occurs in the corporate offerings discussed above due to the availability to the customer of a red herring. The syndicate which is awarded the underwriting in a

municipal security distribution does not always make extensive distribution of preliminary disclosures. As soon as the syndicate is awarded the sale, the confirmations may be sent out. Thus, customers have no effective means of "inspecting" the securities. In such cases, no "acceptance" has taken place under Section 2–606. Underwriters are thereby limited to the enforceability upon the sooner of payment, the ten-day waiting period, or a "reasonable opportunity" to inspect any definitive information which accompanies the confirmation. In the last case, the length of the period for the "reasonable opportunity" would vary depending upon the particular facts.

The analyses reaching these conclusions are by no means certain. Therein lies the problem. Various alternatives have their proponents and detractors. The strongest conclusion is that there is no consensus on the law. Such a state of affairs carries maximum risk of liability for failure to comply with the alternative a particular court may favor under the antifraud provisions. It is therefore desirable to provide some certainty so that offering participants may understand what is expected of them.

D. DUE DILIGENCE STANDARDS

Just as delivery of information in a competitive bidding context causes significant problems, so does the issue of due diligence. There are several alternatives for performance of dues diligence in a competitive bidding setting. The most workable alternative would mesh with the most satisfactory alternative for delivery of information. This due diligence alternative is determined by reference to procedures under competitive bidding as required by the Commission's Rule 50 under the Public Utility Holding Company Act of 1935.

In such an offering, the issuing public utility holding company often designates counsel (other than its own counsel) to act for the successful syndicate. By the time the bids are opened, the due diligence investigation is complete and the underwriters then accept the work and opinion of the designated counsel. There are weaknesses in such a system involving choice of counsel and potential conflicts of interest. But, if the securities are to be sold without unreasonable delay after the bids are opened, it may be the only satisfactory alternative.

This procedural issue is not the only question. The extent of the investigation is also controversial. Under existing case law, unrealistic due diligence standards have been imposed. In one recent case, *Sanders v. John Nuveen & Co.*, CCH Fed. Sec. L. Rep. ¶94,347 (7th Cir. 1975), the court even held that underwriters should review accountants' work papers. This goes beyond the standards of the Securities Act. Under the Securities Act, persons with due diligence defenses and responsibilities are entitled to rely upon the certifications of independent accountants.

Underscoring the inadvisability of this approach, the court refused to consider evidence as to due diligence procedures of other lenders regarding the same issuer. Again, under the Securities Act, the necessary due diligence is that of a reasonably prudent investor in the management of his or her own affairs. These other lenders were managing their own affairs, and there was no serious consideration by the court of the question of whether these lenders were "reasonably prudent." The obligations under Rule 10b-5 are thus undesirably ambiguous and are coming to exceed those in registered offerings. This was not intended by Congress. Consequently, there is a need for an examination of the direction the courts are taking regarding due diligence under Rule 10b-5.

A related problem is that of the due diligence to be required of issuer officials. Under corporate antifraud decisions, issuer officials have disclosure responsibilities. This is particularly true of those officials participating in the offering or the preparation of disclosures. In the municipal context, however, many of these officials are inexperienced in securities matters. As in the accounting area, we are faced with the problem of unsophisticated individuals. These are well-meaning people who are seeking to participate in local government. If they are to be subjected to the risk of heavy antifraud liabilities, it could have serious implications for our governmental system. We must find some way for the average person to continue to participate in government. I fear the threat of these liabilities will interfere with many recent democratic advances. Perhaps the most satisfactory result would be to provide explicitly

for a gross negligence or recklessness standard, rather than the rules now developing in several judicial circuits.

. It is not clear, then, that heavy legal responsibilities should be placed upon unsophisiticated public officials. Neither is it clear that we should require of all such issuers and officials that expensive, sophisticated securities counsel and accountants be employed. Based upon the latest available information, that for the early 1970's, costs of corporate financings are in almost all instances far in excess of that for municipal issues. Particularly is this true of the small offerings. This is reflected by the following table developed by Dr. Petersen from information available from the Commission and the MFOA.

TOTAL COSTS OF FLOTATION

[Municipal and registered corporate securities by size of issue: cost per $1,000 of gross proceeds]

Size of issue	Type of security			
	Municipal		Corporate	
	General obligation	Revenue	Common stock	Debt
$0 to $2,000,000	$20.80	$27.05	$202.70	$133.47
$2,000,000 to $5,000,000	16.20	21.04	119.00	62.30
$5,000,000 to $10,000,000	14.32	19.24	87.30	31.40
$10,000,000 to $20,000,000	13.40	16.29	66.30	18.90
$20,000,000 and over	8.98	13.84	41.53	11.97

It can be anticipated that these differences will be narrowed as municipal issuers continue their increasing use of the Disclosure Guidelines and as underwriters further fulfill their due diligence responsibilities. But surely it is unnecessary to go to the corporate limits, pricing small municipal issuers out of the market just as many small corporate issuers are unable to obtain funds due to the prohibitive expenses.

IV. POSSIBLE LEGISLATIVE COURSES

A. THE SECURITIES ACT APPROACH

A Securities Act registration approach is unwarranted. As outlined in my article in *The Daily Bond Buyer*, there are considerable differences between the municipal and corporate securities markets which favor a less stringent disclosure policy regarding municipal issuers. Many of the differences are misunderstood. It has been assumed that some of them have disappeared. While there have been modifications, in many respects the basic differences remain. These differences are described further in the article, and are outlined here.

The first is the relative absence of fraud and of opportunity for fraud in the municipal market. Municipal governments are not profit-making entities. Their affairs are open to the public and are examined continuously by the news media. Prices of municipal securities fluctuate to a significantly lesser extent than do prices of corporate equity securities, thus further reducing the opportunity for manipulative and fraudulent activities.

The second difference is the degree of risk. Many persons, with a focus on New York's problems, have assumed that this factor is now irrelevant. But, the comparisons of default ratios for corporate and municipal securities are dramatic. According to Dr. Petersen, from 1929 to 1937, approximately $1.35 billion of municipal interest and principal went into default, a little over 7 percent of that outstanding. The corresponding corporate figures are $7 billion and over 30 percent. By 1944, $100 million of municipal debt remained in default, while $3 billion of corporate debt had not been paid.

Since World War II, almost all defaulted debt has been held by banks in the sale locale or state as the issuer. From 1945 through 1974, about $500 million of municipal bonds went into default, or 0.24 percent of municipal debt outstanding at the end of 1974. Professor George H. Hempel estimates permanent losses of principal and interest from 1945 to 1965 to be less than $10 million, or 1/10,000th of outstanding municipal debt at the beginning of 1965. Thus,

from the long-term view, it cannot be concluded that non-New York municipal investments entail the risks assumed by recent market conditions or many public pronouncements.

Further, the investors themselves are of such a character as to vitiate the need for corporate style registration. While many persons are asserting that the municipal market is becoming increasingly individual, banks increased their holdings of outstanding municipal debt in the 1960–74 period from 25 percent to 49 percent, and the percentage held by households declined from 43 percent to 29 percent of the total outstanding. The municipal market, then, in this sense, actually became markedly more, not less, institutional in character. Additionally, the percentage of household wealth represented by municipal investments remained steady at 3 percent, while the percentage in corporate equities was many times that proportion.

The existing exemptions, then, continue to have the same basic importance which supported them in the 1930's, and other considerations now also bear relevance. Issuers have shown that they are seriously interested in regulating themselves in an efficient and capable manner. Never in the history of the securities laws has a group of issuers acted more responsibly. These actions were commenced before the current debate. So this is no time to overreact. We should wish to foster and encourage such voluntarism, not to destroy it.

B. SELF-REGULATION ALTERNATIVES AND PASSIVE REGISTRATION: THE RECOMMENDED APPROACH

The concept of self-regulation is an important and valid one if we must have a new regulatory pattern. There is no need for the Commission to become involved as a supervisor of state and local governments. Neither would regulation by the Board, as now constituted, be self-regulation. It would be quite inequitable to subject issuers to regulation by the same private parties who face them across the bargaining table.

Thus, exploration of this first basic premise for any new regulatory pattern gives birth to several new proposals:

(1) Regulation could be accomplished through a reconstituted Board giving issuers and dealers equality of representation. Objections to such a proposal would undoubtedly be voiced by dealers, since the Board designs dealer rules.

(2) Regulation could be accomplished through a new Board or other quasi-governmental mechanism providing for issuer self-regulation, just as the existing Board is a self-regulatory body for dealers. Issuers, through their voluntary activities, warrant this trust. Such an entity may or may not be subject to Commission oversight.

(3) Issuers could organize their own self-regulatory sructure outside the governmental arena. Such a structure would promulgate rules accepted as industry standards enforceable under Rule 10b–5 and, with federal funding, could operate a data bank for investor information purposes.

The second premise for regulation is that it is not necessary to re-create a corporate review process for municipalities. Various forms of passive registration may then be discussed:

(1) The first is annual filing, such as the present corporate 10–K's, with information accessible to those investors desiring it. Supplemental information could be filed in those unusual instances where it may become operative for a municipality.

(2) Another approach involves prospectus delivery to investors with filing, but no review or comment, procedures. Whether filing is prior or subsequent to offerings would be irrelevant under the circumstances. The greatest problems here lies in designing satisfactory means for delivering the disclosures to investors at a time relevant to the making of investment judgments, while preserving the competitive bidding system.

There is, then, no dearth of alternatives. It is crucial that each receive careful examination, if we are to change the basic regulatory structure, so that adverse regulatory consequences are minimized.

V. CONCLUSIONS

The preferable pattern for regulating municipal securities transactions is the existing pattern. There is no evidence that structural legislative changes are needed. It is desirable to fine tune the antifraud provisions to grant ex-

plicit private rights of action, to solve problems of informational delivery, and to override excessive judicial fervor on due diligence. There is a need to further the development of accounting standards. There is a need for the various market participants to continue to increase their recognition and fulfillment of their responsibilities. But the necessary mechanisms already exist for full enforcement of these obligations by Commission action.

The imposition of a corporate regulatory scheme would add little, if any, real investor protection and would result in greatly increased expenses which must be paid by the taxpayers. This would come at a time when inflation and other factors are increasing the cost of government at an alarming rate. Interestingly, in this case, the taxpayers would pay twice: first for federal regulatory expenses and secondly for municipal compliance.

If a regulatory plan is deemed necessary, it should be based upon a recognition that many arguments for corporate regulation are inapplicable to municipal issuers. The concepts of self-regulation and passive registration are particularly apt for entities reflecting such a high degree of responsibility. It is important to find ways of obtaining the desirable investor protection with the least inconvenience and expense. The beneficiaries will be the public citizens in their dual capacities of investors and taxpayers.

[From the Daily Bond Buyer, Thursday, January 29, 1976]

THE CASE FOR SELF REGULATION IN TAX-EXEMPT BOND FINANCING

(BY ROBERT W. DOTY)

Many voices have proposed of late that drastic changes be made in the regulation of municipal securities issuers. Numerous calls have been issued for the creation of comprehensive schemes granting the Federal Government unprecedented powers over state and local governments. Sen. Thomas F. Eagleton, D–Mo., and Rep. Lionel Van Deerlin, D–Calif., have gone so far as to introduce legislation imposing corporate registration upon municipalities. The haste and lack of wisdom in such approaches is underscored by the failure to realize that the bills would not work: the Securities Act of 1933 and the schedules thereto would become applicable to municipal issuers. But the information required in those schedules is corporate information or that relating to foreign governments. It is totally unrelated to domestic state and local issuers.

There is, then, genuine danger that over-reaction to the New York City crisis and that a misunderstanding of the exemption for municipal issuers will result in legislative excess. Reflexive reactions to present crises which do no more than fall back upon the old concepts of increased Federal regulation of and involvement in important local affairs is inadvisable. This is particularly true since, in this case, we are concerned with one of the most important of all local matters: the power of the purse.

ALREADY REGULATED

It is fundamental to appreciate that we already have regulation of municipal issuers under Rule 10b–5 and the other anti-fraud provisions and that changes, if any, in this pattern should emphasize self-regulatory and passive registration concepts. On Dec. 1, 1975, in "The Money Manager," Securities and Exchange Commissioner Alfred O. Sommer, Jr., presented some of the more cogent recent thinking in emphasizing these concepts. In his article, Commissioner Sommer summarizes the distinctions between the corporate and municipal markets and suggests regulation through the Municipal Securities Rulemaking Board.

Commissioner Sommer thus established a solid base upon which discussions may be grounded. Nevertheless, it is not entirely clear that detailed regulation is necessary. This article contains discussions of the strengths of the existing issuer regulatory pattern and of remedial needs in that regard. Possible legislative courses are then outlined.

Of course, no one can defend fraud. But the present regulatory pattern forbids fraud. No one is opposed to increased disclosure to investor. But the present regulatory pattern requires precisely that disclosure. Municipal securities issuers have come to recognize the significance of the existing legal

requirements. Long before the current proposals were heard, these issuers and numerous other market participants began moving strongly toward far-reaching improvements in disclosure through preparation of the disclosure guidelines. A product of a project funded by the National Science Foundation and sponsored by the Municipal Finance Officers Association, these guidelines have gained, and are continuing to gain, wide market acceptance.

It is far too simplistic to point a finger at New York City and regret that Rule 10b–5 was not sufficient protection for investors. In fact, Rule 10b–5 was not even made explicitly applicable to New York City or other municipal issuer until roughly the time New York's problems became public knowledge.

Only then did the term "person" in the Rule come to include these governments through a little-noticed portion of the Securities Acts Amendments of 1975. True, Section 17 of the Securities Act of 1933, with its similar provisions was applicable. But some courts have questioned whether there is, under Section 17, the implied private right of action that is so widely accepted under Rule 10b–5.

And the Commission certainly never found it necessary to act under Section 17. Indeed, in the entire history of the Federal securities laws, the SEC has never yet taken a municipal issuer to court. New York City is under investigation, and perhaps rightly so. But it is difficult to comprehend by what measure we determine that the anti-fraud provisions are insufficient if they remain untried to date by the relevant enforcement authorities and when the primary anti-fraud provision became explicitly applicable only a few months ago.

ISSUER INITIATIVES

Even now, across the nation, the anti-fraud provisions are having precisely the desired effects. The MFOA has distributed literally hundreds of copies of the Disclosure Guidelines. Over 1,000 have been requested, and a second printing has been necessitated. Issuers everywhere are adding to their disclosures. Underwriters are compelling more disclosure where issuers fall short. Some securities offerings have failed to attract bids, and increased costs have been imposed in others, where potential bidders disappeared after receiving what they regarded as insufficient information.

I do not think it trite to note that the American spirit emphasizes voluntarism over governmental regulation. Never in the history of the securities laws has a group of issuers acted more responsibly. These actions were commenced long before the current debate. So this is no time to over-react. We should not wish to destroy entirely this attitude of self-regulation and individual responsibility.

What is really needed is increased action by the SEC, by issuers, and by underwriters under the present patterns. The Commission should act under the anti-fraud powers to enforce existing laws and to bring about increased awareness of and to strengthen investor rights to sue fraudulent or non-disclosing issuers and underwriters.

All market participants should bring to function the Disclosure Guidelines project, perhaps through a conference or similar mechanism. Issuers should culminate their plans for programs of further education of issuer officials as to their legal responsibilities by insisting on issuer disclosure and by performing full due diligence investigations of the adequacy and accuracy of the information disclosed.

Thus, the present situation is sound, and carries with it strong responsibilities of all the relevant parties. It is important, therefore, to examine the bases for the municipal securities exemptions so that the fundamental adequacy of the present pattern may be fully comprehended.

BASES OF EXEMPTIONS

In adopting the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress determined that the comprehensive regulatory scheme which was thereby created should not be made applicable to municipal securities transactions. Accordingly, provisions were enacted exempting municipal securities issuers from the registration requirements of the Securities Act and from the registration, reporting, and related requirements of the Exchange Act. Congress even exempted from regulation those dealers and brokers conducting business solely in municipal securities, although the policies supporting issuer exemptions did not require it.

These policies are multi-based. Certainly, considerations of comity and intergovernmental relations are involved. They are reflected not only in the securities laws, but in many legislative enactments, ranging from anti-trust to labor legislation. Congress is thus generally quite reluctant to impose detailed regulatory patterns upon state and local governments under our Federal system.

This reluctance has its roots in our Constitution. There are serious questions of the extent to which the Federal Government may regulate state and local governments. Further, since the securities laws give rise to private rights of action, important issues are raised under the 11th Amendment to the Constitution to the extent private litigation may be brought against states. The common law sovereign immunity doctrine poses similar considerations for litigation against both state and local governments. These issues create a context which cannot be ignored in the consideration of other matters.

It is here that Rule 10b–5 and Section 17 fall short. An examination of relevant Supreme Court decisions in other legislative areas, particularly civil rights, anti-trust, and labor, discloses a strong reluctance to imply private rights of action against states and municipalities. Those of us who are accustomed to implied private rights of action under Rule 10b–5 have not been sufficiently careful in the municipal area.

Certainly, my own thinking required severe adjusment. But we are faced with strong policy considerations. If Congress intends that municipalities may be sued under Rule 10b–5, it should say so explicitly in a legislative fine-tuning of the Securities Exchange Act of 1934. At present, unnecessary and undesirable doubts are permitted.

ABSENCE OF FRAUD

Less philosophical bases for the exemptions are found in market conditions. Some of these have changed somewhat, but the basic considerations remain. One of the most basic is the absence of fraud. Since the adoption of the securities laws, few allegations of fraud have been made against governmental issuers of securities, in contrast to the numerous allegations against corporate issuers.

Those frauds occurring in the municipal securities market are found primarily in the activities of "fly-by-night" dealers.

The motives of municipal officials and the absence of opportunities for personal profit from securities frauds provide a marked contrast with the corporate context. Certainly, there are those rare governmental officials who commit fraud or who otherwise benefit from personal dealings with the issuer. Yet, the incidence of such improprieties by corporate officials is much more common. Officials of corporate issuers are relatively unregulated as to their use of issuer or investor funds when compared to municipal officials. Unlike these corporate officials, municipal officials are closely regulated by state and local law in this respect.

Opportunities for personal benefit are further reduced in the municipal securities markets by the relatively small fluctuations in the prices of municipal securities. Municipal securities are debt securities. Even in more unstable circumstances, prices of these securities will fluctuate at a level which is but a fraction of the fluctuations for corporate equity securities. Few dishonest persons are attracted to such a limited source of manipulative profits. And the small price fluctuations furnish additional protections: innocent investors do not unwittingly victimize themselves, for speculation based on rumor or other incomplete information is greatly discouraged.

Neither do municipal officials have motivation to commit fraud on the behalf of the issuers. Transactions of doubtful honesty do not add to any "profits" for a government or to dividends which may be paid to stockholders. Governments are thereby fundamentally different entities from profit corporations, with significant consequences for securities policy.

OPEN GOVERNMENT

Other practical considerations limit municipal officials. The political process is open, with its frequent elections, "sunshine" laws requiring open meetings, and the consuming interest of the news media and the public in governmental affairs. Activities of corporate issuers are conducted on a much more secret

basis. Issuer information, while not in corporate disclosure form, nevertheless is given considerable publicity.

Yet another basis for the exemptions is found in the safety of investment in municipal securities as a class. This safety is much greater than for investment in corporate securities. With the recent obvious examples of New York City and New York State, this statement can no longer be made as an absolute. But it is too easy to assume that issuers as diverse as Houston, Dubuque, Sacramento, or Arlington County, Va., should be subjected to detailed Federal supervision for the sins of New York.

The fact remains that the financial difficulties of municipal issuers are quite unusual, while many corporate issuers experience financial problems on a recurring basis. Municipal defaults, especially in general obligation securities, have been almost nonexistent since the Depression. Corporate defaults are not at all unusual events. This contrast is not surprising. Municipal issuers provide the ultimate safety for their securities through the exercise of their taxing powers. Corporations, however, are much more severely restricted in their ability to increase prices to raise funds.

All comparisons are dramatic. According to John Petersen of MFOA, from 1929 to 1937, approximately $1.35 billion of municipal interest and principal went into default, a little over 7 percent of that outstanding. The corresponding corporate figures are $7 billion and over 30 percent. By 1944, only $100 million of municipal debt remained in default, while $3 billion of corporate debt had not been paid.

Since World War II, almost all defaulted debt has been held by banks in the same locale or state as the issuer. From 1945 through 1974, about $500 million of municipal bonds went into default, or 0.24 percent of municipal debt outstanding at the end of 1974. Prof. George H. Hempel estimates permanent losses of principal and interest from 1945 to 1965 to be less than $10 million, or 1/10,000th of outstanding municipal debt at the beginning of 1965. It cannot be concluded that non-New York municipal investments entail the risks assumed by recent market conditions or many public pronouncements.

INVESTOR PATTERNS

Finally, the investors themselves are of such a character as to vitiate the need for corporate style registration. The tax benefits flowing from municipal investments, the relative illiquidity of these investments in comparison to the ease of transfer of many corporate securities, and the large size of the units in which municipal securities are sold and traded encourage investment by institutions and relatively wealthy investors and discourage investment by the "small," unsophisticated investor. There have always been small investors in the municipal securities market. Today, there are perhaps in absolute terms more of these persons than when the original municipal securities exemptions were enacted. Yet, recent economic studies show that, on a relative basis, these investors have played a decreasing, not an increasing, role in the market.

Again according to Dr. Petersen, from 1960 through 1974, households (wealthy or non-wealthy) decreased the proportion of municipal debt held by them from 43 percent to 29 percent of the total outstanding, while the proportion of corporate equities held has declined from 88 percent to 75 percent and the proportion of corporate bonds held has increased from 12 percent to 19 percent.

Over the 25 years from 1950 through 1974, the percentage of household wealth represented by municipal investments remained steady at 3 percent, and the percentage in corporate equities fluctuated from 31 percent in 1950 to 41 percent in 1960 to 24 percent in 1974. Only about 30 percent of those municipal bonds held by households is estimated to be held by units with less than a 50 percent marginal income tax bracket. Meanwhile, banks increased their holdings of outstanding municipal debt in the 1960–74 period from 25 percent to 49 percent. The municipal market, then, actually became markedly more, not less, institutional in character

REGULATORY PATTERN

All of these considerations were relevant in 1933 and 1934. Nevertheless, Congress did feel that transactions in municipal securities should give rise to liabilities to the extent actually conducted in a fraudulent manner or where

complete disclosure is not forthcoming. Consequently, Section 17 of the Securities Act applies to these transactions.

In 1975, the securities laws were extensively amended with respect to municipal securities transactions. For the first time, Section 10(b), and thereby Rule 10b–5, were made explicitly applicable to issuers. More importantly, Congress ended the exemption of municipal securities dealers from regulation and established the Municipal Securities Rulemaking Board to supervise the regulatory plan, subject to Commission oversight. The pattern is one of dealer self-regulation, for 10 of the 15 Board members must, by law, represent underwriters.

There was a need for dealer regulation stemming from the commission of fraud by a few dishonest firms. However, Congress continued to recognize the importance of maintaining the exemptions for issuers. Consequently, the Board was denied the power to regulate issuers directly or indirectly through disclosure requirements imposed upon underwriters.

A great deal of confusion has resulted. Under the anti-fraud provisions, underwriters have disclosure obligations and must perform due diligence activities. This is part of the problem. One recent case involving exempt securities required due diligence in the extreme, even to the extent of requiring that underwriters see the accountants' work papers. Such impracticality should be remedied by the statement of tests for the anti-fraud provisions based upon reasonableness, not idealism.

Many issuers and underwriters, fearful of these consequences, evidently assume that issuers are not subject to these same provisions because of the applicable exemptions. This is incorrect. In fact the anti-fraud provisions require of issuers disclosures which are quite similar in volume and detail to the disclosures required under the registration provisions of the Securities Act. It is possible that there is no private right of action as there should be, but it cannot be questioned that there are legal obligations upon issuers to make disclosures to investors, and upon underwriters to perform due diligence with respect to those disclosures.

The primary difference from corporate offerings is that there is no prior filing requirement imposed upon issuers. This avoids the Commission review and comment process, with its inherent delay and expense and with the implications that state and local governments are incapable of managing their own affairs with Federal supervision.

COSTS OF FLOTATION

The comparisons of financing costs are particularly important. They indicate potential consequences of excessive regulation. Based upon the latest available information, that for the early 1970s, costs of corporate financings are in almost all instances far in excess of that for municipal issues. Particularly is this true of the smaller offerings. This is reflected in the accompanying table developed by Dr. Petersen from information available from the Commission and the MFOA.

It can be anticipated that these differences will be narrowed as municipal issuers continue their increasing use of the disclosure guidelines and as underwriters further fulfill their due diligence responsibilities. But surely it is unnecessary to go to the corporate limits, pricing small municipal issuers out of the market just as many small corporate issuers are unable to obtain funds due to the prohibitive expenses.

Proposals for the elimination of the various municipal securities exemptions would impose upon issuers a full Securities Act registration process or, in some cases, would subject issuers to regulation by the Rulemaking Board. But the existing exemptions continue to have the same basic importance which has always supported them, and other considerations now also bear relevance: issuers have shown on their own initiative that they are seriously interested in regulating themselves in an efficient and capable manner. In addition, the Board is composed primarily of underwriters and dealers. Of the 15 Board members, 10 are dealers (half commercial bank representatives and half investment bank representatives). Only one Board member must represent issuers.

QUITE INEQUITABLE

The concept of self-regulation is an important and valid one if we must have a totally new regulatory pattern. Regulation of issuers by the Board as now

constituted, however, would not be self-regulation. It would be quite inequitable to subject issuers to regulation by the same private parties who face them across the bargaining table.

Thus, exploration of this first basic premise for any new regulatory pattern gives birth to several new proposals:

(1) Regulation could be accomplished through a reconstituted Board giving issuers and dealers equality of representation. Immediately, objections to such a proposal leap into one's mind; since the Board designs dealer rules, why should issuers have such a strong voice in those determinations?

(2) Regulation could be accomplished through a new Board or other quasi-governmental mechanism providing for issuer self-regulation, just as the existing Board is a self-regulatory body for dealers. Issuers, through their voluntary activities, warrant this trust. Such an entity may or may not be subject to Commission oversight. In all likelihood, the structure for the Rulemaking Board provides an inescapable parallel, so that Commission oversight would result.

(3) Issuers could organize their own self-regulatory structure outside the governmental arena. Such a structure would promulgate rules accepted as industry standards enforceable under Rule 10b–5 and, with Federal funding, could operate a data bank for investor informational purposes.

PASSIVE REGISTRATION

The 2d premise for regulation is that it is not necessary to re-create a corporate review process for municipalities. Various forms of passive registration may then be discussed:

(1) The first is annual filings, such as the present corporate 10-Ks, with information accessible to those investors desiring it. Supplemental information could be filed in those unusual instances where it may become operative for a municipality.

(2) Another approach involves prospectus delivery to investors with filing, but no review or comment, procedures. Whether filing is prior or subsequent to offerings would be irrelevant under the circumstances. The greatest problem here lies in designing satisfactory means for delivering the disclosures to investors at a time relevant to the making of investment judgments, while preserving the competitive bidding system.

There is, then, no dearth of alternatives. It is crucial that each receive careful examination, if we are to change the basic regulatory structure, so that adverse regulatory consequences are minimized.

The preferable pattern for regulating municipal securities transactions is the existing pattern. There is no evidence that structural legislative changes are needed. It is desirable to fine tune the anti-fraud provisions to grant explicit private rights of action, to solve problems of informational delivery, and to override excessive judicial fervor on disclosure and due diligence. There is certainly a need for the various market participants to continue to increase their recognition and fulfillment of responsibilities. But the necessary mechanisms already exist for full enforcement of these obligations by the SEC.

The imposition of a corporate regulatory scheme would add little, if any, real investor protection and would result in greatly increased expenses which must be paid by the taxpayers. This would come at a time when inflation and other factors are increasing the cost of government at an alarming rate. Interestingly, in this case, the taxpayers would pay twice: first for Federal regulatory expenses and secondly for municipal compliance.

If a regulatory plan is deemed necessary, it should be based upon a recognition that many arguments for corporate regulation are inapplicable to municipal issuers. The concepts of self-regulation and passive registration are particularly apt for entities reflecting such a high degree of responsibility. It is important to find ways of obtaining the desirable investor protections while minimizing the regulatory inconvenience and expense. The beneficiaries will be the public citizens in their capacities of investors and taxpayers.

Senator WILLIAMS. You have given us a great deal of helpful observations and we will study and consider how our legislation can reflect the best of your thoughts. I'm sorry we can't get into a

discussion but quite frankly, I have to adjourn and go to another meeting. So thank you very much.

Mrs. DAVIS. You promised me I could make a statement.

Senator WILLIAMS. We will say on the record that you are submitting your statement.

Mrs. DAVIS. I will just read it.

Senator WILLIAMS. Well, I won't be here to hear it.

Mrs. DAVIS. Will they appear as being official?

Senator WILLIAMS. If you will just state for the record, Mrs. Davis, that you're submitting your statement, I will say it will be included in full.

Mrs. DAVIS. I see. In other words, then, it's the same as if I had done it?

Senator WILLIAMS. Exactly.

Mrs. DAVIS. I'll take only 2 minutes. You have been here 4 hours. Are you discriminating against women? You're running for election now. I'm a woman and I'm a minority stockholder. Why don't you stay another minute?

Senator WILLIAMS. Mrs. Davis is submitting her statement for the record and it will be included in full and in the same print as if she had delivered it in person.

Mrs. DAVIS. All right. I accept that.

STATEMENT OF EVELYN Y. DAVIS, EDITOR OF "HIGHLIGHTS AND LOWLIGHTS"

Mrs. DAVIS. As a municipal bondholder who is now stuck in New York City and State securities as well as in some municipals of other States, I urge strongly passage of legislation of full disclosure to the SEC. To allow individual States to issue their individual prospectuses would be tantamount to a further "license to larceny." The New York case has been sufficient to prove to the Senate and the Congress that States cannot be trusted in giving investors full information and that the sentence "first claim to the full taxing power of the city and/or State" is a fraudulent hoax. What is needed is full Federal legislation with uniform standards to apply to all major State and city issuers of municipal securities and with a guarantee that investors would get paid first in case of a municipal bankruptcy and to make the underwriters of such issues fully liable in case investors do not receive their interest and principal on time and to make cities and States make permanent cuts in their payrolls and nonessential services, not just some temporary token cuts as have been made in New York at least until election time. And independent auditors must supply the SEC and the Treasury with figures as to the financial conditions of cities and States, not city and/or State auditors. And in my opinion, the auditors are not giving the Secretary of the Treasury accurate and complete information as to the true financial condition of New York City. Only a bankruptcy will insure complete disclosure and permanent cuts.

As a small stockholder in over 100 corporations, including 11 banks and with my experience in having attended each year most

of those corporations' and banks' annual meetings, the disclosure rules of the SEC have improved over the years due to my prodding and many corporations now voluntarily give investors more information if asked. Municipals should send out each year annual reports to investors, annual reports audited by independent accountants and checked by the SEC. In addition, I strongly urge the holding of annual meetings for bondholders by States and cities to be chaired by State Governors or city mayors depending on the issuer. Should a city or State be in default, then a Federal official should preside over an annual bondholders meeting. Also, municipalities should come under the proxy rules of the SEC with bondholders enabled to make resolutions to be presented to all bondholders. Those who are worried about "unnecessary costs for cities and States" should remember that disclosure is of even more importance for municipals than for corporate issuers because even a one-bond bondholder has to make a minimum investment of $5,000. Investors should also be notified in the uniform prospectuses about the status of welfare, free tuition and other giveaway programs practiced by the city and/or State and comparisons with States and cities which do run balanced budgets ought to be given out each year to investors on request.

And unless we do get disclosure administered by Federal agencies instead of State and/or city agencies, I will urge at stockholder meetings corporations and banks not to buy any municipals. The MAC issues have been bought mostly by banks looking for city and State interest free deposits and by corporations tied through interlocking directorates to those banks. These MAC issues amount to "license fees" for corporations and banks doing business with the City of New York and should be treated by the Internal Revenue Service as illegal political contributions and not be allowed as a legitimate deduction. Neither should the IRS allow a corporation to deduct as salary expense the salary paid to an executive on loan full or part-time to a city or State agency.

While the Williams-Tower bill does not go far enough, nevertheless I am supporting it because it certainly is the first step in the right direction as to fuller disclosure of municipals by a Federal agency. I like to add that the SEC should have public hearings of its own on this subject and not just merely make an administrative investigation and that it should do something for the protection of existing investors, those who were defrauded by the City of New York, the banks, brokerage houses and other underwriters. Aid to New York is not the answer; neither is disclosure by States and municipalities under the supervision of those very same cities and States the answer.

[Whereupon, at 1:50 p.m., the hearing was adjourned.]

APPENDIX

STATEMENT OF THE
AMERICAN BANKERS ASSOCIATION
ON MUNICIPAL SECURITIES DISCLOSURE
SUBMITTED TO THE
SENATE SECURITIES SUBCOMMITTEE

March 30, 1976

The American Bankers Association is a trade association with a membership of some 14,000 banks or about 96% of the banks in the country. Virtually all of these banks buy and hold municipal securities in their own investment portfolio. Approximately 4,000 of these banks exercise fiduciary powers and purchase municipal securities for trusts and other customer fiduciary accounts. Further, banks may underwrite general obligation municipal securities and about 200 banks actively underwrite and make markets in such municipals. Therefore, the association is keenly interested in municipal securities disclosure.

Establishment and adoption of uniform accounting and disclosure standards are needed to assure efficient functioning of the markets for state and local government obligations. At least equally important is the need for clarification of the nature and extent of liabilities of various market participants. Properly designed Federal legislation could serve a constructive role in meeting both of these needs.

Although the recent financial crises of New York City and the New York State Urban Development Authority have imparted a new sense of urgency, the need for improved disclosure has not sprung up overnight. Higher interest rates, increased construction costs, rapid growth of state and local government activity, the

complexity of state and local fiscal systems, and augmented reliance on short-term borrowing have all worked to increase information needs of investors. The growing proportion of municipal securities sold to individual investors, as opposed to institutional lenders, has added to the need for more understandable and uniform accounting and disclosure systems.

The requirements for progress fall into two broad categories: (1) development and articulation of appropriate standards of disclosure, and (2) assuring that these standards are adopted and adhered to on a uniform, nationwide basis, with a clear delineation of legal responsibility for accuracy, timeliness, and completeness.

With respect to the first requirement, substantial progress has been made, notably by the Committee on Government Accounting, the American Institute of Certified Public Accountants, and the Municipal Finance Officers Association. There is, of course, still substantial room for improvement in the specification of appropriate disclosure and the techniques employed to achieve it. But it is not so much lack of workable standards that impedes progress as it is lack of a mechanism to assure that uniform standards are met. It is mainly for this reason that Federal legislation is needed.

Both S. 2574 and S. 2969 propose Federal involvement, but their approaches are very different. S. 2574 would subject state and local government borrowers to Securities and Exchange Commission registration requirements under the statutory framework that now applies to private corporations. The wisdom of this approach is open to serious question because of the different nature of municipal debt instruments and the way they are marketed. The registration process is excessively costly

and cumbersome when considered in relation to the relatively small probability of abuses. Moreover, required registration would impose an extraordinary new workload on the SEC, and would unnecessarily intrude on the delicate relationship of the Federal government to the states and their instrumentalities.

While S. 2969 focuses more directly on the special needs of the municipal securities market, a number of its provisions should be given careful scrutiny. First, S. 2969 lodges responsibility for prescribing disclosure standards in the SEC. Although that agency may well be the appropriate locus of Federal responsibility, it does not have extensive experience in municipal finance. Alternatives should be considered, including creation of a body with special expertise, perhaps related to the Commission in much the same say as is the Municipal Securities Rule-making Board.

Second, although S. 2969 does not require prefilings with SEC, it does, through its amendment of Section 15B(d) (1) of the 1934 act, repeal the prohibition of SEC requirements for filings prior to issue of municipal securities. It is doubtful whether SEC should have power to require pre-filings in the case of municipals, but if it does, the legislation should, at a minimum, specify criteria to be applied by the Commission in making such a determination.

Third, although the disclosure requirements set forth in Section 13A are quite detailed--perhaps unnecessarily so--one specific objective not directly mentioned would seem to merit inclusion. It is that appropriate allowance be made for different standards of disclosure called for by different classes of issues and issuers. This important consideration is stressed in the exposure draft "Disclosure Guidelines for Offerings of

Securuties by State and Local Governments" issued by the Municipal Finance Officers Association in November, 1975.

Fourth, S. 2969 exempts distribution statements that have been approved by a state authority. It does not, however, provide a mechanism for assuring that individual states would adopt uniform disclosure standards for similar types of securities. Failure to require such uniformity could lead to a situation in which investors continue to be confronted with inadequate information upon which to make comparative judgements.

Fifth, S. 2969 does not explicitly deal with the allocation of responsibilities for adequate disclosure. In view of the uncertainty concerning the responsibilities and liabilities of underwriters under the anti-fraud provisions of the 1933 and 1934 Acts, it would be advisable to incorporate in the bill a more concrete delineation of responsibilities for adequate disclosure.

Primary responsibility for accurate, timely and complete disclosure should rest with the issuer. Auditing agencies, whether they be public bodies or priviate firms, should be held to the same standards that apply to work they do in connection with private offerings of securities. The same is true of others who render expert opinions.

In considering the appropriate obligations of underwriters and dealers, it should be kept in mind that the market for municipal debt is very different from that for corporate securities. Most municipal issues must be sold through a competitive bidding process that may involve several underwriters, and a given underwriter may bid on ten or more issues in one week.

It would appear desirable to limit underwriter liability in a way that preserves the workability of the traditional competitive bidding mechanism. Requiring each bidding underwriter to perform the kind of due diligence functions normally performed in connection with negotiated offerings would

be impractical and extremely costly. Not only would underwriter investigations involve costly duplication of effort, but they would entail an intrusion into public affairs that seems both unwarranted and virtually impossible. It is notable that the 1933 Act provides that in the case of registered securities, an underwriter may rely in good faith upon official statements. This is a standard which should definetly be applied to municipal offerings.

Finally, assuming that adequate provisions are made for disclosure standards to be applied on a nationwide basis, it seems sensible to consider delegating to state authorities responsibility for enforcing these standards, provided that such state agencies meet certain minimal tests of competence and independence from other arms of state government.

It seems likely that under such an arrangement most states would choose to set up their own authorities, which would work directly with issuers to assure compliance and would also provide a useful vehicle for communication between the states and their subdivisions and the Federal rulemaking authority. For annual reports, reports of events of default, and distribution statements not cleared by a qualified state agency, some provision for direct enforcement at the Federal level would still be needed. The logical locus of that responsibility would seem to be the Federal rulemaking authority.

SMITH BARNEY, HARRIS UPHAM & CO.
INCORPORATED

1977 MAR 27 PM 2:52

WILLIAM R. GRANT
VICE CHAIRMAN

1345 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10019

March 25, 1976

The Honorable William Proxmire
United States Senate
Washington, D. C. 20510

Dear Bill:

Enclosed is the analysis and recommendations of our Municipal Department with respect to S-2969.

I requested our experts to speak to the issues from the basis of the "real municipal world" and the disclosure requirements needed to make the market-place function more fairly and efficiently. I am certain that there recommendations can be easily converted into the proper legal terminology.

Also enclosed is a copy of our latest economic forecasts. The different sectors looked well balanced with little speculation.

Best regards.

Sincerely,

William R. Grant

WRG:ecm
Encl.

March 15, 1976

MEMORANDUM

TO: William R. Grant

FROM: Allan A. Ryan, III

RE: Williams Bill S-2969

S-2969 is a good start, but in our opinion does not go are enough. The concern is in six areas.

1. Disclosure: This is a complex question. Information requirements will vary depending on whether the security is a specific revenue source, or a general obligation. Legal and statutory requirements may have a profound impact on the ability of an issuer to market and/or service debt. Actions of State or local legislators, the Federal government, and court decisions may also have a dramatic effect on the security. The marketplace itself may dictate whether an issuer is able to raise capital, and the ability of an investor to sell an outstanding obligation.

2. Waiving Disclosure Requirements: A section of 2-2969 specifies the waiving of disclosure requirements if approval for the issuance of debt has been granted by some unspecified, and not necessarily qualified State Agency. No criteria as to adequacy or ability is mentioned. The door is open to circumvention of the proposed legislation.

3. Penalties: The legislation is non-specific as to penalties for either issuers or underwriters other than reference to 11(c) of the Securities Exchange Act of 1934. Antifraud laws, particularly as they apply to public officials is questionable.

4. Availability of Information: The legislation does specify the requirement for annual audited financial statements, and distribution statements applicable to issuers of an established size. It also requires "proper" distribution. Recognizing there are literally hundreds of thousands of existing holders in tax-exempt obligations, and equally vast numbers of potential investors, some centralized location where information would be available appears necessary.

Whether or not disclosure is required by an issuer, unless it is adequately and properly presented to investors it will have been a useless exercise.

5. Legality: Qualifications for the issuance of legal opinions necessary to assure investors that offerings comply with Federal and IRS requirements, and local laws and statutes is not addressed at all. Professionals have a growing awareness and sensitivity to the problem. It is doubtful, however, that the average investor fully understands the implications and importance of qualified bond counsel. There are many excellent firms specializing in this legal area. Offerings, nevertheless, come to market with opinions rendered by firms with little background in the highly specialized field of tax-exempt law. Tax-exempt bonds are often sold with the opinion of the State's Attorney General. This is usually an elected official, who may or may not have any background in tax-exempt law. His opinion is analogous in the financial area to inhouse audits, or feasibility studies versus those of recognized outside experts.

6. Underwriting Practices: This is an area which is technical, complicated, and perhaps not perceived to be within the scope of the proposed legislation. If, however, one of the primary aims of S-2969 is to inform and protect the small investor, the disclosure of basic information should be required by underwriters as well as issuers.

We agree with the basic aims of S-2969. The development of improved and standardized disclosure, and the avoidance of registration and review similar to current corporate requirements are desirable. We also believe self regulation will not work. The market, as a controlling mechanism, only operates in hindsight. Further, the question of disclosure cannot be properly addressed without simultaneously addressing underwriting practices and proceedures.

Our initial recommendations would be:

1. Establish a more comprehensive code of disclosure requirements, standardized as to demographic, financial and tax information, purpose, control and application of bond proceeds; budgetary and auditing procedures; legal and statutory requirements; feasibility and engineering studies; form; and the intervals at which continuing information is to be made available.

   Two sets of standards, one applicable to general obligation credits, the second to revenue bonds should be developed.

2. All material should be filed and available to the public at a centralized location.

3. The time period in which compliance would be required could be staged and perhaps lengthened in areas where examination and reporting by recognized consultants would be mandatory.

4. Acceptance of these procedures would be voluntary. If an issuer elected to conform his liability and that of the underwriter would be within specified limits. If, however, the issuer chose not to conform this would have to be clearly stated on any informational material, whether financial reports, official statements or notices of sale.

5. Offering terms, anticipated underwriting profits, commissions, fees, etc. should be identified. In the case of advance refundings, savings, the amount and when they occur, and any unusual profit and how it arose would also have to be clearly identified. Providing this information would not be elective.

Any fiduciary relationships between issuer and underwriter should be disclosed. These would include financial advisory services performed, whether an underwriter was acting as a trustee or paying agent, dispository relationships, etc.

6. Whether or not conforming to Federal standards all public officials, elected or appointed, and their areas of financial or legal responsibility would be described.

7. No minimum limitation based on outstanding debt or offering size would be stipulated. In other words, smaller issuers who wished to conform would have the opportunity.

8. Criteria regarding the qualifications of State Agency's to authorize the issuance of bonds, and bond counsel to render legal opinions should be established.

We, like everyone concerned with the municipal market, recognize that S-2969 and our own recommendations represent substantial changes to a mechanism which for all its defects has worked. Thousands of issuers annually have access to capital at market rates. A relatively few, in comparison to the total, do not and are in part responsible for the current reevaluation. Equally responsible is the underwriting and investing community who failed to insist on adequate information until it was too late.

Care must be exercised to avoid medicine so strong that the disease and the patient both die. With over 8,000 new issues a year, formal registration with currently available resources is

out of the question. We believe, however, that formalized disclosure requirements, a codeification of professional standards and marketing practices, and the establishment of severe but equitable penalties would be beneficial. Necessary to the long range health of the tax-exempt market is an envirnoment that will attract on one hand competent financial and legal professionals, and on the other, broaden investor participation. To the extent S-2969 will improve professional standards and increase investor confidence it will have a positive effect on the municipal industry.

SMITH HARNEY, HARRIS UPHAM & CO. INC.
ECONOMIC ASSUMPTIONS
March 16, 1976

Table I

	(DOLLARS IN BILLIONS)						(PERCENT CHANGE FROM YEAR EARLIER)					
	73	74	75	76	77	78	73	74	75	76	77	78
GNP	1306.3	1406.9	1498.8	1677.2	1874.2	2058.9	11.5	7.7	6.5	11.9	11.7	9.9
CONSUMER EXPENDITURES	808.5	885.9	963.8	1069.3	1186.9	1294.8	10.3	9.6	8.8	10.9	11.0	9.1
DURABLES	123.0	121.9	128.0	150.7	173.8	190.8	10.5	-0.8	5.0	17.7	15.3	9.8
NON-DURABLES	334.4	375.7	409.8	447.5	489.6	529.0	11.7	12.4	9.1	9.2	9.4	8.1
SERVICES	351.3	388.2	426.0	471.1	523.6	574.9	8.9	10.5	9.7	10.6	11.1	9.8
GROSS PRIVATE DOMESTIC INVESTMENT	220.5	212.3	182.6	230.3	283.9	332.7	17.1	-3.7	-14.0	26.1	23.3	17.2
PRODUCERS DURABLE EQUIPMENT	87.5	93.5	95.8	104.4	119.7	140.6	17.8	6.8	2.5	8.9	14.7	17.5
NON-RESIDENTIAL CONSTRUCTION	49.0	54.4	52.7	55.2	61.7	72.7	15.1	11.1	-3.1	4.7	11.8	17.9
RESIDENTIAL CONSTRUCTION	66.5	54.6	48.8	62.8	75.3	82.8	7.2	-17.9	-10.6	28.8	19.9	10.0
INVENTORY CHANGE	17.5	9.8	-14.6	8.0	27.2	36.5						
NET EXPORTS	7.4	7.8	21.2	15.7	12.2	10.6						
GOVERNMENT PURCHASES OF GOODS & SVCS	270.0	301.1	331.2	361.9	391.1	420.8	6.7	11.5	10.0	9.3	8.1	7.6
FEDERAL	102.0	111.7	123.2	134.9	144.0	152.6	-0.1	9.5	10.3	9.5	6.8	6.0
STATE & LOCAL	168.0	189.4	208.0	227.0	247.1	268.1	11.2	12.8	9.8	9.1	8.9	8.5
GNP(1972 DOLLARS)	1233.4	1210.7	1186.0	1253.3	1327.8	1397.7	5.3	-1.8	-2.0	5.7	6.0	5.3
FIXED NON-RESIDENTIAL INVESTMENT	136.5	147.9	148.5	159.5	181.4	213.3	16.8	8.4	0.4	7.4	13.7	17.6
EXPENDITURES FOR PLANT & EQUIP.	NA	112.2	112.7	120.2	137.0	161.0	NA	NA	0.5	6.6	13.5	17.5
OTHER	NA	35.7	35.8	39.3	44.4	52.3	NA	NA	0.1	9.8	14.0	18.0
PRETAX CORPORATE PROFITS	117.0	132.1	118.4	150.4	183.0	212.0	21.7	12.9	-10.4	27.0	21.7	15.8
AFTER TAX CORPORATE PROFITS	68.8	79.5	72.1	89.3	106.4	123.2	26.0	15.6	-9.3	23.8	19.2	15.7
GNP PRICE DEFLATOR(1972=100)	105.9	116.3	126.3	133.8	141.1	147.3	5.9	9.8	8.7	5.9	5.5	4.4
CPI(1967=100)	133.0	147.7	161.3	171.5	181.0	189.5	6.2	11.1	9.2	6.3	5.6	4.7
NON-FARM OUTPUT/MANHOUR(1967=100)	112.0	109.4	110.5	114.3	118.1	121.9	2.0	-2.4	1.0	3.4	3.4	3.1
COMPENSATION/MANHOUR(1967=100)	149.4	163.7	178.7	193.0	207.8	221.1	7.8	9.5	9.2	8.0	7.7	6.4
PERSONAL INCOME	1054.3	1154.7	1245.9	1375.6	1520.5	1661.0	11.9	9.5	7.9	10.4	10.5	9.2
DISPOSABLE PERSONAL INCOME	903.1	983.6	1076.7	1179.8	1298.9	1412.6	12.7	8.9	9.5	9.6	10.1	8.8
PERSONAL SAVINGS	72.7	74.1	88.9	84.9	83.7	86.7	47.3	1.9	20.1	-4.5	-1.4	3.7
SAVINGS RATE	8.0	7.5	8.2	7.2	6.4	6.1						
FRB INDEX(1967=100)	125.4	124.3	113.4	123.4	133.7	143.8	9.0	-0.9	-8.7	8.8	8.4	7.6
EMPLOYMENT(000,000)	84.4	85.9	84.8	87.1	89.1	91.1	3.4	1.8	-1.4	2.7	2.4	2.2
UNEMPLOYMENT RATE	4.9	5.6	8.5	7.6	6.9	6.4						
FEDERAL GOV. EXPENDITURES -NIA	264.8	300.1	356.9	392.6	422.7	454.6	8.2	13.3	18.9	10.0	7.7	7.5
FEDERAL GOV. RECEIPTS - NIA	257.9	288.4	282.9	329.1	382.9	431.6	13.4	11.8	-1.9	16.3	16.4	12.7
FEDERAL BUDGET SURPLUS(DEFICIT) - NIA	-6.9	-11.7	-74.0	-63.5	-39.8	-23.0						
STATE AND LOCAL EXPENDITURES - NIA	180.9	201.3	222.6	243.9	266.1	289.2	10.5	11.3	10.6	9.6	9.1	8.7
STATE AND LOCAL RECEIPTS - NIA	193.8	209.4	232.4	255.9	279.3	302.3	9.2	8.0	11.0	10.1	9.1	8.3
STATE AND LOCAL SURPLUS(DEFICIT) - NIA	12.9	8.2	9.9	11.9	13.2	13.1						
AUTO SALES(000,000 UNITS)	11.5	8.9	8.7	10.1	11.2	11.5	4.4	-22.7	-2.2	16.4	11.4	2.4
HOUSING STARTS(000,000 UNITS)	2.0	1.3	1.2	1.6	1.8	1.8	-13.4	-34.8	-12.6	33.2	17.7	0.0

Figures as reported through the fourth quarter 1975 (final) except for profits.

TENTATIVE - NOT FOR DISTRIBUTION

SHEARSON HAYDEN STONE INC. TENTATIVE - NOT FOR DISTRIBUTION

ECONOMIC ASSUMPTIONS

March 16, 1976

Table II

	(Dollars in Billions)				(Quarters at Annual Rate)							
	75: 1	75: 2	75: 3	75: 4	76: 1	76: 2	76: 3	76: 4	77: 1	77: 2	77: 3	77: 4
GNP	1433.6	1460.6	1528.5	1572.5	1611.2	1652.1	1696.2	1749.5	1798.4	1847.9	1898.6	1951.8
CONSUMER EXPENDITURES	926.4	950.3	977.4	1001.0	1027.5	1054.5	1082.3	1112.8	1142.9	1173.3	1202.1	1229.5
DURABLES	118.9	123.8	131.8	137.6	143.9	148.2	152.1	158.5	164.9	171.4	176.9	181.9
NON-DURABLES	394.1	404.8	416.4	423.7	431.7	441.9	452.6	463.6	473.9	484.5	495.0	504.8
SERVICES	413.4	421.6	429.2	439.7	451.9	464.4	477.6	490.7	504.2	517.3	530.2	542.8
GROSS PRIVATE DOMESTIC INVESTMENT	168.7	161.4	194.9	205.4	216.0	224.0	234.5	246.7	261.3	275.4	291.6	307.2
PRODUCERS DURABLE EQUIPMENT	94.4	95.0	95.6	98.3	100.1	102.8	105.7	108.9	112.9	117.1	121.9	126.9
NON-RESIDENTIAL CONSTRUCTION	54.9	51.1	51.2	53.6	53.8	54.4	55.6	56.9	58.4	60.3	62.6	65.4
RESIDENTIAL CONSTRUCTION	44.2	45.0	50.4	55.4	58.2	61.3	64.5	67.2	71.2	73.9	76.7	79.5
INVENTORY CHANGE	-24.8	-29.6	-2.1	-2.0	4.0	5.5	8.7	13.7	18.8	24.1	30.4	35.4
NET EXPORTS	17.3	24.2	22.1	21.2	17.3	16.0	15.2	14.5	13.7	12.7	11.7	10.8
GOVERNMENT PURCHASES OF GOODS & SVCS	321.2	324.7	334.1	344.8	350.5	357.5	364.2	375.5	380.4	386.5	393.2	404.4
FEDERAL	119.4	119.2	124.2	129.9	131.0	133.0	134.5	141.0	141.0	142.0	143.5	149.5
STATE & LOCAL	201.9	205.5	209.9	214.8	219.5	224.5	229.7	234.5	239.4	244.5	249.7	254.9
GNP(1972 DOLLARS)	1158.6	1168.1	1201.5	1215.9	1231.4	1244.2	1258.9	1278.4	1297.6	1317.2	1338.0	1358.6
FIXED NON-RESIDENTIAL INVESTMENT	149.3	146.1	146.7	151.9	153.9	157.1	161.3	165.8	171.3	177.4	184.5	192.3
EXPENDITURES FOR PLANT & EQUIP.	114.6	112.5	112.2	111.8	116.2	118.5	121.4	124.6	128.3	132.3	136.8	141.8
OTHER	34.7	33.6	34.5	40.1	40.0	40.6	41.5	42.5	43.7	45.1	46.7	48.5
PRETAX CORPORATE PROFITS	97.1	108.2	129.5	138.8	139.7	146.6	153.5	162.7	168.1	177.9	188.4	197.9
AFTER TAX CORPORATE PROFITS	59.6	66.6	78.8	83.4	83.4	87.5	90.9	95.4	98.1	103.6	109.4	114.7
GNP PRICE DEFLATOR(1972=100)	123.7	125.0	127.2	129.3	130.8	132.8	134.7	136.8	138.6	140.3	141.9	143.7
CPI(1967=100)	157.2	159.6	162.8	165.5	167.6	170.2	172.8	175.3	177.6	179.9	182.2	184.3
NON-FARM OUTPUT/MANHOUR(1967=100)	107.7	109.8	112.3	112.1	113.0	113.8	114.6	115.6	116.6	117.6	118.6	119.6
COMPENSATION/MANHOUR(1967=100)	173.9	176.9	180.6	183.4	187.4	191.1	194.8	198.5	202.7	206.2	209.6	212.9
PERSONAL INCOME	1203.6	1223.8	1261.7	1294.5	1323.8	1356.2	1390.8	1431.6	1464.9	1501.1	1539.2	1578.0
DISPOSABLE PERSONAL INCOME	1024.0	1081.7	1097.1	1114.0	1136.1	1162.2	1193.9	1227.0	1255.8	1293.1	1313.2	1345.4
PERSONAL SAVINGS	73.6	107.5	95.9	88.6	83.4	82.3	85.6	87.7	83.6	82.0	82.8	86.6
SAVINGS RATE	7.2	9.9	7.9	7.9	7.4	7.1	7.2	7.1	6.7	6.4	6.3	6.4
FRB INDEX(1967=100)	111.6	110.4	114.2	117.5	120.2	122.1	124.3	126.9	129.4	132.2	135.1	137.9
EMPLOYMENT(000,000)	84.3	84.4	85.1	85.2	86.3	86.8	87.3	87.8	88.3	88.8	89.4	90.0
UNEMPLOYMENT RATE	8.1	8.7	8.6	8.5	7.7	7.6	7.5	7.4	7.2	7.1	6.9	6.6
FEDERAL GOV. EXPENDITURES - NIA	337.4	352.3	363.8	374.2	380.4	388.0	395.2	406.8	412.0	418.1	424.8	435.8
FEDERAL GOV. RECEIPTS - NIA	283.6	250.1	293.3	304.5	313.2	324.5	332.4	346.3	363.4	376.1	389.3	402.8
FEDERAL BUDGET SURPLUS(DEFICIT) - NIA	-53.7	-102.2	-70.5	-69.6	-67.1	-63.5	-62.8	-60.5	-48.6	-42.0	-35.5	-32.9
STATE AND LOCAL EXPENDITURES - NIA	215.5	219.4	224.8	230.6	235.6	241.2	246.8	252.1	257.6	263.2	268.1	274.6
STATE AND LOCAL RECEIPTS - NIA	221.2	228.2	237.7	242.5	247.5	253.0	258.6	264.4	270.1	276.3	282.3	288.3
STATE AND LOCAL SURPLUS(DEFICIT) - NIA	5.7	8.8	12.9	12.0	11.9	11.8	11.8	12.2	12.5	13.1	13.3	13.7
AUTO SALES(000,000 UNITS)	8.4	9.0	9.2	9.1	9.9	10.0	10.0	10.4	10.8	11.2	11.4	11.5
HOUSING STARTS(000,000 UNITS)	1.0	1.0	1.3	1.4	1.4	1.5	1.6	1.7	1.8	1.8	1.9	1.9

- Figures as reported through the fourth quarter 1975 (final) except for profits.

TENTATIVE - NOT FOR DISTRIBUTION

~~SMITH BARNEY, HARRIS UPHAM & CO., INC.~~

ECONOMIC ASSUMPTIONS
March 16, 1976

TENTATIVE-NOT FOR DISTRIBUTION

Table III

(PERCENT CHANGE FROM PRIOR QUARTER AT ANNUAL RATE)

	75: 1	75: 2	75: 3	75: 4	76: 1	76: 2	76: 3	76: 4	77: 1	77: 2	77: 3	77: 4
GNP	-2.1	7.7	19.9	12.0	10.2	10.5	11.1	13.2	11.7	11.5	11.4	11.7
CONSUMER EXPENDITURES	3.2	10.7	11.9	10.0	11.0	11.0	11.0	11.7	11.3	11.0	10.2	9.4
DURABLES	5.6	17.5	28.5	14.9	19.7	12.4	11.0	17.9	17.0	16.8	15.6	11.6
NON-DURABLES	7.4	11.3	12.0	7.2	7.7	9.9	10.0	10.0	9.2	9.3	8.9	8.1
SERVICES	9.6	8.2	7.4	10.2	11.5	11.6	11.8	11.5	11.5	10.8	10.3	9.9
GROSS PRIVATE DOMESTIC INVESTMENT	-58.6	-16.2	112.6	23.4	22.3	15.6	20.2	22.3	26.0	23.3	25.7	23.2
PRODUCERS DURABLE EQUIPMENT	-2.5	2.6	2.6	11.8	7.3	11.3	11.9	12.7	15.4	16.0	17.2	17.7
NON-RESIDENTIAL CONSTRUCTION	-8.3	-24.9	0.8	20.1	1.8	3.9	9.7	9.7	11.0	13.3	16.6	18.7
RESIDENTIAL CONSTRUCTION	-32.1	7.4	57.4	46.0	21.4	23.6	22.7	17.2	26.5	16.0	15.7	15.6
INVENTORY CHANGE												
NET EXPORTS												
GOVERNMENT PURCHASES OF GOODS & SVCS	8.9	4.4	12.1	13.4	6.7	8.3	7.7	13.0	5.4	6.6	7.1	11.8
FEDERAL	4.1	-0.7	17.9	19.7	3.4	6.2	4.6	20.8	3.0	2.9	4.3	17.8
STATE & LOCAL	11.9	7.3	8.8	9.7	9.0	9.5	9.5	8.6	8.7	9.8	8.8	8.5
GNP(1972 DOLLARS)	-9.2	3.3	11.9	4.9	5.2	4.2	4.8	6.3	6.1	6.2	6.5	6.3
FIXED NON-RESIDENTIAL INVESTMENT	-4.7	-8.3	1.7	15.0	5.3	8.7	11.2	11.6	13.8	15.0	17.0	18.0
EXPENDITURES FOR PLANT & EQUIP.	-5.6	-7.2	-1.1	-1.3	16.7	8.1	10.2	10.7	12.4	13.2	14.5	15.3
OTHER	-1.7	-12.0	11.1	81.7	-1.0	6.5	9.0	9.6	11.9	13.2	15.3	16.4
PRETAX CORPORATE PROFITS	-62.3	54.2	105.2	32.0	-0.2	24.7	20.2	26.3	13.8	25.5	25.7	21.7
AFTER TAX CORPORATE PROFITS	-59.5	55.9	96.0	25.7	-0.1	21.0	16.4	21.7	11.9	24.0	24.3	20.9
GNP PRICE DEFLATOR(1972=100)	7.8	4.3	7.1	6.8	4.8	6.0	6.0	6.4	5.2	4.9	4.7	5.1
CPI(1967=100)	8.3	6.2	8.4	6.6	5.3	6.4	6.3	5.8	5.4	5.4	5.1	4.8
NON-FARM OUTPUT/MANHOUR(1967=100)	-1.1	8.0	9.4	-0.7	3.3	2.9	2.8	3.5	3.5	3.5	3.4	3.4
COMPENSATION/MANHOUR(1967=100)	9.0	6.8	8.9	6.3	9.0	9.1	8.0	7.9	8.6	7.2	6.8	6.5
PERSONAL INCOME	3.0	6.9	13.0	10.8	9.4	10.1	11.6	12.2	9.6	10.3	10.3	10.8
DISPOSABLE PERSONAL INCOME	3.2	24.5	2.0	10.3	8.2	9.5	11.3	11.6	9.0	9.7	9.7	10.2
PERSONAL SAVINGS	-39.9	355.1	-59.2	13.2	-20.1	-6.6	16.9	10.2	-17.3	-7.9	2.6	21.7
SAVINGS RATE												
FRB INDEX(1967=100)	-28.3	-4.5	14.6	12.2	9.5	6.3	7.4	8.7	9.1	9.1	9.1	8.5
EMPLOYMENT(000,000)	-5.6	0.6	3.3	0.5	5.1	2.4	2.2	2.4	2.3	2.5	2.4	2.9
UNEMPLOYMENT RATE												
FEDERAL GOV. EXPENDITURES - NIA	25.8	18.9	13.7	11.9	6.8	8.3	7.6	12.3	5.2	6.1	6.6	10.7
FEDERAL GOV. RECEIPTS - NIA	-12.3	-39.5	89.1	16.2	11.9	15.2	13.1	17.8	21.3	14.7	14.9	14.6
FEDERAL BUDGET SURPLUS(DEFICIT) - NIA												
STATE AND LOCAL EXPENDITURES - NIA	13.0	7.4	10.2	10.7	9.0	9.7	9.7	8.9	9.0	9.0	9.0	8.7
STATE AND LOCAL RECEIPTS - NIA	12.3	13.3	17.7	8.4	8.4	9.2	9.1	9.3	9.0	9.5	9.9	9.8
STATE AND LOCAL SURPLUS(DEFICIT) - NIA												
AUTO SALES(000,000 UNITS)	89.3	-17.8	77.8	-4.3	40.1	4.1	0.0	17.0	16.3	15.7	7.3	3.6
HOUSING STARTS(000,000 UNITS)	-15.2	30.6	107.1	39.6	9.8	31.4	29.5	27.4	12.3	11.9	11.6	11.3

Figures as reported through the fourth quarter 1975 (final) except for profits.

TENTATIVE-NOT FOR DISTRIBUTION

SMITH BARNEY, HARRIS UPHAM & CO. INC.
ECONOMIC ASSUMPTIONS
March 16, 1976

TENTATIVE-NOT FOR DISTRIBUTION

Table IV

	(PERCENT CHANGE FROM YEAR EARLIER)											
	75: 1	75: 2	75: 3	75: 4	76: 1	76: 2	76: 3	76: 4	77: 1	77: 2	77: 3	77: 4
GNP	4.6	5.0	7.3	9.1	12.4	13.1	11.0	11.3	11.6	11.9	11.9	11.6
CONSUMER EXPENDITURES	9.1	8.3	7.7	10.2	10.9	11.0	10.7	11.2	11.2	11.3	11.1	10.5
DURABLES	0.4	0.6	2.2	17.3	21.0	19.7	15.4	15.2	14.5	15.7	16.3	14.7
NON-DURABLES	9.5	8.8	8.5	9.5	9.5	9.2	8.7	9.4	9.8	9.6	9.4	8.9
SERVICES	11.4	10.1	9.7	8.8	9.3	10.2	11.3	11.6	11.6	11.4	11.0	10.6
GROSS PRIVATE DOMESTIC INVESTMENT	-22.8	-24.1	-6.1	-2.3	28.0	38.8	20.3	20.1	21.0	23.0	24.3	24.5
PRODUCERS DURABLE EQUIPMENT	2.1	2.8	1.6	3.5	6.0	8.2	10.6	10.8	12.8	14.0	15.3	16.6
NON-RESIDENTIAL CONSTRUCTION	2.8	-5.5	-5.2	-4.5	-1.9	6.4	8.6	6.2	8.5	10.9	12.6	14.8
RESIDENTIAL CONSTRUCTION	-23.3	-20.9	-9.4	13.8	31.6	36.3	28.1	21.2	22.5	20.5	18.8	18.4
INVENTORY CHANGE												
NET EXPORTS												
GOVERNMENT PURCHASES OF GOODS & SVCS	11.7	9.5	9.2	9.7	9.1	10.1	9.0	8.9	8.6	8.1	8.0	7.7
FEDERAL	12.5	9.5	9.3	9.9	9.7	11.6	8.3	8.5	7.6	6.9	6.7	6.0
STATE & LOCAL	11.3	9.5	9.2	9.4	8.7	9.3	9.4	9.2	9.1	8.9	8.7	8.7
GNP(1972 DOLLARS)	-5.7	-4.0	-0.7	2.5	6.3	6.5	4.8	5.1	5.4	5.9	6.3	6.3
FIXED NON-RESIDENTIAL INVESTMENT	2.3	-0.3	-0.9	0.5	3.1	7.5	10.0	9.2	11.3	12.9	14.4	16.0
EXPENDITURES FOR PLANT & EQUIP.	6.8	1.0	-1.6	-3.8	1.4	5.4	9.3	11.4	10.4	11.6	12.7	13.8
OTHER	-10.1	-4.4	1.3	15.0	15.2	20.8	20.2	5.9	9.2	10.9	12.4	14.2
PRETAX CORPORATE PROFITS	-24.3	-16.5	-11.7	12.0	42.9	35.5	18.5	17.2	21.1	21.3	22.7	21.6
AFTER TAX CORPORATE PROFITS	-24.5	-13.6	-9.8	11.7	38.9	31.3	15.3	14.4	17.7	18.4	20.3	20.2
GNP PRICE DEFLATOR(1972=100)	10.9	9.4	8.1	6.5	5.7	6.2	5.9	5.8	5.9	5.7	5.3	5.0
CPI(1967=100)	11.0	9.7	8.7	7.4	6.6	6.7	6.1	5.9	6.0	5.7	5.4	5.2
NON-FARM OUTPUT/MANHOUR(1967=100)	-2.7	0.1	3.0	3.8	4.9	3.6	2.0	3.1	3.2	3.3	3.5	3.5
COMPENSATION/MANHOUR(1967=100)	10.8	9.5	9.9	7.8	7.9	8.1	7.9	8.3	8.1	7.9	7.6	7.2
PERSONAL INCOME	7.9	7.7	7.7	8.3	10.0	10.8	10.2	10.6	10.7	10.7	10.6	10.2
DISPOSABLE PERSONAL INCOME	7.4	11.7	9.1	9.7	10.9	7.4	9.8	10.1	10.4	10.4	10.0	9.6
PERSONAL SAVINGS	9.4	60.9	33.0	6.0	13.8	-23.4	-0.3	-1.0	-0.1	-0.5	-3.7	-1.2
SAVINGS RATE												
FRB INDEX(1967=100)	-10.6	-12.0	-9.0	-3.1	7.7	10.6	9.8	8.0	7.6	8.3	8.7	8.7
EMPLOYMENT(000,000)	-1.9	-1.9	-1.2	-0.3	2.4	2.8	2.5	3.0	2.3	2.3	2.4	2.5
UNEMPLOYMENT RATE												
FEDERAL GOV. EXPENDITURES - NIA	20.0	20.0	18.4	17.5	12.7	10.1	8.6	8.7	8.3	7.8	7.5	7.1
FEDERAL GOV. RECEIPTS - NIA	2.9	-12.4	-2.0	3.9	10.4	29.7	13.3	13.7	16.0	15.9	17.1	16.3
FEDERAL BUDGET SURPLUS(DEFICIT) - NIA												
STATE AND LOCAL EXPENDITURES - NIA	11.9	10.2	9.9	10.3	9.3	9.9	9.8	9.3	9.3	9.1	9.0	8.9
STATE AND LOCAL RECEIPTS - NIA	9.6	10.1	11.3	12.9	11.9	10.9	8.8	9.0	9.1	9.2	9.2	9.1
STATE AND LOCAL SURPLUS(DEFICIT) - NIA												
AUTO SALES(000,000 UNITS)	-10.4	-12.5	-6.4	27.6	18.3	25.5	8.7	14.3	9.1	12.0	14.0	10.6
HOUSING STARTS(000,000 UNITS)	-38.5	-30.3	4.4	33.7	42.7	43.0	27.2	24.3	25.0	21.0	15.6	11.8

Figures as reported through the fourth quarter 1975 final) except for profits.

Thomas F. Mitchell
100 Bush Street, Penthouse
San Francisco, California 94104

February 18, 1976

Mr. Howard Menell
Senate Banking Committee
New Senate Office Building, Rm. 5300
Washington, D.C. 20510

Dear Howard:

Thank you for your recent invitation to offer comments for possible consideration by the Senate Banking Committee in its deliberations on the Eagleton bill. I have taken the liberty of inviting members of my firm who have far more experience and knowledge of industry practice than I to submit comments of their own, particularly where their views differ from mine. I hope that my having done so will prove helpful to you and to members of the Committee.

Let me begin with a full disclosure statement of my own. I am an inactive member of the District of Columbia Bar. I was introduced to municipal finance through a 15-month association with the Center for Capital Market Research at the University of Oregon. Since July, 1975 I have been employed by an independent municipal financing consulting firm. My remarks represent my personal views, not necessarily those of the firm. I trust that my mentioning these facts will assist you in evaluating these remarks.

POSSIBLE SOURCES OF DISCLOSURE STANDARDS

Federal - The Eagleton bill, S. 2574, would remove state and local government obligations from the list of securities exempted from the registration requirements of the Securities Act of 1933. It is but one of a number of proposals regarding standards of disclosure in the offer and sale of municipal securities. The Municipal Securities Rulemaking Board, established pursuant to the 1975 amendments to the Securities Exchange Act, will soon promulgate standards of disclosure for underwriters and others involved in the offer, sale, and distribution of municipal securities. However, the Board is prohibited by law from requiring disclosure by municipal issuers themselves. The U.S. Treasury has recently proposed that a system of mandatory uniform accounting standards be developed and applied to municipal issuers. The Kennedy-Reuss bill creating a taxable bond option includes an advisory agency which, presumably, could develop suggested disclosure guidelines.

State - At the state level, standards of disclosure might be developed by municipal debt advisory commissions or possibly through legislation requiring certification by a competent state agency. In most states, however, new legislation would be required to create such agencies and to confer the requisite authority. With a very few exceptions, supervision of state and local issues by official state agencies does not now exist.

Other - Finally, there are privately-developed standards of disclosure for municipal issuers. These may be developed by industry organizations such as the Municipal Finance Officers Association, or they may be developed by individual banks, underwriters and dealers, bond rating agencies, bond counsel, and financial advisors.

THE DISCLOSURE PROBLEM

Because the concept of "materiality" is so imprecise, and because there does not yet exist an authoritative system of disclosure standards, there presently exists in the municipal bond market confusion amounting almost to chaos. The exchange of ideas and information within the financial community is just beginning. In the absence of a consensus or of authoritative criteria regarding disclosure, each party seeks to learn for itself what it deems necessary to avoid potential liability for failure to disclose or to state correctly all material facts. The tendency is to demand a very great quantity of information, often with little thought given to the materiality of what has been demanded. Although such information may not be readily available and may be generated only at substantial cost to the issuer, the issuer is often forced to comply as a practical matter to insure receiving a bid for its securities. And, recent experience shows that even a massive prospectus or official statement does not guarantee a bid. The present uncertainty regarding disclosure is clearly unsatisfactory both for issuers and for the prospective purchasers of their obligations.

THE NEED FOR FULL DISCLOSURE

This is not to suggest that greater disclosure by municipal issuers is undesirable. On the contrary, I believe that more, rather than less, disclosure will aid issuers as well as prospective investors. I favor greater disclosure for two reasons: first, to prevent abuses, and second, to enhance the economic efficiency of the market for municipal securities. On the whole, there has not occurred in the municipal bond market anything like the abuses which prompted passage of the federal securities laws in the 1930's. Nevertheless, it is possible that the

69-141 O - 76 - 23

conduct of some municipal issuers has amounted to violation of the anti-fraud provisions of the federal securities laws. I believe that a system of disclosure, if carefully designed to weigh the cost of generating the information desired against the materiality of such information, will effectively reduce the opportunity for abuse. However, a far more important function of disclosure by municipal issuers is, in my opinion, the providing of information to the financial community. History may record that the real significance of the federal securities laws lies not in the protection which they afford against abuse, but rather in the information which they generate. An impressive array of academic literature suggests that the capital market for corporate securities is remarkably efficient, that it adjusts quickly and correctly to new information, and that it efficiently allocates capital among competing users.

Economic Inefficiency of the Municipal Securities Market - The market for municipal securities, on the other hand, is economically inefficient. It has a vast number of issuers, each acting subject to a bewildering variety of legislation both among the states and within each state. Laws governing ancillary matters such as authorization by the electorate, debt or tax limits, or service charges on revenue projects, vary widely. Accounting requirements and practices are diverse. While certain prospective purchasers of municipal securities, especially local banks, are often very well informed about the merits of local issues, such information is usually proprietary and is not shared with others in the financial community. On the whole, the information base in the municipal securities market is therefore often limited and shallow. Where information is not readily available, the number of bidders is likely to be less than it could be, and the spreads demanded by those who do bid are likely to be greater. In this direct sense, the lack of information in the municipal securities market is costly to municipal issuers.

The lack of generally available information also encourages inefficient allocation of capital. A soundly financed and administered issuer may have to pay more in interest to sell its obligations than it would if more were known, or more widely known, about it. At the same time, a more poorly financed or administered issuer may sell at a lower interest cost than it should, thus being deprived of the warning signal which an efficient market imposes in the form of higher than normal interest rates. In any event, I do firmly believe that the market for municipal securities is relatively economically inefficient. Although I have no idea of the annual cost of such inefficiency, I would suppose it to be quite large. I believe that a well administered system which encourages disclosure would reduce this cost.

Two Preliminary Questions - However, even if more disclosure be conceded as a worthy goal, two questions must be faced at the outset. The first is

whether there ought to be some form of exemption or short-form procedure for small issues. In one sense, a municipality offering a small issue ought to have to disclose the same kind of information as another offering a larger issue. There is first the matter of satisfying the antifraud provisions. Secondly, the argument that better information reduces interest costs and enhances the market's allocational efficiency applies with equal force to large and small issues. On the other hand, information is costly to gather, to edit, and to present. The cost of disclosure may at some point outweigh its value for a small issue. Moreover, regardless of the amount and quality of disclosure, small issues may appeal only to that segment of the market -- local banks or underwriters -- which is already adequately informed. It simply may not be cost effective to require the same standard of disclosure for all issues. The same observations would seem to hold equally true for small issuers, with an added comment. Imposing a uniform standard of disclosure regardless of the size of issue or issuer may encourage the states to form municipal bond banks. But however much a bond bank may reduce an issuer's costs of complying with disclosure standards, it may prove inefficient in other respects, such as timely allocation of funds.

A second question attending the disclosure concept is that of determining to whom the disclosure statement should be addressed. A prospectus or official statement adequate for sophisticated individual or institutional investors is one thing; one which will adequately inform an inexperienced individual citizen is quite another. I think some consideration should be given to the likely composition of purchasers of municipal securities in the years to come. In particular, the taxable bond option, should it become law with a high subsidy rate, may result in a municipal securities market dominated once again by sophisticated individual and institutional investors.

WHO SHOULD ADMINISTER THE DISCLOSURE SYSTEM?

The SEC. - As I indicated previously, I do favor a system of disclosure for issuers of municipal securities. The more I consider the question, the more I believe that the Securities and Exchange Commission should be the agency to develop and administer any such system. The present procedure governing registration of corporate issues -- under which the issuer files a registration statement which becomes effective after a given period unless the SEC interposes an objection and requires amendment, or issues a stop order, or accelerates the effective date -- can readily be adapted to the offer and sale of municipal issues. Of course, a new disclosure Schedule would have to be developed, perhaps more along the lines of present Schedule B (applicable to issues of foreign governments) than Schedule A (governing corporate issues). Moreover, any

registration procedure developed for municipal issues must take account of the widespread and salutary practice of competitive bidding, which has been shown to reduce interest costs to municipal issuers. Information about actual coupon rates and attendant debt service schedules, reoffering yields, and the underwriting syndicate must obviously await acceptance of a bid. I am sure that the SEC can devise a reasonable and effective pre- and post-award procedure. I express no opinion as to the propriety of requiring continual reporting, which might require amendment of the Securities Exchange Act. Perhaps such reporting could be made optional, or perhaps it could be made into a means of expediting subsequent registrations for issuers coming frequently to the market.

The SEC is the single governmental agency having substantial knowledge of the kind and quality of information which issuers must disclose in order to avoid liability under the antifraud provisions of the securities laws. It is thus uniquely equipped to devise authoritative standards and to end the confusion which presently characterizes the market for municipal securities. Moreover, there is no question of the SEC being "dominated" by one or the other segment of the market. In framing its disclosure rules, it is completely free to seek advice from all interested parties potentially affected by its actions. Although it would take some time for the SEC to decide what disclosure is appropriate for municipal issuers and then to act accordingly, I believe that SEC jurisdiction could ultimately prove an efficient and effective solution to the disclosure problem. As it is now, issuers are being overwhelmed by requests from prospective purchasers. There is no consensus as to what should be disclosed, and there is a definite tendency to "overkill" the problem. Issuers in effect try to satisfy all prospective bidders so as to assure their receiving a bid. And, there is often no guarantee that the information which the bidders have requested is in fact material. In sum, I view the SEC as the agency best able to bring order out of the present chaos and to develop the efficient flow of information which should prove so beneficial to issuers in the long run.

The Municipal Securities Rulemaking Board - Other agencies are, in my opinion, not as well equipped as the SEC to deal with the disclosure problem. The Municipal Securities Rulemaking Board is prohibited by law from requiring disclosure by issuers "directly or indirectly." In practice, this prohibition is ineffective, because underwriters will demand information from issuers before they will offer bids. The board can at least systematize or standardize the kinds of information demanded of "persons other than issuers," but there is no guarantee that underwriters and other prospective bidders will limit their demands on issuers to what has been required by the board. Even if this were the case, or even if the Tower Amendment were repealed by Congress so that the board could reach municipal issuers directly, issuers might feel uncomfortable with any system of disclosure developed by the board because of its composition. I certainly do not wish to impugn the impartiality or qualifications of the members of the board or its staff. I merely wish to state

that some issuers feel that the present composition of the board renders it "unrepresentative." Repealing the Tower Amendment and changing the composition of the board may well prove necessary to deal with objections of this kind. Whether or not there is agreement that a federally administered system of disclosure for municipal securities is desirable, Congress must in any event do some hard thinking about the jurisdiction, composition, and functions of the board.

Other Agencies - The Treasury's concern with disclosure by municipal issuers has thus far been limited to development of uniform accounting standards. Accounting is by far the most important aspect of disclosure, but it is not the only one. The Treasury cannot offer the overall expertise as to disclosure and protection against securities fraud that the SEC can.

Regulation of the kind proposed at the state level - either through debt advisory commissions or through an audit/certification process - could result in a wide variation in the quality and extent of disclosure. While regulation on a state-by-state basis would presumably reduce the possibility of fraud or other abuse, it is not likely to create a standard body of information. Markets within states might become more efficient, but not the market among the states.

Voluntary standards of disclosure lack authority and thus may not be followed by all segments of the market. What will be disclosed may depend from time to time upon whether there exists a buyers' or a sellers' market, and, in any event, the quality of information furnished may suffer from lack of an authoritative interpretation as to what information is material. The present unsatisfactory state of affairs might well continue indefinitely. One might expect any developing consensus among issuers and underwriters to be disrupted periodically as each new 10b-5 ruling appears.

GENERAL OBSERVATIONS REGARDING DISCLOSURE

For all of these reasons, I believe that, if the desirability of a uniform system of disclosure for municipal securities be conceded, the SEC is the preferred agency to administer the system, and that it can do so satisfactorily by adapting registration procedures to the requirements and practices of the municipal securities market. But there are some general observations which ought to be made concerning disclosure by municipal issuers.

First, state and local governments must borrow to discharge essential governmental functions. Therefore, any administrative system of disclosure

should be designed to keep time and expense as low as possible consistent with satisfaction of antifraud requirements. Every effort should be made to keep the disclosure cost effective. An administrative quagmire is the last thing municipal issuers need. A second observation, related to the first, is that multiplication of regulatory agencies, particularly at the federal level, should be assiduously avoided. This is especially important given the number and diversity of proposals for ensuring adequate disclosure which have been made in recent months. Third, any system of disclosure should preserve the right of the issuer to obtain independent legal and financial advice. Banks, underwriters, and other prospective purchasers are typically very well advised. Care should be taken to insure that issuers are similarly well advised.

Finally, disclosure requirements should be designed with an eye towards the availability of information. In theory, of course, what is material is material, regardless of whether or not it is readily available. Accounting data are extremely important in evaluating the ability of a municipal issuer to make good its obligations. Other information, while useful, may not be quite so important and may not now be stored in readily accessible form. To cite an example, a special district may have its taxes collected for it by the county. Although it knows its aggregate receipts, it may not know exactly how much each of its ten largest taxpayers paid, or even who they are. To find out, the special district may have to examine thousands of entries on the county's tax rolls. I believe that the SEC or any other agency establishing and enforcing disclosure requirements must first ascertain what information is absolutely essential. With respect to information which is desirable but not essential, the regulatory agency might want to ascertain the form in which such information is usually kept and the manner in which it is to be displayed. If the two are not compatible, it may be possible to require disclosure of such information on a prospective basis only, so that data collection and storage systems could be changed to facilitate future disclosure without a costly examination of past data which are inadequately or inconveniently stored. Long and serious study of this kind will be required to avoid excessive cost to issuers.

CONCLUSION

This concludes my remarks about the Eagleton bill. In summary, I question whether there is any reason to continue to exempt sales of securities aggregating over $20 billion annually from the normal administrative framework governing the offer and sale of securities. I therefore favor the idea of SEC regulation of state and local government securities through the registration process, subject to the qualification that every effort be made to make the registration process as efficient and cost effective

as possible. Such a course of action would not impose on the prerogatives of state and local governments. On the contrary, by reducing the possibility of abuse and by improving the quality and broadening the quantity and availability of material information, disclosure under the aegis of the SEC could substantially enhance the economic efficiency of the market for municipal securities. Greater efficiency in the capital market is decidedly in the national interest. The basis of federal action would, of course, be the power to regulate the use of the mails and the means and instrumentalities of interstate commerce. Problems of sovereign immunity could be dealt with, if desired, by conditioning sale of municipal securities in interstate commerce upon consent to suit in case of alleged securities acts violations.

Thank you again for extending me the opportunity to comment on the Eagleton bill and on the broader question of disclosure for municipal securities. I hope that my remarks may be of some use to you and to members of the Committee. Please feel free to make use of as much or as little of this letter as you care to. I would, of course, be very happy to discuss further with you any ideas or opinions set forth in this letter or to consider any issues which I have omitted.

Yours very truly,

Thomas F. Mitchell

Thomas F. Mitchell

TFM:skt

An association of the municipal bond dealers of Texas

MUNICIPAL ADVISORY COUNCIL of TEXAS
Texas State Bank Building
AUSTIN 78701
512 476-6947

W. E. TINSLEY, Executive Director
CECIL M. PARRISH, Asst. Exec. Director

February 2, 1976

Mr. Howard Menell
Senate Banking Committee
Room 5300 New Senate Office Bldg
Washington, D.C. 20510

Dear Mr. Menell:

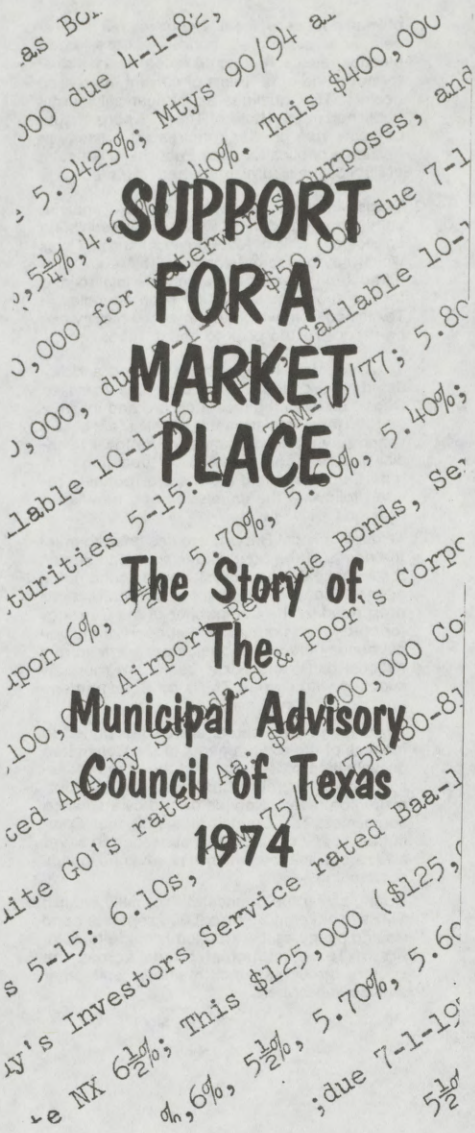
In keeping with our telephone conversation, I am enclosing a leaflet descriptive of the activities of this Council. I appreciated the opportunity to visit with you about the matter of registration of Municipal Securities and plan to file a written statement with you sometime by the first week in March.

Sincerely yours,

Executive Director

WET/ds

Enclosures: 24 copies - "Support For A Market Place"



CONCERNING THE COUNCIL

The Council is chartered as a trade association of dealers in Texas municipal securities. It is a non-profit organization dedicated to the betterment of that market place where approximately $1-1/2 billion of capital from the investor community is annually made available to state and local government in Texas for financing public improvements.

The Council has been operating continuously since January, 1955. It maintains offices in Austin, the seat of State government, where it employs a staff of twenty persons in the operation of a program which requires a $300,000 annual budget. This undertaking is supported entirely by the dealers in Texas municipal securities who comprise the Council's membership.

THOSE IN THE MARKET PLACE

The market place which the Council serves is made up of three separate communities:

1. **The Community of Borrowers**—the 3,000 agencies of state and local government in Texas that accomplish capital borrowing by the issuance of "municipal" bonds;

2. **The Community of Lenders**—the investors of the nation: the banks, insurance companies, trust funds, individuals and others who are the owners of the $9 billion of Texas municipal bonds now outstanding and who are the source of the $1-1/2 billion capital required annually by state and local government in Texas;

3. **The Community of Municipal Securities Dealers**—the hundred-odd firms, including the largest banks of the State and the Nation, who comprise the Council's membership and who originate, underwrite, distribute and maintain a market for the bonds issued by state and local government in Texas.

These are the major groups which are directly involved in the market place served by the Council. Several subgroups which are essential to its efficient operation are also served by the Council. Numbered among these are the municipal bond attorneys and the national bond rating agencies as well as several agencies of state and federal government which have examinatory jurisdiction over investment portfolios of banks and insurance companies.

THE SUPPORT PROVIDED

To meet the needs of a market place whose participants have such a diversity of interest, the Council is required to have a many-faceted program. Its principal functions can be categorized, however, into three broad areas of activity:

1. **Financial Publications.** Seventy-five percent of the Council's budget is devoted to keeping the investor and bond dealer groups supplied with current financial information on each individual bond issuing agency in the State as well as continuously providing data in a broad interpretation of the Texas municipal bond scene.

2. **Governmental Agency Liaison.** Financial and statistical data which explain needs and procedures in the area of capital financing by state and local government are supplied to the executive and legislative branches of state government and their numerous administrative agencies. Liaison is also maintained with the numerous state-wide associations of public officials to provide a better understanding of factors bearing on the market acceptance of their bonds.

3. **Security Industry Betterment.** Part of the Council's program is devoted to maintenance of the high standards of business and ethical conduct which protect both the investor and borrower communities and which enhance the image of the municipal securities dealer.

FINANCIAL PUBLICATIONS—THE MAJOR SUPPORT

Current and reliable information is the life's blood of any securities market. The claim has been made that there is no other system in the Nation, whether privately or publicly operated, which approaches that of the Municipal Advisory Council of Texas in the comprehensiveness and timeliness of its coverage of the Texas municipal bond scene with the publications below described.

1. **Texas Bond Reporter**—a weekly magazine devoted to items of current interest to the dealer in Texas municipal securities. TBR has a nation-wide circulation and is mailed from Austin on Friday by First Class Mail. A regular feature is the Calendar of Scheduled Bond Sales, and its other sections give coverage to official notices of sale, bonds called for redemption, scheduled bond elections, bond election results, reports on recent sales, industry news and other items of current interest to dealers. TBR qualifies as a "financial journal published in the State of Texas" where statute or home rule charter requires advertisement in such a publication, and Publisher's Affidavit of Publication is furnished where required.

2. **Texas Municipal Reports**—a series of individually-prepared financial analyses for each state agency and unit of local government in Texas which has bonds outstanding. These are prepared from credit files which are maintained for the approximately 3,000 such agencies in Texas and from which the financial history can be reconstructed back to about 1935.

   Texas Municipal Reports are revised and updated on a schedule which produces a revised Report on even the most obscure and inactive unit of local government at least each two years. Any material change in the local financial picture is the occasion for updating of a report, however, and reports are routinely revised following the emmission of a new issue of bonds.

   Texas Municipal Reports are designed to meet the needs of the bondholder, the bond dealer, the municipal bond analyst, and the bond rating agency. They meet all of the requirements prescribed by the Comptroller of the Currency for credit file information in support of municipal bonds held in the investment portfolio of a national bank, and Texas banks are routinely supplied with current TMRs by Council member dealers at no cost.

   Texas Municipal Reports are also designed to meet all of the requirements of the Committee on Valuation of Securities of the National Association of Insurance Commissioners for information on revenue bonds owned by insurance companies. The Council files with that Committee a copy of each TMR published to cover an issuing agency which has revenue bonds outstanding.

   During a year the Council will normally publish TMRs to cover more than 2,000 separate bond issuing agencies. Distribution is made to holders of Texas municipal bonds across the country through Council members and other eligible subscribers.

3. **MAC Special Reports**—a series of intermittently-prepared studies of subjects which are not well adapted to coverage in Texas Bond Reporter or Texas Municipal Reports. The annual compilation of assessed valuations and tax rates of all taxing jurisdictions in Texas is typical of the subject matter covered in MAC Special Reports.

4. **MAC Legislative Report**—a weekly publication which is produced during sessions of the Texas Legislature to keep the municipal bond dealer community informed on legislative matters falling within its scope of interest. At the close of the session, a digest is published to explain briefly all laws enacted which are of interest to a bondholder or bond dealer.

5. **Maps of the Taxing Jurisdictions of Texas**—a series of maps of each of the 254 counties in Texas showing in colored outline the boundaries of each taxing jurisdiction in the county. The base map in each instance is the official Texas Highway Department map of the county, size 18" x 24".

HOW THE COUNCIL IS FINANCED

The Council is a nonprofit association whose income arises from two major sources: (1) subscription fees to publications, and (2) an underwriting assessment which dealer members pay on each new issue of bonds which they underwrite. The rate for the latter is $1 per $1,000 of new issue underwriting not to exceed $600 on any single issue.

HOW THE COUNCIL IS GOVERNED

The affairs of the Council at the policy level are under a board of trustees of nine men who are elected from the municipal securities industry in Texas. The Bylaws require geographical distribution of board members and a balance between size of firms and nature of business conducted; that is, origination, distribution, financial advisory, et cetera. The chief executive officer has the title of executive director and has a background of many years as an analyst and as a dealer in municipal securities.

THE COUNCIL'S ACCOMPLISHMENTS

A listing of all of the beneficial changes which the Council has brought about in the market place which it serves would be quite lengthy and would risk the criticism of self-applause. But the record is clearly established, and credit is due to those who have contributed their time and talent for the benefit of the community.

1. A system of reporting which is without equal in America has been established to cover the credit performance of bonds of state and local government in Texas.

2. Standards for financial advisory services have been established at a level which has resulted in the devising and offering of new issues with a degree of professionalism which is not exceeded in bonds of any other state.

3. The number of bond ratings in Texas had quadrupled, even before the initiation of the fee-rating system, and the quality of the average rating has been advanced by almost a full grade.

4. For more than a decade no issue of Texas revenue bonds in the portfolio of an insurance company has been classified as unamortizable by the Committee on Valuation of Securities of the National Association of Insurance Commissioners by reason of inadequate financial information on file with that Committee.

5. Several constructive amendments to the Texas Constitution reflect the expertise of Council committees, and numerous beneficial statutes were initiated by or bear the mark of such committees. The Council, while not a lobbying organization, has through the efforts of its members cooperated with other groups in successfully opposing several legislative proposals deemed to have a detrimental effect on the municipal bond community. Numbered among such proposals were measures to authorize industrial development bonds, one to authorize advance refunding and the so-called "trial de novo" amendment.

6. The high quality of local governmental accounting and financial reporting as measured against information requirements of the municipal bond community is evidenced by the fact that approximately one-third of all awards by the National Committee on Governmental

Accounting of its coveted Certificate of Conformance for Annual Financial Report have been to Texas recipients. (The Council has maintained a very active educational program in this area but claims only a portion of the credit for this outstanding achievement.)

THOSE WHO BENEFIT FROM THE COUNCIL'S ACTIVITIES

All who participate in the market place which the Council serves realize substantial benefits from its activities.

The Community of Municipal Securities Dealers benefits through the maintenance of high standards of business conduct with enhancement of its public image and through improvements in the business climate in which it operates.

The Community of Lenders benefits through a timely and reliable flow of information through which it continuously appraises the degree of security which surrounds its $9.5 billion investment in Texas municipals. This process weighs heavily in influencing future borrowing costs.

The Community of Borrowers, the approximately 3,000 agencies of state and local government in Texas are the real beneficiaries of the Council's activities. Benefits to the bond dealer and bondholder are passed on to the issuer of the bonds in the form of reduced rate of interest on future borrowings in a manner which can be computed in dollars and cents.

THE DOLLAR BENEFITS OF THE COUNCIL'S ACTIVITIES

It is a well-established and undisputed fact that bonds of state and local government in Texas enjoy a better market than the national average. Consistently, and at any given time, Texas bonds will trade in the market place at yields which are 15 to 20 percentage points below the national average for bonds of comparable security, rating, and maturity.

The new issue volume in Texas municipals is about $1.4 billion annually. Assuming an average maturity of 12 years for $1.4 billion of bonds, an improvement of only 1/10th of 1% in interest rate produces a saving in interest cost of $10.5 million over the life of the issue. A conservative estimate, then, of the monetary value of the activities of the Municipal Advisory Council of Texas to the bond issuing agencies of state and local government in Texas is upwards of $10 million annually.



MUNICIPAL FINANCE
OFFICERS ASSOCIATION

SUITE 512
1730 RHODE ISLAND AVENUE, N.W.
WASHINGTON, D.C. 20036
202: 466-2014

CURRENT REPORTING AND DISCLOSURE STAFF WORK PAPER

For Use By

STATE AND LOCAL GOVERNMENTS

Exposure Draft
February 18, 1976

GENERAL INSTRUCTIONS

A. USE OF WORK PAPER

This work paper is designed for use by state and local governments in providing information to investors on a continuing basis. It is intended only to suggest information which may be considered of importance by investors. It is not intended to create disclosure requirements or a legal obligation to disclose any or all items of information suggested.

Information such as that suggested has often been released to investors by state and local governments. It has also been given to rating agencies. Such information is commonly found in budget documents, audited financial statements and other easily accessible records. It is suggested that as much accurate information as possible should be furnished so that investors may make informed trading and investment judgments.

Due to the breadth and vagueness of the definitions relied upon by various authorities as to what may be considered to be "material" information, no full statement is possible of all information which should be considered for disclosure. The Supreme Court has stated that "material" information includes all information which "a reasonable investor might [consider] important in the making of [a] decision".[1] This Work Paper, therefore, provides only a general indication of information which may be provided.

B. ADDITIONAL INFORMATION.

This Work Paper suggests disclosure of information that is most likely to be material to investors. It is possible that other information, not suggested herein, may at times be material and in such cases should be provided.

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1. See the Appendix for a brief discussion of the concept of materiality and of the relevant sections of the federal securities acts.

In addition to the information suggested, there should be added such further material information as may be necessary so as to make any statements made not misleading under the circumstances. Care should be taken to review the financial, historical and other factual information as given so as to determine whether qualifications or additional information should be stated. If reliable information is available which indicates material changes in trends or other disclosures, such information should be presented.

Some sections of this Work Paper are more appropriate for disclosures regarding outstanding general obligation securities. Others are more appropriate for disclosures regarding outstanding revenue securities or regarding outstanding special obligation securities. In some cases, a particular security may have characteristics both of a general obligation security and of a revenue security or of a special obligation security. For example, revenue sources from a project or projects or a specific tax may be the primary source of payment and security for an issue of bonds, while additional security is furnished by the general taxing power of the issuer. Under these circumstances, consideration should be given to making the appropriate disclosures suggested as to both types of securities.

C. OMMISSION OF INFORMATION

In some cases certain specific suggested information will not be material under the circumstances. In such instances, there is no need to report the information.

Information need be given only insofar as it is known or reasonably available on a reliable basis. If reliable information is unknown and not

reasonably available, the information may be omitted. However, non-disclosure of information on grounds that it is not "reasonably" available should only occur in very unusual circumstances. Normally, disclosure should be made of all material information suggested in this Work Paper or of information of a similar nature which reflects adequately the risk of investment in the securities. Information which is available in the issuer's records or which can be obtained from another source, such as U.S. Government census reports, normally should be obtained, compiled and reported. There should be an appropriate indication of the source of the information, if the source is other than the issuer. Where relevant material information is omitted as not reasonably available, a statement to such effect should be made in the report, together with the reasons for the omission.

D. CONTENTS OF REPORTS

The purpose of a report is to inform investors of the investment merits of outstanding securities and of other matters which an informed investor might consider prior to making a trading or other investment decision. Hence, the information set forth in the report should be presented in a concise, understandable fashion. Material should be set forth in the manner which will give appropriate emphasis to such material in view of its relative importance. Avoid unnecessary and irrelevent details, repetition and unnecessary technical language. Material suggested in particular sections of this Work Paper and appearing elsewhere in the report need not be duplicated. However, appropriate cross-references should be used. No reference need be made in the report to inapplicable sections of this Work Paper, and unless a section specifically suggests them, negative answers may be omitted.

E. REPORTING PROCEDURES.

To insure dissemination of reported information, it is advisable that procedures be created whereby interested parties may receive information on a continuing basis. Such parties may include holders of securities, potential investors, securities dealers, analysts and rating agencies. It is suggested that issuers or their underwriters maintain a mailing list of all parties who are interested in receiving information furnished by the issuers. Information may then be mailed to such parties. A reasonable copying, mailing and handling charge may be imposed upon recipients. To facilitate the availability of the information, a reference should be made in official statements for offerings of securities to the existence of the mailing list and the availability of the information.

Such a reference should appear conspicuously in securities issued. A reference such as that suggested may read as follows:

> The issuer has not legally bound itself to furnish to investors current information on a continuing basis and does not covenant to do so, but from time to time, it may elect to provide such information to parties named in a mailing list maintained by the issuer for such purpose. Names may be entered on the mailing list by writing [title of officer and address].

Issuers should make information available to local news publications for dissemination. Certain issuers, whose securities are widely held or actively traded, should also make information available to regional and national news publications. In addition to information made available at regular intervals, issuers should be prepared to make copies of the information available upon request and upon payment of a reasonable copying, mailing and handling charge by parties not listed in the mailing list.

F. TIME OF RELEASE OF INFORMATION.

This Work Paper provides for the release of current information on an annual basis. This should be done at a time when the information is still

meaningful for investors, such as within 90 to 180 days after the end of the issuers's, or in the case of revenue securities, the relevant enterprises, fiscal year. Where this is not possible, release of the information should be made at the earliest possible time.

This Work Paper also provides for release, on other than an annual basis, of information describing certain events which may have a dramatic effect on the issuer's finances and of information in official statements (Section 6). Such information should be released immediately upon its availability in a reliable form. Issuers should endeavor to obtain reliable information as early as possible so that a prompt release may be made.

G. FINANCIAL AND ACCOUNTING STANDARDS.

Financial and accounting information should be prepared and presented in accordance with generally accepted accounting principles, as presented and recommended in National Committee on Governmental Accounting,[2] Governmental Accounting, Auditing, and Financial Reporting (1968) and the Industry Audit Guide of the Committee on Governmental Accounting and Auditing of the American Institute of Certified Public accountants, entitled Audits of State and Local Governmental Units (1974), as such generally accepted accounting principles are supplemented and modified from time to time.[3] These sources make appropriate allowance for state legal requirements on presentation of financial information. The financial statements should be accompanied by an opinion of independent certified or public accountants, or, where

2. The National Committee on Govermental Accounting has been reconstituted as the National Council on Governmental Accounting.
3. Copies of the NCGA publication are available from the Municipal Finance Officers Association, 1313 East 60th Street, Chicago, Illinois 60637. The AICPA Industry Audit Guide is available from the AICPA, 1211 Avenue of the Americas, New York, New York 10036.

appropriate, of state authorities performing procedures and issuing opinions equivalent to those of independent accountants.

H. POLLUTION CONTROL AND OTHER INDUSTRIAL DEVELOPMENT OR INDUSTRIAL REVENUE BONDS.

This work paper is not appropriate for disclosures regarding pollution control or other industrial development or industrial revenue bonds. The investment risk of such securities is in most instances dependent upon the financial success of the private entity involved. Consequently, disclosures substantially similar to those prescribed by Form 10-k promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 should be considered regarding the private entity in such cases. Where additional security is provided by the issuer, disclosures suggested by this Work Paper should also be made.

I. DEFINITIONS.

Unless the context otherwise indicates, the following terms have the stated meanings for purposes of this Work Paper:

(1) "Issuer" means the governmental unit, subdivision or agency which is the issuer of the outstanding securities, including all departments, divisions and organizations under its operating control.

(2) "Enterprise" means any undertaking or group of undertakings of a governmental unit or units or subdivisions or agencies thereof expected to generate revenues which are to be a material source of payment for the principal of and interest or premium on the securities.

(3) "Default" means a default as provided in the laws or authorizing or governing instruments with respect to the securities.

(4) "Payments of principal" of securities and similar references include, but are not limited to, sinking fund payments.

SUGGESTED DISCLOSURES

SECTION 1. FINANCIAL INFORMATION.

See General Instructions B and G.

(a) Furnish appropriate financial statements of the issuer, or in the case of revenue securities, the enterprise, to indicate the issuer's financial ability to fulfill its obligations to the holders of outstanding securities. The financial statements selected for presentation should be selected in accordance with generally accepted accounting principles as presented and recommended in the sources referred to in General Instruction G, as such generally accepted accounting principles are supplemented and modified from time to time. Those financial statements should be presented for, and as of the end of, the last fiscal year. Receipts and assets which cannot be used to discharge the issuer's obligations to the holders of outstanding securities and expenditures chargeable against such receipts should be clearly indicated.

Explanation of Section 1(a):

1. Include comparable data for any additional fiscal years necessary to keep the data given from being misleading. The financial information should reflect the retroactive adjustment of any material items affecting the comparability of the results. State the basis on which the financial statements have been prepared, such as a cash accrual or modified accrual basis. Data for all undertakings which individually or together are material sources of payment for the principal of or interest on the securities should be shown on a consolidated basis, and where informative, may also be shown separately for specific undertakings or groups of undertakings.

2. Disclose the effects in dollar amounts of extraordinary receipts or expenditures and describe the nature and purpose of the receipts or expenditures.

3. Subject to appropriate variation to conform to the nature of the enterprise items should be included in the operational statements for enterprises net sales or operating revenues; cost of goods sold or operating expenses (or gross profit); interest charges; net income; and special items.

4. In connection with the financial statements, whenever necessary, reflect information or explanations of material significance to investors in appraising the results shown, including analyses of material increases or decreases in significant categories.

(b) If the issuer has outstanding general obligation securities, and if more than 15 percent of the receipts of the issuer in either of its two most recent fiscal years comes from

(i) a single enterprise owned or operated by the issuer (such as a public utility or transportation system), or

(ii) a number of such enterprises engaging in essentially similar functions or operating as an integrated enterprise,

and if the receipts from such enterprise(s) may be used for payment of principal of or interest or premium on the securities, provide an appropriate financial summary regarding such enterprise(s).

(c) If payment of principal of or interest or premium on the outstanding securities is guaranteed or insured in any respect, furnish appropriate financial or other information as to the guarantor or insurer. Under normal circumstances, it is unnecessary to include more than a very brief financial summary as to a state guarantor.

SECTION 2. CHANGES IN OUTSTANDING INDEBTEDNESS.

The disclosures suggested by this Section 2 should be reported as to indebtedness of an issuer or, if applicable as to indebtedness payable from revenues of enterprise, if any of the following conditions have occurred:

(i) any increases in indebtedness, if the aggregate amount of all such increases exceeds 5% of the aggregate amount of such outstanding indebtedness as last reported pursuant to this Work Paper; or

(ii) any decreases in indebtedness, (including, but not limited to, sinking fund payments) if the aggregate amount of all such decreases exceeds 5% of the aggregate amount of such outstanding undebtedness as last reported pursuant to this Work Paper; or

(iii) any issuances of indebtedness, if the terms and conditions of any previously unreported undebtedness of the issuer limit or qualify the rights of holders of any outstanding securities.

If any of the conditions described in the preceding sentence occur, the following information should be reported:

(a) Title of class of securities or other indebtedness involved, the amount of the class outstanding as last previously reported, and the amount currently outstanding as of a specified date.

(b) A brief description of the transaction or transactions resulting in any change and a statement of the aggregate net proceeds received or to be received by the issuer or the enterprise.

(c) The principal purposes for which net proceeds received or to be received in a transaction involving an increase in indebtedness are authorized or proposed for each such purpose.

(d) As to each new class of securities or other indebtedness containing terms and conditions materially affecting the rights of holders of any outstanding securities, appropriate information as to such class to enable investors to understand the terms and conditions of outstanding securities.

Explanation of Section 2:

A "class" of securities or other indebtedness is a separate issue which differs from any other issue as to security or other significant terms, other than interest rate or maturity.

SECTION 3. DEBT AND REVENUE STRUCTURE.

If outstanding securities are solely revenue securities, information suggested for disclosure generally regarding the issuer need not be provided except to the extent it relates specifically to the enterprise or is relevant to its revenues, expenses or operations. For example, a response in such a case to Section 3(a) and (b) need only disclose information as to indebtedness payable from revenues of the enterprise. Similarly, in such a case, a response to Section 3(c) need only be given where the issuer's tax delinquencies have a bearing upon the enterprise's operations or financial condition. Such considerations are applicable throughout this Work Paper, but they are particularly applicable with respect to information suggested in this Section 3. See General Instruction B.

(a) Using appropriate indications of items relating to general obligation securities, items relating to special obligation securities, and items relating to revenue securities, furnish the information called for by the following table as to appropriate categories of long-term and short-term securities and other indebtedness of the issuer (other then unpaid bills fewer than 90 days past due):

Category of Indebtedness	Amount Authorized	Amount outstanding as of [date] (less sinking fund installments paid to such date.)

Explanation of Section 3(a):

1. The "appropriate" categories of indebtedness will vary from issuer to issuer. Generally, the purpose of the indebtedness, for example, School Debt or Tax Anticipation Notes, or the maturity of the indebtedness, for example, Sundry Short-Term Debt, may be used as a basis for categorization.

2. Debt should be regarded as "authorized" when all material discretionary legal steps have been taken by the issuer for its authorization for issuance, such as required approval of the city council or the voters. Actions tending to be of a ministerial or judicial nature, such as validation in some jurisdictions, should not be regarded as discretionary for this purpose.

3. The information should be as of a specified date not earlier than the end of the last fiscal year of the issuer or the enterprise. The date chosen should be such as to indicate all material amounts of indebtedness on the date of the report.

(b) Furnish a debt service schedule for total principal, interest and premium requirements of the issuer under outstanding indebtedness, and where appropriate, under authorized indebtedness, to the final maturity date of all outstanding securities with appropriate indications of items relating to general obligation securities, and items relating to special obligation securities, and items relating to revenue securities. Indicate in footnotes to the schedule any assumptions, such as interest rates on authorized but unissued debt, on which information in the schedule is based. The schedule may be presented in substantially the following tabular form:

Fiscal year ending [date]	General obligation indebtedness	Special assessment indebtedness	Utility revenue indebtedness	Other indebtedness (describe)	Total
19	$	$	$	$	$
19	$	$	$	$	$
19	$	$	$	$	$
.	.	.	.	.	.
.	.	.	.	.	.
.	.	.	.	.	.
(year)	$	$	$	$	$

(c) State in an appropriate form the total tax levy and the accumulated amount of delinquent taxes as of the end of the prior fiscal year and as of a recent date and the tax delinquency rate for such fiscal year and for the current fiscal year to date. State the value of total tax title liens owned by the issuer as of the end of the prior fiscal year and as of a recent date.

(d) Give in tabular or other appropriate form with respect to the issuer, as of the end of its last fiscal year, information as to

(i) its assessed vaulation of taxable real property; (ii) its estimated true valuation of taxable real property; (iii) its assessed valuation of taxable real property expressed as a percentage of its estimated true valuation thereof. Segregate such information as to industrial, commercial, utility and residential properties.

(e) Give information as of the end of the issuer's last fiscal year in respect of the issuer's (i) debt per capita; (ii) debt expressed as a percentage of total assessed valuation of taxable real and personal property; (iii) debt expressed as a percentage of total estimated true valuation of taxable real property; and (iv) debt per capita expressed as a percentage of per capita income of individual taxpayers residing in the jurisdiction.

(f) Furnish the information called for by the following table as to indebtedness of overlapping governmental entities:

Name of overlapping entity	Amount of authorized debt	Amount of outstanding debt (less sinking fund)	Percent of outstanding debt chargeable to persons or property in issuer's boundaries

Explanation of Section 3 (f):

See Explanation 2 of Section 3(a) as to the definition of "authorized " debt. Where possible, the information should be as of a specified date no earlier than the end of the last fiscal year of the issuer. Unless inappropriate, the information in the last column should be based upon the estimated true valuation of real property in the respective jurisdictions.

SECTION 4. DESCRIPTION OF ENTERPRISE.

The information suggested in this Section 4 normally should be disclosed only in the case of outstanding revenue securities. See General Instruction B.

(a) Describe changes since the beginning of the previous fiscal year in the operations performed and intended to be performed by any enterprise. The description should include, but not limited to, information as to changes in matters such as the following:

1. The principal products produced and services rendered by the enterprise , and the principal markets for, and methods of distribution of, such products and services.

2. The numbers of customers of the enterprise in residential, commercial, industrial and utility categories, and the loss or addition of major customers, the loss of whom has had or would have an adverse effect upon the operations or financial condition of the enterprise.

3. The prices charged by the enterprise for its products or services.

4. The sources and availability of raw materials essential to the operations of the enterprise.

5. Licenses, permits and franchises of the enterprise.

6. The numbers of employees of the enterprise by nonsupervisory, supervisory and executive categories; and the percentage of employees of the enterprise who belong to unions or other collective bargaining groups.

7. Governmental regulation of the operations of the enterprise, and the effects thereof on the operations of the enterprise.

(b) If the enterprise is engaged in more than one line of business, or has more than one class of products or services, provide appropriate information of the nature suggested in paragraph (a) as to the principal lines of business and classes of products and services.

SECTION 5. ADDITIONAL INFORMATION FOR ANNUAL RELEASE.

A report should be made of any material change in any item of information disclosed in the last applicable official statement of the

issuer released pursuant to Section 6(a), below, of this Work Paper.

Explanation of Section 5:

1. In addition to changes in items of information disclosed in such official statement, other information may be material to investors. Reports of such information should also be made. See General Instruction B.

2. If the last official statement of the issuer was not prepared pursuant to the appropriate sections of the Disclosure Guidelines for Offerings of Securities by State and Local Governments, the response to this Section 5 should include the information suggested for disclosure in the appropriate sections of such Guidelines to the extent such information was not presented in such official statement or has not otherwise been released pursuant to this Work Paper.

SECTION 6. INFORMATION FOR RELEASE ON OTHER THAN AN ANNUAL BASIS.

(a) Release should be made of each official statement for an offering of securities of the issuer containing information substantially more current than that contained in the last official statement for an offering. The official statement should be prepared pursuant to the Disclosure Guidelines for Offerings of Securities by State and Local Governments. Information regarding a fiscal year not covered in any such prior official statement should be regarded as "substantially more current", as should other information materially differing from information previously reported in such a prior official statement. Release of each official statement should be made in the manner suggested in General Instructions E and F of this Work Paper.

(b) Release should be made as promptly as possible of information concerning any material development about the issuer or an enterprise not previously released pursuant to this Work Paper or not otherwise receiving adequate public disclosure. Normally, disclosure of the continuation of a prior trend in any item of information without a material change in

the direction or rate of change of the trend, should be made pursuant to sections of this Work Paper other than this Section 6(b). However, information concerning any unusually rapid change or the occurrence of any event which can be expected to affect reasonable investment or trading decisions should be released as suggested in General Instructions E and F. Due to the breadth of the concept of materiality, as discussed generally in the Appendix, no fully comprehensive list of the types of information which should be released under this Section 6(b) can be given. However, some examples of such information include:

(1) The occurrence of a default in any outstanding indebtedness of the issuer, or the issuance of refunding indebtedness to avoid the occurrence of such a default. This should include a description of the indebtedness and creditors involved, the circumstances leading to the transaction, the relevant provisions of the authorizing and governing instruments, and the amounts of principal, interest and premium involved.

(2) The occurrence of a sudden change or disruption in services provided by an issuer or services or products provided by an enterprise.

(3) The occurrence of any event described in Section 2 of this Work Paper, except that those events referring to a 5% increase or decrease should be deemed instead for this purpose to refer to a 15% increase or decrease.

(4) A severe natural disaster or precipitous economic change materially affecting the issuer's economy.

(5) A change in a rating of any outstanding securities of the issuer.

APPENDIX

The disclosure of information in the securities markets is governed by federal regulations that are designed to protect investors against misleading statements or omissions of important facts. Rule 10b-5 promulgated by the Securities and Exchange Commission under Section 10(b) of the Securities Act of 1934 provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange.
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact unnecessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or,
>
> (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. Section 17(a) of the Securities Act of 1933 contains similar provisions requiring full disclosure.

"Full" disclosure for this purpose means disclosure of all information material to investors. The Supreme Court has stated that "material" information includes all information which " a reasonable investor might [consider] important in the making of [a] decision." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) [emphasis added]. The antifraud provisions have been held to protect "speculators and chartists" as well as "conservative" investors. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). Consequently, the requirement of full disclosure of material information means a considerable amount of information must be disclosed to prevent liability and to prevent the

possibility of injunctions or other legal remedies which may arise as a result of violations of these provisions. In addition to civil remedies for violation of the federal antifraud provisions, Section 24 of the Securities Act of 1933 and Section 32 of the Securities Exchange Act of 1934 provide for criminal penalties in the event of a "willful" violation of any of the provisions, including the antifraud provisions, contained in those Acts.

Municipal Issuers Service Corporation

General Managers, Municipal Bond Insurance Association
34 South Broadway, White Plains, N.Y. 10601
(914) 946-4242

March 19, 1976

The Honorable Harrison A. Williams
Chairman
Subcommittee on Securities
Senate Committee on Banking,
Housing and Urban Affairs
352 Russell Senate Office Building
Washington, D. C. 20510

Statement for the
Subcommittee on Securities
of
The Senate Committee on Banking,
Housing and Urban Affairs
In Connection with S.2969
"The Municipal Securities Full
Disclosure Act of 1976"

Dear Senator Williams:

The purpose of this statement is to express the support of Municipal Issuers Service Corporation ("MISC") and Municipal Bond Insurance Association ("MBIA") for the philosophy of S.2969, "The Municipal Securities Full Disclosure Act of 1976," and to outline a concern about one section of the bill. In that regard I have a suggestion for an amendment.

Municipal Bond Insurance Association

MISC is the General Manager and Agent of MBIA which is an association composed of four major insurance companies having combined assets of $5 billion: The AEtna Casualty and Surety Company, St. Paul Fire and Marine Insurance Company, AEtna Insurance Company and United States Fire Insurance Company. MBIA issues insurance policies which unconditionally and irrevocably guarantee the payment of the

principal of and interest on municipal bonds to the bondholders in the event that the municipality defaults on such payments.

Both MBIA and MISC were formed in the spring of 1974 when a need was recognized to assist smaller municipalities in obtaining financing for necessary projects. At that time it was quite apparent that financially stable but less well known cities and towns because of their small size and lack of previous financing history were being denied access to capital markets. Such municipalities were either unable to market their bonds or were faced with the prospect of paying high interest rates in order to obtain necessary financing.

MBIA and MISC are able to assist such municipalities in obtaining financing for necessary projects at lower interest costs to their taxpayers by providing an unconditional guarantee that the payment of principal and interest will be made despite a default by the municipality on such payments. At the time the bonds are sold, an insurance policy is issued insuring payment of principal of and interest on the bonds, and this policy remains in effect for the life of the issue of bonds. The enforceability of the insurance policy is not affected by a transfer of ownership of the insured bond.

The effect of the insurance policy is that investors will accept a lower rate of return on their investment than they would otherwise have required for the issue if not so insured. This result is a net interest cost savings for the municipality. By insuring the bonds, Standard and Poor's rating is upgraded on the bonds from whatever rating the municipality could obtain based on its own credit to a rating of "AAA," the highest rating given by Standard and Poor's to any municipal bond. This rating is an indication that the MBIA insured bonds are obligations of the highest quality with the strongest capacity for timely payment of debt service. The premium for the insurance policy is paid for by the municipality or by the initial purchaser of the

bonds and generally amounts to only a small fraction of the amount which is saved by the municipality in interest costs over the life of the bonds.

To date, the MBIA insurance program has been approved by the insurance departments or commissions of virtually all of the 50 states. MBIA is subject to regulation in each of these states. During approximately 2 years of operation, MBIA has insured more than 160 issues of bonds with a face value of nearly $740,000,000. The municipalities which have issued MBIA insured bonds are located in more than 20 different states.

S.2969, "The Municipal Securities Full Disclosure Act of 1976"

MBIA and MISC support the principle of full and complete disclosure in connection with the offering and sale of municipal securities. Investors should be given the opportunity to be as fully informed as practicable. The general purpose of S.2969 is to provide a regulatory plan for assuring such disclosure and to require certain reporting and disclosure in connection with the sale of municipal securities by municipalities.

These are laudable goals, yet S.2969 as presently drafted would amend Section 3(a)(10) of the Securities Exchange Act of 1934 (the "Exchange Act") so that, if literally read, it would require private insurance companies which insure municipal bonds to comply with the municipal reporting requirement of S.2969. In fact, the bill as drafted could be read to apply to all private insurers of all types of securities.

In its present status, Section 2(b) of S.2969 would amend the definition of "security" in Section 3(a)(10) of the Exchange Act to include a "guarantee" of certain securities including municipal securities. The Section-by-Section analysis of S.2969 does not clarify the intent of the Section, providing as follows:

> "Thus the reporting requirements of new Section 13A of the Act would be specifically applicable to the guarantor of a municipal security. Section 2(1) of the Securities Act of 1933 defines 'security' in a similar manner."

It is clear from the framework, as well as the intent, of the legislation that private insurance companies which issue insurance policies guaranteeing municipal securities should not be included within the requirements of S.2969. This can be seen from the reporting requirements proposed, which are specifically applicable to municipalities and not to privately-owned companies. Rather, the intent of Section 2(b) of S.2969 is to make clear that any political subdivision or political entity which guarantees obligations issued by any other political entities will be subject to the requirements to prepare and file an Annual Report, a Report of Events of Default and to furnish and file a Distribution Statement. Yet, as I have pointed out, a literal reading of the language of Section 2(b) of S.2969 would include insurance policies of private insurance companies within the definition of "securities" and subject such companies to all of the provisions applicable to municipalities.

Since the outset of federal regulation of the securities industry, Congress in the federal securities laws and later in the McCarran-Ferguson Act has left the regulation of the business of writing insurance to the various states. We are confident that Congress has no intention by this bill to reverse this long standing policy.

The Present Statutory and Regulatory Framework

At the present time, under both the Securities Act of 1933 (the "Securities Act") and the Exchange Act, insurance policies are not subject to regulation under the federal securities laws. Depending on the interpretation, insurance policies by virtue of Sections 2(1) and 3(a)(8) of the

Securities Act are either not within the definition of "securities" and thus not subject to the various provisions of the Securities Act or are specifically exempted from the various provisions of the Securities Act. The legislative history of Section 3(a)(8) of the Securities Act is relevant on this matter. This section was added to assure the clarity of the intent of Congress to exclude insurance policies from regulation:

> "Paragraph (8) makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy and like contracts are not regarded in the commercial world as investment securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible. H.R. Rep. No. 85, p. 15, 73rd Congress, 1st Sess. 1933."

MBIA has insured over 160 issues of municipal bonds acting in reliance upon a "no action" letter granted by the staff of the Securities and Exchange Commission on September 28, 1973, based upon the insurance policy exemption contained in Section 3(a)(8) of the Securities Act. This "no action" position of the Securities and Exchange Commission is consistent with the statutory provisions and Congressional policy relating to insurance policies.

Further, under the Exchange Act, federal court decisions interpreting the definition of the term "security" in Section 3(a)(10) of the Exchange Act have consistently held that true insurance policies are not securities and therefore are not within the ambit of the federal securities laws, including Rule 10b5. See, Collins v. Baylor, 302 F. Supp. 408 (D.Ill. 1969); Olpin v. Ideal National Insurance Co., 419 F.2d 1280 (10th Cir. 1969). It should be noted, of

course, that the Exchange Act's provisions do apply to variable annuity contracts, which the courts have held to be insurance contracts, but securities. The MBIA po is unconditional in nature and is a true insurance policy.

The purpose of Section 2(b) of S.2969 is an attempt to conform the definition of the term "securities" in the Exchange Act to the definition of "securities" in the Securities Act. The obvious question that arises is how a minor change in the definition of "securities" in the Exchange Act can have the impact of changing more than 40 years of Congressional policy. The reason is that the Exchange Act does not contain an exemption comparable to Section 3(a)(8) of the Securities Act relating to insurance policies. Therefore, the change proposed in the Exchange Act by S.2969 is susceptible to being misinterpreted as requiring that insurance policies issued to guarantee payments of principal of and interest on municipality securities would be subject to the federal securities regulation. Furthermore, if the "guarantee of" language is inserted in Section 3(a)(10) of the Exchange Act, it would subject all guarantors and insurers of all securities defined in that section to the reporting provisions of proposed Section 13(A) of the Exchange Act.

Proposed Changes

For the foregoing reasons, I recommend that the Committee amend Section 3(a)(10) to make explicit that insurance policies are not intended to be included in the definition of "securities." This could be done by having Section 2(b) of S.2969 read as follows:

> "(b) Section 3(a)(10) of such Act is amended by inserting 'guarantee for,' immediately after 'receipt for,' and by inserting 'and shall not include any insurance policy insuring or guaranteeing payment of principal of and interest on any municipal security which policy is issued by

a corporation or other entity subject to the supervision of the insurance department or commissioner, bank commissioner or any other agency or officer performing like functions, of any state or territory of the United States or of the District of Columbia' immediately after 'or any renewal thereof the maturity of which is likewise limited.'"

In the alternative, Section 2(e) of S.2969 could be amended to include the following language as a new subparagraph (d).

"The provisions of Section (a) and (b) shall not apply with respect to any insurance policy issued to insure or guarantee the payment of principal of and interest on any municipal security issued by a corporation or other entity subject to the supervision of the insurance department or commissioner, bank commissioner, or any agency or officer performing like functions, of any state or territory of the United States or of the District of Columbia."

I appreciate the opportunity to express my views on this important legislation. Please feel free to contact me if you have any questions or if I may be of any assistance.

Respectfully,

John R Butler

John R. Butler

JRB:srl

MUNICIPAL SECURITIES RULEMAKING BOARD
1629 K Street, N.W., Suite 700
Washington, D.C. 20006

March 10, 1976

Senator Harrison A. Williams
Chairman
Subcommittee on Securities
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Williams:

I am pleased to enclose herewith the position paper of the Municipal Securities Rulemaking Board on the disclosure issue, which reflects the Board's deliberations at its meeting of February 26-27, 1976 on S.2969. The paper covers three subjects -- the need for Federal legislation; suggestions of the Board relating to the development of disclosure guidelines; and suggestions relating to statutory provisions governing the responsibilities and liabilities of issuers, underwriters and others engaged in the distribution of municipal securities.

We regard the prompt resolution of the issue of disclosure as critical to the protection of investors and the proper functioning of the municipal securities industry, and hope that our views will be useful to the Subcommittee in connection with its study of this matter.

The Board will be glad to furnish to you, should you deem it appropriate, suggested statutory provisions illustrating the recommendations set forth in the enclosed paper, as well as a discussion of pertinent constitutional issues. Members of the Board and its staff will also make themselves available for any conferences or discussions with members of the Subcommittee and its staff, and will assist you in any other way we can.

Sincerely yours,

Roswell C. Dikeman

Roswell C. Dikeman
Chairman

RCD:ker
Enc.

cc: Hon. Roderick M. Hills

MUNICIPAL SECURITIES RULEMAKING BOARD
1629 K STREET, N.W.
WASHINGTON, D. C. 20006

March 10, 1976

Statement to Subcommittee on Securities,
Senate Committee on Banking, Housing
and Urban Affairs

The Municipal Securities Rulemaking Board (the "Board") appreciates this opportunity to present its views to the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs concerning S. 2574 and S. 2969.

The Board's membership consists of five persons representing municipal securities brokers and dealers other than bank dealers, five persons representing bank dealers, and five persons who are public members, including two issuer representatives and one investor representative. A list of the Board members and their current business affiliations is attached to this statement as Appendix A.

Section 15B(d) of the Securities Exchange Act of 1934 (the "1934 Act") precludes the Board from promulgating rules which would, directly or indirectly, require issuers of municipal securities to furnish information to investors concerning their securities. Nevertheless, because of the Board's composition as well as its central role in regulation of the municipal securities marketplace, the subject of disclosure in connection with the new issue of municipal securities and the related

subject of the respective responsibilities and liabilities of participants in the process -- issuers, underwriters and others -- have been and continue to be of substantial concern to the Board. Investor confidence in the municipal securities markets and the fair and efficient functioning of those markets are principal goals of the Board's mandate under the Securities Acts Amendments of 1975.

Need for Federal Legislation

The Board concurs with the sponsors of S. 2574 and S. 2969 on the need for federal legislation concerning disclosure in connection with new issues of municipal securities. However, to resolve the current dislocations in the municipal securities markets, it is essential that such legislation address two fundamental issues:

1. What information should issuers reasonably be required to make available to prospective investors to enable them to make an investment decision concerning municipal securities?
2. What are the respective responsibilities and liabilities of issuers, underwriters and others involved in the process of distributing municipal securities to the public with respect to the disclosure (or lack thereof) of such information?

As the Subcommittee is aware, these questions have not received legislative or judicial answers, nor has the Securities and Exchange Commission (the "Commission") proposed administrative solutions to the uncertainties currently surrounding these issues.

Information on which to base an investment decision often is unavailable with respect to municipal securities. Indeed, substantial uncertainty exists concerning the nature and scope of such information and the appropriate form of its presentation. In order to bring their securities to market in recent months, many issuers of municipal securities have undergone protracted and costly negotiations with underwriters for increasingly comprehensive and possibly non-material items of disclosure. Underwriters, for their part, are asked to assess their potential liabilities without guidance as to what information may or may not be material.

The Board recognizes the constructive efforts of the Municipal Finance Officers Association to develop appropriate disclosure guidelines for new issues of municipal securities. Nevertheless, we believe that without national guidelines having official standing, the confusion presently in evidence in the municipal markets will continue, at least for an undesirably extended period of time. If state and local governments are to be able to raise funds at a reasonable cost through the private sector, Congress must establish the mechanism for defining the scope of information to be provided to investors.

While we note the lack of recognized standards on disclosure, we also have grave concern about the deficiencies in the present statutory framework with respect to the responsibilities and liabilities of issuers, underwriters and others engaged in the distribution process. We think it clear

that the anti-fraud provisions of the federal securities laws provide inadequate guidance to market participants as to their obligations and potential liabilities in bringing municipal securities to market and therefore do not serve to further the protection of investors. Faced with the slow and costly process of civil damage actions and Commission enforcement proceedings for failure to adhere to undefined obligations, underwriters have become increasingly wary of the municipal markets. Many assert that the risks in distributing municipal securities without a proper statutory framework for measuring risk are too severe. The underwriters' dilemma is compounded by substantial question concerning municipal issuers' amenability to suit for violation of the federal securities laws.

In urging enactment of federal legislation to deal with the current uncertainties relating to the issuance and distribution of municipal securities, we believe the following factors must be considered:

1. In our system of constitutional federalism, states have inherent powers and privileges that reflect their position as sovereigns in relation to the federal government. We believe it is appropriate that Congress defer to the greatest extent consistent with the need for legislation to the prerogatives of state governments and their instrumentalities. We therefore urge that compliance with disclosure guidelines established under federal legislation not be made a condition precedent to the offer or sale of securities by state and local governments.

Voluntary disclosure guidelines established under federal legislation would, we believe, be adopted by most issuers as a consequence of market demands. At the same time, this approach appears to us to avoid difficult questions of constitutional law and policy concerning the balancing of state prerogatives with the power of the federal government to regulate activities in interstate commerce.

2. In fashioning a legislative solution to the disclosure issue, recognition should be given to the historically stable nature of municipal securities. Since 1940 the incidence of default on municipal debt has been negligible. We believe the solution to the disclosure issue should not impose disproportionate burdens -- in terms of cost or restrictions on issuers' ability to raise funds in the capital markets -- than are justified by the present conditions. For these reasons, among others, it is our view that registration of municipal securities with the Commission, as proposed in S. 2574, is not an appropriate solution.

3. The vast majority of general obligation securities are sold through competitive bid. Often, the competitive bid procedure is mandated by state law on the theory that it results in lower costs to borrowers and is therefore in the public interest. At the same time, the competitive bid process imposes severe time constraints on underwriters in their ability to ascertain the adequacy of information supplied to them by issuers. The time elapsing between publication of a notice of

sale and the date bids are required to be submitted often does not exceed seven days and almost never exceeds two weeks.

The volume of potential bids to which an underwriter is exposed is substantial. According to statistics published in The Daily Bond Buyer on March 3, 1976, an aggregate of 925 issues of municipal securities were sold during the period January - February 1976, and a total of 8,107 issues during 1975. We estimate that between two-thirds and three-quarters of all such issues (which include both general obligation and revenue bonds) were sold on a competitive bid basis. It is common for an underwriter to bid on at least ten issues per week and the more active underwriters may bid on as many as 40 issues per week, in addition to participating in negotiated sales of municipal securities. The success rate on bids does not exceed 25%.

While the time constraints imposed by the bidding process make it impossible for underwriters to undertake an investigation in depth of a municipal issuer's affairs, it is questionable whether such an investigation would be feasible under any circumstances with respect to issuers of general obligation securities. In comparision to the well-recognized indicia of the viability of business corporations, the factors that contribute to the health of a governmental entity are at once complex and not readily determinable.

In view of these factors, we believe it appropriate to limit the liabilities of underwriters in the municipal area by affording them a defense based on the absence of reasonable

grounds to believe or belief that the information furnished by the issuer contains a material misstatement or omission. This approach would eliminate the imposition of a due diligence obligation on underwriters of municipal securities which, for the reasons previously stated, cannot be fulfilled.

4. Issuers should be responsible for the accuracy and completeness of information contained in an official statement which they prepare or which is derived from their own records. We do not believe, however, that an issuer should be held responsible for information derived from public sources not under the control or jurisdiction of the issuer in the absence of actual knowledge or reckless disregard for the accuracy or completeness of such information. For example, assuming the absence of these elements, a municipality should not be responsible for the accuracy of demographic information derived from a state or federal source. Investigation and verification by issuers of information from such sources would be a practical impossibility.

With respect to officers of the issuer involved in the preparation of an official statement, several factors lead us to conclude that it would be inappropriate, as a matter of sound public policy, to impose personal liability on these individuals except for active fraud or gross negligence amounting to fraud. Many public officials serve with little or no compensation on a part-time basis, while others with substantial full-time responsibilities are not compensated at levels comparable to

private industry. The imposition of personal liability on public officials other than as outlined above would discourage individuals from entering into public service. We are also concerned that the threat of personal liability for matters which are, in effect, outside the control of the individual public officer would impose constraints upon the officer in the conduct of his normal duties.

We note that public officials act in a fiduciary capacity with respect to their constituents. Under the laws of their respective jurisdictions, public officials are normally held to a high standard of duty, which should be viewed as adequate to deter improper conduct on their part in connection with the offer and sale of municipal securities. An additional deterrent results from the potential imposition of liability on the issuer they serve for wrongful acts on their part.

* * * * * * *

In view of our concerns, we suggest that a number of modifications be made in the approach taken in S. 2969. These are detailed below and are divided into recommendations on (1) the development of disclosure guidelines and (2) the establishment of a statutory framework of responsibilities and liabilities.

Disclosure

1. As indicated above, we perceive an important need for the development of recognized standards of disclosure in the municipal securities area. While the scope of information

available to investors has improved substantially over the course of the past year, the notice of sale continues to be the only document prepared by many issuers in connection with offerings of their securities. Further, real question exists as to the nature and scope of information which may be material to investors. The absence in most instances of audited financial statements prepared in accordance with uniform auditing standards further impairs the reliability and comparability of information available to investors. We therefore support the development of disclosure guidelines through a mechanism established by Congress.

In this regard, we urge that Congress recognize the importance of effective input from the interests affected by the guidelines -- state and local governments, underwriters and investors. These groups should not be relegated to a mere commentator role in the context of Commission rulemaking in accordance with the Administrative Procedure Act. Issuers, as well as market professionals and investors should, in our view, have a direct role in the formulation of the guidelines.

We therefore propose that Congress provide for the appointment by the Commission of an independent committee which would be charged with the responsibility for formulating disclosure guidelines. Such guidelines would take effect unless disapproved by the Commission as not in the public interest. The committee would be composed of representatives of issuers, underwriters and the public (which could include bond attorneys,

accountants and investor representatives) in equal proportions. We recommend that a deadline for the initial formulation of the guidelines be prescribed in the legislation.

2. We question the advisability of a statutory enumeration of categories of information required in annual reports and official statements since any such enumeration risks either the omission of matters which may be of material importance with respect to a particular type of offering or inclusion of other matters which may not be material under particular circumstances. For example, financial data concerning the issuer would be both irrelevant and misleading in the case of an industrial revenue bond issue. One need only look at the evolution of the contents of registration statements prepared pursuant to the Securities Act of 1933 (the "1933 Act"), particularly in the area of information concerning the business of the issuer, to recognize the difficulty of setting statutory parameters on information to be furnished to investors.

We therefore recommend that the legislation contain only a general directive to the committee to develop such guidelines concerning disclosure as may be necessary and appropriate for the protection of investors consistent with the public interest.

3. We believe that the disclosure guidelines developed by the committee should provide for an independent audit of the financial affairs of the issuer, at and for a reasonably current date and period. The need is acute for reliable financial information in comparable form for state and local government

issuers. The guidelines should recognize that such an audit may be conducted either by an independent governmental authority or by independent public or certified accountants.

4. We recommend that the guidelines on disclosure apply to all issuers without regard to the size of the issuer or the offering. The legislation should specify that in developing the guidelines the committee should differentiate as appropriate among classifications of issues and issuers.

5. We believe that preparation of annual reports by issuers is desirable and that the disclosure guidelines should include standards of information to be included in such reports according to appropriate classifications of issuers. Nevertheless, for the reasons set forth above, we do not believe that compliance with such standards should be made mandatory.

Responsibilities and Liabilities of Participants in the Distribution Process

Our earlier discussion noted the uncertainties in the municipal markets caused by the lack of statutory definition of the responsibilities and liabilities of issuers, underwriters and others engaged in the distribution of municipal securities. Municipal securities are "exempt securities" for purposes of the registration requirements of the 1933 Act and the reporting requirements of the 1934 Act. While the offer and sale of municipal securities are subject to the anti-fraud provisions of the federal securities laws, i.e., section 17(a) of the 1933 Act, sections 10(b) and 15(c)(1) of the 1934 Act, and rules and regulations of the Commission thereunder, these provisions afford

69-141 O - 76 - 26

scant guidance as to the scope of liability of persons engaged in the distribution of new issues of municipal securities.

Section 17(a) of the 1933 Act makes it unlawful for any person to engage in fraud or to receive any money or other property on the basis of any untrue statement or omission of material fact in the offer or sale of any securities by use of the mails or any means of interstate commerce. Under section 10(b) of the 1934 Act, the Commission is empowered to prescribe rules relating to the use by any person of manipulative or deceptive devices or contrivances in connection with the purchase or sale of any security. Rule 10b-5 makes it unlawful for any person, in connection with the purchase or sale of any security, to use the mails or any means of interstate commerce to engage in any fraudulent, manipulative or deceptive act or practice or to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading. Although originally promulgated as a prophylactic rule against fraud, rule 10b-5 has frequently formed the basis of private damage suits in connection with securities transactions. Various circuits have reached differing conclusions as to the basis for civil liability under rule 10b-5, some requiring a showing of scienter while others have premised liability on simple negligence or gross negligence.

The uncertainties stemming from a lack of statutory guidance on the parameters of liability and the obligations of issuers and

underwriters of municipal securities to investors have been exacerbated by the expanding scope of liability under rule 10b-5. Most recently, the Seventh Circuit held in Sanders v. John Nuveen & Co. (October 30, 1975) that underwriters of commercial paper were liable in damages to investors for omission of material fact concerning the financial affairs of the issuer, notwithstanding the availability of independently audited financial statements on which the underwriters claimed reliance. The purportedly independent public accountant who certified the financial statements was, in fact, an active participant in the issuer's fraud. The court found that the underwriters had not been diligent in investigating the affairs of the issuer -- including conducting a review of the accountant's work papers -- to ascertain the reliability of the information supplied. This decision, which was reached with respect to securities exempt from the registration requirements of the 1933 Act, appears to impose a greater duty on underwriters to ascertain the reliability of information concerning an issuer than that provided for non-exempt securities under section 11 of the 1933 Act.

Also relevant to this discussion is section 15(c)(1) of the 1934 Act, under which the Commission is authorized to prescribe rules defining what constitutes a manipulative, deceptive or other fraudulent device or contrivance in connection with the activities of brokers, dealers and municipal securities dealers relating to securities transactions. The Commission has

promulgated rule 15c1-2 pursuant to this section, containing prohibitions similar to those set forth in rule 10b-5. Unlike rule 10b-5, however, rule 15c1-2 defines as fraudulent those misstatements or omissions of material fact which are made with knowledge or reasonable grounds to believe that they are untrue or misleading. The relationship between the differing standards of liability set forth in rules 10b-5 and 15c1-2 has not been clarified by the Commission.

In addition to establishing the framework for registration of securities, section 11 of the 1933 Act establishes a system of liabilities and defenses which appears to define the parameters of liability, short of active fraud, for participants in an offering of registered securities. There are no similar provisions applicable to municipal securities transactions.

We note that in the municipal area, a further complicating factor is the question of an issuer's amenability to private suit for violation of the federal securities laws. Under Article III of the Constitution and the Eleventh Amendment, the judicial power of the federal courts does not extend to private actions against a state in the absence of express or implied waiver of such immunity by the state. In Forman v. Community Services, Inc., 500 F. 2d 1246, 1256 (2d Cir. 1974), rev'd on other grounds sub nom. United Housing Foundation v. Forman, 95 S. Ct. 2051 (1975), the Second Circuit held that Congress may condition "the right of a state to be involved in the sale and distribution of securities upon amenability to suit in federal

court as provided by [the federal securities laws]." Nevertheless, while the Court in Forman looked to legislative history as demonstrating Congressional intent that the anti-fraud provisions of the 1934 Act apply to issuers of municipal securities, the more recent decision of the United States Supreme Court in Edelman v. Jordan, 415 U.S. 651 (1974), appears to require an express civil liability provision applicable by its terms to state issuers of securities before permitting suit under the federal securities laws. On this basis, it is possible that the change in the definition of "person" in section 3(a)(9) of the 1934 Act, by virtue of the Securities Acts Amendments of 1975, to include any "government, or political subdivision, agency, or instrumentality of a government" does not extend civil liability in damages to state issuers under section 10(b) of the 1934 Act.

* * * * *

While statutory clarification of the obligations and liabilities of issuers, underwriters and others engaged in the distribution of municipal securities is essential, it does not follow, for the reasons indicated earlier, that the obligations imposed on underwriters of registered securities and officers of corporate issuers are appropriate for underwriters or public officials in the municipal area. We have the following specific recommendations concerning provisions affecting the obligations and liabilities of persons engaged in the distribution of municipal securities:

1. The obligations and liabilities of issuers of municipal securities to investors should be clarified, and an appropriate basis for recovering damages from issuers should be established in express terms by legislation. This would involve in the first instance a statement of findings by Congress on the importance of the municipal securities markets as a national asset to be preserved and strengthened; recognition that the distribution of new issues of municipal securities may be effected by means of the mails and other instrumentalities of interstate commerce and constitutes an important part of interstate commerce; and reference to the necessity of clarifying, in the public interest and for the protection of investors, the respective obligations and liabilities of issuers and other participants in the municipal securities markets.

We recommend that Congress create, on the basis of such findings, an express cause of action for damages in connection with the offer or sale of new issues (appropriately defined) of municipal securities, based on material misstatements or omissions. Issuers, and within certain prescribed limits underwriters, accountants, experts, engineers and appraisers, would be included within the scope of liability established under such a provision. The liability of accountants, experts and other such persons would apply only with respect to the portions of the disclosure document which they had prepared.

In structuring this express civil liability provision, we believe it appropriate to follow the framework of section 11 of

the 1933 Act. Our proposal contemplates that certain defenses be established for each category of participant in the distribution process. Such defenses should accurately reflect the ability of the various participants to ascertain the accuracy and completeness of the information in question. Thus, issuers of municipal securities would have an absolute liability with respect to all information set forth in an official statement except for information furnished by an official source other than the issuer. However, with respect to such other information, the issuer would be required to demonstrate that it had no reasonable grounds to believe and did not believe that such information was materially inaccurate or misleading.

Accountants, experts and other such persons would have a defense with respect to the information they provide, which would be based on demonstrating that after reasonable investigation they had reasonable grounds to believe and did believe that the information provided by them was true and did not omit any material fact.

We recommend that underwriters be afforded a defense with respect to all information set forth in an official statement based on a showing that they had no reasonable grounds to believe and did not believe that there was any misstatement or omission of material fact. This would accord recognition to the practical impossibility of underwriters' performing a due diligence function in a competitive bid underwriting, while still holding underwriters responsible for material misstatements or omissions

which could be readily ascertained from the information submitted by the issuer.

We recognize that in transactions involving negotiated sales of revenue bonds a different standard of liability than that described above may be appropriate for underwriters. Our views on this point reflect the fact that in a negotiated sale underwriters generally have an opportunity to conduct an investigation of matters relating to the issue prior to sale. Further, with respect to revenue bonds, the security of the issue ordinarily depends on a specified source of funds, and therefore the information an underwriter may seek to verify is more accessible and ascertainable than in the case of general obligation bonds.

Provisions limiting damages, requiring contribution, and imposing a statute of limitations similar to sections 11 and 13 of the 1933 Act should be included in the legislation.

2. In addition to the provisions described in item 1, we believe it necessary and appropriate to establish an express cause of action for civil liability, as well as providing a basis for criminal action and injunctive proceedings, in the case of active fraud or gross negligence. We recommend that the legislation establish a cause of action against all persons engaged in the distribution of new issues of municipal securities, including officials of the issuer involved in the preparation of official statements, based on scienter or reckless disregard for the accuracy or completeness of the information

contained in the official statement. We contemplate that such a provision would be substituted for the implied civil liability for fraud presently recognized under rule 10b-5.

3. Under section 15B(d)(2) of the 1934 Act, the Board is authorized to require municipal securities brokers and municipal securities dealers to furnish investors information generally available from a source other than the issuer. If legislation is enacted establishing a mechanism for the development of disclosure guidelines for new issues of municipal securities, we believe it consistent with the intent of section 15B(d)(2) to authorize the Board to require municipal securities brokers and municipal securities dealers to furnish official statements to investors and prospective investors in a timely manner, provided the official statement prepared by the issuer meets such guidelines.

APPENDIX A

Broker-Dealer Representatives

Gedale B. Horowitz, Partner, Salomon Brothers, New York, New York

Thomas W. Masterson, Senior Vice President and Director, Underwood Neuhaus & Company, Houston, Texas

William J. Rex, Executive Vice President, Foster & Marshall Inc., Seattle, Washington

George Rinker, Jr., Executive Vice President and Director, The Ohio Company, Columbus, Ohio

Wallace G. Sellers, Vice President, Merrill Lynch, Pierce, Fenner & Smith, New York, New York

Bank Dealer Representatives

Richard F. Kezer, Senior Vice President, First National City Bank, New York, New York

Bert C. Madden, Senior Vice President and Manager, Investment Banking Division, Atlanta, Georgia

Frank K. Spinner, Senior Vice President, First National Bank in St. Louis, St. Louis, Missouri

David G. Taylor, Executive Vice President, Continental Illinois National Bank and Trust Co. of Chicago, Chicago, Illinois

John R. Vella, Senior Vice President, Bank of America, San Francisco, California

Public Representatives

Harlan F. Boyles, Deputy Treasurer of North Carolina, Raleigh, North Carolina

Roswell C. Likeman, Partner, Willkie Farr & Gallagher, New York, New York

Harry B. Gilmore, Jr., Investment Consultant, Trustee, Director, Hanover, New Hampshire

Lennox L. Moak, Director of Finance, City of Philadelphia, Philadelphia, Pennsylvania

Richard R. West, Dean of the College of Business Administration and Professor of Finance, University of Oregon, Eugene, Oregon

WILLIAM PROXMIRE, WIS., CHAIRMAN
JOHN SPARKMAN, ALA.
HARRISON A. WILLIAMS, JR., N.J.
THOMAS J. MC INTYRE, N.H.
ALAN CRANSTON, CALIF.
ADLAI E. STEVENSON, ILL.
JOSEPH R. BIDEN, JR., DEL.
ROBERT MORGAN, N.C.
JOHN TOWER, TEX.
EDWARD W. BROOKE, MASS.
BOB PACKWOOD, OREG.
JESSE HELMS, N.C.
JAKE GARN, UTAH

KENNETH A. MC LEAN, STAFF DIRECTOR
ANTHONY T. CLIFF, MINORITY STAFF DIRECTOR
MARY FRANCES DE LA PAVA, CHIEF CLERK

United States Senate
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

March 17, 1976

Mr. Harlan Boyles
Secretary, North Carolina
Local Government Commission
325 North Salisbury Street
Raleigh, North Carolina 27611

Dear Mr. Boyles:

The Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs is presently considering legislation which would subject issuers of municipal securities, in varying degrees, to the Federal securities laws to improve the quality and availability of information required to be disclosed to investors. I am enclosing for your information copies of S. 2969, the Municipal Securities Full Disclosure Act of 1976, as well as additional explanatory information.

Briefly, S. 2969 would require municipal issuers to prepare annual reports and distribution statements as well as specify their basic content. The philosophy underlying the bill is that active state supervision of local finance is desirable and should be encouraged. Accordingly, and exemption from the distribution statement requirements of the bill would be available where such state programs exist (Section 13A(c)).

The prototype for the "state" exemption envisioned in the bill is the Local Government Commission in North Carolina. As Secretary of the Local Government Commission, your experience and views will be helpful to the Subcommittee in future deliberations. Accordingly, I would appreciate your taking the time to respond to the following questions.

1. (a) What action, if any, has the Local Government Commission taken in recent months to respond to growing concerns, shared by issuers, underwriters and investors, over the need for improved disclosure of material information by state and local governments?

(b) Please describe the procedures presently under consideration in North Carolina to require municipal officials to certify the accuracy of information prepared in connection with public offerings?

(c) Do state officials independently verify and certify the information provided and prepared by the borrowing unit?

2. What recourse does or should an investor have against a state or local official for misstatements in official statements and other disclosure documents, or for omissions of material information?

3. Witnesses testified on the desirability of clarifying the application of the antifraud provisions of the securities laws to issuers and underwriters of municipal securities and their respective due diligence responsibilities. Do you have any recommendations as to how Federal legislation in this area should be framed?

4. Please provide the Subcommittee with copies of official statements prepared by the Local Government Commission during the past six months. Documents containing disclaimers or assumptions of responsibility for the accuracy of information, financial and otherwise, included in such statements would be particularly helpful.

I recognize that you are a member of the Municipal Securities Rulemaking Board which, as you know, has already provided the Subcommittee with its comments on the legislation. So that there is no confusion, I want to make it clear that I am soliciting your views in your official capacity as Secretary of the Local Government Commission and as an individual with long and unique experience in the municipal securities markets.

If you have any questions, please do not hesitate to call me or the staff of the Subcommittee on Securities (202) 224-9150.

Sincerely,

Harrison A. Williams, Jr.

Enclosures

HAW:hmk

State of North Carolina
DEPARTMENT OF THE TREASURER

EDWIN GILL
State Treasurer

LOCAL GOVERNMENT COMMISSION
HARLAN E. BOYLES
Secretary

ALBEMARLE BUILDING • 325 NORTH SALISBURY STREET • RALEIGH, N. C. 27611 • AC 919, 829-3064

March 26, 1976

1976 APR -8 PM 12:52

The Honorable Harrison A. Williams, Jr.
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Senator Williams:

I am pleased and honored to be asked to respond to your questions of March 16, 1976 relating to the "state" exemption as provided in S. 2969. As Secretary of the Local Government Commission, I take pride in relating the success we have enjoyed in marketing our local government securities.

The disruption in the marketplace has affected us to a degree and we see a need for calming influences to make themselves felt. My subjective opinion is that we have not been affected to the degree as have units in other states. We believe this has been due to a long history of providing significant fiscal information to the investor in a consistent manner without editorial embellishment. The information has not heretofore been certified either by the issuing unit or the Local Government Commission, but great care has been given to the information because it bore our name and our reputation.

Your questions and my answers thereto are as follows:

1. (a) What action, if any, has the Local Government Commission taken in recent months to respond to growing concerns, shared by issuers, underwriters and investors, over the need for improved disclosure of material information by state and local governments?

Answer: On March 19, 1976, we mailed our first official statement offering general obligation bonds which attempted to respond to the concerns of the marketplace on disclosure. We have marketed successfully several issues until two weeks ago using the same procedures employed for several years. The current official statement of Charlotte, North Carolina and the immediate past offering circular on the same unit are enclosed for comparative purposes. We will be monitoring our new procedures on future offerings, making any necessary modifications.

(b) Please describe the procedures presently under consideration in North Carolina to require municipal officials to certify the accuracy of information prepared in connection with public offerings.

State of North Carolina
DEPARTMENT OF THE TREASURER

EDWIN GILL
State Treasurer

LOCAL GOVERNMENT COMMISSION
HARLAN E. BOYLES
Secretary

ALBEMARLE BUILDING • 325 NORTH SALISBURY STREET • RALEIGH, N. C. 27611 • AC 919, 829-3064

March 26, 1976

The Honorable Harrison A. Williams, Jr.
Page 2

Answer: Please note the description of the proposed certificate concerning the official statement on page 34 of the March 19, 1976 official statement on the Charlotte offering. We believe this certificate to be adequate and probably as positive as reasonably could be expected.

(c) Do state officials independently verify and certify the information provided and prepared by the borrowing unit?

Answer: The preparation of the official statement is a joint effort of the Local Government Commission staff and the local government officials. We are able to verify the information from audit reports (prepared by independent CPA as required by law) on file in our office and from other independent reports on file. Cross checking and knowledge of local units gained from year to year through reviews of their fiscal affairs give us a good insight as to accuracy and inclusiveness of the information. Our greatest weakness lies in verification of demographic data and in litigation that may have been filed recently.

2. What recourse does or should an investor have against a state or local official for misstatements in official statements and other disclosure documents, or for omissions of material information?

Answer: In absence of fraud or gross negligence, I do not believe an investor should have recourse which would impose or threaten personal liability against an official as preparer of the official statement. To permit such a liability or the threat thereof will destroy the system of government we have in our nation. Civic participation in an official capacity will become extinct under such threat and an employee would have to be paid compensation for the added risk. The investor should have recourse against the issuing unit, as opposed to the officials individually, for loss or damages resulting from inaccuracies or an omission in the official statement. The great dilemma would, of course, be in determining a liability attributable to disclosure as opposed to the workings of the marketplace. I would hope Congress would weigh very carefully its action in this direction.

State of North Carolina
DEPARTMENT OF THE TREASURER

EDWIN GILL
State Treasurer

LOCAL GOVERNMENT COMMISSION
HARLAN E. BOYLES
Secretary

ALBEMARLE BUILDING • 325 NORTH SALISBURY STREET • RALEIGH, N. C. 27611 • AC 919, 829-3064

March 26, 1976

The Honorable Harrison A. Williams, Jr.
Page 3

3. Witnesses testified on the desirability of clarifying the application of the antifraud provisions of the securities laws to issuers and underwriters of municipal securities and their respective due diligence responsibilities. Do you have any recommendations as to how Federal legislation in this area should be framed?

Answer: The position of the Municipal Rule Making Board states my basic reasoning and recommendations on the liabilities of underwriters. To require due diligence of an underwriter that goes beyond the information contained in the official statement of an issuer would result in a situation resembling the conditions of today. The underwriter may no longer be willing to take the present risk on the same profit margin with the result that the municipal market would narrow to a point where public facilities can no longer be provided at reasonable costs.

4. Please provide the Subcommittee with copies of official statements prepared by the Local Government Commission during the past six months. Documents containing disclaimers or assumptions of responsibility for the accuracy of information, financial and otherwise, included in such statements would be particularly helpful.

Answer: Recent offering circulars (official statements) are enclosed. Description of the Local Government Commission certificate may be found on page 34 of the March 19, 1976 Charlotte official statement.

A concern I would like to express to you is that we are beginning to create a haven for consultants and lawyers which can only needlessly drive upward the cost of public facilities. The higher costs are borne by the local taxpayer, both wealthy and poor. If I can be of assistance to you, please let me know.

Yours very truly,

Harlan E. Boyles
Secretary

rl
Enclosures
cc: Hon. Harold Edwards, Office of U. S. Senator Robert Morgan

NOTICE AND BLANK PROPOSAL

$26,000,000
City
of
Charlotte
North Carolina
Bonds

SEALED BIDS WILL BE RECEIVED UNTIL
11 O'CLOCK A. M., NORTH CAROLINA TIME
JANUARY 14, 1975

69-141 O - 76 - 27

NOTICE OF SALE
$26,000,000
CITY OF CHARLOTTE, NORTH CAROLINA
BONDS

Sealed bids will be received until 11 o'clock A. M., North Carolina Time, January 14, 1975, by the undersigned at its office in the City of Raleigh, North Carolina, such bids to be opened at said time and place on said day, for the purchase of the following bonds of the City of Charlotte, North Carolina, dated December 1, 1974, and maturing annually, June 1, as follows, without option of prior payment:

$9,535,000	STREET BONDS, SERIES B, maturing annually, $575,000 1976, $360,000 1977, $375,000 1978, $425,000 1979 to 1981, inclusive, $450,000 1982 to 1993, inclusive, $475,000 1994, $475,000 1995, and $600,000 1996.
$6,250,000	AIRPORT BONDS, maturing annually, $100,000 1976 to 1982, inclusive, $400,000 1983 to 1985, inclusive, $350,000 1986, $300,000 1987, $300,000 1988, $375,000 1989 to 1993, inclusive, $400,000 1994 to 1996, inclusive, and $325,000 1997.
$6,220,000	SANITARY SEWER BONDS, SERIES B, maturing annually, $220,000 1976, $225,000 1977 to 1990, inclusive, $350,000 1991, $375,000 1992, $475,000 1993, and $550,000 1994 to 1996, inclusive.
$3,845,000	WATER BONDS, SERIES B, maturing annually, $225,000 1976, $125,000 1977 to 1989, inclusive, $150,000 1990, $225,000 1991, $225,000 1992, $350,000 1993 to 1995, inclusive, and $345,000 1996.
$ 150,000	SIDEWALK BONDS, maturing annually $25,000 1976 to 1981, inclusive.

Denomination $5,000; principal and semi-annual interest (June and December 1) payable in legal tender at First Union National Bank of North Carolina, in the City of Charlotte, North Carolina, or, at the option of the holder or registered owner, at Manufacturers Hanover Trust Company, in New York City; general obligations; unlimited tax; coupon bonds registrable as to principal only; delivery on or about February 10, 1975, at place of purchaser's choice. There will be no auction.

The application by the City of any net revenues of Douglas Municipal Airport to the payment of the principal of and the interest on the $6,250,000

Airport Bonds hereinabove described is subject to the prior lien on such revenues of the outstanding general obligation Airport Bonds of the City, dated April 1, 1963, May 1, 1964 and March 1, 1968, the outstanding Airport Revenue Bonds, Series A, of said City, dated January 1, 1972, issued under and pursuant to a resolution adopted by the City Council on March 20, 1972, any Airport Revenue Bonds hereafter issued under said resolution, and any airport revenue bonds hereafter issued under any resolution hereafter adopted by the City Council.

A separate bid for each issue is required, but no bid for less than all of the bonds offered or for less than the face value of the bonds plus accrued interest will be entertained. Any premium bid will be allocated to each issue in the proportion which the amount of such issue bears to the total of all said issues. Bidders are requested to name the interest rate or rates, in multiples of 1/4 or 1/10 of 1%, and each bidder must specify in his bid the amount and the maturities of the bonds of each rate. The difference between the lowest and highest rates named in the bid shall not exceed 2%. No bid may name more than six interest rates, any of which may be repeated. The bonds of all issues maturing on the same date must bear interest at the same rate. The interest payable on any bond on any interest payment date shall be represented by a single coupon and the interest rate on such bond shall be the same throughout its life. All of the bonds offered will be awarded to the bidder offering to purchase the bonds at the lowest interest cost to the City, such cost to be determined by deducting the amount of any premium bid from the aggregate amount of interest upon all of the bonds from their date until their respective maturities.

Each bid must be submitted on a form to be furnished with additional information by the undersigned, must be enclosed in a sealed envelope marked "Bid for Bonds", and must be accompanied by an official bank check, a cashier's check or a certified check upon an incorporated bank or trust company for $520,000 payable unconditionally to the order of the State Treasurer of North Carolina, on which no interest will be allowed. Award or rejection of bids will be made on the date above stated for receipt of bids and the checks of the unsuccessful bidders will be returned immediately. The check of the successful bidder will be held uncashed as security for the performance of his bid, but in the event the successful bidder shall fail to comply with the terms of his bid, the check may then be cashed and the proceeds thereof retained as and for full liquidated damages.

The unqualified approving opinion of Mitchell, Petty & Shetterly, New York City, will be furnished without cost to the purchaser. There will also be furnished the usual closing papers.

The right to reject all bids is reserved.

LOCAL GOVERNMENT COMMISSION
Raleigh, North Carolina
By: H. E. Boyles
Secretary of the Commission

ADDITIONAL INFORMATION

BONDS AUTHORIZED AND UNISSUED:

Purpose	Total Authorized	Bonds Now Offered	Balance
Water	$ 6,475,000*	$ 3,845,000	$2,630,000
Sanitary Sewer	6,220,000*	6,220,000	
Airport	6,250,000*	6,250,000	
Street Widening, Extension & Improvement	12,460,000+	9,335,000	3,125,000
Street Land	810,000+	200,000	610,000
Bridge	730,000+		730,000
Sidewalk	150,000+	150,000	
Total	$33,095,000	$26,000,000	$7,095,000†

*Approved by the voters at an election on 9/2/72.
+Approved by the voters at an election on 4/10/73.
†Offering of the remaining bonds is anticipated for January 1976.

LEGAL OPINION: A certified copy of the approving legal opinion of Mitchell, Petty & Shetterly, New York City, to be issued on the date of delivery of the bonds now offered, will be printed on the back of such bonds.

CHARLOTTE, located at the midpoint of the Piedmont Crescent Section of the Carolinas, is the largest City and principal financial, trading and distribution center in the two Carolinas. The City ranks among the top 25 distribution centers in the nation. The City is ranked 17th in the U. S. as a regional sales center for national firms. The City's retail sales per household is 32nd in the U. S. and 1st in the Southeast among cities of 250,000 or more, according to Sales Management Magazine. Diversified manufacturing (more than 690 various concerns) includes textiles, hosiery, food products, wearing apparel, printing, machinery and industrial chemicals; the City ranks 4th in the U. S. in wholesale sales of industrial chemicals. Represented in the City are five of the nation's 100 largest banks, operating alongside a branch bank of the Federal Reserve. According to the Federal Reserve figures released in July 1974, the City's current estimated rate of bank debits to demand deposits of $56.000,000,000 placed the City in 40th position among the nation's metropolitan areas. The most recent survey shows 16 banks operating 128 branches in Mecklenburg County. They employ approximately 3,900 people with an estimated payroll of $25,000,000 annually. According to Sales Management Magazine, Charlotte also has the 2nd highest median family income among the large cities in the southern U. S. The 1970 Census shows the City ranking 9th in the percent of households with two or more cars, among the cities within the U. S. with population of 250,000 or more. Transportation facilities include three Class 1 railroads: Norfolk-Southern, Seaboard Coastline and Southern Railway; 115 major motor carriers; and regularly-scheduled flights by five airlines: Delta, Eastern, Piedmont, Southern and United, operating out of Charlotte's Douglas Municipal Airport marks the City as a port of entry and export. The City's public schools enjoy a high reputation throughout the South due to an excellent quality of instruction and physical facilities. Among the colleges in the metropolitan area are one junior college and four senior colleges, including the University of North Carolina at Charlotte. The City is recognized as one of the outstanding medical centers in the Southeast with five hospitals, of which three have nurses' training. The local Medical Society sponsors the largest medical library in the South, not connected with a medical school. The City owns its water system with fresh water being available in abundance, and more than 98% of the City's raw water supply is yet untapped. The City is the County Seat of Mecklenburg County, operates under the Council-Manager form of government and has never defaulted in the payment of principal or interest of any of its obligations.

BID FOR BONDS

_____, 1975

Local Government Commission
Albemarle Building, 325 N. Salisbury Street
Raleigh, North Carolina 27611

Sirs:

Subject to the provisions and in accordance with the terms of the annexed Notice of Sale, which are hereby made a part of this bid, we make the following bid for the bonds of the City of Charlotte, North Carolina, described in said Notice of Sale, this bid being for not less than all of said bonds:

For the $9,535,000 Street Bonds, Series B, $6,250,000 Airport Bonds, $6,220,000 Sanitary Sewer Bonds, Series B, $3,845,000 Water Bonds, Series B, and $150,000 Sidewalk Bonds maturing and bearing interest as follows:

Year of Maturity	Street Bonds, Series B	Airport Bonds	Sanitary Sewer Bonds, Series B	Water Bonds, Series B	Sidewalk Bonds	Interest Rate	Year of Maturity
1976	$575,000	$100,000	$220,000	$225,000	$25,000	_____%	1976
1977	360,000	100,000	225,000	125,000	25,000	_____%	1977
1978	375,000	100,000	225,000	125,000	25,000	_____%	1978
1979	425,000	100,000	225,000	125,000	25,000	_____%	1979
1980	425,000	100,000	225,000	125,000	25,000	_____%	1980
1981	425,000	100,000	225,000	125,000	25,000	_____%	1981
1982	450,000	100,000	225,000	125,000		_____%	1982
1983	450,000	400,000	225,000	125,000		_____%	1983
1984	450,000	400,000	225,000	125,000		_____%	1984
1985	450,000	400,000	225,000	125,000		_____%	1985
1986	450,000	350,000	225,000	125,000		_____%	1986
1987	450,000	300,000	225,000	125,000		_____%	1987
1988	450,000	300,000	225,000	125,000		_____%	1988
1989	450,000	375,000	225,000	125,000		_____%	1989
1990	450,000	375,000	225,000	150,000		_____%	1990
1991	450,000	375,000	350,000	225,000		_____%	1991
1992	450,000	375,000	375,000	225,000		_____%	1992
1993	450,000	375,000	475,000	350,000		_____%	1993
1994	475,000	400,000	550,000	350,000		_____%	1994
1995	475,000	400,000	550,000	350,000		_____%	1995
1996	600,000	400,000	550,000	345,000		_____%	1996
1997		325,000				_____%	1997

we will pay the following amounts:

(1) $9,535,000 for said Street Bonds, Series B
(2) $6,250,000 for said Airport Bonds
(3) $6,220,000 for said Sanitary Sewer Bonds, Series B
(4) $3,845,000 for said Water Bonds, Series B
(5) $ 150,000 for said Sidewalk Bonds

plus a premium of $_____ for all of said bonds, which premium is to be allocated to each issue as provided in said Notice of Sale. We will also pay accrued interest from the date of the bonds to the date of delivery and will accept delivery of the bonds at _____ in _____ in accordance with said Notice of Sale.

We enclose herewith a check for $520,000, as required by said Notice of Sale, payable unconditionally to the order of the State Treasurer of North Carolina, which check is to be returned to us if this bid is not accepted, but otherwise is to be applied in accordance with said Notice of Sale.

The closing papers referred to in said Notice of Sale are to include a certificate, dated as of the day of delivery of the bonds, stating that there is no litigation pending or, to the knowledge of the signers of such certificate, threatened affecting the validity of the bonds.

_____

_____

(No addition or alteration, except as provided above, is to be made to this bid, and it must not be detached from the annexed Notice of Sale. Bidder may, for information only and neither required nor to be construed as a part of the foregoing bid, enter his calculation of net interest cost to be _____%.)

FINANCIAL AND STATISTICAL DATA
IN CONNECTION WITH
and
PERTAINING TO

$26,000,000
City
of
Charlotte
North Carolina
Bonds

for which
SEALED BIDS WILL BE RECEIVED
by the
LOCAL GOVERNMENT COMMISSION
AT ITS OFFICE
in
RALEIGH, NORTH CAROLINA
until
11 O'CLOCK A. M., NORTH CAROLINA TIME
JANUARY 14, 1975

CITY OF CHARLOTTE, NORTH CAROLINA
FINANCIAL SUMMARY

POPULATION – Estimated at 6/30/74, Charlotte-Mecklenburg Planning Commission ..... 304,000+
1970 U. S. Census 241,178
1960 U. S. Census 201,564
1950 U. S. Census 134,042

+Includes a population of approximately 45,000 acquired by annexation of approximately 32.5 square miles on January 25, 1974.

OUTSTANDING DEBT:

At 6/30/74	$110,685,000*
At 6/30/73	93,972,000
At 6/30/72	98,759,500*

*Bonds Issued:

1973-74 $21,500,000 ($8,845M Street Series A, $7,400M Sanitary Sewer Series A, $3,100M Public Improvement, and $2,155M Water Series A.), 13.88 yrs. av. mat., 4.9590% int. cost.

1971-72 $8,700,000 Civic Center Bonds, 14.07 yrs. av. mat., 4.442% int. cost.

1971-72 $7,400,000 ($2,825M Water Series C, $1,025M Sewer Series C, and $3,550M Other), 13.85 yrs. av. mat., 5.0793% int. cost.

ANALYSIS OF OUTSTANDING DEBT INCLUDING BONDS NOW OFFERED:

	At 6/30/1974	At 1/1/1975
Water Bonds - Outstanding	$ 20,570,000	$ 20,530,000
Water Bonds – Now Offered		3,845,000
Total Water Debt	20,570,000	24,375,000
Sanitary Sewer Bonds – Outstanding	26,640,000	26,630,000
Sanitary Sewer Bonds – Now Offered		6,220,000
Total Sanitary Sewer Debt	26,640,000	32,850,000
Airport Bonds – Outstanding	3,335,000	3,335,000
Airport Bonds – Now offered		6,250,000
Total Airport Debt	3,335,000	9,585,000
Other Bonds – Outstanding	60,140,000	59,990,000
Other Bonds – Now Offered		9,685,000
Total Other Debt	60,140,000	69,675,000
	$110,685,000	$136,485,000
Bond Anticipation Notes		5,500,000+

+Maturing 2/19/1975 and payable from sale proceeds of bonds now offered.

NOTE 1: Outstanding Debt shown above does not include outstanding balance of $3,600,000 Airport Revenue Bonds, Series A, which are payable solely from net revenues of the Airport Facility.

NOTE 2: In addition to the debt shown above the City has Lease-Purchase Agreements as follows: $2,245,557 Utilities Building and $2,753,300 Municipal Parking Garage.

TAXES:

Assessed Valuation –	1972-73	1973-74	1974-75
Assessment Ratio*	60%	60%	100%
Real Property	$1,044,402,843	$1,085,865,305	$2,332,758,133
Personal Property	450,589,263	484,615,340	827,989,122
Public Service Companies+	130,498,626	140,832,781	†
Total Assessed Val.	$1,625,490,732	$1,711,313,426	$3,160,747,255
Rate per $100	1.69	1.69	1.02
Levy	27,470,793	28,921,197	32,249,664
Uncollected –			
At 6/30/1973	617,265		
At 6/30/1974	186,062	646,328	
At 10/1/1974	162,483	444,292	26,967,611
Prior years as of above dates	$ 697,242	$ 535,638	$ 455,176

*Percentage of appraisal value as set by County officials. Revaluation of real property was made by County officials and became effective with the 1971 tax levy.

+Valuation of railroads, telephone companies and other utilities as determined by the State Board of Assessment in 1972-73 and the State Department of Revenue in 1973-74, 1974-75

†On 12/31/1974, an assessment of approximately $2,800,000 will be levied against valuations approximating $275,000,000 for Public Service Companies.

OVERLAPPING UNIT:
MECKLENBURG COUNTY:

Assessed Valuation	1973-74	Rate Per $100	Outstanding Debt At 1/1/1974	Population 1970 U. S. Census
Real Property	$1,829,256,819	$1.56	$102,320,000	354,656
Personal Property	795,058,720			
Public Service Companies	259,509,168			
	$2,883,824,707			

Note: The County does not have authorized and unissued bonds.

OPERATIONS – GENERAL FUND

REVENUES:	1973-74	1972-73	1971-72
Taxes	$28,612,292	$26,569,353	$24,713,905
Intergovernmental agencies	7,620,573	6,184,037	5,446,565
Licenses, permits, and fees	1,098,173	1,036,979	1,113,946
Interest on investments	1,009,839	521,410	366,345
Charges for current services	506,852	516,185	689,203
Intragovernmental services	431,516	354,070	–
Fines, forfeitures and penalties	177,444	194,700	195,103
Other	557,921	344,883	189,926
Total revenues	40,014,610	35,721,617	32,714,993
Transfers from other funds	1,691,388	798,289	67,361
Total Revenues and Transfers	41,705,998	36,519,906	32,782,354
EXPENDITURES AND ENCUMBRANCES:			
Public safety	15,829,476	13,980,812	13,298,142
Non-departmental charges	6,571,796	4,159,934	3,745,168
Public works	5,509,004	4,664,556	4,332,637
General government	5,261,651	4,253,606	3,635,039
Sanitation and waste removal	4,876,112	4,708,675	4,104,823
Health and welfare	625,043	600,956	521,183
Service centers	289,129	175,360	–
Total expenditures and encumbrances	38,962,211	32,543,899	29,636,992
Transfers to other funds	1,001,720	3,716,072	1,467,958
Total expenditures, encumbrances, and transfers	39,963,931	36,259,971	31,104,950
Excess of revenues and transfers over expenditures, encumbrances, and transfers	$ 1,742,067	$ 259,935	$ 1,677,404

SUMMARY OF FINANCIAL POSITION – GENERAL FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 245,883	$ 781,211	$ 51,427
Short-term investments, at cost which approximates market	9,629,828	9,010,000	6,200,000
Receivables:			
Property tax	1,111,060	1,090,000	883,546
Sales tax	131,101	134,046	109,931
Other	96,186	100,121	116,407
Due from other governmental agencies	600,874	418,936	250,782
Due from other funds	708,461	471,031	726,898
Materials and supplies, at cost	144,703	134,327	118,937
Other	119,935	6,460	7,175
TOTAL	$12,788,031	$12,146,614	$ 8,465,103
LIABILITIES, ENCUMBRANCES OUTSTANDING, RESERVE, AND FUND BALANCE			
Liabilities:			
Accounts payable	$ 1,535,265	$ 849,003	$ 368,927
Employee withholding, etc.	1,221,094	1,130,498	754,717
Due to other funds	1,355,584	3,947,587	1,563,751
Other	87,536	51,413	98,564
Total liabilities	4,199,479	5,978,501	2,785,959
Encumbrances outstanding	1,564,621	899,947	885,678
Reserve for uncollected receivables	1,338,347	1,338,649	1,109,885
Fund Balance:			
Appropriated	2,324,946	1,500,000	1,779,760
Unappropriated	3,360,638	2,443,517	1,903,821
Total fund balance	5,685,584	3,943,517	3,683,581
TOTAL	$12,788,031	$12,146,614	$ 8,465,103

SUMMARY OF CHANGES IN FUND BALANCE – GENERAL FUND

	1973-74	1972-73	1971-72
Fund Balance - Beginning of year	$ 3,943,517	$ 3,683,582	$ 2,006,177
Excess of revenues and transfers over expenditures, encumbrances, and transfers	1,742,067	259,935	1,677,404
Fund Balance – End of Year	$ 5,685,584	$ 3,943,517	$ 3,683,581

OPERATIONS – WATER AND SEWER FUND

	1973-74	1972-73	1971-72
OPERATING REVENUES	$10,866,432	$10,185,890	$ 7,740,296
OPERATING EXPENSES	8,351,530	7,451,964	6,546,244
Operating income	2,514,902	2,733,926	1,194,052
Non-Operating (Revenues) Expenses and Transfers:			
Interest on investments	(252,147)	(229,079)	(136,948)
Capital outlay	255,797	287,010	194,536
Transfers from other funds	(2,467,228)	(2,343,269)	(1,985,899)
Transfers to other funds	4,176,600	5,431,876	3,433,029
Other, net	(94,843)	(65,103)	139,600
Total non-operating (revenues), expenses, and transfers	1,618,179	3,081,435	1,644,318
Excess (deficiency) of revenues over expenses, and transfers	$ 896,723	$ (347,509)	$ (450,266)

SUMMARY OF FINANCIAL POSITION – WATER AND SEWER FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 73,327	$ 106,975	$ 86,868
Short-term investments, at cost which approximates market	2,285,000	1,775,000	2,757,000
Receivables:			
Water and sewer charges	759,181	682,069	449,066
Other	64,726	63,849	65,842
Materials and supplies, at cost	535,808	503,738	444,819
Due from other funds	307,886	50,919	152,857
Other	88,208	50,615	1,957
Total	$ 4,114,136	$ 3,233,165	$ 3,958,409
LIABILITIES AND RETAINED EARNINGS			
LIABILITIES:			
Accounts payable	$ 371,978	$ 192,019	$ 177,003
Customer deposits	473,480	439,781	402,557
Construction deposits	276,238	173,181	261,198
Due to other funds	106,453	491,071	827,120
Other	52,871	720	6,629
Total liabilities	1,281,020	1,296,772	1,674,507
CONTRIBUTED CAPITAL AND RETAINED EARNINGS:			
Contributed capital/retained earnings prior to July 1, 1973	1,936,393	1,936,393	2,283,902
Retained earnings	896,723	-	-
Total contributed capital and retained earnings	2,833,116	1,936,393	2,283,902
Total	$ 4,114,136	$ 3,233,165	$ 3,958,409

SUMMARY OF CHANGES IN CONTRIBUTED CAPITAL AND RETAINED EARNINGS – WATER AND SEWER FUND

	1973-74	1972-73	1971-72
Contributed capital and retained earnings - beginning balance	$ 1,936,393	$ 2,283,902	$ 2,734,168
Excess (deficiency) of revenues over expenses and transfers	896,723	(347,509)	(450,266)
Contributed capital and retained earnings - ending balance	$ 2,833,116	$ 1,936,393	$ 2,283,902

OPERATIONS – AIRPORT FUND

	1973-74	1972-73	1971-72
OPERATING REVENUES	$ 1,903,885	$ 1,878,657	$ 1,608,250
OPERATING EXPENSES	1,365,011	1,202,432	1,075,429
Operating income	538,874	676,225	532,821
Non-Operating (Revenues) Expenses and Transfers:			
Interest on investments	(124,795)	(81,045)	(50,384)
Other	32,525	24,699	17,411
Transfers from other funds	(557,685)	(600,811)	(464,776)
Transfers to other funds	1,209,952	692,805	1,558,479
Total non-operating (revenues) expenses and transfers	559,997	35,648	1,060,730
Excess (deficiency) of revenues over expenses and transfers	$ (21,123)	$ 640,577	$ (527,909)

SUMMARY OF FINANCIAL POSITION – AIRPORT FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 794,715	$ 148,449	$ 44,009
Short-term investments, at cost which approximates market	1,235,100	1,620,100	839,000
Receivables:			
Revenue charges	127,984	175,494	105,065
Other	17,201	33,182	5,305
Due from other funds	182,876	38,362	14,268
Other	-	-	395,905
Total	$ 2,357,876	$ 2,015,587	$ 1,403,552
LIABILITIES, CONTRIBUTED CAPITAL AND RETAINED EARNINGS			
LIABILITIES:			
Accounts payable	$ 32,533	$ -	$ 10,564
Due to other funds	400,300	72,492	90,245
Other	4,232	1,161	1,386
Total liabilities	437,065	73,653	102,195
CONTRIBUTED CAPITAL AND RETAINED EARNINGS:			
Contributed capital/retained prior to July 1, 1973	1,941,934	1,941,934	1,301,357
Retained earnings	(21,123)		
Total contributed capital and retained earnings	1,920,811	1,941,934	1,301,357
Total	$ 2,357,876	$ 2,015,587	$ 1,403,552

SUMMARY OF CHANGES IN CONTRIBUTED CAPITAL AND RETAINED EARNINGS – AIRPORT FUND

	1973-74	1972-73	1971-72
Contributed capital and retained earnings - beginning balance	$ 1,941,934	$ 1,301,357	$ 1,261,374
Additions:			
Donation of investments from Cannon Estate			567,892
Excess of revenues over expenses and transfers		640,577	
Deductions - Deficiency of revenues over expenses and transfers	(21,123)		(527,909)
Contributed capital and retained earnings - ending balance	$ 1,920,811	$ 1,941,934	$ 1,301,357

OPERATIONS – GENERAL DEBT SERVICE FUND

	1973-74	1972-73	1971-72
REVENUES:			
Taxes:			
Current year property taxes	$ 4,186,760	$ 3,960,560	$ 2,821,653
Prior years property taxes	61,258	38,655	71,160
Intangible taxes	230,496	148,750	104,706
Total	4,478,514	4,147,965	2,997,519
Less errors and rebates	19,011	18,920	10,751
Total taxes	4,459,503	4,129,045	2,986,768
Contribution from ABC Board	236,906	248,188	253,828
Interest on investments	154,254	56,854	87,135
Beer and wine licenses	14,877	13,014	12,945
Total revenues	4,865,540	4,447,101	3,340,676
Transfers from other funds	956,143	615,688	1,163,549
Total revenues and trans.	5,821,683	5,062,789	4,504,225
EXPENDITURES:			
Redemption of serial bonds	2,560,000	2,560,000	2,675,000
Interest on bonds	2,487,331	2,203,712	2,201,513
Fiscal agent fees	19,459	4,071	20,818
Total expenditures	5,066,790	4,767,783	4,897,331
Excess (deficiency) of revenues and transfers over expenditures	$ 754,893	$ 295,006	$ (393,106)

SUMMARY OF FINANCIAL POSITION – GENERAL DEBT SERVICE FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 631	$ 519	$ 56
Short-term investments, at cost which approximate market	2,269,000	1,513,000	774,000
Property tax receivable	185,345	164,652	111,185
Due from other funds	21,742	16,803	372,137
Advance debt service payment	14,400	-	18,474
Total	$ 2,491,118	$ 1,694,974	$ 1,275,852

LIABILITY, RESERVE AND FUND BALANCE

Liability - Due to other funds	$ 129,926	$ 109,368	$ 38,718
Reserve for property tax receivable	185,345	164,652	111,185
Total liability and reserve	315,271	274,020	149,903
Fund Balance:			
Appropriated	573,300	-	230,564
Unappropriated	1,602,547	1,420,954	895,385
Total fund balance	2,175,847	1,420,954	1,125,949
Total	$ 2,491,118	$ 1,694,974	$ 1,275,852

SUMMARY OF CHANGES IN FUND BALANCE – GENERAL DEBT SERVICE FUND

	1973-74	1972-73	1971-72
Fund Balance - beginning of year	$ 1,420,954	$ 1,125,948	$ 1,519,055
Excess (deficiency) of revenues and transfers over expenditures	754,893	295,006	(393,106)
Fund Balance - end of year	$ 2,175,847	$ 1,420,954	$ 1,125,949

OPERATIONS – WATER AND SEWER DEBT SERVICE FUND

	1973-74	1972-73	1971-72
REVENUE – Interest earned on investments	$ 262,395	$ 60,833	$ 41,189
Transfers from other funds	5,001,077	4,697,961	4,087,051
Total revenue and transfers	$ 5,263,472	$ 4,758,794	$ 4,128,240
EXPENDITURES:			
Bond principal	2,070,000	2,070,500	2,080,500
Bond interest	1,693,514	1,377,352	1,487,424
Payments to Mecklenburg County under lease-purchase agreement	626,868	594,017	–
Total expenditures	4,390,382	4,041,869	3,567,924
Excess of Revenue and Transfers over expenditures	$ 873,090	$ 716,925	$ 560,316

SUMMARY OF FINANCIAL POSITION – WATER AND SEWER DEBT SERVICE FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 458	$ 469	$ 182
Short-term investments, at cost which approximates market	2,176,000	1,407,000	550,000
Due from other funds	109,230	75,206	553,788
Due from other governmental agencies	355,621	285,479	–
Accrued interest receivable	233,404	210,729	179,352
Other	2,624	3,245	3,867
Total	$ 2,877,337	$ 1,982,128	$ 1,287,189
LIABILITIES, CONTRIBUTED CAPITAL, AND RETAINED EARNINGS			
LIABILITIES:			
Due to other funds	$ 247	$ –	$ 7,163
Accrued interest payable	238,454	216,582	231,405
Total liabilities	238,701	216,582	238,568
CONTRIBUTED CAPITAL AND RETAINED EARNINGS:			
Contributed capital/retained earnings prior to July 1, 1973	1,765,546	1,765,546	1,048,621
Retained earnings	873,090	–	–
Total contributed capital and retained earnings	2,638,636	1,765,546	1,048,621
Total	$ 2,877,337	$ 1,982,128	$ 1,287,189

SUMMARY OF CHANGES IN CONTRIBUTED CAPITAL AND RETAINED EARNINGS – WATER AND SEWER DEBT SERVICE FUND

	1973-74	1972-73	1971-72
Contributed capital and retained earnings – beginning balance	$ 1,765,546	$ 1,048,621	$ 488,305
Addition – excess of revenues and transfers over expenditures	873,090	716,925	560,316
Contributed capital and retained earnings – ending balance	$ 2,638,636	$ 1,765,546	$ 1,048,621

OPERATIONS – AIRPORT DEBT SERVICE FUND

	1973-74	1972-73	1971-72
REVENUES – Interest earned on investments	$ 49,685	$ 25,777	$ 62,153
Transfers from other funds	738,132	833,416	302,215
Total revenue and transfers	787,817	859,193	364,368
EXPENDITURES:			
Bond principal	320,000	145,000	–
Bond interest	321,527	338,179	147,165
Total expenditures	641,527	483,179	147,165
Excess of revenue and transfers over expenditures	$ 146,290	$ 376,014	$ 217,203

SUMMARY OF FINANCIAL POSITION – AIRPORT DEBT SERVICE FUND

ASSETS	At 6/30/1974	At 6/30/1973	At 6/30/1972
Cash	$ 633	$ 444	$ 983
Short-term investments, at cost which approximate market	520,000	321,665	185,907
Due from other funds	156,933	125,587	75,925
Advance debt service payment	315,997	270,145	95,100
Other	14,133	13,614	–
Total	$ 1,007,696	$ 731,455	$ 357,915
LIABILITIES, CONTRIBUTED CAPITAL, AND RETAINED EARNINGS			
LIABILITIES:			
Due to other funds	$ 136,254	$	$ –
Accrued interest on bonds payable	131,935	138,238	140,712
Total liabilities	268,189	$ 138,238	140,712
CONTRIBUTED CAPITAL AND RETAINED EARNINGS:			
Contributed capital/retained earnings prior to July 1, 1973	593,217	593,217	217,203
Retained earnings	146,290		
Total contributed capital and retained earnings	739,507	593,217	217,203
Total	$ 1,007,696	$ 731,455	$ 357,915

SUMMARY OF CHANGES IN CONTRIBUTED CAPITAL AND RETAINED EARNINGS – AIRPORT DEBT SERVICE FUND

	1973-74	1972-73	1971-72
Contributed capital and retained earnings – beginning balance	$ 593,217	$ 217,203	$ –
Additions – excess of revenues and transfers over expenditures	146,290	376,014	217,203
Contributed capital and retained earnings - Ending balance	$ 739,507	$ 593,217	$ 217,203

NOTES TO FINANCIAL SUMMARIES

(1) BASIS OF ACCOUNTING:

The accounts of the City are maintained and the accompanying financial summaries have been prepared except as noted in the succeeding paragraph, from accounting records maintained on the modified accrual basis of accounting and reflect the City's use of budgetary accounting procedures. Accordingly, certain revenues, such as property taxes, are recognized only when received. Receivables, principally for uncollected property taxes, are recorded and included in the accompanying financial summaries, with offsetting reserves equal to the amount of such receivables. Certain legal commitments for encumbrances are fully reserved.

The accounts of the following funds are maintained on the modified accrual basis of accounting but the accompanying financial summaries for these funds have been prepared using the accrual basis of accounting.

Water and Sewer Operating Fund
Water and Sewer Debt Service Fund
Airport Operating Fund
Airport Debt Service Fund

Unappropriated fund balances of the following funds at June 30, 1974 are restricted for amounts representing employee's vested vacation pay which has been earned, but not paid at June 30, 1974, and are not recorded as accrued liabilities in the accompanying financial summaries;

General Fund	$1,542,049
Airport Operating Fund	$ 19,709
Water and Sewer Operating Fund	$ 230,796

(2) FUND BALANCE:

Unappropriated fund balances as determined in accordance with the General Statutes of North Carolina, differs from amounts reported as contributed capital and retained earnings, for the funds noted below, since utilization of the accrual basis of accounting results in balances which are not in accordance with such statutes.

Fund	Unappropriated Fund Balance	1973-74	1972-73	1971-72
Water and Sewer:	Operating	$ 672,010	$1,162,909	$1,067,334
	Debt Service	1,038,065	1,485,920	1,100,674
Airport:	Operating	1,396,302	1,891,373	1,190,121
	Debt Service	686,604	358,329	255,735

(3) RECLASSIFICATION AND OTHER CHANGES TO PRIOR YEAR FINANCIAL SUMMARIES:

Financial summaries for the year ended June 30, 1972 which were previously presented in a similar report in connection with solicitation of bids pursuant to the sale of bonds have been restated in the accompanying summaries to reflect certain reclassification and other changes to conform with certain recommendations affecting financial reporting contained in the audit guide for audits of state and local governmental units issued by the AICPA Committee on Governmental Accounting and Auditing.

NOTE: In addition to the foregoing financial summaries, copies of the City's Annual Financial Report are available in the office of Mr. J. B. Fennell, City Director of Finance, 600 E. Trade Street, Charlotte, North Carolina 28202 (Telephone AC 704 374-3051).

ANNUAL DEBT REQUIREMENTS FOR UTILITIES FROM JUNE 30, 1974, AND MATURITIES OF BONDS NOW OFFERED:

Fiscal Year	Existing Debt		Bonds Now Offered
	Principal	Principal & Interest	
1974-75	$ 2,875,000	$ 4,591,391.25	$
1975-76	2,420,000	3,999,541.25	445,000
1976-77	2,420,000	3,893,591.25	350,000
1977-78	2,420,000	3,796,520.00	350,000
1978-79	2,420,000	3,703,517.50	350,000
1979-80	2,420,000	3,616,430.00	350,000
1980-81	2,420,000	3,530,667.50	350,000
1981-82	2,420,000	3,448,867.50	350,000
1982-83	2,420,000	3,368,530.00	350,000
1983-84	2,420,000	3,287,717.50	350,000
1984-85	2,420,000	3,206,817.50	350,000
1985-86	2,420,000	3,131,315.00	350,000
1986-87	2,410,000	3,046,967.50	350,000
1987-88	2,390,000	2,946,555.00	350,000
1988-89	2,395,000	2,871,102.50	350,000
1989-90	2,325,000	2,715,915.00	375,000
1990-91	2,130,000	2,436,897.50	575,000
1991-92	2,120,000	2,354,617.50	600,000
1992-93	1,825,000	1,980,862.50	825,000
1993-94	1,150,000	1,238,425.00	900,000
1994-95	970,000	1,013,987.50	900,000
1995-96			895,000
	$47,210,000	$64,180,236.25	$10,065,000

69-141 O - 76 - 28

ANNUAL DEBT REQUIREMENTS FOR AIRPORT FROM JUNE 30, 1974, AND MATURITIES OF BONDS NOW OFFERED:

Fiscal Year	Existing Debt		Bonds Now Offered
	Principal	Principal & Interest	
1974-75	$ 145,000	$ 277,835.00	$
1975-76	145,000	269,135.00	100,000
1976-77	145,000	260,822.50	100,000
1977-78	145,000	254,205.00	100,000
1978-79	145,000	247,587.50	100,000
1979-80	145,000	240,950.00	100,000
1980-81	145,000	235,640.00	100,000
1981-82	145,000	230,330.00	100,000
1982-83	145,000	225,020.00	400,000
1983-84	145,000	219,710.00	400,000
1984-85	145,000	214,760.00	400,000
1985-86	205,000	269,790.00	350,000
1986-87	265,000	321,940.00	300,000
1987-88	270,000	316,570.00	300,000
1988-89	200,000	237,700.00	375,000
1989-90	200,000	229,200.00	375,000
1990-91	200,000	220,600.00	375,000
1991-92	200,000	212,000.00	375,000
1992-93	200,000	206,000.00	375,000
1993-94			400,000
1994-95			400,000
1995-96			400,000
1996-97			325,000
	$3,335,000	$4,689,795.00	$6,250,000

NOTE: The above annual debt requirements does not include $3,600,000 Airport Revenue Bonds, Series A, which are payable solely from net revenues of the Airport Facility.

ANNUAL DEBT REQUIREMENTS FOR OTHER FROM JUNE 30, 1974, AND MATURITIES OF BONDS NOW OFFERED:

Fiscal Year	Existing Debt		Bonds Now Offered
	Principal	Principal & Interest	
1974-75	$ 2,967,000	$ 5,529,820.00	$
1975-76	2,972,000	5,392,442.50	600,000
1976-77	2,972,000	5,249,282.50	385,000
1977-78	2,972,000	5,111,860.00	400,000
1978-79	2,972,000	4,977,525.00	450,000
1979-80	2,975,000	4,851,490.00	450,000
1980-81	2,970,000	4,723,375,00	450,000
1981-82	2,970,000	4,605,747.50	450,000
1982-83	2,970,000	4,494,610.00	450,000
1983-84	2,970,000	4,386,775.00	450,000
1984-85	2,965,000	4,275,012.50	450,000
1985-86	2,965,000	4,162,032.50	450,000
1986-87	2,955,000	4,027,352.50	450,000
1987-88	2,955,000	3,897,972.50	450,000
1988-89	2,955,000	3,772,392.50	450,000
1989-90	2,950,000	3,636,982.50	450,000
1990-91	2,925,000	3,476,270.00	450,000
1991-92	2,860,000	3,288,035.00	450,000
1992-93	2,800,000	3,105,750.00	450,000
1993-94	2,400,000	2,589,000.00	475,000
1994-95	1,000,000	1,085,000.00	475,000
1995-96	700,000	735,000.00	600,000
	$60,140,000	$87,373,727.50	$9,685,000

ANNUAL DEBT REQUIREMENTS FOR ALL PURPOSES FROM JUNE 30, 1974, AND MATURITIES OF BONDS NOW OFFERED:

Fiscal Year	Existing Debt		Bonds Now Offered
	Principal	Principal & Interest	
1974-75	$ 5,987,000.00	$ 10,399,046.25	$ $
1975-76	5,537,000.00	9,661,118.75	1,145,000
1976-77	5,537,000.00	9,403,696.25	835,000
1977-78	5,537,000.00	9,162,585.00	850,000
1978-79	5,537,000.00	8,928,630.00	900,000
1979-80	5,540,000.00	8,708,870.00	900,000
1980-81	5,535,000.00	8,489,682.50	900,000
1981-82	5,535,000.00	8,284,945.00	900,000
1982-83	5,535,000.00	8,088,160.00	1,200,000
1983-84	5,535,000.00	7,894,252.50	1,200,000
1984-85	5,530,000.00	7,696,540.00	1,200,000
1985-86	5,590,000.00	7,563,137.50	1,150,000
1986-87	5,630,000.00	7,396,260.00	1,100,000
1987-88	5,615,000.00	7,161,097.50	1,100,000
1988-89	5,550,000.00	6,881,195.00	1,175,000
1989-90	5,475,000.00	6,582,097.50	1,200,000
1990-91	5,255,000.00	6,133,767.50	1,400,000
1991-92	5,180,000.00	5,854,652.50	1,425,000
1992-93	4,825,000.00	5,292,612.50	1,650,000
1993-94	3,550,000.00	3,827,425.00	1,775,000
1994-95	1,970,000.00	2,098,987.50	1,775,000
1995-96	700,000.00	735,000.00	1,895,000
1996-97			325,000
	$110,685,000.00	$156,243,758.75	$26,000,000

NOTE: In addition to the debt shown above the City has Lease-Purchase Agreements as follows: $2,245,557 Utilities Building and $2,753,300 Municipal Parking Garage.

NOTICE AND BLANK PROPOSAL

$10,000,000
City
of
Fayetteville
North Carolina
Electric
Bonds
Series A

SEALED BIDS WILL BE RECEIVED UNTIL
11 O'CLOCK A. M., NORTH CAROLINA TIME
FEBRUARY 10, 1976

NOTICE OF SALE
$10,000,000
CITY OF FAYETTEVILLE, NORTH CAROLINA
ELECTRIC BONDS, SERIES A

Sealed bids will be received until 11 o'clock A. M., North Carolina Time, February 10, 1976, by the undersigned at its office in the City of Raleigh, North Carolina, such bids to be opened at said time and place on said day, for the purchase of $10,000,000 Electric Bonds, Series A, of the City of Fayetteville, North Carolina (first series of an authorized issue of $18,000,000 Bonds), dated March 1, 1976 and maturing annually, March 1, $500,000 1978 to 1991, inclusive, and $600,000 1992 to 1996, inclusive, without option of prior payment.

Denomination $5,000; principal and semi-annual interest (March 1 and September 1) payable in legal tender at First-Citizens Bank and Trust Company, in the City of Raleigh, North Carolina, or, at the option of the holder or registered owner, at Chemical Bank, in New York City; general obligations; unlimited tax; coupon bonds registrable as to principal only; delivery on or about March 1, 1976, at place of purchaser's choice. There will be no auction.

Bidders are requested to name the interest rate or rates, in multiples of 1/4 or 1/10 of 1%, and each bidder must specify in his bid the amount and the maturities of the bonds of each rate. The difference between the lowest and highest rates named in the bid shall not exceed 2%. No bid may name more than six interest rates, any of which may be repeated. All bonds maturing on the same date must bear interest at the same rate. The interest payable on any bond on any interest payment date shall be represented by a single coupon and the interest rate on such bond shall be the same throughout its life. The bonds will be awarded to the bidder offering to purchase the bonds at the lowest interest cost to the City, such cost to be determined by deducting the amount of any premium bid from the aggregate amount of interest upon all of the bonds from their date until their respective maturities. No bid for less than the face value of the bonds plus accrued interest will be entertained.

Each bid must be submitted on a form to be furnished with additional information by the undersigned, must be enclosed in a sealed envelope marked "Bid for Bonds", and must be accompanied by an official bank check, a cashier's check or a certified check upon an incorporated bank or trust company for $200,000, payable unconditionally to the order of the State Treasurer of North Carolina, on which no interest will be allowed. Award or rejection of bids will be made on the date above stated for receipt of bids and the checks of unsuccessful bidders will be returned immediately. The check of the successful bidder will be held uncashed as security for the

performance of his bid, but in the event the successful bidder shall fail to comply with the terms of his bid, the check may then be cashed and the proceeds thereof retained as and for full liquidated damages.

It is anticipated that CUSIP identification numbers will be printed on the bonds, but neither the failure to print such numbers on any bond nor any error with respect thereto shall constitute cause for a failure or refusal by the purchasers thereof to accept delivery of or pay for the bonds in accordance with the terms of their bid. All expenses in relation to the printing of CUSIP numbers on said bonds and the CUSIP Service Bureau charge for the assignment of said numbers shall be paid for by the City of Fayetteville.

The unqualified approving opinion of Brown, Wood, Ivey, Mitchell & Petty, New York City, will be furnished without cost to the purchaser. There will also be furnished the usual closing papers.

The right to reject all bids is reserved.

LOCAL GOVERNMENT COMMISSION
Raleigh, North Carolina
By: H. E. Boyles
Secretary of the Commission

BID FOR BONDS

_____, *1976*

Local Government Commission
Albemarle Building, 325 N. Salisbury Street
Raleigh, North Carolina 27611

Sirs:

Subject to the provisions and in accordance with the terms of the annexed Notice of Sale, which are hereby made a part of this bid, we make the following bid for the $10,000,000 Electric Bonds, Series A, of the City of Fayetteville, North Carolina, described in said Notice of Sale, this bid being for not less than all of said bonds:

For the $10,000,000 Electric Bonds, Series A, maturing and bearing interest as follows:

Year of Maturity	Principal Amount	Interest Rate	Year of Maturity	Principal Amount	Interest Rate
1978	$500,000	_____%	1988	$500,000	_____%
1979	500,000	_____%	1989	500,000	_____%
1980	500,000	_____%	1990	500,000	_____%
1981	500,000	_____%	1991	500,000	_____%
1982	500,000	_____%	1992	600,000	_____%
1983	500,000	_____%	1993	600,000	_____%
1984	500,000	_____%	1994	600,000	_____%
1985	500,000	_____%	1995	600,000	_____%
1986	500,000	_____%	1996	600,000	_____%
1987	500,000	_____%			

we will pay $10,000,000 plus a premium of ($_____).

We will also pay accrued interest from the date of the bonds to the date of delivery and will accept delivery of the bonds at _____ _____ in _____ in accordance with said Notice of Sale.

We enclose herewith a check for $200,000, as required by said Notice of Sale, payable unconditionally to the order of the State Treasurer of North Carolina, which check is to be returned to us if this bid is not accepted, but otherwise is to be applied in accordance with said Notice of Sale.

The closing papers referred to in said Notice of Sale are to include a certificate, dated as of the day of the delivery of the bonds, stating that there is no litigation pending or, to the knowledge of the signers of such certificate, threatened affecting the validity of the bonds.

_____

_____

(No addition or alteration, except as provided above, is to be made to this bid, and it must not be detached from the annexed Notice of Sale. Bidder may for information only and neither required nor to be construed as a part of the foregoing bid, enter his calculation of net interest cost to be

_____%.)

FINANCIAL AND STATISTICAL DATA
IN CONNECTION WITH
and
PERTAINING TO

$10,000,000
City
of
Fayetteville
North Carolina
Electric
Bonds
Series A

for which
SEALED BIDS WILL BE RECEIVED
by the
LOCAL GOVERNMENT COMMISSION
AT ITS OFFICE
in
RALEIGH, NORTH CAROLINA
until
11 O'CLOCK A. M., NORTH CAROLINA TIME,
FEBRUARY 10, 1976

CITY OF FAYETTEVILLE, NORTH CAROLINA
FINANCIAL STATEMENT

POPULATION –	1950 U. S. Census	34,715
	1960 U. S. Census	47,106
	1970 U. S. Census	53,510
	Estimated Present	59,500

OUTSTANDING DEBT:

At 6/30/1973	$12,540,000*	At 12/31/1975 –	
At 6/30/1974	11,583,000	Water Bonds	$ 6,530,000
At 6/30/1975	15,726,000*	Sanitary Sewer Bonds	2,876,000
		Electric Light & Power Bonds	2,815,000
		Other Bonds	3,375,000
			$15,596,000

*Bonds Issued:
1972-73 $2,500,000 Sanitary Sewer, 11.56 yrs. av. mat., 4.6552% int. cost.
1974-75 $5,000,000 Water, 15.28 yrs. av. mat., 6.1022% int. cost.

Note 1: Bond Anticipation Notes included in Outstanding Debt at 6/30/1973 $100,000.

Note 2: Outstanding Debt does not include $142,000 Parking Facility Revenue Bonds, dated 6/1/1967 which are payable solely from net revenues of the facility.

TAXES:

Assessed Valuation –	1973-74	1974-75	1975-76
Assessment Ratio*	50%	100%	100%
Real Property	$198,775,160	$419,428,765	$495,331,242
Personal Property	51,841,008	122,194,890	117,696,655
Public Service Companies+	23,810,377	50,021,622	50,320,284
Total Assessed Val.	$274,426,545	$591,645,277	$663,348,181
Rate per $100	1.21	.620	.630
Levy	3,337,325	3,707,448	4,179,093
Uncollected –			
At 6/30/1974	159,139		
At 6/30/1975	58,893	175,316	
At 12/31/1975	49,071	112,944	1,078,196
Prior years as of above dates	$ 116,225	$ 80,039	$ 73,327

*Percentage of appraisal value as set by County officials for fiscal year 1973-74; for fiscal years 1974-75 and 1975-76, Ratio has been established by Statute. Revaluation of real property was made by County officials and became effective with the 1972 tax levy.

+Valuation of railroads, telephone companies and other utilities as determined by the State Board of Assessment.

OVERLAPPING UNIT HAVING OUTSTANDING DEBT:

CUMBERLAND COUNTY – 1975-76 Assessed Valuation $1,694,903,100; Rate $1.06 per $100; Outstanding Debt at 12/31/1975 $24,270,000; Population 1970 U. S. Census 212,042; Bonds Authorized and Unissued – $9,900,000 ($3,500M Technical Institute, $5,600M County Courthouse and $800M School). Offering of $9,900,000 bonds is scheduled for sale on 2/24/1976.

BALANCE SHEET – GENERAL FUND

ASSETS	At 6/30/1973	At 6/30/1974	At 6/30/1975
Cash	$ 3,748,724	$ 5,724,550	$ 7,305,426
Receivables:			
Taxes	199,028	242,239	282,169
Assessments	122,010	132,287	236,691
Other	24,607	20,657	88,338
Due from other funds	10,605	50,785	100,705
Inventories	18,700	19,654	34,205
	$ 4,123,674	$ 6,190,172	$ 8,047,534
LIABILITIES AND FUND BALANCE			
Accounts payable	$ 254,066	$ 462,919	$ 859,140
Tax and deposit prepayments	3,700	3,700	10,218
Due to other funds	279,267	1,625,352	3,823,574
Reserves:			
Receivables	345,574	394,756	607,198
Capital improvements	577,216	1,117,347	1,051,244
Inventories	18,700	19,654	34,205
	1,478,523	3,623,728	6,385,579
Fund balance:			
At beginning of year	319,994	2,645,151	2,566,444
Revenue over (under) expenditures	2,325,003	(76,184)	(702,636)
(Increase) decrease in reserves	154	(2,523)	(201,853)
At end of year	2,645,151	2,566,444	1,661,955
	$ 4,123,674	$ 6,190,172	$ 8,047,534

OPERATIONS – GENERAL FUND

REVENUE	1972-73	1973-74	1974-75
Taxes - Ad Valorem	$ 2,816,477	$ 2,840,946	$ 3,305,442
State of North Carolina:			
Intangibles tax	104,264	123,600	107,308
Franchise tax	420,917	472,099	516,287
Beer and wine tax	137,090	147,306	165,825
Highway fund allocation	292,492	380,936	674,389
Local option sales tax	645,397	783,296	905,327
General revenue sharing	1,547,432	2,438,183	3,512,062
Licenses and permits	230,874	266,487	261,576
Court costs and fees	19,635	17,922	18,156
Assessments and interest	6,035	35,240	34,988
Recreation	96,687	37,434	32,131
Cemetery	15,214	25,446	20,027
Airport	223,436	251,404	308,578
Refunds	87,579	223,547	133,095
Sales and service	103,157	109,869	178,333
Interest on investments	88,212	327,669	479,977
Other	13,224	28,864	41,833
	6,848,122	8,510,248	10,695,334
Contribution from other funds	1,116,165	1,118,020	1,592,658
Total revenue	7,964,287	9,628,268	12,287,992
EXPENDITURES			
Administrative	139,515	1,308,826	1,986,952
Departmental:			
Police	1,205,391	1,390,510	1,609,766
Fire	960,454	1,084,969	1,284,812
Street	269,849	322,305	401,833
Sanitation	871,525	837,236	973,131
Engineering	274,783	339,919	392,703
Finance	165,620	146,276	180,822
Building	49,366	62,989	84,038
Recreation	391,033	255,396	491,757
Cemetery	69,372	70,396	89,928
Airport	189,556	210,199	240,788
Other	74,813	237,057	87,031
	4,661,277	6,266,078	7,823,561
Contribution to other funds		1,644,372	2,611,965
Capital outlay	978,007	1,794,002	2,555,102
Total expenditures	5,639,284	9,704,452	12,990,628
Revenue over (under) expenditures	$ 2,325,003	$ (76,184)	$ (702,636)

BALANCE SHEET – UTILITIES FUND

	At 6/30/1973	At 6/30/1974	At 6/30/1975
Current assets:			
Cash	$ 7,108,677	$ 1,733,865	$ 3,016,749
Receivable –			
Customer accounts	665,748	716,863	1,526,980
Doubtful accounts			(75,008)
Assessments	29,022	55,490	49,431
Other	103,559	142,650	121,744
Inventory	1,714,385	2,924,948	3,378,731
Due from other funds	914	1,230,365	
Due from Cumberland County		433,000	185,186
Other	94,551	115,526	
	9,716,856	7,352,707	8,203,813
Fixed assets:			
Utility systems	55,583,332	65,902,187	74,295,956
Accumulated depreciation	(22,361,878)	(24,634,074)	(27,316,012)
	33,221,454	41,268,113	46,979,944
	$42,938,310	$48,620,820	$55,183,757
Current liabilities and reserves:			
Payable - accounts	$1,059,161	$1,237,858	$2,158,662
- contracts	263,155	85,775	32,874
Due to other funds		1,544	
Customer deposits	703,946	750,691	928,616
Project deposits	1,683,545		2,155,557
Current maturities - bond principal	520,000	520,000	620,000
Reserves –			
Receivables	798,329	1,348,002	
Inventory	1,714,385	2,924,948	
Other	1,963,008	115,526	
	8,705,529	6,984,344	5,895,709
Other liabilities:			
Long-term maturities - bond principal	7,685,000	7,165,000	11,545,000
Invested in fixed assets	25,016,454	33,583,113	34,814,944
	32,701,454	40,748,113	46,359,944
Sub-total	41,406,983	47,732,457	52,255,653
Retained earnings:			
At beginning of year	1,616,366	1,531,327	888,363
Net income (loss)	2,089,208	2,731,554	1,740,324
Depreciation	2,174,312	2,367,864	
Capital outlay	(3,495,330)	(3,643,321)	
(Increase) decrease - reserves	(378,293)	(1,605,529)	1,234,868
(Increase) decrease - other	45,064	26,468	(415,451)
Bond principal	(520,000)	(520,000)	(520,000)
At end of year	1,531,327	888,363	2,928,104
	$42,938,310	$48,620,820	$55,183,757

OPERATIONS – UTILITIES FUND

	1972-73	1973-74	1974-75
Operating revenue:			
Electric	$14,745,947	$15,669,159	$22,535,577
Water	1,715,057	1,946,475	1,669,753
Sewer	864,587	1,439,784	785,573
Other		198,868	133,910
	17,325,591	19,254,286	25,124,813
Operating expense:			
Administrative	655,853	764,884	838,561
Customer service	1,385,972	722,083	1,025,710
Electric	8,905,247	10,304,268	16,041,654
Water	554,341	544,925	627,020
Sewer	330,766	359,259	425,346
	11,832,179	12,695,419	18,958,291
Operating income before depreciation	5,493,412	6,558,867	6,166,522
Depreciation	2,174,312	2,367,864	2,728,269
Operating income	3,319,100	4,191,003	3,438,253
Non-operating income:			
Interest	219,153	159,547	165,787
Sales and service	176,775		219,768
Other	14,074		
	410,002	159,547	385,555
Sub-total	3,729,102	4,350,550	3,823,808
Non-operating expense:			
Bond interest and fees	368,562	348,175	639,250
Contribution to General fund	1,271,332	1,118,020	1,270,550
Other		152,801	173,684
	1,639,894	1,618,996	2,083,484
Net income (loss)	$2,089,208	$2,731,554	$1,740,324

BALANCE SHEET – DEBT SERVICE FUND

ASSETS	At 6/30/1973	At 6/30/1974	6/ /1975
Cash	$ 58,617	$ 87,538	$ 138,656
Receivables:			
Taxes	25,202	33,125	32,125
Assessments	105,284	81,045	70,604
Due from other funds	2,040	2,040	2,040
	$ 191,143	$ 203,748	$ 243,425
LIABILITIES AND FUND BALANCE			
Due to other funds	$ 8,264	$ 49,522	$ 99,185
Reserve for receivables	130,486	114,170	102,729
	138,750	163,692	201,914
Fund balance:			
At beginning of year	45,793	52,393	40,056
Revenue over (under) expenditures	6,600	(12,337)	1,455
At end of year	52,393	40,056	41,511
	$ 191,143	$ 203,748	$ 243,425

OPERATIONS – DEBT SERVICE FUND

REVENUE	1972-73	1973-74	1974-75
Taxes - Ad Valorem	$ 482,344	$ 500,417	$ 417,246
N. C. intangibles tax	19,418	21,983	19,384
Interest on investments	18,831	39,857	40,018
Assessments and interest	54,496	29,830	14,399
Contributions from other funds	888,562	868,175	1,159,250
Total revenue	1,463,651	1,460,262	1,650,297
EXPENDITURES			
Bond principal	907,000	957,000	857,000
Interest and fees	550,051	515,599	791,842
Total expenditures	1,457,051	1,472,599	1,648,842
Revenue over (under) expenditures	$ 6,600	$ (12,337)	$ 1,455

BONDS AUTHORIZED AND UNISSUED: $19,500,000 consisting of $1,500,000 Water (balance of a $6,500,000 authorization) approved by the voters at an election on 4/6/1974 and $18,000,000 Electric ($10,000M now offered) approved by the voters at an election on 12/16/1975. An offering date for the remaining authorization has not been established at this time, but it is anticipated that the remaining $8,000,000 Electric will be sold in approximately six months.

LEGAL OPINION: A certified copy of the approving legal opinion of Brown, Wood, Ivey, Mitchell & Petty, New York City, to be issued on the date of delivery of the bonds now offered, will be printed on the back of such bonds.

FAYETTEVILLE, County Seat of Cumberland County is located in the coastal plains area of North Carolina - sixty miles south of the capital city of Raleigh. Fort Bragg and Pope Air Force Base, one of the largest military complexes in the world, is located within five miles of outer city limits boundary line,west of the City. It is an old City, rich in history, which since World War II has experienced phenomenal growth in population, territory (presently 30 sq. miles) and commercial activity. Retail sales have grown from 194,000,000 in 1963 to 610,400,000 in 1974 for a growth of 215%. This growth is due to the City's location as a distribution center, its abundance of raw water, its exceptionally mild year-round climate, which makes it attractive to many army retirees and to new industrial concerns. In recent years nine internationally known companies started construction on new plants and these, with a number of smaller ones, which have located here recently will furnish employment to 10,000 people. The City is favorably situated with respect to transportation facilities. The Cape Fear River affords an eight foot year-round channel to the Atlantic Ocean and is used considerably by barge traffic. Three major north-south highways pass through the City and its 2,540 motel rooms make it a mecca for tourists. Numerous truck and transfer warehouses and facilities are in and around the City in addition to four railroads and a modern airport. On air, passengers rose from 25,215 in 1963 to 150,808 in 1974. Off air, passengers rose from 27,381 to 154,918 over the same period. Although the City's downtown business area has slowed in growth, several successful shopping centers have been developed, and more than offset this factor. Today, manufacturing - principally automobile tires, small tools, plastics and textiles - is a major factor in the City's economy, but agriculture is still important. Tobacco, soybeans, poultry, cattle and swine are major farm products. The City has operated under the council-manager plan of government since 1949 and has never defaulted in the payment of any of its indebtedness.

ANNUAL DEBT REQUIREMENTS FROM JUNE 30, 1975, AND MATURITIES OF BONDS NOW OFFERED:

Fiscal Year	UTILITIES Existing Debt Principal	UTILITIES Existing Debt Principal & Interest	UTILITIES Bonds Now Offered	OTHER Existing Debt Principal	OTHER Existing Debt Principal & Interest	ALL PURPOSES Existing Debt Principal	ALL PURPOSES Existing Debt Principal & Interest	ALL PURPOSES Bonds Now Offered	Fiscal Year
1975-76	$ 620,000	$ 1,239,012.50	$	$ 337,000	$ 476,735	$ 957,000	$ 1,715,747.50	$	1975-76
1976-77	620,000	1,211,775.00		337,000	465,020	957,000	1,676,795.00		1976-77
1977-78	625,000	1,190,037.50	500,000	337,000	453,105	962,000	1,643,142.50	500,000	1977-78
1978-79	625,000	1,162,400.00	500,000	335,000	439,080	960,000	1,601,480.00	500,000	1978-79
1979-80	625,000	1,133,850.00	500,000	310,000	401,600	935,000	1,535,450.00	500,000	1979-80
1980-81	625,000	1,104,750.00	500,000	285,000	364,730	910,000	1,469,480.00	500,000	1980-81
1981-82	625,000	1,075,650.00	500,000	285,000	353,565	910,000	1,429,215.00	500,000	1981-82
1982-83	625,000	1,046,175.00	500,000	195,000	252,390	820,000	1,298,565.00	500,000	1982-83
1983-84	625,000	1,016,337.50	500,000	195,000	244,195	820,000	1,260,532.50	500,000	1983-84
1984-85	625,000	991,525.00	500,000	195,000	235,670	820,000	1,227,195.00	500,000	1984-85
1985-86	625,000	956,350.00	500,000	195,000	227,135	820,000	1,183,485.00	500,000	1985-86
1986-87	625,000	923,750.00	500,000	195,000	218,590	820,000	1,142,340.00	500,000	1986-87
1987-88	625,000	891,312.50	500,000	195,000	209,940	820,000	1,101,252.50	500,000	1987-88
1988-89	625,000	857,750.00	500,000	165,000	171,290	790,000	1,029,040.00	500,000	1988-89
1989-90	625,000	823,750.00	500,000			625,000	823,750.00	500,000	1989-90
1990-91	625,000	789,750.00	500,000			625,000	789,750.00	500,000	1990-91
1991-92	400,000	530,750.00	600,000			400,000	530,750.00	600,000	1991-92
1992-93	400,000	506,750.00	600,000			400,000	506,750.00	600,000	1992-93
1993-94	400,000	482,750.00	600,000			400,000	482,750.00	600,000	1993-94
1994-95	400,000	458,750.00	600,000			400,000	458,750.00	600,000	1994-95
1995-96	400,000	433,750.00	600,000			400,000	433,750.00	600,000	1995-96
1996-97	175,000	183,750.00				175,000	183,750.00		1996-97
	$12,165,000	$19,010,675.00	$10,000,000	$3,561,000	$4,513,045	$15,726,000	$23,523,720.00	$10,000,000	

Notice and Blank Proposal

City of Charlotte, North Carolina

$8,465,000 Public Improvement Bonds

Series 1976

Sealed Bids Will Be Received Until 11 A.M., North Carolina Time, March 30, 1976

69-141 O - 76 - 29

NOTICE OF SALE
$8,465,000
CITY OF CHARLOTTE, NORTH CAROLINA
PUBLIC IMPROVEMENT BONDS, SERIES 1976

Sealed bids will be received until 11 o'clock A. M., North Carolina Time, March 30, 1976, by the undersigned at its office in the City of Raleigh, North Carolina, such bids to be opened at said time and place on said day, for the purchase of $8,465,000 Public Improvement Bonds, Series 1976, of the City of Charlotte, North Carolina, (representing a consolidation of $3,125,000 Street Widening, Extension and Improvement Bonds, $2,500,000 Public Transportation System Bonds, $1,500,000 Sidewalk Bonds, $730,000 Bridge Bonds and $610,000 Street Land Bonds), dated April 1, 1976 and maturing annually, April 1, $365,000 1977, $350,000 1978, $300,000 1979 to 1990, inclusive, $350,000 1991, $400,000 1992, $475,000 1993, $850,000 1994, $1,200,000 1995 and $875,000 1996, without option of prior payment.

Denomination $5,000; principal and semi-annual interest (April 1 and October 1) payable in legal tender at North Carolina National Bank, in the City of Charlotte, North Carolina, or, at the option of the holder or registered owner, at Manufacturers Hanover Trust Company, in New York City; general obligations; unlimited tax; coupon bonds registrable as to principal only; delivery on or about April 26, 1976, at place of purchaser's choice. There will be no auction.

Bidders are requested to name the interest rate or rates, in multiples of 1/4 or 1/10 of 1%, and each bidder must specify in his bid the amount and the maturities of the bonds of each rate. The difference between the lowest and highest rates named in the bid shall not exceed 2%. No bid may name more than six interest rates, any of which may be repeated. All bonds maturing on the same date must bear interest at the same rate. The interest payable on any bond on any interest payment date shall be represented by a single coupon and the interest rate on such bond shall be the same throughout its life. The bonds will be awarded to the bidder offering to purchase the bonds at the lowest interest cost to the City, such cost to be determined by deducting the amount of any premium bid from the aggregate amount of interest upon all of the bonds from their date until their respective maturities. No bid for less than the face value of the bonds plus accrued interest will be entertained.

Each bid must be submitted on a form to be furnished with additional information by the undersigned, must be enclosed in a sealed envelope marked "Bid for Bonds", and must be accompanied by an official bank check, a cashier's check or a certified check upon an incorporated bank or trust company for $169,300, payable unconditionally to the order of the State Treasurer of North Carolina, on which no interest will be allowed. Award or rejection of bids will be made on the date above stated for receipt of bids and the checks of unsuccessful bidders will be returned immediately. The check of the successful bidder will be held uncashed as security for the performance of his bid, but in the event the successful bidder shall fail to comply with the terms of his bid, the check may then be cashed and the proceeds thereof retained as and for full liquidated damages.

It is anticipated that CUSIP identification numbers will be printed on the bonds, but neither the failure to print such numbers on any bond nor any error with respect thereto shall constitute cause for a failure or refusal by the purchasers thereof to accept delivery of or pay for the bonds in accordance with the terms of their bid. All expenses in relation to the printing of CUSIP numbers on said bonds and the CUSIP Service Bureau charge for the assignment of said numbers shall be paid for by the City of Charlotte.

The unqualified approving opinion of Brown, Wood, Ivey, Mitchell & Petty, New York City, will be furnished without cost to the purchaser. There will also be furnished the usual closing papers.

The right to reject all bids is reserved.

LOCAL GOVERNMENT COMMISSION
Raleigh, North Carolina
By: H. E. Boyles
Secretary of the Commission

Official Statement of the

Local Government Commission of North Carolina

dated March 19, 1976

in relation to

City of Charlotte, North Carolina

$8,465,000 Public Improvement Bonds, Series 1976

Sale Date: March 30, 1976

This Official Statement will be used by the Commission only in connection with its Public Invitation for Bids for the purchase of the Bonds.

Bids Received: 11 A.M., North Carolina Time, March 30, 1976 at the Office of the Local Government Commission, Albemarle Building, 325 North Salisbury Street, Raleigh, North Carolina 27611.

CITY OF CHARLOTTE, NORTH CAROLINA

Council

John M. Belk ..... Mayor

James B. Whittington ..... Mayor Pro Tem

Betty Chafin	Pat Locke
Louis Davis	Neil C. Williams
Harvey B. Gantt	Joe D. Withrow

City Staff

David A. Burkhalter ..... City Manager

John B. Fennell ..... Director of Finance

Bryce A. Stuart ..... Director of Budget and Evaluation

Henry W. Underhill, Jr. ..... City Attorney

Bond Counsel

Brown, Wood, Ivey, Mitchell & Petty

New York, New York

TABLE OF CONTENTS

	Page
Introduction	4
Description of Bonds	4
Purpose of Bonds	4
Security for Bonds	5
The North Carolina Local Government Commission	5
The City	6
Revenue Structure	8
Expenditures	13
Local Government Budget and Fiscal Control Act	13
1976 Budgets	14
1976 Budget Outlook	18
Accounting and Auditing	20
Statistical Summary	22
Debt Information	24
Tax Information	29
Pension Plans	30
Contingent Liabilities	33
Litigation	33
Approval of Legal Proceedings	34
Tax Exemption	34
Certificates Concerning Official Statement	34
Miscellaneous	35
Appendices:	
A—Financial Statements	36
B—Proposed Form of Legal Opinion of Brown, Wood, Ivey, Mitchell & Petty	51

State of North Carolina
DEPARTMENT OF THE TREASURER

EDWIN GILL
State Treasurer

LOCAL GOVERNMENT COMMISSION
HARLAN E. BOYLES
Secretary

ALBEMARLE BUILDING • 325 NORTH SALISBURY STREET • RALEIGH, N. C. 27611 • AC 919, 829-3064

OFFICIAL STATEMENT

relating to

CITY OF CHARLOTTE, NORTH CAROLINA

$8,465,000 PUBLIC IMPROVEMENT BONDS, SERIES 1976

MARCH 19, 1976

INTRODUCTION

This Official Statement, including the cover page and the appendices, is intended to furnish information in connection with the public invitation for bids for the purchase of $8,465,000 Public Improvement Bonds, Series 1976 (herein called the "Bonds") of the City of Charlotte, North Carolina (herein called the "City").

The information furnished herein includes a brief description of the City and its government, revenue structure, budget, debt management, and economic conditions. The City has assisted the Local Government Commission in gathering and assembling the information contained herein.

DESCRIPTION OF BONDS

The Bonds are dated April 1, 1976 and mature annually, April 1, $365,000 1977, $350,000 1978, $300,000 1979 to 1990, inclusive, $350,000 1991, $400,000 1992, $475,000 1993, $850,000 1994, $1,200,000 1995, and $875,000 1996, without option of prior payment.

The Bonds are in the denomination of $5,000 each and are coupon bonds registrable as to principal only. Interest on the Bonds is payable semi-annually on the 1st days of April and October of each year, and both the principal of and the interest on the Bonds are payable in legal tender at North Carolina National Bank, in the City of Charlotte, North Carolina, or, at the option of the holder or registered owner, at Manufacturers Hanover Trust Company, in the Borough of Manhattan, City and State of New York.

PURPOSE OF BONDS

The Bonds are being issued pursuant to the provisions of The Local Government Bond Act, as amended, Article 7, as amended, of Chapter 159 of the General Statutes of North Carolina and ordinances and orders duly adopted by the City Council of the City, each of which ordinances and orders was approved by the vote of a majority of the qualified voters of the City who voted thereon at an election or a referendum duly called and held. The proceeds of the Bonds will be used for the purpose of providing funds, with any other available funds, for constructing a number of street, sidewalk and bridge improvements, including the acquisition of land and rights-of-way therefor, and for purchasing

the existing privately-owned bus system in the City, acquiring new equipment therefor and installing certain improvements in connection therewith, including shelters for passengers. No notes have heretofore been issued in anticipation of the receipt of the proceeds of sale of the bonds.

SECURITY FOR BONDS

The Bonds are general obligations of the City, all the taxable real and tangible personal property within which is subject to the levy of an ad valorem tax, without limitation of rate or amount, to pay the Bonds and the interest thereon.

Under State law, an action of mandamus would lie against municipal officers to compel the levy of taxes sufficient to make the required payments of principal of and interest on the Bonds.

THE NORTH CAROLINA LOCAL GOVERNMENT COMMISSION

The North Carolina Local Government Commission (herein called "The Commission"), a division of the Department of State Treasurer, is a State agency which approves and supervises the issuance of the bonded indebtedness of all local government units and assists these units in the area of fiscal management. The Commission is composed of nine members: the State Treasurer, the Secretary of State, the State Auditor, the Secretary of Revenue, and five others by appointment (three by the Governor, one by the Lieutenant Governor, and one by the Speaker of the House of Representatives). The State Treasurer serves as Chairman and selects the Secretary of the Commission, who heads the administrative staff serving the Commission.

The major function of the Commission is the approval, sale and delivery of all North Carolina local government bonds and notes. A second key function is monitoring certain fiscal and accounting standards prescribed by statute for the units. In addition, the local governments receive, upon request, on-site assistance from the Commission respecting exising financial and accounting systems as well as aid in establishing new systems. Further, educational programs and materials are provided for local officials concerning finance and cash management.

Before any unit can incur bonded indebtedness, the proposed bond issue must be approved by the Commission. In determining whether to give such approval the Commission may consider, among other things, the unit's debt management procedures and policies, its compliance with the Local Government Budget and Fiscal Control Act, and its ability to service the proposed debt. All general obligation issues are sold on the basis of formal sealed bids submitted at the Commission's offices in Raleigh and are subsequently delivered to the successful bidder by the Commission. The Commission maintains records for all local units of all principal and interest payments coming due in the current and future fiscal years and monitors the payment by the units of their debt service through a system of monthly reports.

As a part of its role in assisting and monitoring the fiscal programs of local units, the Commission attempts to ensure that the local units follow generally accepted accounting principles, systems, and practices. The Commission's staff also counsels the units in treasury and cash management, budget preparation, investment policies and procedures, and accounting machine acquisition. Educational programs, in the form of seminars or classes, are also provided by the Commission in order to accomplish these tasks. The monitoring of the units' financial systems is accomplished through the examination and analysis of the annual audited financial statements and other required reports. *Annual audited financial statements are required by law for all local units. As of the date hereof, all audits are performed by certified public accountants.* The Commission must approve the audit contract, particularly as it relates to the scope of the audit, before the audit may begin, and must also approve invoices for the audit fee. Approval of final payment is not given until the audit report is rendered in accordance with the requirements of the contract.

If a local unit of government defaults on a required payment of principal or interest, the Commission has the power to assist the defaulting unit to refinance or otherwise correct the cause of the default.

THE CITY

General Description

The City is located in the Piedmont Crescent of the Carolinas, the nation's sixth largest urban region according to an Appalachian Regional Commission study based on the 1970 Census, and is the largest city in this region. It was incorporated in 1768, became the county seat of Mecklenburg County (herein called the "County") in 1774, and has grown from an initial 360 acres to a present area covering approximately 105 square miles, including approximately 32.5 square miles annexed on January 25, 1974. The present population of the County is estimated at approximately 394,000, of which the City accounts for approximately 305,000, including approximately 45,000 acquired by such annexation.

The City is empowered by statute to levy an annual ad valorem property tax on the appraised value of all taxable real and tangible personal property located therein. The tax rate may not exceed $1.50 per $100 assessed valuation for operating purposes (unless the voters of the City shall approve a higher rate), but is unlimited for debt service purposes; however, see "Debt Information—Legal Debt Limit" herein respecting the amount of debt that the City can presently issue. The County is the only other unit levying such taxes on property within the corporate limits of the City (see "Debt Information—Direct and Overlapping Bonded Debt" herein).

The City is empowered by statute to extend its corporate limits by annexation, and is engaged in an on-going review of areas for possible future annexation; however, no annexation proceedings are pending as of the date of this Official Statement. The Charlotte-Mecklenburg Planning Commission estimates that the aggregate assessed value of non-municipal properties which presently qualify under the statute for annexation is approximately $350,000,000.

Economic Characteristics

The City is a center in the two Carolinas for trading and distribution. According to the 1975 Survey of Buying Power published by Sales Management Magazine, the metropolitan area (Charlotte-Gastonia, Standard Metropolitan Statistical Area ("SMSA"), which includes Gaston, Mecklenburg, and Union Counties) is ranked 20th among the nation's standard metropolitan statistical consolidated areas for wholesale sales and 15th for such sales excluding merchant wholesalers, as compared to a population ranking of 53rd. Diversified manufacturing (more than 690 various concerns) includes textiles, hosiery, food products, wearing apparel, printing, machinery, and industrial chemicals; the Charlotte-Gastonia SMSA ranks 5th in the United States in wholesale sales of industrial chemicals.

Offices of five of the nation's 100 largest banks and a branch of the Federal Reserve Bank are located in the City. Bank debits to demand deposit accounts in the Charlotte-Gastonia SMSA's banks were approximately $55,330,989,000 on December 31, 1975, an increase over 1974 of approximately 8 percent, placing the Charlotte-Gastonia SMSA in 40th position among the nation's SMSA's. There are presently 16 banks operating 130 branches in the City and County. They employ approximately 4,300 people with an estimated payroll of approximately $34,694,000.

According to the Charlotte Chamber of Commerce the Charlotte-Gastonia SMSA is ranked 6th in retail sales per household and 9th in department store sales among the Southeastern SMSA's in the nation as compared to a population ranking of 12th. The 1970 census showed the City ranking 9th in the percent of households with two or more cars among cities having populations of 250,000 or more.

Government

The City is governed by a mayor and seven council members elected bi-annually. The mayor presides over all council meetings, but can only vote in case of a tie and lacks any type of veto power. The Council enacts all general and technical ordinances, including budgetary appropriations and construction and zoning ordinances, approves all contracts in excess of $5,000, and originates general management policies. The Council employs a City Manager who directs the daily operations of the City through appointed department heads.

Education

The City and County have a consolidated public school system which is a part of the State public school system. The fiscal 1976 budget for the City-County school system contemplates that current operating expenses, including salaries of teachers, clerical workers and janitors, and the costs of transportation, fuel, water, and lights, will be funded by the State, County, and Federal governments in percentages of approximately 52, 42, and 6 percent, respectively. The County is responsible for capital improvements, maintenance of plant, instructional supplies, and insurance; however, the State has funded a substantial amount of capital improvements in the City-County system in recent years by allocating proceeds of State bond sales to such system. *The City has no direct financial responsibility for any part of the school system.*

Among the colleges in the Charlotte-Gastonia SMSA are six senior colleges and four junior colleges, including the University of North Carolina at Charlotte, a member of the State consolidated system of higher education. Nurses training programs are offered at three of the five hospitals located in the City.

Transportation

Major expansion, maintenance, and betterments of primary and secondary highways within the City limits are primarily the responsibility of the State. The City is primarily responsible for acquisition of right-of-way for such expansion or betterments, related sidewalk improvements, street lighting, and traffic signals. At June 30, 1975 the number of miles of streets in the City maintained by the State was approximately 190 linear miles.

Major expansion, maintenance, and betterments of the local street system is primarily the responsibility of the City. Major expansions are funded principally by bond issues and current revenues. Maintenance and betterments are funded principally from the City's proportionate share of the amount produced by a one-cent State tax on each gallon of motor fuel. At June 30, 1975 the number of miles of streets maintained by the City was approximately 984 linear miles.

On December 1, 1974, the City entered into a lease-purchase option to acquire the privately-owned bus transit system and a management contract for its operation. $2,500,000 of the proceeds of the Bonds will be applied to the acquisition and improvement of the system's capital facilities. In addition, the City has applied for a capital assistance grant of approximately $6,100,000 from the Federal Urban Mass Transit Administration ("UMTA") for such purposes. UMTA has allocated such sum to the City, subject to compliance by the City with certain conditions. The City anticipates that it will be able to comply with such conditions. The City is also receiving operating assistance from UMTA to assist in the development of a public transit system that meets the community's needs for dependable and efficient transportation.

The City's Douglas Municipal Airport has developed into the major air carrier airport in the Carolinas. This is evidenced by a recent report issued by the Federal Aviation Agency which ranks the airport thirty-sixth nationally in air carrier movements during 1974. According to a report released by the Airport Operator's Council International, the airport has advanced in ranking among the nation's thirty-eight medium-hub airports for enplaned passengers from fifteenth in 1970 to tenth in 1974. During the same period, this source reports that the airport, as compared to other medium-hub airports, advanced in air cargo volume from ninth in 1970 to fourth in 1974. The airport has regularly-scheduled flights by five airlines: Delta, Eastern, Piedmont, Southern, and United.

Federal grants-in-aid will finance 75% of the estimated $15.8 million cost, excluding land, for a new parallel runway currently under construction. There is currently litigation pending which seeks to enjoin the paving of such runway (see "Litigation" herein).

According to the Charlotte Chamber of Commerce, more than one-third of the nation's largest trucking firms ranked by gross operating revenues operate terminals in the Charlotte-Gastonia SMSA. Eight of the ten largest firms operate such terminals in such SMSA. The City is also served by Illinois Central Gulf Railroad, Seaboard Coast Line—Louisville & Nashville Railroads, and Southern Railway Company.

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Other

For additional statistical material concerning the City, see "Statistical Summary" herein.

REVENUE STRUCTURE

The following is a description of the City's revenue structure. See Appendix A for a detailed statement of revenues for the three fiscal years ended June 30, 1975.

General and Special Revenue Funds

The City has three basic non-enterprise operating funds which have been consolidated for financial and budgetary reporting purposes into the General and Special Revenue Funds: the General Fund, Powell Bill Fund, and Park and Recreation Commission General Fund. The General Fund is the principal fund used to finance the City's non-enterprise operations. The Powell Bill Fund has been established to account for receipts from the State of the City's share of gasoline tax dedicated for the purpose of local street maintenance and betterments. The Park and Recreation Commission is a separate legal entity comprised of a commission appointed by the City Council whose principal source of revenues is City property taxes. A description of significant General and Special Revenue Funds' revenues follows below.

Ad Valorem Taxes — An annual ad valorem property tax is levied by the City on the appraised value of all real and tangible personal property located therein as of the January 1 preceding the fiscal year in which such tax is due. All counties and municipalities are on a July 1-June 30 fiscal year. Such tax may be paid without penalty not later than December 31 of the year in which it is levied. The tax rate may not exceed $1.50 per $100 assessed valuation for operating purposes (unless the voters shall approve a higher rate), and is unlimited for debt service purposes. The County Tax Collector acts as agent for the City in listing and collecting property taxes levied by the City. Such taxes represent over one-half of total revenues in the General and Special Revenue Funds.

Sales Taxes—A one percent local sales tax levy is shared between the County and all incorporated municipalities in the County, including the City, based on their respective property tax levies. This tax was imposed under a 1967 State law applying only to the County. The County is also authorized to levy, but does not presently levy, an additional one percent local sales tax under the 1971 Local Government Sales and Use Tax Act, the proceeds of which would be shared by the County and all incorporated municipalities in the County, including the City, based on their respective property tax levies. As of the date of this Official Statement, 95 of the State's 100 counties are imposing the tax authorized in 1971.

Intangible Personal Property Tax — Certain items of intangible personal property are classified taxable by the State, in behalf of counties and municipalities. The base and rates are as follows: accounts receivable less accounts payable, notes and bonds receivable less notes and bonds payable, cash on hand, and shares of stock at market value on December 31 are all taxed at 25¢ per $100, and bank deposits, average of quarter balances, are taxed at 10¢ per $100. The value of shares of stock representing the portion of net income taxable in North Carolina is deductible from such stock. The net revenue, after deduction of the cost of collection and administration, is distributed to counties and municipalities. Intangible taxes received by the City are shared by the City's General Fund and Municipal Debt Service Fund (hereinafter mentioned), and the Park and Recreation Commission General Fund based on the ratios of their respective tax levies.

Intergovernmental — State-Shared Revenues — A tax of 6 percent is levied by the State on the gross receipts of electric power and light, gas, telephone and telegraph utility companies, except that gas companies pay 4 percent on the first $25,000 of receipts. The City receives from the State one-half of the tax on gross receipts of such companies from sales inside the City.

A State tax at the rate of 9¢ per gallon is levied on gasoline and other motor fuels. An appropriation of one cent per gallon is made and distributed to municipalities for local street maintenance and betterments, and is allocated on the basis of local street mileage and population. Municipalities also receive a refund of 8¢ per gallon utilized by them.

The State levies an excise tax on beer and wine sales. Beer is taxed at the rate of $15 per barrel. Wine is taxed on a per gallon rate as follows: fortified wine — 70¢; unfortified wine — 60¢; and North Carolina wine — 5¢. Counties and municipalities where beer and wine are sold share in the excise taxes on beer and unfortified wine, based on population therein, as follows: twenty-three and three-fourths percent on beer excise tax revenue and fifty percent on the excise tax on unfortified wine. Excise taxes received by the City are shared in by the City's General Fund and Municipal Debt Service Fund, and the Park and Recreation Commission General Fund based on their respective tax levies.

Intergovernmental — State Grants — The City receives matching grants from the State Law Enforcement Assistance Administration ("L.E.A.A.") which have been utilized principally for the acquisition of police equipment. The funding of such grants is 90 percent Federal, 5 percent State, and 5 percent City.

Intergovernmental — Federal Grants — The City received Federal categorical grants prior to and during the three fiscal years ended June 30, 1975 for a municipal information systems project, which terminated as of June 30, 1975, and during the three years ended June 30, 1975 for certain job training and development and emergency employment programs, which were consolidated into the manpower block grant program and were accounted for in a separate special revenue Manpower Fund for the fiscal year ended June 30, 1975.

Intergovernmental — Alcoholic Beverage Control Board Revenues — Liquor may be sold only in county or municipal Alcoholic Beverage Control ("ABC") stores. Profits from operation of the stores are retained by the County or municipality. The City receives 47.5 percent of the distributed profits from such operation within the County. Such profits are shared by the City's General Fund and Municipal Debt Service Fund, and the Park and Recreation Commission General Fund based on their respective property tax levies.

Intergovernmental — County Reimbursements — The City maintains and pays debt service costs for a joint City-County law enforcement center. The City also funds the operating budget of the joint City-County Planning Commission, the Community Relations Committee, and a purchasing operation. The County reimburses the City for the County's share of the costs of the center, the Commission, the Committee, and the purchasing operation, and such reimbursements are accounted for as revenues.

Licenses, Permits, and Fees — The City levies a license tax for business privilege licenses which is collected by the County Tax Collector as agent for the City. License taxes vary according to the type of business. Charges are also imposed for motor vehicle licenses, dog licenses, and other miscellaneous licenses.

Intragovernmental Services — Computer and garage services rendered and charged by certain General Fund departments to other non-General Fund departments are reported as intragovernmental revenues for financial reporting purposes.

Charges for Current Services — Building inspection fees and Park and Recreation Commission facility fees for use of its Memorial Stadium, Park Center, and Revolution Golf Course are the principal sources of charges for current services. Building inspection fees vary for different types of building construction, electrical, or plumbing inspections. Such fees are deposited in the City's General Fund. Park and Recreation Commission facility fees are deposited in the Park and Recreation Commission General Fund.

The following table shows the consolidated tax and non-tax revenues and transfers for the five fiscal years ended June 30, 1975:

Fiscal Year Ended June 30,	Tax Revenues	Percentage Increase Over Previous Year	Tax and Non-Tax Revenues and Transfers	Percentage Increase Over Previous Year
1971	$21,204,742		$29,674,612	
1972	25,974,772	22.5%	35,680,413	20.2%
1973	27,909,623	7.4	40,987,289	14.9
1974	30,040,646	7.6	46,614,510	13.7
1975	36,397,660	21.2	53,170,222	14.1

Note: The increase in tax revenues for 1972 reflects increased assessed property values due to revaluation. The increase in tax revenues for 1975 reflects the expansion of the property tax base by annexation of approximately 32.5 square miles with a population of approximately 45,000 on January 25, 1974. Assessed property values for 1975 aggregated approximately $3.6 billion (assessment ratio equaled 100 percent) as compared with $1.7 billion in 1974 (assessment ratio equaled 60 percent).

Municipal Debt Service Fund

The Municipal Debt Service Fund is established to provide and account for the payment of interest on and principal of all general obligation debt, other than that issued for and serviced by revenue producing governmental enterprises and that payable exclusively from special assessments. A separate property tax levy is made for debt service purposes. All interest earned in the City's General Fund and in all non-enterprise bond and capital projects funds, exclusive of interest earned in certain federal categorical grant capital projects funds which is restricted for expenditure only in such funds, is transferred to the Municipal Debt Service Fund. This fund also shares in profits from operation of the ABC stores, intangible personal property tax, and beer and wine excise taxes based on the respective tax levies for the City's General Fund and Municipal Debt Service Fund, and the Park and Recreation Commission General Fund.

The following table shows the tax and non-tax revenues and transfers for the Municipal Debt Service Fund for the five fiscal years ended June 30, 1975:

Fiscal Year Ended June 30,	Tax Revenues	Percentage Increase Over Previous Year	Tax and Non-Tax Revenues and Transfers	Percentage Increase Over Previous Year
1971	$ 2,238,843		$ 4,231,507	
1972	2,986,768	33.4%	4,504,225	6.4%
1973	4,129,045	38.2	5,062,789	12.4
1974	4,459,503	8.0	5,821,683	15.0
1975	5,482,127	22.9	8,188,589	40.7

Note: See note following the table under "General and Special Revenue Funds" herein for comments respecting increases in tax revenues for 1972 and 1975. In 1973, the increase in tax revenues reflects an increase in the tax rate for debt service purposes from 19¢ to 25¢ (assessment ratio equaled 60 percent), an increase of 31.6 percent. In addition, transfers from other funds of interest earned were $2,268,813 for 1975 as compared to $956,143 for 1974.

In fiscal 1976, the tax rate for debt service purposes was reduced from 15¢ to 11¢, a decrease of 26.6 percent from the 1975 rate (assessment ratio equaled 100 percent).

Revenue Sharing Fund

The Revenue Sharing Fund is used to account for the City's Federal Revenue Sharing entitlements and subsequent transfers of such entitlements to other funds, principally for expenditure on capital

projects. The Fiscal Assistance to State and Local Government Act, approved by the 92nd Congress on October 20, 1972, will terminate as of December 31, 1976 unless Congressional action is taken prior to such date to extend such assistance.

Water and Sewer Funds

The Water and Sewer Funds account for water and sewer services supplied to customers under a rate structure designed to produce revenues sufficient to provide for operating expenses, including depreciation, and interest on water and sewer debt.

The 1974 annexation (see "The City — General Description") while enhancing property tax revenues, caused an initial negative impact on utility revenues. Water and sewer rates were reduced by one-half for approximately 6,500 accounts in the annexed area resulting in an annual loss of revenues of approximately $750,000; however, the accompanying expansion of services initially generated additional growth in related services, and should generate long-term growth in all services, resulting in additional revenues.

Revenues were also negatively affected by a decline in average daily water usage of 1.2 million gallons or 3.2 percent from 37.5 million gallons in 1974 to 36.3 million gallons in 1975 after a significant increase in 1974. This decrease is attributed to the unusual 97.5 percent increase in rainfall between May and September, 1975, normally the peak period for water and sewer billing, as compared with the preceding year. Water usage during the first quarter of 1976 reflected a return to the long-term upward trend as the daily average usage during the period was 39.9 million gallons.

The effect of annexation and the decrease in water consumption on revenues was offset by an increase in sewer service fees attributable principally to additional revenues generated from privately owned sewer systems acquired during 1975 as a result of annexation discussed above, and in increased rates for water and sewer services averaging 17.7 percent, effective May 1, 1975. The rate increases are estimated at current usage to generate additional revenues in 1976 of approximately $1.9 million and were necessitated principally by the effect of inflationary pressures on operating expenses and rapid capital facilities expansion.

The following table shows the consolidated operating and non-operating revenues of the Water and Sewer Funds for the five fiscal years ended June 30, 1975:

Fiscal Year Ended June 30,	Operating Revenues	Percentage Increase Over Previous Year	Operating and Non-Operating Revenues	Percentage Increase Over Previous Year
1971	$ 7,705,949		$ 8,316,987	
1972	7,981,157	3.6%	8,790,313	5.7%
1973	10,185,890	27.6	10,994,536	25.1
1974	10,866,432	6.7	12,591,738	15.3
1975	10,966,003	.9	12,953,806	2.9

Note: Water and sewer rate increases were placed in effect in June, 1972 which were designed to increase operating revenues by 23.4 percent.

Airport Funds

The Airport Funds account for the operation of the City's Douglas Municipal Airport. Revenues, principally charges for use of facilities, continue to be adequate to provide for operating expenses, including depreciation, and interest on airport bonds.

During 1975, the effects of the national economic recession were also felt in the aviation industry, as reflected by a slight decline in enplaned passengers from 1,170,022 for 1974 to 1,148,006 for

1975, a reduction of 22,016. Gross landing weight, which is the basis for airline use charges, increased during this period resulting in additional landing area revenues for 1975, as compared to 1974, of $222,279, an increase of 47.2 percent. Eastern added new scheduled flights in the Spring of 1975 resulting in an additional 10,000 available passenger seats boarding from Charlotte.

The following table shows the consolidated operating and non-operating revenues of the Airport Funds for the five fiscal years ended June 30, 1975:

Fiscal Year Ended June 30,	Operating Revenues	Percentage Increase Over Previous Year	Operating and Non-Operating Revenues	Percentage Increase Over Previous Year
1971	$ 1,469,835		$ 1,605,984	
1972	1,590,289	8.2%	1,706,693	6.3%
1973	1,878,657	18.1	2,161,607	26.7
1974	1,903,885	1.3	2,386,644	12.3
1975	2,139,592	12.4	2,839,911	19.0

Other Funds—Federal and State Grants-in-Aid

At January 31, 1976 total unearned City grant authorizations amounted to approximately $30,517,000 for the following programs:

Program	Unearned Grant Authorizations January 31, 1976
Water & Sewer Facilities	$ 1,169,000
Manpower	3,619,000
Community Development	9,396,000
Urban Redevelopment	10,025,000
Model Cities	100,000
Airport Facilities	5,977,000
Open Space Facilities	37,000
Traffic Improvements	183,000
Park Development	11,000
Total	$30,517,000

Such authorizations will be earned as expenditures are made by the City for such programs.

These programs are principally for capital facilities, except for the manpower program and approximately 20 percent of the community development program. Objectives of the manpower program include the provision of comprehensive manpower services to enable individuals to secure and retain employment, public service employment, manpower training for unemployed and underemployed persons, and part-time employment and on-the-job training for certain students from low income families. Objectives of the community development program include the development of urban communities to provide for improved housing and living environment, and the expansion of economic opportunities, principally for persons of low and moderate income. Although such objectives of the latter program involve substantial capital expenditures for physical development, approximately 20 percent of expenditures are for related social support programs for services to adults and families, children and youth, and aging citizens.

EXPENDITURES

Expenditures for the years ended June 30, 1975, 1974, and 1973 for the General and Special Revenue Funds (see "Revenue Structure — General and Special Revenue Funds" herein), Municipal Debt Service Fund, Revenue Sharing Fund, Water and Sewer Funds, and Airport Funds are presented in Appendix A.

LOCAL GOVERNMENT BUDGET AND FISCAL CONTROL ACT

The Local Government Budget and Fiscal Control Act, as amended by the 1975 General Assembly primarily to facilitate adherence by local governments to the accounting principles contained in the American Institute of Certified Public Accountants' Industry Audit Guide, *Audits of State and Local Governmental Units*, sets forth the procedure by which the City's budget is adopted and administered. Such Act requires the adoption of a balanced budget, including all appropriations required for debt service as estimated by the finance officer. Also required is the elimination of any deficit in a fund resulting from adverse deviations in estimated and actual revenues. Any deficit is required to be eliminated by the imposition of a property tax levy at rates which will produce the revenue necessary to balance appropriations and revenues. The annual budget must be adopted by the Council by July 1 of the fiscal year to which it applies, except that a capital project budget which authorizes all appropriations necessary for the completion of a capital project and which need not be readopted in any subsequent fiscal year may be adopted in lieu of annual appropriations for such project.

1976 BUDGETS

The following are the budgets for the City's General and Special Revenue Funds, Municipal Debt Service Fund, Revenue Sharing Fund, Water and Sewer Operating and Debt Service Funds, and Airport Operating and Debt Service Funds for the fiscal year ending June 30, 1976:

GENERAL AND SPECIAL REVENUE FUNDS CONSOLIDATED BUDGET FOR THE YEAR ENDING JUNE 30, 1976, AS AMENDED AT DECEMBER 31, 1975

Revenues and Unencumbered Fund Balance—By Source

Revenues:	
Local:	
Taxes:	
General property	$32,876,130
Sales	4,570,000
Intangible	751,000
Licenses, permits, fees	1,478,000
Interest on investments	235,000
Alcoholic beverage control	724,500
Charges for current services	773,400
Mecklenburg County:	
Law Enforcement Center	377,757
Planning Commission	288,121
Other	187,239
Fines, forfeitures, penalties	185,550
Housing Authority	118,000
Other	184,000
Total local	42,748,697
State:	
State-shared:	
Gasoline tax	3,367,500
Utility franchise tax	3,290,000
Beer and wine	946,000
Sales tax refund	174,000
Total state-shared	7,777,500
State grant—	
L. E. A. A.	73,298
Total state	7,850,798
Federal grants	34,890
Total revenues	50,634,385
Unencumbered Fund Balance	4,062,061
Total	$54,696,446

Expenditures and Transfers—By Function

Expenditures:	
Public safety	$19,539,244
Health and welfare	6,843,482
General government administration	5,884,340
Transportation	9,507,158
Cultural, recreation, and community relations	4,259,813
Service centers	992,157
Community planning and development	959,953
Social services	600,054
Non-departmental	4,986,492
Total expenditures	53,572,693
Transfers To Other Funds	1,123,753
Total	$54,696,446

MUNICIPAL DEBT SERVICE FUND
BUDGET FOR THE YEAR ENDING JUNE 30, 1976, AS AMENDED AT DECEMBER 31, 1975

Revenues and Unencumbered Fund Balance

Revenues:	
Property taxes	$4,664,019
Interest on investments	1,300,000
Contribution from Alcoholic Beverage Control Board	225,625
Intangible personal property tax	137,000
Beer and wine licenses	16,100
Total revenues	6,342,744
Unencumbered Fund Balance	1,623,161
Total	$7,965,905

Expenditures

Retirement Of Bond Principal	$4,072,000
Interest On Bonds	3,635,605
Lease Purchase Agreements	250,300
Other	8,000
Total	$7,965,905

REVENUE SHARING FUND
BUDGET FOR THE YEAR ENDING JUNE 30, 1976, AS AMENDED AT DECEMBER 31, 1975

Revenues—Federal Revenue Sharing Entitlements	$5,184,858
Transfers—Capital Improvements	$5,184,858

Note: Revenue sharing entitlements are appropriated for capital improvements, and such entitlements are transferred to capital project funds for subsequent expenditure during the life of the projects.

WATER AND SEWER OPERATING AND DEBT SERVICE FUNDS CONSOLIDATED BUDGET FOR THE YEAR ENDING JUNE 30, 1976, AS AMENDED AT DECEMBER 31, 1975

Revenues, Transfer, and Unencumbered Fund Balance

Revenues:	
Operating:	
Metered water sales	$ 7,196,000
Sewer service fees	6,121,344
Other	625,986
Total operating	13,943,330
Non-operating:	
Interest on investments	750,000
Other	41,000
Total non-operating	791,000
Total revenues	14,734,330
Transfer From Revenue Sharing Fund	906,000
Unencumbered Fund Balance	1,686,659
Total	$17,326,989

Expenditures

Operating:	
Water supply and treatment	$ 3,899,229
Sewer system and treatment	2,864,846
Employee benefits	722,693
Customer accounting and collection	738,879
Administrative and engineering	789,295
Refundable water and sewer construction deposits	356,000
Contingencies	30,000
Total operating	9,400,942
Non-operating:	
Interest:	
City bonds and other liabilities	2,368,672
County bonds	964,935
Redemption of bonds:	
City	2,865,000
County	600,000
Lease purchase agreement payments	90,000
Purchase of private systems	1,037,440
Total non-operating	7,926,047
Total	$17,326,989

Note: See "Debt Information—Lease Purchase Agreements and Other Commitments" respecting non-operating expenditures.

AIRPORT OPERATING AND DEBT SERVICE FUNDS CONSOLIDATED BUDGET FOR THE YEAR ENDING JUNE 30, 1976, AS AMENDED AT DECEMBER 31, 1975

Revenues and Unencumbered Fund Balance

Revenues:	
Operating:	
Terminal building and area	$1,457,000
Landing area	620,000
Other	302,000
Total operating	2,379,000
Non-operating—Interest on investments	155,000
Total revenues	2,534,000
Unencumbered Fund Balance	5,641
Total	$2,539,641

Expenditures and Transfers

Expenditures:	
Operating:	
Terminal building and area	$ 700,451
Landing areas	413,381
Other	34,448
Total operating	1,148,280
Non-operating:	
Interest on bonds	658,972
Redemption of bonds	445,000
Other	12,000
Total non-operating	1,115,972
Total expenditures	2,264,252
Transfers To Capital Projects Funds	275,389
Total	$2,539,641

Budgets for the Water and Sewer and Airport Capital Projects and Bond Funds have not been included herein because such budgets are prepared on an aggregate project expenditure basis rather than on a current fiscal year expenditure basis, and the expenditures and revenues therein, except interest transferred to debt service funds, are capitalized for financial reporting purposes.

1976 BUDGET OUTLOOK

General and Special Revenue Funds

Description	Six Months Ended December 31, 1975	1974	Percent Increase (Decrease)
Local:			
Taxes:			
General property	$15,340,479	$14,396,199	6.6 %
Sales	2,353,296	2,182,601	7.8
Intangible	1,169,727	1,129,268	3.6
Licenses, permits, fees	1,038,931	1,152,331	(9.8)
Interest on investments	344,439	506,252	(32.0)
Alcoholic beverage control	181,094	362,188	(50.0)
Charges for current services	385,689	421,520	(8.5)
Mecklenburg County:			
Law Enforcement Center	188,878	146,426	29.0
Planning Commission	149,829	116,781	28.3
Other	90,259	85,219	5.9
Fines, forfeitures, penalties	104,114	94,955	9.6
Other	180,798	243,459	(25.7)
Total local	21,527,533	20,837,199	3.3
State:			
State-shared:			
Gasoline tax	3,323,231	3,427,979	(3.1)
Utility franchise tax	1,724,224	1,435,358	20.1
Beer and wine	875,004	860,281	1.7
Sales tax refund	200,719	161,240	24.5
Total State-shared	6,123,178	5,884,858	4.0
State grant:			
L. E. A. A.	49,684	310,324	(84.0)
Other		2,951	(100.0)
Total State	6,172,862	6,198,133	(.4)
Federal Grants	43,139	1,485,978	(97.1)
Total	$27,743,534	$28,521,310	(2.7)%

Note: On January 2, 1976, the City's General and Special Revenue Funds received an Alcoholic Beverage Control distribution of $181,094 for the quarter ended December 31, 1975. The distribution for the quarter ended December 31, 1974 was received during such quarter.

Assessed values as of January 12, 1976 according to the County Tax Supervisor approximated $4,436,500,000 as compared to values used for the fiscal year ending June 30, 1976 tax levy of approximately $4,410,500,000, or approximately $26,000,000 more than the estimated values used for the tax levy. The Tax Supervisor has indicated that additional assessments will be made on real and personal property for late listings and court settlements of protested 1975 appraised value revaluations between January 13 and June 30, 1976.

Property tax collections for the six months ended December 31, 1975 and the seven months ended January 31, 1976 exceeded collections for the same periods in 1974 and 1975 by approximately 6.6 percent and 10.3 percent, respectively. A 95 percent collection rate was assumed for estimating property tax revenues (collections) for the 1976 budget. The actual collection rate for the five years ended June 30, 1975 is computed as follows:

Fiscal Year	Tax Levy	Current Year Taxes Collected	Percentage of Levy Collected During Fiscal Year
1971	$20,070,625	$19,391,942	96.6%
1972	24,881,384	24,429,189	98.2
1973	27,511,998	26,894,732	97.8
1974	28,976,346	28,219,098	97.4
1975	37,069,282	35,574,206	96.0

As of January 31, 1976 only $1,592,400 remains to be collected from prior year levies which is 4.3% of the 1975 fiscal year levy.

A decrease in Federal grants for the six-months ended December 31, 1975 and 1974 of approximately $1,442,839 or 97.1 percent is attributed principally to the termination as of June 30, 1975 of a Federal categorical grant for a municipal information systems project, and the consolidation of Federal categorical grants for certain job training and development and emergency employment programs into the Manpower block grant program which was accounted for in a separate special revenue Manpower Fund for the fiscal year ended June 30, 1975.

A decrease in interest revenues reflects the effect of a decline in the prime interest rate from a high of 10.5 percent in December 1974 to 7.25 percent at December 31, 1975. Interest revenues for the six months ended December 31, 1975 are approximately 40% of estimated interest for 1976 in the Powell Bill Fund and Park and Recreation Commission General Fund. All General Fund interest will be transferred to the Municipal Debt Service Fund by June 30, 1976.

No shortages in total estimated revenues for 1976 are presently anticipated.

Unencumbered appropriations for the five fiscal years ended June 30, 1975 are shown below:

Fiscal Year Ended June 30,	Appropriations	Expenditures, Encumbrances, and Transfers	Unencumbered Appropriations: Amount	Unencumbered Appropriations: Percent of Appropriations
1971	$27,646,251	$27,397,772	$ 248,479	.89%
1972	31,835,294	30,737,563	1,097,731	3.44
1973	38,384,621	36,259,941	2,124,680	5.53
1974	41,739,669	39,963,931	1,775,738	4.25
1975	47,679,480	46,954,010	725,470	1.52

Municipal Debt Service Fund

The following table shows the revenues of the Municipal Debt Service Fund for the six months ended December 31, 1975 and 1974:

Description	Six Months Ended December 31: 1975	1974	Percent Increase (Decrease)
Property taxes	$2,193,079	$2,468,284	(11.1)%
Intangible taxes	167,104	195,961	(14.7)
Alcoholic beverage control	56,406	112,812	(50.0)
Interest on investments	464,841	652,868	(28.8)
Beer and wine licenses	1,799	1,669	7.8
Total	$2,883,229	$3,431,594	(16.0)%

Note: On January 2, 1976 the City's Municipal Debt Service Fund received an Alcoholic Beverage Control Distribution of $56,406 for the quarter ended December 31, 1975. The distribution for the quarter ended December 31, 1974 was received during such quarter.

69-141 O - 76 - 31

Property tax revenues for the seven months ended January 31, 1976 and 1975 were $2,328,730 and $2,453,104, respectively, a decrease of 5.1 percent.

The decline in property taxes and intangible taxes (see "Revenue Structure—Municipal Debt Service Fund" for basis of allocation) reflects a reduction in the property tax rate for 1976 to eleven cents from fifteen cents for 1975 per $100 assessed value, a reduction of 26.6 percent. (See "General and Special Revenue Funds" above for comments respecting interest declines.) No shortages in total estimated revenues for 1976 are presently anticipated.

Revenue Sharing Fund

The following table shows the revenues of the Revenue Sharing Fund for the six months ended December 31, 1975 and 1974:

	Six Months Ended December 31		
Description	1975	1974	Percent Increase (Decrease)
Federal entitlements	$2,618,974	$2,799,898	(6.4)%
Interest on investments	291,764	297,766	(2.0)
Total	$2,910,738	$3,097,664	(6.0)%

Revenue sharing quarterly entitlements for the six months ended December 31, 1975 are holding with budget projections. No shortages in budgeted revenues are presently anticipated.

Water and Sewer and Airport Consolidated Operating and Debt Service Funds

The following tables show the consolidated revenues of the Water and Sewer and Airport Operating and Debt Service Funds for the six months ended December 31, 1975 and 1974:

Water and Sewer	Six Months Ended December 31		
Description	1975	1974	Percent Increase (Decrease)
Metered water sales	$3,442,450	$2,903,041	18.6%
Sewer service charges	3,153,563	2,529,253	24.7
Interest on investments	610,914	862,669	(29.2)
Other	402,586	256,265	57.1
Total	$7,609,513	$6,551,228	16.2%

Airport	Six Months Ended December 31		
Description	1975	1974	Percent Increase (Decrease)
Terminal building and area	$ 761,023	$ 695,190	9.5%
Landing area	386,319	312,273	23.7
Interest on investments	290,753	196,843	47.7
Other	106,432	92,079	15.6
Total	$1,544,527	$1,296,385	19.1%

Based on actual collections to date it is estimated that budgeted revenues for the Water and Sewer and Airport Consolidated Operating and Debt Service Funds will be realized (See "Revenue Structure" above for these Funds).

ACCOUNTING AND AUDITING

The Local Government Budget and Fiscal Control Act sets forth certain fiscal control requirements respecting principally the duties of the finance officer, the system of accounting, budgetary accounting

for appropriations, investment of idle funds, semi-annual reports of financial information to the Local Government Commission, and an annual independent audit.

Such Act requires a municipality or county to use the modified accrual basis of accounting in recording transactions; however, the Commission is empowered to prescribe regulations as to (1) features of accounting systems, (2) "basis of accounting, including identifying in detail the characteristics of a modified accrual basis, identifying what revenues are susceptible to accrual, and permitting or requiring use of a basis other than modified accrual in a fund that does not account for the receipt of a tax", and (3) definition of terms not clearly defined in the Act. See the notes to the financial statements included in Appendix A for a summary of significant accounting policies including the basis of accounting utilized by the City to maintain its accounts.

The Act also requires each municipality or county to have its accounts audited annually by a certified public accountant or by an accountant certified by the Commission as qualified to audit local government accounts. A written audit contract is required to be submitted to the Commission for its approval as to form, terms, and conditions. The City's accounts have been audited by the firm of Haskins & Sells, Certified Public Accountants, for the fiscal years ended June 30, 1975, 1974, and 1973. Copies of the City's Annual Financial Report for these years containing the report of independent certified public accountants are available in the office of Mr. J. B. Fennell, Director of Finance, Cameron-Brown Building, 301 South McDowell Street, Charlotte, North Carolina 28202 (Telephone AC 704-374-3051). Certain financial statements of the City which are based on such Annual Financial Reports have been prepared by the City and are attached as Appendix A to this Official Statement.

STATISTICAL SUMMARY

	1975	1974	1973	1972	1971	1965
Outstanding general obligation bonds	$130,698,000	$110,685,000	$ 93,972,000	$ 98,759,500	$ 87,447,000	$ 64,701,500
Population	305,500	304,000(a)	255,500	251,500	246,500	245,800
Per capita outstanding general obligation bonds	$ 427.82	$ 364.10	$ 367.80	$ 392.68	$ 354.75	$ 263.23
Ratio of outstanding general obligation bonds to assessed values	3.61%	3.88%	3.47%	3.92%	4.44%	4.85%
Per capita income	$ (b)	$ 5,262	$ 4,662	$ 4,226	$ 3,913	$ 2,625
City and County final public school enrollment (excluding kindergarten)	77,596	78,626	79,873	81,121	82,507	73,914
Unemployment rate	7.6%	3.3%	2.5%	2.8%	3.6%	3.0%
Industry employment by place of work:						
Manufacturing:	(b)	37,950	37,790	36,400	36,220	31,040
Food		5,040	4,730	4,530	4,800	4,150
Textiles		4,690	4,970	4,970	5,460	6,930
Apparel		1,920	1,940	1,900	1,820	1,620
Paper		1,570	1,770	1,620	1,620	3,860
Printing		3,820	3,950	3,860	3,600	
Chemicals		4,360	4,070	3,910	4,010	3,000
Rubber		2,530	2,500	2,060	2,020	
Stone, clay & glass		1,250	1,300	1,170	1,070	
Primary metals		960	1,140	1,250	1,100	2,890
Fabricated metals		2,010	2,190	2,130	1,960	
Non-metallic machinery		5,160	4,500	4,370	4,440	4,010
Transportation equipment		1,220	1,580	1,630	1,280	
Other manufacturing		3,420	3,150	3,000	3,040	4,580
Non-manufacturing:	(b)	161,310	153,500	145,180	136,110	97,480
Construction		13,690	13,540	13,000	11,500	8,470
Transportation, communication, and public utilities		22,000	20,980	19,630	18,650	14,440
Trade		54,440	52,220	50,300	48,120	35,850
Finance, insurance and real estate		16,600	16,190	14,780	13,250	8,760
Service and miscellaneous		31,700	29,540	27,180	25,530	17,500
Government		22,880	21,030	20,290	19,060	
Estimated housing units started:						
Number	429	1,519	994	3,059	7,892	
Valuation	$ 16,133,580	$ 32,308,466	$ 14,507,632	$ 26,600,030	$ 42,269,597	$ 21,655,510

(Continued)

(Concluded):

STATISTICAL SUMMARY

	1975	1974	1973	1972	1971	1965
Building permits:						
Permits issued—New construction:						
Number of permits	473	597	679	948	1,234	1,926
Valuation	$ 43,339,339	$107,562,059	$ 77,691,620	$ 71,689,524	$ 77,731,808	$ 43,403,865
Permits issued—Repairs and alterations:						
Number of permits	3,276	2,992	2,834	2,575	2,186	2,062
Valuation	$ 21,723,285	$ 34,515,984	$ 14,745,398	$ 15,134,238	$ 16,007,988	$ 3,676,976
Streets:						
Miles of streets	1,174	1,144	873	868	867	669
Miles of streets resurfaced	91	76	81	46	51	45
Patching (thousand sq. yds.)	122	111	105	124	125	175
Number of street lights	27,292	22,818	21,067	19,750	18,408	11,650
Water and sewer:						
Number of water accounts	89,531	87,810	86,400	84,500	82,478	71,808
Daily average consumption of water (thousands of gallons)	36,300	37,500	36,200	34,200	33,800	25,349
Miles of water lines	1,313	1,275	1,237	1,215	1,091	965
Number of fire hydrants	4,183	4,020	3,910	3,807	3,234	2,786
Miles of sewer lines	1,285	1,162	1,132	1,055	941	725
Number of treatment plants	8	8	8	8	3	2
Airport:						
Number of feet of runways	15,347	15,347	15,347	15,347	15,347	15,347
Number of scheduled airline arrivals and departures per day	188	168	194	188	178	140
Passengers boarding	1,148,006	1,170,022	1,084,065	948,142	840,141	529,769

Notes: (a) Includes a population of approximately 45,000 acquired by annexation of approximately 32.5 square miles on January 25, 1974.
(b) Data not available.

Sources:
Population: estimated by Charlotte-Mecklenburg Planning Commission.
Per capita income: estimated by Charlotte Chamber of Commerce.
School enrollment: estimated by Charlotte-Mecklenburg Board of Education.
Employment data: estimated by North Carolina Employment Security Commission.
Housing and building data: estimated by Charlotte Building Inspection Department.

DEBT INFORMATION

Legal Debt Limit

Article V, Sec. 4 of the State Constitution provides, among other things, that no unit of local government may contract debts (debt being defined by the Constitution as the borrowing of money) secured by a pledge of its faith and credit in an amount exceeding two-thirds of the amount by which the unit's outstanding indebtedness shall have been reduced during the preceding fiscal year unless the debt is approved by a majority of the qualified voters of the unit who vote thereon at a referendum. In addition, The Local Government Bond Act, as amended, provides that, subject to certain exceptions, no bond order may be adopted by the governing body of a unit of local government unless it appears from the sworn statement of debt filed in connection therewith that the net debt of the unit does not exceed 8% of the appraised value of property subject to taxation by the issuing unit before the application of any assessment ratio. Said limitation does not apply to funding and refunding bonds, bonds issued for water, gas or electric power purposes, or two or more of such purposes, certain sanitary sewer, sewage disposal or sewage purification plant bonds, bonds or notes issued for erosion control purposes, and bonds or notes issued for the purposes of erecting jetties or other protection works to prevent encroachment by certain bodies of water. As of December 31, 1975, the City had the statutory capacity to incur additional debt in an amount exceeding $270,000,000.

Tax Anticipation Notes

Units of local government are authorized by the Constitution and Article 9, as amended, of Chapter 159 of the General Statutes of North Carolina to borrow money for the purpose of paying appropriations made for the current fiscal year in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50% of such taxes uncollected as of the date of the proposed loan authorization. The City has not borrowed in anticipation of taxes since fiscal 1970.

Revenue Anticipation Notes

Said Article 9, as amended, authorizes units of local government to borrow money for the purpose of paying appropriations made for the current fiscal year in the amount of receipts of revenues, other than taxes, estimated in its budget to be realized in cash during such fiscal year, and to issue negotiable notes in evidence thereof. A revenue anticipation note may not mature later than 30 days after the close of the fiscal year in which it is issued and may not be renewed beyond that time. No revenue anticipation loan may be made if the amount thereof, together with the amount of all revenue anticipation notes authorized or outstanding on the date the loan is authorized, would exceed 80% of the revenues of the issuing unit, other than taxes, estimated in its budget to be realized in cash during such fiscal year. The City has never issued such notes.

Grant Anticipation Notes

Said Article 9, as amended, authorizes units of local government to borrow money for the purpose of paying appropriations made for a capital project in anticipation of the receipt of moneys from grant commitments for such capital project from the State or the United States or any agencies of either, and to issue its negotiable notes in evidence thereof. Such note may not mature later than 12 months after the estimated completion date of such capital project and may be renewed from time to time, but no renewal shall mature later than 12 months after such estimated completion date. No such note may be issued if the amount thereof, together with the amount of all other notes authorized or issued in anticipation of the same grant commitment, shall exceed 90% of the unpaid amount of said grant commitment. The City has never issued such notes.

Outstanding Bonded Debt

At June 30, 1973	$ 93,972,000	At December 31, 1975:	
At June 30, 1974	110,685,000*	Water Bonds	$ 23,145.000
At June 30, 1975	130,698,000*	Sanitary Sewer Bonds	31,250.000
		Other Bonds	76,298,000
			$130,693,000

*Bonds issued during the year ended June 30:

1974 $21,500,000 ($8 845,000 Street Bonds, Series A, $7.400,000 Sanitary Sewer Bonds, Series A, $3,100,000 Public Improvement Bonds, and $2,155,000 Water Bonds, Series A) 13.88 years average maturity, 4.9590% net interest cost.

1975 $26,000.000 ($9.535 000 Street Bonds, Series B, $6,250,000 Airport Bonds, $6.220,000 Sanitary Sewer, Series B, $3,845,000 Water Bonds, Series B and $150,000 Sidewalk Bonds) 12.99 years average maturity, 5.7190% net interest cost.

Note: Outstanding Bonded Debt shown above does not include outstanding balance of $3,400,000 Airport Revenue Bonds, Series A, which are payable solely from net revenues of the Airport.

Lease Purchase Agreements and Other Commitments

The City is a party to the following lease purchase agreements:

Lease purchase agreement between the City and Queens Properties, Inc., a North Carolina corporation, for the building utilized by the City-County Utility Department as office and administrative quarters. The lease commenced on October 1, 1973 and ends on November 30, 1999 or such earlier date as the City may have exercised its rights to prepay the purchase price in accordance with the terms of the agreement. The rent for the facility is $89,822.30 payable annually. Such rent is payable solely from revenues generated by the water and sewer system. The agreement was approved by the Local Government Commission in accordance with and under the provisions of Article 8, Chapter 159, of the General Statutes of North Carolina. If the City does not exercise its option to prepurchase the facility, the title to the facilities will be vested in the City at the end of the lease period.

Lease purchase agreement between the City and McGuire Properties, Inc., a North Carolina corporation, for the lease of a 5½ story parking garage facility. The term of the lease is for an eleven year period commencing on December 23, 1974, and ending on December 23, 1985. The annual rental for the parking garage facility is $250,300 payable from the City's Municipal Debt Service Fund. This agreement was approved by the Local Government Commission pursuant to and in accordance with Article 8, Chapter 159, of the General Statutes of North Carolina.

An agreement between the City and the County dated January 17, 1972, consolidated and merged the separate water and sewer utility operations of the two governments into a single department to function on a countywide basis under the administrative direction of the City. As part of the agreement, the County leased all real and personal property used and owned by the County for water and sewer purposes to the City in consideration of the City's payment to the County of amounts on a semiannual basis equal to the County's outstanding net debt service cost for water and sewer general obligation bonds. The City's payment pursuant to such agreement for fiscal 1976 is $1,381,085 and, for fiscal years 1977 to 1997, inclusive, will average $1,373,175. Such amounts are payable from the revenues generated by the water and sewer system. Upon the payment of the debt service, the County is obligated to convey title to all real and personal property to the City.

The City has entered into an agreement for the use of certain computer equipment. This agreement, which may be terminated by the City upon proper notice, requires payments of $272,000 for fiscal 1976, $341,000 in fiscal 1977 to 1981, inclusive, and $171,000 in fiscal 1982. Payments for fiscal 1975 were approximately $90,000. Such payments have been made from the City's General Fund.

Certain developers have contracts with the City for construction of water and sewer lines. Under terms of these contracts, the developers are required to deposit with the City an amount equal to the

estimated cost of constructing the lines, which lines when completed and accepted, become the property of the City. Refunds of deposits, which may be either wholly or partially refundable depending upon terms of the contracts, are based upon revenues collected from the use of the lines, and are paid principally over periods not exceeding fifteen years and twenty years for water and sewer lines, respectively. Refundable water and sewer construction deposits totaled $6,474,316 at June 30, 1975. Amounts to be refunded are not presently determinable as to the year of maturity.

The City has entered into installment purchase contracts principally for privately-owned sewer systems acquired by annexation (see "The City—General Description") which totaled $3,132,269 at June 30, 1975. Such amounts are payable annually over a four-year period including interest based on semi-annual prime interest rates.

Mecklenburg County Debt

Fiscal year ended June 30, 1976 Assessed Valuation $6,837,951,526 as of January 12, 1976; Rate $.79 per $100; Outstanding Debt at December 31, 1975 $97,350,000; Population 1970 U. S. Census 354,656; Bonds Authorized and Unissued—None. On May 18, 1976, a referendum will be held in the County on the questions of issuing $10,000,000 County Hospital Bonds and $400,000 Ambulance Facilities Station Bonds.

Direct and Overlapping Bonded Debt

	City of Charlotte	Mecklenburg County	Total Direct and Overlapping Debt
Gross bonded debt (including $3,400,000 revenue bonds)	$134,093,000	$97,350,000	$231,443,000
Percent of gross bonded debt applicable to City based on assessed valuations	100%	65%	
City's share of gross bonded debt	$134,093,000	$63,277,500	$197,370,500
Deductions from gross:			
Enterprise bonded debt directly supported by operating revenues and bonded debt supported by special assessments	67,283,000	12,733,000	80,016,000
Municipal Debt Service Fund Balance	2,661,807		2,661,807
Total deductions	69,944,807	12,733,000	82,677,807
City's share of net bonded debt supported by taxes	$ 64,148,193	$50,544,500	$114,692,693

Note: The assessed property valuation as of January 12, 1976 for the County totaled $6,837,951,526, which includes the City's valuation of $4,436,863,417 resulting in a City/County ratio of approximately 65 percent.

City Bonds Authorized and Unissued

Purpose	Authorized and Unissued	Bonds Now Offered	Balance
Water	$ 2,630,000‡	$	$2,630,000
Street Widening, Extension and Improvement	3,125,000*	3,125,000	
Street Land	610,000*	610,000	
Bridge	730,000*	730,000	
Sidewalk	1,500,000**	1,500,000	
Public Transportation System	2,500,000**	2,500,000	
	$11,095,000	$8,465,000	$2,630,000†

‡Approved by the voters at an election on September 2, 1972.
*Approved by the voters at an election on April 10, 1973.
**Approved by the voters at a referendum on April 8, 1975.
†Offering of the remaining authorization has not been scheduled at this time.

Miscellaneous Debt Information

The City has not defaulted on the payment of any bonds or notes and has not issued any refunding bonds.

ANNUAL BONDED DEBT REQUIREMENTS FROM JUNE 30, 1975, AND MATURITIES OF BONDS NOW OFFERED

Fiscal Year	UTILITIES Existing Debt Principal	UTILITIES Existing Debt Principal & Interest	OTHER Existing Debt Principal	OTHER Existing Debt Principal & Interest	OTHER Bonds Now Offered	ALL PURPOSES Existing Debt Principal	ALL PURPOSES Existing Debt Principal & Interest	ALL PURPOSES Bonds Now Offered
1975-76	$ 2,865,000	$ 5,040,191.25	$ 3,817,000	$ 7,319,840.00	$	$ 6,682,000	$ 12,360,031.25	$
1976-77	2,770,000	4,810,316.25	3,602,000	6,907,867.50	365,000	6,372,000	11,718,183.75	365,000
1977-78	2,770,000	4,690,495.00	3,617,000	6,747,302.50	350,000	6,387,000	11,437,797.50	350,000
1978-79	2,770,000	4,574,742.50	3,667,000	6,623,850.00	300,000	6,437,000	11,198,592.50	300,000
1979-80	2,770,000	4,464,905.00	3,670,000	6,455,427.50	300,000	6,440,000	10,920,332.50	300,000
1980-81	2,770,000	4,356,392.50	3,665,000	6,286,252.50	300,000	6,435,000	10,642,645.00	300,000
1981-82	2,770,000	4,251,842.50	3,665,000	6,127,565.00	300,000	6,435,000	10,379,407.50	300,000
1982-83	2,770,000	4,148,755.00	3,965,000	6,275,367.50	300,000	6,735,000	10,424,122.50	300,000
1983-84	2,770,000	4,045,192.50	3,965,000	6,106,972.50	300,000	6,735,000	10,152,165.00	300,000
1984-85	2,770,000	3,941,542.50	3,960,000	5,935,010.00	300,000	6,730,000	9,876,552.50	300,000
1985-86	2,770,000	3,843,290.00	3,970,000	5,771,810.00	300,000	6,740,000	9,615,100.00	300,000
1986-87	2,760,000	3,736,192.50	3,970,000	5,587,280.00	300,000	6,730,000	9,323,472.50	300,000
1987-88	2,740,000	3,613,030.00	3,975,000	5,403,780.00	300,000	6,715,000	9,016,810.00	300,000
1988-89	2,745,000	3,515,527.50	3,980,000	5,227,080.00	300,000	6,725,000	8,742,607.50	300,000
1989-90	2,700,000	3,365,215.00	3,975,000	5,035,732.50	300,000	6,675,000	8,400,947.50	300,000
1990-91	2,705,000	3,264,635.00	3,950,000	4,818,982.50	350,000	6,655,000	8,083,617.50	350,000
1991-92	2,720,000	3,174,292.50	3,885,000	4,574,710.00	400,000	6,605,000	7,749,002.50	400,000
1992-93	2,650,000	2,990,137.50	3,825,000	4,337,750.00	475,000	6,475,000	7,327,887.50	475,000
1993-94	2,050,000	2,273,200.00	3,275,000	3,615,500.00	850,000	5,325,000	5,888,700.00	850,000
1994-95	1,870,000	1,994,762.50	1,875,000	2,059,000.00	1,200,000	3,745,000	4,053,762.50	1,200,000
1995-96	895,000	935,275.00	1,700,000	1,794,625.00	875,000	2,595,000	2,729,900.00	875,000
1996-97			325,000	339,625.00		325,000	339,625.00	
Total	$54,400,000	$77,029,932.50	$76,298,000	$113,351,330.00	$8,465,000	$130,698,000	$190,381,262.50	$8,465,000

Note: The amounts do not reflect debt requirements for $3,400,000 Airport Revenue Bonds, Series A outstanding as of the date of this Official Statement.

TAX INFORMATION

	Year Ended June 30,		
	1974	1975	1976
Assessed Valuation:			
Assessment Ratio*	60%	100%	100%
Real Property	$1,085,865,305	$2,363,259,659	$3,065,588,187
Personal Property	484,325,751	1,005,116,671	1,072,828,591
Public Service Companies**	141,122,370	274,052,225	298,446,639
Total Assessed Valuation	$1,711,313,426	$3,642,428,555	$4,436,863,417
Rate per $100	1.69	1.02	.88
Levy	28,976,346	37,069,282	39,180,524
Uncollected:			
At June 30, 1974	691,222		
At June 30, 1975	327,447	1,303,269	
At December 31, 1975	270,781	832,872	13,717,340†

Note: Uncollected taxes levied prior to the year ended June 30, 1974 were $823,765, $602,783, and $543,635 at June 30, 1974 and 1975, and December 31, 1975, respectively.

*Percentage of appraisal value as set by County officials for the fiscal year June 30, 1974; for the fiscal years ended June 30, 1975 and 1976, the ratio has been established by statute. Revaluation of real property was made by County officials and became effective with the 1971 tax levy.

**Valuation of railroads, telephone companies and other utilities as determined by the State Board of Assessment.

†$8,320,634 of such amount was collected in December, 1975, and has been paid to the City since December 31, 1975.

Ten Largest Taxpayers For Fiscal Year Ending June 30, 1976

Name	Amount Levied
1. Southern Bell Telephone and Telegraph Co.	$1,267,249
2. Duke Power Company	640,937
3. International Business Machine Corp.	229,138
4. American Telephone and Telegraph Company	217,020
5. Independence Square Associates	195,727
6. Jefferson Pilot Broadcasting Company	189,277
7. Piedmont Natural Gas Company, Inc.	185,952
8. Belk Bros.	160,944
9. Knight Publishing Co.	159,717
10. Lance, Inc.	149,179

PENSION PLANS

The City participates in three separate retirement systems or plans: (1) the majority of city employees are included in the City's participating membership in the North Carolina Local Governmental Employees' Retirement System; (2) city firemen are covered by the Charlotte Firemen's Retirement System; and (3) members of the police force belong to the Law Enforcement Officers' Benefit and Retirement Fund.

The Park and Recreation Commission has a separate contributory pension plan. The City is not legally required to fund this plan.

The North Carolina Local Governmental Employees' Retirement System

The North Carolina Local Governmental Employees' Retirement System began operation on July 1, 1945 as a service agency for public employees of counties, cities, towns, boards, commissions and other similar political entities. The State Treasurer is custodian of the system funds. The system is supported by the joint contributions of members and participating employers. The rates of contribution by the participating employers are set on the basis of actuarial valuations made for each participating employer as soon as practicable after one year of participation.

The act establishing this system, Chapter 128, Article 3 of the North Carolina General Statutes, provides that the contributions of the participating employers shall consist of a normal contribution to cover the liability on account of service currently rendered and an accrued liability contribution on account of the liability assumed by each such employer for benefits based on service rendered prior to the date of participation.

The normal contribution rate is to be determined as the uniform percentage of the earnable compensation of the average new entrant throughout his entire period of active service which would be sufficient to provide for the payment of any pension payable on his account and for the pro rata share of the cost of administration of the system. The current normal contribution rate for all employers, including the City, is 3.24 percent of payroll. The accrued liability contribution rate is set for each employer on the basis of prior service credits allowable to the employees thereof determined on the basis of separate initial valuations for each employer.

The system is administered through a Board of Trustees by the State of North Carolina. The administrative costs are borne by participating employers. The State of North Carolina makes no contributions to the system.

The number of governmental units participating in the system on December 31, 1974 was 471, and the number of members, including those retired, on that date was 47,342. The numbers of persons receiving retirement allowances, refunds, and death benefits during 1974 were, respectively, 3,698, 5,435 and 71. The death benefit, effective July 1, 1969, is optional with each unit.

The system provides both retirement and death benefits on an employee and employer contribution basis. Members contribute 5 percent of their individual compensation not in excess of $5,600 and 6 percent of the excess over $5,600. The benefits of the pension system are available to the members at various times throughout their creditable service. An individual is qualified for a vested deferred benefit, when age 60 is reached, after five years of creditable service to the local government. Unreduced benefits are available upon 30 years of creditable service or at age 65. Benefit payments are computed based upon the average annual compensation in the five consecutive years of membership service that produces the highest average. This average final compensation computation is then adjusted by a percentage formula, total years of service factor, and by an age service factor if the individual is not eligible for unreduced benefits.

Following is a cash flow analysis of the system for the three fiscal years of the system ended December 31:

	1972	1973	1974*
Income			
Employee Contributions	$ 9,922,204	$11,642,545	$13,957,753
Employer Contributions	12,229,766	13,515,893	13,241,526
Interest on Investments	10,458,774	12,031,177	13,763,734
Other Income	117,841	554,259	717,426
	$32,728,585	$37,743,874	$41,680,439
Disbursements			
Payments to Retired	$ 3,715,238	$ 4,676,114	$ 5,825,730
Death Benefits	473,617	475,309	535,833
Refunds	2,359,162	3,111,597	5,440,923
Interest Credited to Members	1,607,280	1,889,150	2,183,699
Administrative Expense	182,278	173,650	210,173
	$ 8,337,575	$10,325,820	$14,196,358
Excess of Income over Disbursements	$24,391,010	$27,418,054	$27,484,081

*Unaudited

Sources: Books of Accounts as of December 31, 1974; Reports on Audit for all prior years.

Contributions to the system are determined on an actuarial basis by the firm of George B. Buck Consulting Actuaries, Inc. The latest actuarial study was for the period ended December 31, 1974, and included a 4½ percent investment return assumption. As a matter of administrative policy, the unfunded accrued liability of each unit will be funded over a period of 24 years, by an actuarial rate, calculated as of the date the unit joins the system. This rate is to be adjusted annually, if necessary, in accordance with current actuarial determinations.

Summarized below is financial information concerning the system for the three fiscal years of the system ended December 31:

	1972	1973	1974
Total Present Assets	$191,911,722	$220,954,382	$247,705,573
Employee Contributions	9,922,204	11,642,545	13,957,753
Employer Contributions	12,229,766	13,515,893	13,241,526
Unfunded Accrued Liability*	34,857,118	40,453,343	50,206,161

*These figures reflect only the aggregate amount of unfunded accrued liability of all units as of December 31 of the year indicated. This total liability is not shared among the units and therefore in no way represents the unfunded accrued liability of a particular member unit.

Sources: Books of Accounts as of December 31, 1974; Reports on Audit for all prior years; and Annual Reports of the Independent Actuary, 1972-1974.

The City joined the system February 1, 1946 and since February 1, 1970 has had no unfunded accrued liability. The actuarially determined contribution rate applicable to the eligible payroll of the City for the 1976 fiscal year is 3.41 percent, which is the sum of the 3.24 percent normal contribution rate and .17 percent optional benefit rate.

Following are the amounts contributed to the system by the City and its participating employees for the three fiscal years of the system ended December 31:

	1972	1973	1974
Employee Contributions	$740,462	$828,828	$946,616
Employer Contributions*	$626,365	$671,506	$578,391

*City contributions for the three fiscal years ended June 30, 1973, 1974 and 1975 were $573,682, $687,734 and $622,553, respectively.

Charlotte Firemen's Retirement System

The Charlotte Firemen's Retirement System, established pursuant to Chapter 926 of the Session Laws of the General Assembly of North Carolina of 1975 and administered solely by the City, provides retirement benefits for uniformed members of the Charlotte Fire Department. As of January 1, 1975 the Firemen's system had a membership of 557 active and 78 retired members.

The retirement benefits are available to the members at various times throughout their creditable service beginning at age 50 and 25 years of creditable service, but not later than age 65 or 30 years of creditable service. Benefit amounts are based on years of service and salary during last five years of service. Benefits equal to total contributions paid into the system less any retirement benefits actually received are paid to his beneficiary upon the death of a member.

Following is a cash flow analysis of the system for the three years ended December 31, 1975:

	1973	1974	1975
Income			
Employee Contributions	$ 481,241	$ 565,394	$ 663,798
Employer Contributions	646,799	609,894	708,293
Investment Income	261,482	271,625	339,064
Other Income	5,586	21,509	
	$ 1,395,108	$ 1,468,422	$ 1,711,155
Disbursements			
Payments to Retired	$ 301,731	$ 335,353	$ 383,085
Refunds	34,260	46,132	12,287
Operating Expenses	3,854	4,899	5,791
	$ 339,845	$ 386,384	$ 401,163
Excess of Income over Disbursements	$ 1,055,263	$ 1,082,038	$ 1,309,992

Sources: Annual Audits of the Charlotte Firemen's Retirement System for the fiscal years 1973-1975.

Contributions to the system, which are determined on an actuarial basis by the firm of Tillinghast & Company, Inc., consulting actuaries, include rates that provide for both normal and accrued liability funding. The latest actuarial valuation by independent actuary, based on data as of June 30, 1974, included a 4½ percent annual investment yield assumption. The system is being supported by a matching contribution rate of 10.1 percent that will provide for the annual normal cost, interest on the unfunded accrued liability, and amortization of the principal amount of the unfunded accrued liability over 61 years. In addition, the City is annually contributing for a five-year period $44,500 to the system to fund a special 2 percent benefit adjustment for members retired prior to January 1, 1972.

Summarized below is financial information concerning the system for the three fiscal years ended June 30, 1975:

	1973	1974	1975
Total Present Assets*	$ 6,581,964	$ 7,283,120	$ 7,881,459
Employee Contributions (June 30)	481,241	565,394	663,798
Employer Contributions (June 30)	646,799	609,894	708,293
Unfunded Accrued Liability*	9,038,374	9,624,201	11,431,674

*As of January 1 of the year indicated.

Sources: Annual Audits of the Charlotte Firemen's Retirement System for the years 1973-1975; and annual actuarial studies of the system for the years 1973-1975.

Law Enforcement Officers' Benefit and Retirement Fund

The Law Enforcement Officers' Benefit and Retirement Fund is administered by the State of North Carolina pursuant to G.S. 143-166. It had a membership of 7,250 at June 30, 1974 composed primarily of local government law enforcement officers. The system is funded by certain fees collected through the General Court of Justice and by contributions from members and their employers. The City has no liability for any contributions except those paid on behalf of members during each fiscal year. The payments made by the City to the Law Enforcement Officers' Benefit and Retirement Fund during the last three fiscal years ended June 30 were:

	1973	1974	1975
City of Charlotte contributions	$238,888	$268,664	$334,280

Charlotte Park and Recreation Commission Pension Plan

The City's contribution to the Park and Recreation Commission Pension Plan is based on actuarial determinations which provide for (1) normal costs; (2) interest on unfunded accrued liability; and (3) amortizations of the principal amount of the unfunded accrued liability of approximately $210,000 over an eighteen year period based on an actuarial determination as of November 1, 1975 by The Bankers Life Company. Park and Recreation Commission General Fund contributions to such plan for the years ended June 30, 1975, 1974, and 1973 were $43,203, $36,104, and $32,662, respectively.

CONTINGENT LIABILITIES

On February 19, 1975, United States Department of Labor ("DOL") auditors met with certain City and Charlotte-Mecklenburg School Board administrative officials for a preliminary audit conference respecting principally audit findings on grants awarded to the City totaling $1,845,941 as prime sponsor and subcontracted to the School Board for operation of a 1975 summer and regular school program and 1974 summer program for employment of economically disadvantaged youth under Titles I and III of the Comprehensive Employment and Training Act of 1973. The auditors indicated their examination disclosed that a substantial number of participants in the programs appeared to be ineligible for employment due to insufficient information in the participants' employment files or because DOL income standards were exceeded. The School Board officials have offered explanations of mitigating circumstances to the auditors; however, the effect of such explanations on the auditor's final findings cannot be determined until a final audit report is prepared, which will be approximately 90 to 120 days. If participants' files can be adequately documented by School Board officials, and if such documentation reveals that such participants were ineligible, and should other audit findings be correct, then DOL could recover such ineligible costs. In such event, it is the opinion of the City Attorney that the School Board would be obligated to reimburse the City for such costs.

LITIGATION

The City is a party defendant in a suit pending in the General Court of Justice, Superior Court Division, Mecklenburg County, North Carolina, which involves a claim by Southern Bell Telephone and Telegraph Company to obtain compensation for adjusting its facilities to accommodate construction of the Charlotte expressway system. The plaintiff has alleged that it has incurred costs approximating

$483,000 in relocating its cable facilities for expressway construction. In 1974, plaintiff requested that this lawsuit be placed in the inactive file primarily because of the lack of construction activity with respect to the expressway system. It is the opinion of the City Attorney that the issue involved in this litigation will be resolved in favor of the defendants as a matter of law and that no monetary damages will occur.

A suit is pending in the U. S. District Court, Western District of North Carolina, which seeks to enjoin the construction of a new 10,000 foot runway at Douglas Municipal Airport on the grounds that the runway project had previously been inadequately assessed as to its environmental impact on the surrounding area. At the conclusion of a hearing held in August 1975, the Court ordered that paving and lighting of the new runway not be commenced until a supplementary environmental impact statement has been prepared and submitted to the appropriate Federal agencies. A consultant has been retained by the City and the Federal defendant and work is substantially completed on the preparation of the supplementary environmental impact statement. It is anticipated that the completed statement will be presented to the appropriate Federal agencies on April 1, 1976. A contract for paving the new runway was awarded by the City in June 1975 in the amount of $7,020,014. The paving contractor has given notice that it intends to assert a claim for damages of approximately $1,000,000 for additional costs and losses incurred as a result of the delay in proceeding with construction under the contract. Alleged damages will continue to accrue if further delay is experienced beyond July 1976. A lighting contract for the installation of a lighting system for the new runway was awarded by the City in June 1975 in the amount of $784,498. At present no claim for damages has been made by the lighting contractor. Because of the Court's order, no work is proceeding under either contract at this time. It is the opinion of the City Attorney that, assuming favorable Federal review, work can commence on both contracts by July 1976.

The City is a party defendant in numerous other proceedings where (i) an adverse adjudication will not have a material adverse effect on the City's financial condition or (ii) the City's liability, if determined to exist, will be covered by adequate insurance.

APPROVAL OF LEGAL PROCEEDINGS

Certain legal matters incident to the authorization and issuance of the Bonds are subject to the approval of Brown, Wood, Ivey, Mitchell & Petty, New York, New York, Bond Counsel, whose approving legal opinion will be available at the time of the delivery of the Bonds and will be printed on the Bonds. The proposed form of such opinion is attached hereto as Appendix B.

TAX EXEMPTION

In the opinion of Bond Counsel, interest on the Bonds is exempt from all present Federal income taxes.

CERTIFICATES CONCERNING OFFICIAL STATEMENT

Concurrently with the delivery of the Bonds, the Mayor, the City Manager, and the Director of Finance of the City will certify that, to the best of their knowledge, the Official Statement did not as of its date, and does not as of the date of delivery of the Bonds, contain an untrue statement of a material fact or omit to state a material fact which should be included therein for the purpose for which the Official Statement is to be used, or which is necessary in order to make the statements contained therein, in the light of the circumstances in which they were made, not misleading.

In addition, concurrently with the delivery of the Bonds, the Secretary of the Local Government Commission will furnish his certificate to the effect that nothing has come to his attention which would lead him to believe that the Official Statement, as of its date and as of the date of delivery of the Bonds, contains an untrue statement of a material fact or omits to state a material fact which should be included therein for the purpose for which the Official Statement is to be used, or which is necessary to make the statements contained therein, in the light of the circumstances in which they were made, not misleading.

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion or estimates, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any of the statements will be realized.

Reference herein to the State Constitution, the acts authorizing the Bonds and all other acts referred to herein are only brief outlines of certain provisions thereof and do not purport to summarize or describe all provisions thereof.

The execution of this Official Statement has been duly authorized by the Local Government Commission of North Carolina and the City Council of the City.

LOCAL GOVERNMENT COMMISSION
OF NORTH CAROLINA

By H. E. BOYLES
Secretary of the Commission

CITY OF CHARLOTTE, NORTH CAROLINA

By JOHN M. BELK
Mayor

By DAVID A. BURKHALTER
City Manager

By JOHN B. FENNELL
Director of Finance

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APPENDIX A

The following financial statements, including the notes thereto, have been prepared by the City and are based on certain audited financial statements included in the City's Annual Financial Reports for the fiscal years ended June 30, 1975, 1974, and 1973. (See "Accounting and Auditing" in the Official Statement.)

GENERAL AND SPECIAL REVENUE FUNDS
CONSOLIDATED BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
ASSETS			
Cash	$ 288,809	$ 333,118	$ 883,807
Short-Term Investments, At Cost Which Approximates Market	13,525,000	11,269,828	10,905,000
Receivables:			
Property tax	1,651,102	1,175,530	1,150,658
Sales tax	212,875	161,423	156,692
Other	341,435	96,186	100,121
Total receivables	2,205,412	1,433,139	1,407,471
Due From Other Governmental Agencies	129,738	600,874	418,936
Due From Other Funds	1,120,931	600,530	151,914
Materials and Supplies, At Cost	206,346	180,253	156,880
Other	8,370	119,935	6,460
Total	$17,484,606	$14,537,677	$13,930,468
LIABILITIES, ENCUMBRANCES OUTSTANDING, RESERVES, AND FUND BALANCES			
Liabilities:			
Accounts payable	$ 1,981,877	$ 1,724,783	$ 873,022
Contracts payable	497,737	284,254	24,978
Employee withholdings, etc.	1,408,398	1,221,094	1,130,737
Due to other funds	1,225,963	1,360,839	4,044,665
Other	137,549	113,664	73,920
Total liabilities	5,251,524	4,704,634	6,147,322
Encumbrances Outstanding	1,646,371	1,850,422	1,301,740
Reserves:			
For uncollected receivables	2,002,198	1,433,139	1,407,471
Other			69,770
Total reserves	2,002,198	1,433,139	1,477,241
Fund Balances:			
Appropriated	4,050,881	2,385,201	1,543,500
Unappropriated	4,533,632	4,164,281	3,460,665
Total fund balances	8,584,513	6,549,482	5,004,165
Total	$17,484,606	$14,537,677	$13,930,468

See accompanying notes to financial statements.

GENERAL AND SPECIAL REVENUE FUNDS
CONSOLIDATED STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES, AND TRANSFERS
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Revenues:			
Taxes	$36,397,660	$30,040,646	$27,909,623
Intergovernmental agencies	11,241,981	10,547,937	8,966,528
Licenses, permits, and fees	1,500,365	1,098,173	1,036,979
Interest on investments	1,256,444	1,234,872	608,840
Charges for current services	718,063	780,590	830,942
Intragovernmental services	620,612	431,516	354,070
Fines, forfeitures, and penalties	190,490	177,444	194,700
Other	744,000	611,944	287,318
Total revenues	52,669,615	44,923,122	40,189,000
Transfers From Other Funds	500,607	1,691,388	798,289
Total revenues and transfers	53,170,222	46,614,510	40,987,289
Expenditures and Encumbrances:			
Public safety	19,575,521	16,828,846	14,673,528
Health and welfare	6,798,020	5,803,574	5,539,978
General government and administration	5,401,354	4,690,269	4,000,756
Transportation	7,640,554	6,089,504	5,375,632
Cultural, recreation, and community relations	3,751,160	3,073,208	2,314,075
Service centers	1,017,063	926,206	686,440
Job training and development, and emergency employment	854,383	1,132,624	90,805
Community planning and development	775,608	768,079	470,287
Social services	453,204	39,540	33,204
Non-departmental	3,875,736	3,336,502	2,788,490
Total expenditures and encumbrances	50,142,603	42,688,352	35,973,195
Transfers To Other Funds	1,914,088	2,380,841	3,996,215
Total expenditures, encumbrances and transfers	52,056,691	45,069,193	39,969,410
Excess of Revenues and Transfers Over Expenditures, Encumbrances, and Transfers	$ 1,113,531	$ 1,545,317	$ 1,017,879

See accompanying notes to financial statements.

GENERAL AND SPECIAL REVENUE FUNDS
CONSOLIDATED STATEMENT OF CHANGES IN FUND BALANCES
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Fund Balances, Beginning Of Year	$ 6,549,482	$ 5,004,165	$ 2,021,424
Restatements:			
To reflect return of prior years advances by the General Fund to the General Capital Projects Fund for project costs covered by a State grant received in 1974	921,500		
To reflect certain reserves as fund balance			1,964,862
Fund Balance, Beginning Of Year, As Restated	7,470,982	5,004,165	3,986,286
Excess Of Revenues and Transfers Over Expenditures, Encumbrances, and Transfers	1,113,531	1,545,317	1,017,879
Fund Balances, End Of Year	$ 8,584,513	$ 6,549,482	$ 5,004,165

MUNICIPAL DEBT SERVICE FUND
BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
ASSETS			
Cash	$ 348	$ 631	$ 518
Short-Term Investments, At Cost Which Approximates Market	3,150,000	2,269,000	1,513,000
Property Tax Receivable	282,658	185,345	164,652
Due From Other Funds	1,224,542	21,742	16,806
Advance Debt Service Payment	12,328	14,400	16,469
Total	$ 4,669,876	$ 2,491,118	$ 1,711,445
LIABILITY, RESERVES, AND FUND BALANCE			
Liability:			
Due to other funds	$ 102,250	$ 129,926	$ 109,369
Reserves:			
For property tax receivable	282,658	185,345	164,652
Other			16,470
Total reserves	282,658	185,345	181,122
Fund Balance:			
Appropriated	1,623,161	573,300	
Unappropriated	2,661,807	1,602,547	1,420,954
Total fund balance	4,284,968	2,175,847	1,420,954
Total	$ 4,669,876	$ 2,491,118	$ 1,711,445

See accompanying notes to financial statements.

MUNICIPAL DEBT SERVICE FUND
STATEMENT OF REVENUES, EXPENDITURES, AND TRANSFERS
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974 AND 1973

	1975	1974	1973
Revenues:			
Taxes	$ 5,482,127	$ 4,459,503	$ 4,129,045
Contribution from Alcoholic Beverage Control Board	225,625	236,906	248,188
Interest on investments	195,731	154,254	56,854
Beer and wine licenses	16,293	14,877	13,014
Total revenues	5,919,776	4,865,540	4,447,101
Transfers From Other Funds	2,268,813	956,143	615,688
Total revenues and transfers	8,188,589	5,821,683	5,062,789
Expenditures and Encumbrances:			
Redemption of serial bonds	2,955,000	2,560,000	2,560,000
Interest on bonds	2,855,108	2,487,331	2,203,713
Lease-purchase agreement	250,300		
Fiscal agents' fees	19,060	19,459	4,071
Total expenditures	6,079,468	5,066,790	4,767,784
Excess Of Revenues and Transfers Over Expenditures and Encumbrances	$ 2,109,121	$ 754,893	$ 295,005

MUNICIPAL DEBT SERVICE FUND
STATEMENT OF CHANGES IN FUND BALANCE
FOR THE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Fund Balance, Beginning Of Year	$ 2,175,847	$ 1,420,954	$ 895,385
Restatement To Reflect Certain Reserves As Fund Balance			230,564
Fund Balance, Beginning Of Year, As Restated	2,175,847	1,420,954	1,125,949
Excess Of Revenues and Transfers Over Expenditures and Encumbrances	2,109,121	754,893	295,005
Fund Balance, End Of Year	$ 4,284,968	$ 2,175,847	$ 1,420,954

See accompanying notes to financial statements.

REVENUE SHARING FUND
BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
ASSETS			
Cash	$ 9,997	$ 954	$ 1,200
Short-Term Investments, At Cost Which Approximates Market	8,585,000	7,435,000	2,992,000
Receivables—Sales tax	6,452		
Due From Other Funds			500,900
Total	$ 8,601,449	$ 7,435,954	$ 3,494,100
LIABILITY AND FUND BALANCE			
Liability—Due to other funds	$ 654,726	$ 944,584	
Fund Balance:			
Appropriated	7,574,127	6,017,060	
Unappropriated	372,596	474,310	$ 3,494,100
Total fund balance	7,946,723	6,491,370	3,494,100
Total	$ 8,601,449	$ 7,435,954	$ 3,494,100

REVENUE SHARING FUND
STATEMENT OF REVENUES AND TRANSFERS
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Revenues:			
Federal revenue sharing entitlements	$ 5,458,668	$ 5,705,061	$ 5,302,713
Interest on investments	663,185	474,310	75,214
Total revenues	6,121,853	6,179,371	5,377,927
Transfers From Other Funds	510,000	1,085,537	
Total revenues and transfers	6,631,853	7,264,908	5,377,927
Transfers To Other Funds	5,176,500	4,267,638	1,883,827
Excess Of Revenues and Transfers Over Transfers	$ 1,455,353	$ 2,997,270	$ 3,494,100

REVENUE SHARING FUND
STATEMENT OF CHANGES IN FUND BALANCE
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Fund Balance, Beginning Of Year	$ 6,491,370	$ 3,494,100	
Excess Of Revenues and Transfers Over Transfers	1,455,353	2,997,270	$ 3,494,100
Fund Balance, End Of Year	$ 7,946,723	$ 6,491,370	$ 3,494,100

See accompanying notes to financial statements.

WATER AND SEWER FUNDS
CONSOLIDATED BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
ASSETS			
Current Assets:			
Cash	$ 118,598	$ 176,055	$ 197,269
Short-term investments, at cost which approximates market	18,454,359	19,726,485	11,843,091
Receivables:			
Water and sewer charges	782,164	759,181	682,069
Accrued interest	261,928	312,022	277,328
Sales tax	120,079	120,679	84,272
Other	113,234	25,096	37,927
Total receivables	1,277,405	1,216,978	1,081,596
Due from other funds	21,677	2,577,799	170,649
Due from other governmental agencies	1,964,465	1,205,089	2,300,757
Materials and supplies, at cost	679,261	535,808	503,737
Other	57,083	62,391	13,950
Total current assets	22,572,848	25,500,605	16,111,049
Plant and Equipment:			
Water and sewer systems	96,865,607	90,551,503	87,954,365
Machinery and equipment	1,759,721	1,632,004	1,448,124
Land	1,849,861	1,518,288	1,451,063
Buildings and structures	2,511,584	1,384,501	1,211,033
Construction-in-progress	21,566,059	11,464,390	5,792,241
Total	124,552,832	106,550,686	97,856,826
Less accumulated depreciation	23,155,885	20,565,519	18,137,871
Plant and equipment, net	101,396,947	85,985,167	79,718,955
Total	$123,969,795	$111,485,772	$95,830,004
LIABILITIES, CONTRIBUTED CAPITAL, AND RETAINED EARNINGS			
Liabilities:			
Current liabilities:			
Current maturities of long-term liabilities	$ 4,279,537	$ 3,496,636	$ 3,167,932
Accounts payable	2,113,602	1,450,102	199,801
Contracts payable—Retained percentage	281,998	533,180	423,583
Customer deposits	496,887	473,480	439,781
Construction deposits	561,990	276,238	
Due to other funds	112,174	2,575,187	395,370
Interest on bonds payable	339,495	238,454	216,582
Other	73,307	133,240	57,920
Total current liabilities	8,258,990	9,176,517	4,900,969
Long-term liabilities:			
Bonds payable	51,535,000	44,335,000	37,654,500
Amounts due under lease purchase agreements:			
Mecklenburg County	8,061,809	6,915,551	8,122,377
Other	1,130,342		
Refundable water and sewer construction deposits	6,474,316	5,305,098	3,650,536
Outside acquisitions payable	2,274,543	487,908	359,770
Total long-term liabilities	69,476,010	57,043,557	49,787,183
Total liabilities	77,735,000	66,220,074	54,688,152
Contributed Capital and Retained Earnings:			
Contributed capital/retained earnings, June 30, 1973	41,141,852	41,141,852	41,141,852
Subsequent to June 30, 1973:			
Contributed capital	2,200,175	1,854,020	
Retained earnings	2,892,768	2,269,826	
Total subsequent to June 30, 1973	5,092,943	4,123,846	
Total contributed capital and retained earnings	46,234,795	45,265,698	41,141,852
Total	$123,969,795	$111,485,772	$95,830,004

See accompanying notes to financial statements.

WATER AND SEWER FUNDS
CONSOLIDATED INCOME STATEMENT
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Operating Revenues:			
Metered water sales	$ 5,591,820	$ 5,825,946	$ 5,570,132
Sewer service fees	4,992,533	4,778,093	4,381,878
Other	381,650	262,393	233,880
Total operating revenues	10,966,003	10,866,432	10,185,890
Operating Expenses:			
Water supply and treatment	2,681,186	2,241,330	1,944,369
Sewer system and treatment	2,452,215	1,891,359	1,640,402
Customer accounting and collection	782,324	626,851	543,566
Employee benefits	747,499	756,273	655,956
Administrative and engineering	468,721	374,116	324,402
Total operating expenses	7,131,945	5,889,929	5,108,695
Operating income before depreciation	3,834,058	4,976,503	5,077,195
Depreciation	2,650,925	2,461,601	2,340,268
Operating income	1,183,133	2,514,902	2,736,927
Non-Operating Revenues (Expense):			
Interest on long-term debt	(2,547,994)	(1,970,382)	(1,651,369)
Interest on investments	1,789,641	1,625,188	776,157
Other, net	198,162	100,118	32,489
Total non-operating revenues (expense)	(560,191)	(245,076)	(842,723)
Net Income	$ 622,942	$ 2,269,826	$ 1,894,204

WATER AND SEWER FUNDS
CONSOLIDATED STATEMENT OF CHANGES IN RETAINED EARNINGS
FOR THE TWO YEARS ENDED JUNE 30, 1975 AND 1974

	1975	1974
Retained Earnings, Beginning Of Year	$2,269,826	
Net Income	622,942	$2,269,826
Retained Earnings, End Of Year	$2,892,768	$2,269,826

See accompanying notes to financial statements.

WATER AND SEWER FUNDS
CONSOLIDATED STATEMENT OF CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 1973

Fund Balance, Beginning Of Year, As Previously Reported		$19,090,922
Restatement Of Fund Balance For:		
Change in basis of accounting from modified accrual basis of accounting to accrual basis of accounting to:		
Reclassify reserves to fund balance	$11,970,362	
Change accounting principles	(199,706)	11,770,656
Recognition of equity in addition to plant and equipment under the Mecklenburg County water and sewer facilities lease purchase agreement for Federal, State, and county aid		2,504,114
Fund Balance, As Restated		33,365,692
Additions:		
Contributed Capital—Federal, State, and local grants, and other	5,881,956	
Net income	1,894,204	7,776,160
Deductions—Reclassification of fund balance to contributed capital/retained earnings, June 30, 1973		(41,141,852)
Fund Balance, End Of Year		$ -0-

See accompanying notes to financial statements.

AIRPORT FUNDS
CONSOLIDATED BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
ASSETS			
Current Assets:			
Cash	$ 58,170	$ 19,769	$ 200,997
Short-term investments, at cost which approximates market	9,954,101	5,844,984	5,256,553
Receivables:			
Revenue charges	46,665	127,984	175,494
Accrued interest	89,817	55,890	75,177
Sales tax	2,808	5,852	7,163
Total receivables	139,290	189,726	257,834
Due from other governmental agencies	1,510,575	1,438,947	
Advance debt service payment	285,641	315,997	270,145
Due from other funds	91,213	15,470	10,917
Total current assets	12,038,990	7,824,893	5,996,446
Plant and Equipment:			
Land	6,067,887	6,067,887	6,053,884
Buildings and structures	4,827,157	4,826,017	4,826,551
Equipment	237,952	192,069	162,807
Runways	9,478,448	9,478,448	9,479,231
Construction-in-progress	10,305,713	5,544,581	185,271
Total	30,917,157	26,109,002	20,707,744
Less accumulated depreciation	4,223,424	3,664,883	3,114,391
Plant and equipment, net	26,693,733	22,444,119	17,593,353
Total	$38,732,723	$30,269,012	$23,589,799

See accompanying notes to financial statements.

AIRPORT FUNDS
CONSOLIDATED BALANCE SHEET
JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
LIABILITIES, CONTRIBUTED CAPITAL, AND RETAINED EARNINGS			
Liabilities:			
Current liabilities:			
Current maturities of bonds payable	$ 445,000	$ 370,000	$ 320,000
Accounts payable	583,569	521,221	
Contracts payable—Retained percentage	603,746	348,393	
Due to other funds	23,347	1,173,518	19,141
Interest on bonds payable	154,836	131,934	142,145
Other	34,124	10,676	12,761
Total current liabilities	1,844,622	2,555,742	494,047
Bonds payable:			
General obligation bonds	9,195,000	3,190,000	3,335,000
Revenue bonds	3,400,000	3,600,000	3,825,000
Total bonds payable	12,595,000	6,790,000	7,160,000
Total liabilities	14,439,622	9,345,742	7,654,047
Contributed Capital and Retained Earnings:			
Contributed capital/retained earnings, June 30, 1973	15,935,752	15,935,752	15,935,752
Subsequent to June 30, 1973:			
Contributed capital	6,833,610	4,287,412	
Retained earnings	1,523,739	700,106	
Total subsequent to June 30, 1973	8,357,349	4,987,518	
Total contributed capital and retained earnings	24,293,101	20,923,270	15,935,752
Total	$38,732,723	$30,269,012	$23,589,799

See accompanying notes to financial statements.

AIRPORT FUNDS
CONSOLIDATED INCOME STATEMENT
FOR THE THREE YEARS ENDED JUNE 30, 1975, 1974, AND 1973

	1975	1974	1973
Operating Revenues:			
Terminal building and area	$ 1,255,269	$ 1,303,797	$ 1,177,247
Landing area	692,921	470,642	511,230
Other	191,402	129,446	190,180
Total operating revenue	2,139,592	1,903,885	1,878,657
Operating Expenses:			
Terminal building and area	540,783	495,630	404,752
Loading area	320,648	276,363	215,681
Other	26,536	35,333	29,507
Total operating expenses	887,967	807,326	649,940
Operating income before depreciation	1,251,625	1,096,559	1,228,717
Depreciation	565,315	557,685	553,792
Operating income	686,310	538,874	674,925
Non-Operating Revenue (Expense):			
Interest on investments	700,319	482,759	282,950
Interest on long-term debt	(562,996)	(321,527)	(338,178)
Total non-operating revenue (expense)	137,323	161,232	(55,228)
Net Income	$ 823,633	$ 700,106	$ 619,697

AIRPORT FUNDS
CONSOLIDATED STATEMENT OF CHANGES IN RETAINED EARNINGS
FOR THE TWO YEARS ENDED JUNE 30, 1975 AND 1974

	1975	1974
Retained Earnings, Beginning Of Year	$ 700,106	
Net Income	823,633	$700,106
Retained Earnings, End Of Year	$1,523,739	$700,106

AIRPORT FUNDS
CONSOLIDATED STATEMENT OF CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 1973

Fund Balance, Beginning Of Year, As Previously Reported		$ 9,553,283
Restatement Of Fund Balance For Change In Basis Of Accounting From Modified Accrual Basis To Accrual Basis Of Accounting To:		
Reclassify reserves to fund balance	$2,920,824	
Change accounting principles	3,638	2,924,462
Fund Balance, As Restated		12,477,745
Additions:		
Contributed capital—Federal grants	2,838,310	
Net income	619,697	3,458,007
Deductions—Reclassification of fund balance to contributed capital/retained earnings, June 30, 1973		(15,935,752)
Fund Balance, End Of Year		$ -0-

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting policies of the City of Charlotte, North Carolina, (City) conform to the accounting policies prescribed by the American Institute of Certified Public Accountants' Industry Audit Guide, *Audits of State and Local Governmental Units* (Audit Guide). The following is a summary of the City's significant accounting policies.

Bases of Accounting

The accounts of all City funds are maintained, and the accompanying financial statements for all funds, other than accrual basis funds (enterprise and, with certain exceptions, Capital Projects, Trust and Agency and Special Assessment funds), have been prepared, on the modified accrual basis of accounting. Under this basis:

(a) Revenues are recorded as received in cash except for revenues susceptible to accrual (both measurable and available), principally grants or contributions from intergovernmental agencies in certain Special Revenue and Capital Projects funds.

(b) Expenditures are recorded on the accrual basis except that: interest on long-term debt is recorded as an expenditure when paid; commitments (encumbrances), such as purchase orders and contracts, are recorded as expenditures when executed.

(c) Depreciation on fixed assets is provided only on those assets in use by enterprise funds.

Funds Included in Financial Statements

See "Revenue Structure" in the Official Statement.

Fixed Assets and Depreciation

Plant and equipment in the Water and Sewer and Airport Funds are recorded at cost except prior to June 30, 1963 it is recorded at appraised values. Such plant and equipment (including the cost at June 30, 1975, 1974, and 1973 of $14,983,640, $12,190,457, and $12,553,551, respectively, of water and sewer facilities being acquired by the City from the County, and the capitalized present value of future lease obligations under a non-cancelable lease-purchase agreement for a water and sewer operations center —See Note 3) of the Water and Sewer and Airport Funds are depreciated on the straight-line basis over the estimated useful lives of the depreciable asset groups by application of composite rates. Estimated useful lives and current year's depreciation of such plant and equipment are summarized as follows:

Description	Estimated Useful Life (Years)	Depreciation For Year Ended June 30 1975	1974	1973
Water and Sewer Funds:				
Water and sewer systems	40	$2,412,163	$2,263,788	$2,165,180
Machinery and equipment	10	175,972	163,200	144,812
Building and structures	40	62,790	34,613	30,276
Total Water and Sewer Funds		$2,650,925	$2,461,601	$2,340,268
Airport Funds:				
Runways	33⅓	$ 284,353	$ 284,354	$ 284,377
Building and structures	20	241,358	241,301	241,328
Equipment	5 and 10	39,604	32,030	28,087
Total Airport Funds		$ 565,315	$ 557,685	$ 553,792

Pension Plans

See "Pension Plans" in the Official Statement.

Contributed Capital and Retained Earnings

To conform to the classifications recommended by the Audit Guide, all grants or contributions in aid of construction received subsequent to June 30, 1973 have been reported in the enterprise funds as contributed capital, and cumulative net income earned subsequent to June 30, 1973 has been reported as retained earnings. It is not considered practicable to determine the contributed capital and retained earnings components of fund balance prior to July 1, 1973.

Property Taxes

The Mecklenburg County Tax Collector acts as agent for the City in listing and collecting property taxes levied by the City.

Comparative Financial Statements

Comparative financial statement data for the years ended June 30, 1974, and 1973 are included in the accompanying financial statements. Expenditures and encumbrances in the General Fund have been refined in 1975 for more detailed descriptions of functional categories, and certain 1974, and 1973 amounts, principally non-departmental charges, have been reclassified to conform to 1975 classifications. Certain other amounts have also been reclassified in other funds to conform with the current year's presentation.

2. FUND BALANCES:

Appropriated fund balances at June 30, 1975 for non-enterprise funds consist of the following items:

	Appropriations For				
Fund	Unexpended Project Allotments	1975-76 Budget	Materials and Supplies, June 30, 1975	Other	Total
Revenue Sharing Fund	$7,574,127				$7,574,127
General and Special Revenue Funds		$3,740,014	$278,298	$32,569	4,050,881
Municipal Debt Service Fund		1,623,161			1,623,161

3. LONG-TERM DEBT:

The following table summarizes the long-term liabilities of the Water and Sewer Funds and Airport Funds due subsequent to June 30, 1975:

Description	1976		1977-1981		Subsequent to 1981		Total Debt Due	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
Water and Sewer Funds:								
General obligation bonds	$ 2,865,000	$ 2,175,191	$13,850,000	$ 9,046,851	$37,685,000	$11,407,891	$54,400,000	$22,629,933
Capitalized lease purchase agreements:								
Mecklenburg County water and sewer facilities	533,333	847,752	3,691,666	4,727,363	4,370,143	3,256,751	8,595,142	8,831,866
Utility department operations center	23,478	66,345	139,259	309,853	991,083	625,718	1,153,820	1,001,916
Refundable water and sewer construction deposits					6,474,316		6,474,316	
Outside acquisitions payable	857,726		2,274,543				3,132,269	
Total Water and Sewer	$ 4,279,537	$ 3,089,288	$19,955,468	$14,084,067	$49,520,542	$15,290,360	$73,755,547	$32,463,715
Airport Funds:								
General obligation bonds	$ 245,000	$ 492,723	$ 1,225,000	$ 2,259,643	$ 7,970,000	$ 3,350,732	$ 9,440,000	$ 6,103,098
Revenue bonds	200,000	166,250	2,000,000	611,563	1,400,000	67,688	3,600,000	845,501
Total Airport	$ 445,000	$ 658,973	$ 3,225,000	$ 2,871,206	$ 9,370,000	$ 3,418,420	$13,040,000	$ 6,948,599

Certain general obligation bonds are to be repaid from earnings of such funds. The taxing power of the City is pledged to the payment of such bonds and will be utilized to the extent that revenues would be insufficient to retire such bonds at maturity. (See "Debt Information" in the Official Statement for information respecting other liabilities included in the above table.)

4. RESTATEMENTS:

Fund balances at July 1, 1974 have been increased in the General and Special Revenue Funds to reflect a return of prior years advances by the General Fund to the General Capital Projects Fund for project costs of $921,500 covered by a State grant received in 1974.

Contributed capital subsequent to June 30, 1973 has been decreased by $1,412,838 and liabilities for construction deposits have been increased by $866,340 to reflect the correction of an understatement of water and sewer deposits and by $546,498 to reflect the correction of the amount due Mecklenburg County under a lease purchase agreement as of June 30, 1974.

The opening fund balances at July 1, 1972 in the General and Special Revenue Funds and Municipal Debt Service Fund have increased by $1,964,862 and $214,094, respectively, from the closing balances at June 30, 1972 to reclassify certain reserves, principally appropriations for the fiscal 1973 budget, to fund balances.

The opening fund balances at July 1, 1972 in the Water and Sewer Funds and Airport Funds have been restated (1) to reflect a change from the modified accrual to the accrual basis of accounting for financial reporting purposes to reclassify reserves, principally for encumbrances and construction-in-progress, to fund balances (an increase of $11,970,362 and $2,920,824, respectively), and to change accounting principles (a decrease of $199,706 and an increase of $3,638, respectively), and (2) in the Water and Sewer Funds to recognize the City's equity resulting from Federal, State, and county aid in additions to plant and equipment under the Mecklenburg County water and sewer lease purchase agreement. (See note 3 above.) As a result of the change in the basis of accounting, net income for the Water and Sewer Funds and Airport Funds for the year ended June 30, 1973 was increased by $293,797 and $9,598, respectively, from the amounts previously reported, had the change not been made.

5. COMMITMENTS AND CONTINGENCIES:

See "Debt Information—Lease Purchase Agreements and Other Commitments, Contingent Liabilities" and "Litigation" in the Official Statement.

Appendix B

BROWN, WOOD, IVEY, MITCHELL & PETTY

30 BROAD STREET

NEW YORK, N. Y. 10004

212-944-7225

JOSEPH W. ARMBRUST, JR.
GEORGE B. BOYLE
E. MICHAEL BRADLEY
WILLIAM E. CARTER
WILLIAM R. CARTER
RICHARD CONWAY CASEY
PHILIP W. CLARK
KENNETH T. COTE
THOMAS D. CREAN
JOSEPH GUANDOLO
HENRY W. HAPPEL
ROGER J. HAWKE
J. COURTNEY IVEY
CHARLES J. JOHNSON, JR.
RALPH L. JONES
GEORGE R. LASHNITS
F. LEE LIEBOLT, JR.
JAMES B. MAY
WALTER G. McNEILL
PETER J. MICHEL
HENRY F. MINNEROP
ROBERT L. MITCHELL
RICHARD S. PETTY
PAUL C. PRINGLE
JOHN A. QUISENBERRY
JOHN C. RICHARDSON
A. FRANCIS ROBINSON, JR.
RICHARD D. RUDDER
HOMER D. SCHAAF
NORMAN D. SLONAKER
THOMAS R. SMITH, JR.
EDWARD P. TOLLEY, JR.
SEDGWICK A. WARD
KAREL WESTERLING
HOWARD W. WHITAKER, JR.
MICHAEL G. WOLFSON

(Proposed Form of Legal Opinion)

City Council of the
City of Charlotte, North Carolina

Gentlemen:

We have examined certified copies of the legal proceedings, including the election and referendum proceedings and other proofs submitted, relative to the issuance and sale of

$8,465,000

CITY OF CHARLOTTE, NORTH CAROLINA
PUBLIC IMPROVEMENT BONDS, SERIES 1976

Dated April 1, 1976.

Denomination $5,000.

Numbered 1 to 1,693, inclusive.

Maturing annually, April 1, in numerical order, lowest numbers first, and bearing interest, payable semi-annually (April 1 and October 1) as follows:

Year of Maturity	Principal Amount	Interest Rate	Year of Maturity	Principal Amount	Interest Rate
1977	$365,000		1987	$ 300,000	
1978	350,000		1988	300,000	
1979	300,000		1989	300,000	
1980	300,000		1990	300,000	
1981	300,000		1991	350,000	
1982	300,000		1992	400,000	
1983	300,000		1993	475,000	
1984	300,000		1994	850,000	
1985	300,000		1995	1,200,000	
1986	300,000		1996	875,000	

69-141 O - 76 - 33

No option of payment prior to maturity.

Both principal and interest are payable at North Carolina National Bank, in the City of Charlotte, North Carolina, or, at the option of the holder or registered owner, at Manufacturers Hanover Trust Company, in the Borough of Manhattan, City and State of New York, in any coin or currency of the United States of America which, at the respective dates of payment thereof, is legal tender for the payment of public and private debts.

Registrable as to principal only.

Representing a consolidation of $3,125,000 Street Widening, Extension and Improvement Bonds, $2,500,000 Public Transportation System Bonds, $1,500,000 Sidewalk Bonds, $730,000 Bridge Bonds and $610,000 Street Land Bonds.

We have also examined one of said bonds as executed (bond numbered 1).

We are of the opinion that such proceedings and proofs show lawful authority for the issuance and sale of said bonds pursuant to The Local Government Bond Act, as amended (succeeding The Municipal Finance Act, 1921 as amended), and Article 7, as amended, of Chapter 159 of the General Statutes of North Carolina and that said bonds constitute valid and binding general obligations of said City of Charlotte, all the taxable real and tangible personal property within which is subject to the levy of an ad valorem tax, without limitation of rate or amount, to pay said bonds and the interest thereon.

We are further of the opinion that the interest on said bonds is exempt from all present Federal income taxes.

Respectfully submitted,

(To be signed "Brown, Wood, Ivey, Mitchell & Petty")

BID FOR BONDS

_____, 1976

Local Government Commission
Albemarle Building, 325 N. Salisbury Street
Raleigh, North Carolina 27611

Sirs:

Subject to the provisions and in accordance with the terms of the annexed Notice of Sale, which are hereby made a part of this bid, we make the following bid for the $8,465,000 Public Improvement Bonds, Series 1976 of the City of Charlotte, North Carolina, described in said Notice of Sale, this bid being for not less than all of said bonds:

For the $8,465,000 Public Improvement Bonds, Series 1976 maturing and bearing interest as follows:

Year of Maturity	Principal Amount	Interest Rate	Year of Maturity	Principal Amount	Interest Rate
1977	$365,000	_____%	1987	$ 300,000	_____%
1978	350,000	_____%	1988	300,000	_____%
1979	300,000	_____%	1989	300,000	_____%
1980	300,000	_____%	1990	300,000	_____%
1981	300,000	_____%	1991	350,000	_____%
1982	300,000	_____%	1992	400,000	_____%
1983	300,000	_____%	1993	475,000	_____%
1984	300,000	_____%	1994	850,000	_____%
1985	300,000	_____%	1995	1,200,000	_____%
1986	300,000	_____%	1996	875,000	_____%

we will pay $8,465,000 plus a premium of ($_____).

We will also pay accrued interest from the date of the bonds to the date of delivery and will accept delivery of the bonds at _____

in _____
in accordance with said Notice of Sale.

We enclose herewith a check for $169,300, as required by said Notice of Sale, payable unconditionally to the order of the State Treasurer of North Carolina, which check is to be returned to us if this bid is not accepted, but otherwise is to be applied in accordance with said Notice of Sale.

The closing papers referred to in said Notice of Sale are to include a certificate, dated as of the day of the delivery of the bonds, stating that there is no litigation pending or, to the knowledge of the signers of such certificate, threatened affecting the validity of the bonds.

_____

_____

(No addition or alteration, except as provided above, is to be made to this bid, and it must not be detached from the annexed Notice of Sale. Bidder may for information only and neither required nor to be construed as a part of the foregoing bid, enter his calculation of net net interest cost to be
_____%.)

ROBERT J. KUTAK
HAROLD L. ROCK
HARRY B. COHEN
WILLIAM G. CAMPBELL
ALAN JAY GARFINKLE
THOMAS A. WOODWARD
GLEN A. BURBRIDGE
RICHARD L. WEILL
JOHN E. MUSSELMAN
WALLACE H. JOHNSON
RICHARD A. SPELLMAN
STEVEN S. HUFF
JEFFREY J. SCOTT
GREGORY DuBOIS ERWIN
THOMAS J. McCUSKER
EUGENE L. HOHENSEE
GEORGE H. KRAUSS
MAUREEN E. McGRATH
DELMAR L. RASMUSSEN
DIRK W. deROOS
ANGELO P. PARKER
J. MICHAEL GOTTSCHALK
JAMES D. ARUNDEL
JOHN J. WAGNER
GREGORY W. SEARSON
JOHN E. HUBBARD
RICHARD D. CIMINO
GARETH G. MORRIS
HAVEN N. B. PELL
PAUL DOUGLAS BUDD
WILLIAM E. HOLLAND
PAUL R. TUFT
C. GREGORY H. EDEN
MARK H MITCHELL
LARRY L. CARLILE
VIRGINIA F. CRISMAN
SARAH J. PENN
LAUREN M. RONALD
RICHARD L. SCHULZE
PATRICIA J. WINTER

KUTAK ROCK COHEN CAMPBELL GARFINKLE & WOODWARD
600 WOODMEN TOWER
OMAHA, NEBRASKA 68102
(402) 346-6000

WILLIAM GRODINSKY
FRANK L. BURBRIDGE
GAIL E. BURBRIDGE
COUNSEL

April 8, 1976

Mr. Howard A. Menell
Subcommittee on Securities
Senate Committee on Banking,
Housing and Urban Affairs
5300 Dirkson Senate Office Building
Washington, D. C. 20510

Re: S.2969--"The Municipal Securities Full Disclosure Act of 1976"

Dear Howard:

In accordance with your request during our telephone conversation yesterday, I have enclosed a copy of the request for a no-action letter which was submitted to Neal S. McCoy, Chief Counsel, Division of Corporation Finance of the Securities and Exchange Commission on August 21, 1973, by our firm on behalf of Municipal Issuers Service Corporation and the insurance companies which comprise Municipal Bond Insurance Association; and a copy of the no-action letter which was issued on September 28, 1973, in response to our firm's request.

I would be very pleased to provide you with whatever additional information you may require for your consideration of the above referenced legislation and I am looking forward to stopping in to see you when I am in Washington on Thursday, April 22, and Friday, April 23.

Please give me a call if you have any questions.

Sincerely,

Haven

Haven N. B. Pell

HNBP:srl
Enclosures

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SEP 28 1973

Gregory deBois Erwin, Esq.
Kutak Rock Cohen Campbell Garfinkle & Woodward
600 Woodmen Tower
Omaha, Nebraska 68102

Re: Municipal Issuers Service Corporation

Dear Mr. Erwin:

This is in reference to your letter of August 21, 1973 regarding the applicability of the registration requirements of the Securities Act of 1933, as amended, ("Securities Act") to the proposed issuance by MISC of policies to insure the payment of principal and interest on obligations, the interest on which is exempt from federal income taxation under Section 103(a)(1) of the Internal Revenue Code of 1954 ("Municipal Obligations").

On the basis of the facts presented, this Division will not recommend any action to the Commission if the subject insurance is sold without compliance with the registration requirements of the Securities Act in reliance upon your opinion as counsel that the securities are exempt under Section 3(a)(3) thereof.

Sincerely yours,

Peter J. Romeo
Special Counsel

By _____
John H. Griffin, Law Clerk

KUTAK ROCK COHEN CAMPBELL GARFINKLE & WOODWARD
600 WOODMEN TOWER
OMAHA, NEBRASKA 68102
(402) 346-6000

WILLIAM GRODINSKY
ROBERT R. TROYER
OF COUNSEL

1933 Act/3(a)(2)
1933 Act/3(a)(8)

August 21, 1973

Securities and Exchange Commission
500 North Capital Street
Washington, D. C. 20549

Attention: Neal S. McCoy, Chief Counsel
Division of Corporation Finance

Request for "No Action" Letter

Municipal Issuers Service Corporation
Municipal Bond Insurance Association

Gentlemen:

We are counsel to Municipal Issuers Service Corporation ("MISC"). We are submitting this request on behalf of MISC and on behalf of The Aetna Casualty and Surety Company, Aetna Insurance Company, St. Paul Fire and Marine Insurance Company and United States Fire Insurance Company, as members of Municipal Bond Insurance Association (the "Association"). Both MISC and the Association will be described in further detail herein.

The purpose of this letter is to request advice regarding the applicability of the Securities Act of 1933, as amended (the "Act"), to the offer and sale to the general

public of tax-exempt municipal obligations of the type referred to in Section 103(a)(1) of the Internal Revenue Code of 1954, as amended, which municipal obligations have been insured as to the payment of the principal and interest under an insurance policy issued by the members through the Association and sold by MISC as its exclusive representative. Specifically, the Division is requested to advise whether it would recommend any action to the Commission if municipal obligations so insured were offered and sold to the general public without registration under the Act in reliance upon our opinion as counsel that no registration is required because the municipal obligations are exempt securities under Section 3(a)(2) of the Act and the insurance is exempt under Section 3(a)(8) of the Act.

For your information in considering this request, we are submitting the following Exhibits:

Exhibit 1	Constitution of Municipal Bond Insurance Association.
Exhibit 2	Proposed Municipal Bond Guaranty Insurance Policy to be issued by the members through the Association.
Exhibit 3	Regulation No. 61, Part 63 of Title 11 of the New York Official Compilation of Codes, Rules and Regulations, as presently in effect.
Exhibit 4	Proposed Management Agreement between the Association and MISC.

MISC was incorporated under the New York General Corporation Law on July 22, 1971, and is licensed as an agent for fidelity and surety insurance in the State of New York. The Association is a voluntary, nonprofit, unincorporated association of insurers organized under the New York General Associations Law, and will be duly qualified to conduct business as a joint underwriting association in the State of New York. The members of the Association are all duly qualified to conduct business as insurance companies in all fifty states and the District of Columbia.

The Association's sole purpose is to engage in the business of providing guaranty insurance against financial loss by reason of the non-payment of the principal of and interest on municipal obligations when due. MISC will act through the Management Agreement (Exhibit 4) as the general manager and exclusive representative of the Association, except that the underwriting activities will be performed in conjunction with a committee of the members. MISC will have the power to bind the insurance companies which are members of the Association, with their approval, on a several, but not a joint, basis.

In general, the business to be engaged in by MISC and the Association is similar to the business conducted by American Municipal Bond Assurance Corporation, which has been previously considered by the Division of Corporation Finance in a letter dated June 16, 1972 (CCH Fed. Sec. L. Rep. ¶78,924) in which the Division advised that it would not recommend any action if the insurance on municipal obligations were sold without compliance with the registration requirements of the Act.

Our opinion that no registration is required under the Act of either the municipal obligations or the insurance is based upon the following factual representations:

1. The members of the Association will insure only obligations which are exempt from registration under Section 5 of the Act by virtue of Section 3(a)(2) of the Act.

2. The members of the Association will insure only obligations upon which interest is exempt from federal income taxation pursuant to Section 103(a)(1) of the Internal Revenue Code of 1954, as amended.

3. MISC is and will continue to be licensed as an agent for fidelity and surety insurance by, and is and will continue to be subject to the regulation of, the Insurance Department of the State of New York, and prior to conducting business in other states, it will subject itself to the regulation of appropriate administrative authorities performing like functions in such states.

4. The Association, prior to conducting business in any state, will become qualified to conduct business as a joint underwriting association in such state, and will subject itself to the regulation of the insurance department or other administrative authority performing like functions in such state.

5. Each member of the Association is licensed to conduct business as an insurance company in those states in which the Association will be qualified, and is subject to the regulation of the insurance department or other administrative authority performing like functions in each of such states.

6. All insurance policies will be issued in accordance with Regulation No. 61 of the Insurance Department of the State of New York relating to insurance of municipal bonds (Exhibit 3), and in accordance with any similar rules and regulations which may be adopted in other states in which policies are issued.

7. All policies will be sold to, and the premiums will be paid by, the municipal issuer or the initial underwriter of the issue.

8. Policies will not be offered or sold to individual investors, nor will investors be required or permitted to make any payments for insurance.

9. All premiums will be paid at the time of issuance of the policies, and no payments in future years will be required.

10. Policies will insure only the payment of the principal of and interest on insured municipal obligations when due, and a default in the payment of such principal or interest on the part of the issuer will not permit the holders of insured municipal obligations to accelerate future prescribed principal and interest payments.

11. Policies will not protect the holders of insured municipal obligations against losses which may be suffered as a result of a decline in the market value of their holdings.

12. Each member of the Association has agreed that in the event of default on an insured municipal obligation, it will supply its proportionate share of the amount which, when added to the proportionate shares of the other members of the Association and any amount supplied by the issuer, will be sufficient to pay the principal and interest then due. The proportionate share of liability which will be assumed by each member of the Association will be equal to the member's proportionate interest in the Association at the time the commitment for the insurance was entered into. Each member of the Association contemplates entering into a re-insurance agreement with the American Re-Insurance Company whereby a portion of

the liability assured by each member will be ceded to the reinsurer. The cession of such portion of liability will not release any member from its primary obligation to bear its proportionate share of liability set forth in the policy.

13. Any payments made by the members of the Association will be made to an escrow agent (which typically will be the paying agent designated by the issuer to make payments of the principal of and interest on the municipal obligations).

14. Insurance payments by the members of the Association will not relieve the issuer of its duty to pay on defaulted municipal obligations. In order to receive payment from the escrow agent, the holders of defaulted obligations will be required to assign to the members of the Association any rights which they may have against the issuer and to surrender the bonds or applicable coupons. The issuer will therefore be obligated to the members of the Association for defaulted payments, and will continue to be obligated to make principal and interest payments in future years to the individual investors.

15. All policies will be backed by adequate reserves, as prescribed by the Insurance Department of the State of New York and by the administrative authorities performing like functions in other states in which business is conducted.

16. Amounts payable in the event of default are measurable in fixed dollar terms, and in no way are dependent upon or related to investments made by the members of the Association.

17. In the event of default, the members of the Association will be subject to the claims of the escrow agent or the individual holders of insured municipal obligations.

18. Insurance to be issued by the members of the Association covers only the duties of those otherwise obliged, and does not relieve them of their obligations.

Based upon the foregoing, it is our opinion that the exemption provided for municipal obligations by Section 3(a)(2) of the Act would not be impaired by the fact that payment of the principal of and interest on such obligations were insured. Obligations payable out of revenues from a specified municipal facility, such as a municipal waterworks, customarily make provision for payment of the principal and interest from proceeds of insurance recoveries resulting from damage to the facility, and such provisions have been held not to change the exempt status of the obligations. In the case of the insurance proposed to be issued by the members of the Association and sold by MISC, the fundamental character of the municipal obligation remains unaltered. The issuer has an unconditional and continuing obligation to pay the principal and interest, and if the insurers are called upon to make payments, they have the right to recover such payments from the issuer. Investors in insured municipal obligations still look to the issuer for payment of their principal and interest, but the insurance provides them with additional protection in the event the issuer becomes unable to make payments on its obligations as due.

It is also our opinion that the insurance to be issued by the members of the Association and sold by MISC is a customary and accepted form of insurance to which the exemption in Section 3(a)(8) of the Act is applicable. Guaranty insurance has been defined as "a contract whereby one,

for consideration, agrees to indemnify another against . . . loss by nonpayment of notes." Black's Law Dictionary (4th Ed. Rev. 1968), p. 943. Similarly, policies guaranteeing payment of obligations by mortgagors had been held by the United States Supreme Court to be insurance policies before the Act was adopted. Bowers v. Lawyers Mortgage Co., 285 U.S. 182, 189 (1932); United States v. Home Title Ins. Co., 285 U.S. 191, 195 (1932). Thus, it is our opinion that guaranty insurance is a traditional form of insurance, and that the policies proposed to be issued by the members of the Association are bona fide insurance policies to which the exemption of Section 3(a)(8) of the Act is applicable.

The policies to be issued by the members of the Association and sold by MISC are clearly distinguishable from insurance policies in which the return to the insured depends upon the investment experience of the insurer, or policies which are sold to individual investors in order to guarantee the future market value of mutual funds or other investment portfolios.

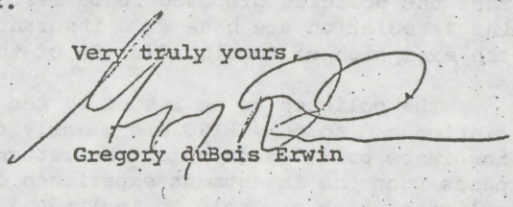
There is also authority to the effect that insurance policies are exempt from all of the provisions of the Act because they are not "securities" within the meaning of Section 2(1) of the Act (see 1 L. Loss, Securities Regulation 497 (2d Ed. 1961)), and to the effect that Section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. §1012(b), precludes the Securities Act of 1933 from being applied to the registration or regulation of insurance policies (see S.E.C. v. Variable Annuity Life Insurance Co., 379 U.S. 65, 67 (1959)). We feel that these points are meritorious, but in view of the reasonably clear exemption provided by Section 3(a)(8) of the Act, we feel that extended discussion thereof is unnecessary at this time.

In accordance with Release No. 33-5127, we are enclosing an original and three copies of this letter with

exhibits, and three extra copies of the letter for the convenience of the staff.

Representatives of MISC, the four members of the Association and this firm will be happy to provide any additional information you may desire or to meet with members of the staff if it is felt that a conference would be desirable. If you have any questions, please feel free to call the undersigned or Richard L. Weill of this office collect.

Very truly yours,



Gregory duBois Erwin

WILMER, CUTLER & PICKERING
1666 K STREET, N. W.
WASHINGTON, D. C. 20006

CABLE ADDRESS: WICRING WASH., D. C.
INTERNATIONAL TELEX: 440-239
TELEX: 89-2402
TELEPHONE 202 872-6000

EUROPEAN OFFICE
5, CHEAPSIDE
LONDON, EC2V 6AA, ENGLAND
TELEPHONE 01-236-2401
TELEX: 851 883242
CABLE ADDRESS: WICRING, LONDON

RICHARD H. WILMER
LLOYD N. CUTLER
JOHN H. PICKERING
MANUEL F. COHEN
HUGH R. H. SMITH
LOUIS F. OBERDORFER
J. ROGER WOLLENBERG
CHARLES C. GLOVER, III
MARSHALL HORNBLOWER
HENRY T. RATHBUN
REUBEN CLARK
SAMUEL J. LANAHAN
WILLIAM R. PERLIK
SAMUEL A. STERN
ARNOLD H. LERMAN
ROBERT P. STRANAHAN, JR.
MAX O. TRUITT, JR.
JOEL ROSENBLOOM
HOWARD P. WILLENS
ANDREW T. A. MACDONALD
ROBERT A. HAMMOND, III
DANIEL K. MAYERS

TIMOTHY B. DYK
DAVID R. ANDERSON
J. RODERICK HELLER, III
ARTHUR F. MATHEWS
JAMES S. CAMPBELL
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JAMES ROBERTSON
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F. DAVID LAKE, JR.
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C. BOYDEN GRAY
RONALD J. GREENE
JAY F. LAPIN
DEANNE C. SIEMER
GARY D. WILSON

EZEKIEL G. STODDARD
GERARD C. SMITH
COUNSEL

RICHARD A. ALLEN
PETER D. BEWLEY
STEWART A. BLOCK
LACKLAND H. BLOOM, JR.
MICHAEL L. BURACK
RICHARD W. CASS
BARRY O. CHASE
WILHELMINA REUBEN COOKE
MICHELE B. CORASH
PATRICIA D. DOUGLASS
S. ALLEN EARLY, III
JAMES R. FARRAND
NANCY C. GARRISON
NEAL M. GOLDBERG
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FRANCES M. GREEN
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MICHAEL S. HELFER
A. STEPHEN HUT, JR.
C. LORING JETTON, JR.

DAVID R. JOHNSON
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NOEL ANKETELL KRAMER
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MICHAEL S. SCHOOLER
KAREN KOSER SCHWARTZ
THEODORE S. SIMS
MARIANNE K. SMYTHE
DOUGLAS G. THOMPSON, JR.
ALAN S. WEITZ
WALTER T. WINSLOW, JR.
ROGER M. WITTEN

March 9, 1976

Dear Mr. Chairman:

In accordance with your request during the hearings on S. 2574 and S. 2969 on February 25, I am pleased to enclose for your consideration a memorandum discussing the constitutionality of legislation that would expressly provide for civil damage actions in federal courts by investors against state and local issuers, and their officials, who use the facilities of interstate commerce in marketing their bonds. If we can be of any further assistance to the Subcommittee, I hope you will call on me.

With best regards,

Sincerely,

Henry T. Rathbun

Henry T. Rathbun

Senator Harrison A. Williams, Jr.
Chairman, Subcommittee on Securities
Senate Committee on Banking, Housing
and Urban Affairs
352 Russell Senate Office Building

By Hand

cc: Stephen J. Paradise, Esq.
Howard A. Mennell, Esq.

WILMER, CUTLER & PICKERING
1666 K STREET, N. W.
WASHINGTON, D. C. 20006

March 9, 1976

MEMORANDUM

Subject: Constitutionality of a Federal Statute Providing for Civil Damage Actions in Federal Courts Against Issuers of Municipal Securities and Their Officials

This memorandum addresses the question whether Congress has the constitutional authority to provide for civil actions in federal courts by investors against issuers of municipal securities */ and issuer officials, for damages incurred on account of false or misleading disclosure in connection with the offer or sale of municipal securities in interstate commerce. The memorandum assumes that the statute providing for such actions would be similar to Section 11 of the Securities Act of 1933 (the "1933 Act"), which provides for civil damage actions against, among others, issuers of corporate securities and their officials. The memorandum concludes that Congress does have the constitutional authority to provide for such civil damage actions with respect to municipal securities.

This memorandum does not discuss the authority of Congress to regulate the interstate offer or sale of municipal securities

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*/ The term "municipal securities" is used in this memorandum in the same sense as the term is defined in Section 3(a)(29) of the Securities Exchange Act of 1934. The term "issuers of muncipal securities" thus includes states, cities, counties, and the agencies of states and their political subdivisions, among others.

because it seems clear that Congress has this power under Article I, Section 8, Clause 3 (the "Commerce Clause") of the Constitution. E.g., Fry v. United States, 421 U.S. 542 (1975); Maryland v. Wirtz, 392 U.S. 183 (1968); National League of Cities v. Brennan, Civ. Action No. 74-1812 (D.D.C., Dec. 31, 1974), prob. juris noted, 420 U.S. 906 (1975), set for reargument, 421 U.S. 986 (1975). Instead, the memorandum focuses on the remedial question -- whether Congress can provide for civil damage actions in federal courts against states, units of local government, and their officials, in order to effectuate the purposes of the regulation it has the power to establish.

The memorandum first provides some background information about the municipal securities disclosure legislation now pending in Congress, and about the legal question whether Congress has the authority to include in such legislation provisions for civil damage actions in federal courts against issuers of municipal securities and their officials. The memorandum then turns, in order, to a discussion of the liability of a state itself, of units of local government subordinate to the state, and of officials of issuers of municipal securities.

Background

The Senate Committee on Banking, Housing and Urban Affairs is presently considering S. 2969, "The Municipal Securities Full Disclosure Act of 1976," introduced by Senator Williams and Senator Tower. In general, that bill would require that certain large issuers of municipal securities disclose financial and other

69-141 O - 76 - 34

information about themselves in annual reports and distribution statements (collectively, the "disclosure documents"). S. 2969 does not, as drafted, specifically deal with the question of the responsibility of the issuer or its officials for the accuracy and completeness of the information contained in the disclosure documents. It has been suggested that Congress impose upon issuers of municipal securities and their officials the kind of liability for damages that is imposed on issuers of corporate securities and their officials under Section 11 of the 1933 Act.

Under Section 11,*/ an issuer is, in general, liable for damages suffered on account of any untrue statement of a material fact in a registration statement or on account of any omission to state a material fact required to be stated or necessary to make the statements in the registration statement not misleading. Corporate officials are liable for damages as well, but have defenses not available to the issuer, including the defense that the corporate official "had, after reasonable investigation, reasonable ground to believe and did believe" that the registration statement was true and that there was no omission to state a material fact.

In view of the fact that issuers of municipal securities are often states, state agencies, and units of local government, and that their officials are often elected executive officers, the question has been raised whether there is any legal prohibition

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*/ A copy of Section 11 is attached as Appendix A to this memorandum.

against including in S. 2969 provisions relating to issuers of municipal securities and their officials like those in Section 11 of the 1933 Act relating to issuers of corporate securities and their officials. The question is one of federal not state law, of course, and a state could not by its own law immunize itself, its units of local government or its officials from liability provided for in a valid federal statute. E.g., Parden v. Terminal Ry. Co., 377 U.S. 184, 195-96 (1964).

The validity of the federal legislation envisioned would be tested under the Eleventh Amendment, which reads as follows:

> "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state."

The Eleventh Amendment by its terms only limits the judicial power of the United States with respect to suits against a state by a citizen of another state, or by aliens. It does not literally apply to suits by a citizen against his own state. However, it has been the law since at least Hans v. Louisiana, 134 U.S. 1 (1890), that suits by a citizen against his own state are also barred. Thus the general rule is that the Eleventh Amendment "denies to the federal courts authority to entertain a suit brought by private parties against a state without its consent." Ford Motor Co. v. Department of Treasury, 323 U.S. 459, 464 (1945). But it is equally

clear that "[i]mmunity from suit under the Eleventh Amendment is a personal privilege which may be waived." Missouri v. Fiske, 290 U.S. 18, 24 (1933); Clark v. Barnard, 108 U.S. 436, 447-48 (1883). See generally, Note, Private Suits Against States in the Federal Courts, 33 U.Chi. L. Rev. 331, 333-336 (1966). */

State Liability

Since the Eleventh Amendment prohibits suits in the federal courts against a state without the state's consent, the only way that a state issuer could be sued for damages in federal court by an investor is if the state is found to have consented to the suit. Congress may, however, as a condition of participation in the interstate offer and sale of securities, require that a state waive its immunity from suit for damages in the federal courts. The cases, particularly the recent Supreme Court cases, show that Congress has this power.

Parden v. Terminal Ry. Co., 377 U.S. 184 (1964), is the most important case. Alabama operated a common carrier by railroad engaging in interstate commerce. The plaintiffs sued under the

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*/ There is no provision of the Constitution other than the Eleventh Amendment that might prevent Congress from providing for the kind of civil damage action in federal courts against issuers of municipal securities and their officials described above. Moreover, there is no federal "common law" doctrine of sovereign immunity for states or their political subdivisions, e.g., Markham v. City of Newport News, 292 F.2d 711 (4th Cir. 1961), and even if there were some applicable non-constitutional judicial doctrine of sovereign immunity, it could be overridden by a properly drawn federal statute. Accordingly, this memorandum focuses entirely on the impact of the Eleventh Amendment on Congress' power to create a civil damage action relating to municipal securities like the one Section 11 of the 1933 Act creates relating to corporate securities.

Federal Employer's Liability Act ("FELA") to recover for personal injuries sustained while employed by the Railway. The lower courts had dismissed the case because it was against a state. The Supreme Court noted that it was facing, for the first time, a state's claim of immunity against a suit by an individual based on a cause of action expressly created by the Congress. 377 U.S. at 187. This raised, said the Court, two questions: (1) did Congress intend to subject a state to a suit for damages under FELA, and (2) does Congress have the power to do so? Id.

The Court reviewed the wording and legislative history of the FELA and concluded that Congress did intend to subject "state-owned as well as privately owned common carriers by railroad in interstate commerce" to the Act. 377 U.S. at 190. The Court then rejected the state's contention that Congress "in view of the immunity doctrine" lacked the power to subject a state to suit. The Court pointed out that the state could waive its immunity from suit, and that the determination of whether there had been a waiver was a matter of federal law. See, e.g., Petty v. Tennessee-Missouri Bridge Comm'n, 359 U.S. 275 (1959). The Court then held that Alabama "necessarily consented" to the suit for damages authorized by the FELA, 377 U.S. at 192:

> "By adopting and ratifying the Commerce Clause, the States empowered Congress to create such a right of action against interstate railroads; by enacting the FELA in the exercise of this power, Congress conditioned the right to operate a railroad in interstate commerce upon amenability to suit in federal court as provided by the Act; by thereafter operating a railroad in interstate commerce, Alabama must be taken to have accepted that condition and thus to have consented to suit."

The four dissenters in Parden agreed "that it is within the power of Congress to condition a State's permit to engage in the interstate transportation business on a waiver of the State's sovereign immunity from suits arising out of such business." The dissent went on, 377 U.S. at 198:

> "Congress might well determine that allowing regulable conduct such as the operation of a railroad to be undertaken by a body legally immune from liability directly resulting from these operations is so inimical to the purposes of its regulation that the State must be put to the option of either foregoing participation in the conduct or consenting to legal responsibility for injury caused thereby."

The dissent concluded, however, that the statute and legislative history did not reveal a clear congressional intent to require states to consent to suits under the FELA.

Based on Parden, there would seem little doubt that Congress could require that as a condition of engaging in the offer or sale of securities in interstate commerce a state consent to suits for damages in the federal courts. Subsequent Supreme Court cases have reaffirmed Congress' power to do this, but have emphasized that Congress must be very explicit about its intention to require a state to waive its immunity from suit as a condition of engaging in a federally regulated activity.

In Employees of the Department v. Department of Public Health and Welfare, 411 U.S. 279 (1973), for example, the Court concluded that Congress, in enacting amendments to the Fair Labor

Standards Act ("FLSA") that applied to state hospitals,*/ had not intended to "lift the sovereign immunity of the States" or to "conditio[n] the operation of these facilities on the forfeiture of immunity from suit in a federal forum." 411 U.S. at 285. This conclusion was based on the available indicia of congressional intent: a review of the statutory language, particularly the fact that the provision of the FLSA creating a private cause of action was not altered by Congress at the time that the substantive provisions of the Act were extended to state hospitals; the fact that the Secretary of Labor had authority to sue states for unpaid minimum wages and overtime, which suggested that "private enforcement . . . was not a paramount objective", 411 U.S. at 286; the fact that to allow private suits would not just make the citizen "whole" as in Parden, but would, under the FLSA, "let him recover double against a State," id.; and the fact that "not a word in the history of the 1966 amendments" demonstrated a congressional intent to require a state to waive its immunity, 411 U.S. at 285.

The holdings of Parden and Employees were reaffirmed in Edelman v. Jordan, 415 U.S. 651 (1974). The question there was whether by participating in the federal program of Aid to the Aged, Blind and Disabled ("AABD"), which involved federal and state funding, the state had waived its immunity and consented to the bringing of a suit by individuals for back payments withheld in violation of federal law and regulations. The Court said, 415 U.S. at 672:

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*/ The FLSA amendments that regulated wages and working conditions had been held valid as applied to the states as an exercise of Congress' power under the Commerce Clause in Maryland v. Wirtz, 392 U.S. 183 (1968).

> "The question of waiver or consent under the Eleventh Amendment was found in those cases [Parden and Employees] to turn on whether Congress had intended to abrogate the immunity in question, and whether the State by its participation in the program authorized by Congress had in effect consented to the abrogation of that immunity."

Edelman, however, did not even involve "the threshold fact of congressional authorization to sue a class of defendants which literally incudes States," id., since the AABB statute did not contain any civil remedy provision. Accordingly, the suit for damages was barred.

The lower federal courts have reached differing answers to the question whether private rights of action against state agencies may be maintained under the present Section 10b of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder. Compare Forman v. Community Services, Inc., 500 F.2d 1246, 1256 (2d Cir. 1974), rev'd on other grounds sub nom. United Housing Foundation v. Forman, 421 U.S. 837 (1975) with Yeomans v. Kentucky, 514 F.2d 993 (6th Cir.), cert. denied, 96 S. Ct. 404 (1975). These cases turned on the question whether Congress expressed with sufficient clarity an intention to require a state to waive its sovereign immunity as a condition of offering or selling its securities in interstate commerce. None of these cases, nor others in different contexts,*/ raises any doubt, however,

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*/ Compare Intracoastal Transportation, Inc. v. Decatur County, 482 F.2d 361 (5th Cir. 1973) with Chesapeake Bay Bridge & Tunnel Dist. v. Lauritzen, 404 F.2d 1001 (4th Cir. 1968); see Daye v. Pennsylvania, 483 F.2d 294 (3d Cir. 1973), cert. denied sub nom. Meyers v. Pennsylvania, 416 U.S. 946 (1974); Dawkins v. Craig, 483 F.2d 1191 (4th Cir. 1973), cert. denied, 415 U.S. 938 (1974). In Fitzpatrick v. Bitzer, 519 F.2d 559 (2d Cir. 1975), the court found

(footnote continued)

that under Parden Congress may, by expressing its intention with sufficient clarity, provide that any state that thereafter offers or sells municipal securities in interstate commerce shall be deemed to have consented to suits in federal courts by investors damaged by the state's incomplete or inaccurate disclosure.

Issuers of Municipal Securities Other Than States

It is even clearer that Congress can provide for civil damage actions against issuers of municipal securities other than states. Units of local governments, such as cities and counties, are not protected by the Eleventh Amendment, e.g., Lincoln County v. Luning, 133 U.S. 529 (1980); Hopkins v. Clemson Agricultural College, 221 U.S. 636, 645 (1911); Hander v. San Jacinto Jr. College, 519 F.2d 273, supplemented, 522 F.2d 203 (5th Cir. 1975). Thus there is no legal prohibition that might preclude Congress from permitting investors to sue subsidiary units of government in the federal courts in a cause of action similar to that created for private investors against corporate issuers in Section 11 of the 1933 Act.

(footnote continued from previous page)

that Congress had intended, in legislation passed after the lawsuit began, to authorize private suits for back pay by state employees under Title VII of the Civil Rights Act of 1964, but that no such suit could be maintained in federal court, 519 F.2d at 568. The case involved an attack on a state retirement plan established before the amendments to Title VII, 519 F.2d at 561, and the court declined to find a waiver because the state had no choice but to hire employees, 510 F.2d at 568. The Supreme Court has granted certiorari, 96 S. Ct. 561 (1975). The statute at issue in Fitzpatrick is, in any event, far different from the statute described in this memorandum, for presumably any liability provisions included in S. 2969 would apply only with respect to municipal securities issued after its effective date, and issuers of municipal securities have numerous alternative sources of funds if they refuse to consent to be sued in federal court for damages caused by omissions or misstatements in their disclosure documents. Indeed, though the Fitzpatrick court did not cite it, Forman, which is also a Second Circuit case, holds that under Parden a state does consent to suit by engaging in regulated securities transactions.

Nor, for reasons described above, would there be any other defense arising out of its governmental status that a unit of local government could interpose in the face of an explicit federal statute to the contrary. But even if there were, it would be of no avail. For if, as demonstrated above, Congress can require as a condition of offering or selling securities in interstate commerce that a state agree to be sued in the federal courts, a fortiorari Congress may do so with respect to a local government unit subordinate to the state itself.

Issuer Officials

Officials of state and local governments do not have, in their individual capacities, any protection under the Eleventh Amendment and may be sued in their individual capacities for actions taken within the sphere of their official responsibilities which violate the Constitution or federal laws. E.g., Ex parte Young, 209 U.S. 123 (1908); Scheuer v. Rhodes, 416 U.S. 232 (1974). Thus, Congress could constitutionally provide that an issuer official can be sued personally by an investor to recover damages suffered on account of a material misstatement or omission in disclosure documents for which the issuer official was responsible.*/

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*/ A suit is against an issuer official in his individual capacity when it seeks money damages from him. When money damages are sought from the state, even though the suit is in form against a state official, the Eleventh Amendment is applicable and the question or waiver must be determined in accordance with the principles stated above. See Edelman v. Jordan, supra, 415 U.S. at 663; Ford Motor Co. v. Department of Treasury, supra, 323 U.S. at 464.

There is, of course, a common law doctrine that provides a "qualified immunity" or a special defense to officials of the executive branch of government who act in good faith to carry out their duties.*/ The Supreme Court relied on this doctrine in a series of cases construing a civil rights statute that protects federal constitutional rights from invasion by state or local officials, 42 U.S.C. § 1983 (1970). The Court held in Wood v. Strickland, 420 U.S. 308, 322 (1975), for example, that a school board member could be sued for damages in his personal capacity for invading the plaintiff's constitutional rights, but that the official would be liable "only if he knew or reasonably should have known that the action he took within the sphere of his official responsibility would violate the constitutional rights of the student affected, or if he took the action with the malicious intention to cause a deprivation of constitutional rights . . . . " A similar standard has been employed by lower courts with respect to both federal and state executive officers in other contexts. See Bivens v. Six Unknown Named Agents, 456 F.2d 1339 (2d Cir. 1971); Safeguard Mut. Ins. Co. v. Miller, 472 F.2d 732 (3d Cir. 1973).

There is no indication in the cases, and no apparent reason to believe, that this old common law doctrine has federal constitutional stature. Accordingly, Congress could, notwithstanding this doctrine, impose the same liability on issuer officials

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*/ An absolute immunity prevents a lawsuit from being maintained at all, but a qualified immunity is in the nature of a defense that "depends upon the circumstances and motivations of [defendant's] actions, as established by the evidence at trial," Imbler v. Pachtman, 44 U.S.L.W. 4250, 4253 n. 13 (March 2, 1976).

that it could impose on states or units of local government for damages caused by misstatements or omissions in disclosure documents they prepare. However, the point is a theoretical one only. For under Section 11 (and presumably under a comparable provision in any municipal disclosure legislation), an issuer official can avoid all liability if he shows that after reasonable investigation he had reasonable ground to believe and did believe in the completeness and accuracy of the information. Section 11, in short, already embodies the kind of "good faith" defense that has been found applicable, though not constitutionally required, in other contexts.

Conclusion

For the reasons stated above, Congress has the constitutional authority to provide, in a manner similar to Section 11 of the 1933 Act, for civil actions in federal courts against issuers of municipal securities, and issuer officials, for damages incurred on account of false or misleading disclosure in connection with the offer or sale of municipal securities in interstate commerce.

APPENDIX A

[¶ 651] CIVIL LIABILITIES ON ACCOUNT OF FALSE REGISTRATION STATEMENT

Sec. 11. (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

[¶ 652] [Signers of Registration Statement]

(1) every person who signed the registration statement;

[¶ 653] [Directors and Partners]

(2) every person who was a director of (or person performing similar functions), or partner in, the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

[¶ 654] [Persons Named as Being, or About to Become, Directors or Partners]

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

[¶ 655] [Accountants, Engineers, Appraisers, and Other Professional Persons]

(4) every accountant engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

[¶ 656] [Underwriters]

(5) every underwriter with respect to such security.

[¶ 657] [Purchase after Publication of Earning Statement]

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the securities relying on such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

[¶ 658] [Defenses of Persons Other than Issuer]

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

[¶ 659] [Resignation before Effective Date]

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing, that he had taken such action and that he would not be responsible for such part of the registration statement; or

[¶ 660] [Statement's Becoming Effective without Defendant's Knowledge]

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1), and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

[¶ 661] [Belief on Reasonable Grounds that Statements Were True]

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and

[¶ 662] [Statement Made on Authority of Defendant as Expert]

(B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and

[¶ 663] [Statement Made on Authority of Expert Other than Defendant]

(C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and

[¶ 664] [Statement Made by Official Person; Copy of Public Official Document]

(D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

[¶ 665] ["Reasonable" Investigation and "Reasonable" Grounds for Belief]

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

[¶ 666] [Person Becoming Underwriter after Effectiveness of Registration Statement]

(d) If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

[¶ 667] [Amount of Damages; Bond for Costs of Suit]

(e) The suit authorized under subsection (a) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this title the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

[¶ 668] [Joint and Several Liability]

(f) All or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

[¶ 669] [Limitation on Amount of Damages]

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public. [Sec. 11 was amended generally by Act of June 6, 1934, 48 Stat. 907.]