



**NEWS**

**SECURITIES AND  
EXCHANGE COMMISSION**

Washington, D. C. 20549

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SECURITIES MARKETS SHOULD NOT BE "TRICK OR TREAT"

Address by

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Washington, D.C.  
October 31, 1974

As is traditional on Halloween, some of us will accompany our young children as they enjoy the "trick or treat" festivities this evening. We go with the youngsters to protect them from hazards which could not only destroy the fun of the evening but could jeopardize their personal well being. I believe this has some relevance to the emerging responsibilities of the Securities and Exchange Commission in protecting unsophisticated investors from possible abuses of which they are unaware in our municipal securities' markets.

Contrary to the situation which existed in the past, when municipal securities were purchased almost entirely by wealthy individuals and institutions who were aware of possible hazards and could protect themselves, today these securities are also being sold to individuals who need protection.

We were all saddened when we discovered recently that some returning Vietnam prisoners of war became involved

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in what was obviously more of a trick than a treat. In this case, which I consider to be one of the most egregious and flagrant violations of the securities laws, returning Vietnam POW's, many of whom had accumulated substantial amounts of cash from back pay and disability compensation during their imprisonment, received "cold call" letters of solicitation from a municipal bond firm acknowledging the great debt of gratitude owed them by all Americans and offering assistance to ease the POW's adjustment period, including rendering of investment advice. Our investigation discovered that these individuals were sold extremely high risk industrial revenue bonds with the representation that the dealer would buy them back, in effect indemnifying them against loss. In one instance, the bond issue was in default at the time of sale, and in another, the repurchase agreement had been dishonored. In at least two other cases, no delivery of bonds had been made and in other instances no actual purchases had been made after the firm had received the investor's money.

Of particular importance is the fact that the firm was not registered with the Commission because under present law it was exempt as a dealer solely in municipal bonds, and thus was not subject to our regulatory standards, recordkeeping requirements, and general oversight inspections.

Earlier this month, the Commission obtained an injunction against the involved municipal bond dealer, R. J. Allen & Associates, Inc., and certain officers and employees for violations of the antifraud provisions, but enforcement actions against wrongdoers after the damage has been done and investors have lost their money is not a substitute for appropriate surveillance and fraud prevention. This case, in addition to the cases we brought against firms in Tennessee and against the Paragon Securities Company, strongly supports the belief that sales practices for municipal securities should be subject to SEC jurisdiction, a belief which led to the drafting of legislation for the regulation of trading in municipal securities by brokers, dealers, and banks.

The Municipal Securities Act of 1974, which has now been enacted by the Senate (S. 2474), is directed solely at the activities of professionals in the municipal securities trading markets and is designed to ensure that their practices and qualifications are consistent with the maintenance of investor confidence in the fairness of those markets. It was not intended to, nor does it impose, pre-issuance obligations, such as pre-filing of prospectuses or other selling documents

with the Commission, and does not even address the question of regulating disclosures by municipal issuers.

Moreover, I can assure you that the Commission has not sought and does not contemplate seeking authority from Congress to review disclosure documents of municipal issuers in connection with their financings. However, the Commission does have an interest in disclosure documents used by issuers of municipal securities because such documents are subject to the antifraud provisions of the Securities Act and the Securities Exchange Act.

Misleading information or an omission to state material facts necessary to make a statement not misleading in connection with the purchase or sale of a municipal security violates the antifraud provisions and may result in a Commission injunctive action as well as liability for civil damages. In view of the present law, it is only prudent for municipal issuers to ensure that disclosure standards are high enough to avoid violations of the antifraud provisions.

The Commission has not brought a great number of fraud cases relating to the offering of municipal securities, but this may be explained by the fact that in past years, the market has been comprised mainly of institutions and wealthy

individuals that can be expected to protect themselves against fraud. Recently, however, the Commission filed a complaint for a preliminary and permanent injunction against several corporations and individuals engaged in selling a primary offering of nursing home revenue bonds issued by the city of Covington, Kentucky. The gravamen of the complaint was that the disclosure document utilized in connection with the public sale of the bonds allegedly contained false and misleading information. While the issuer, Covington, was not named as a defendant and was allegedly defrauded along with public investors, it was believed by some that the Commission's allegations indicated a "back door" approach to somehow regulate issuers in a primary market. On the contrary, these allegations did not reflect a novel or unique action as a matter of law under either the Securities Act or the Securities Exchange Act.

The Commission should, and will, continue to look at all municipal offerings where public investors are solicited in the same light as it does other sales of securities in the primary market to ensure that there is adequate disclosure to investors of information that is not fraudulent or misleading.

I have given this background on the Commission's involvement with municipal securities because when John Petersen, Washington Director of your Association, asked me to participate in your seminar today, he thought it would be valuable for me to present my ideas on what the Commission, issuers and other participants could do to best serve the informational needs of the markets for municipal securities. Before responding to this request, it seemed important that I discuss Commission activities with respect to municipal securities under our fraud powers and the authority which we believe Congress should grant us to regulate practices for municipal securities; but at the same time to make it very clear that municipal securities are exempt from the registration requirements of the Securities Act and to dispell any notion that we are suggesting a removal of that exemption in pending legislation.

Because Section 3(a)(2) of the Securities Act exempts securities issued by municipalities from registration with the SEC, neither the Commission nor any other federal government agency has authority to establish specific disclosure requirements or standards for issuers of municipal securities. Instead, that responsibility must be borne by the states, the

issuers themselves, and organizations of which they are voluntary members. This seminar on improving Municipal Credit Information and Quality is evidence of your active concern in these important issues and in the desirability of improving practices of providing information on municipal debt. Although I have attempted to become informed on present practices which appear to range from very poor to excellent, I do not have a sufficient knowledge of required disclosure practices for municipal security issuers throughout the nation to suggest that the existing practices in any jurisdiction should serve as a pattern for others to follow. I take some comfort in knowing that you are also studying present practices with the purpose of developing appropriate guidelines for improving the quality and availability of information on municipal securities to investors.

The SEC is not completely inexperienced in administering disclosure requirements applicable to municipal securities. Certain types of industrial revenue bond offerings and offerings of foreign municipalities, such as Canadian provincial government authorities which do a great deal of financing in this country, must be registered with the Commission. We have also accumulated considerable



experience in connection with public offerings of corporate securities and, despite differences in corporate and municipal securities, some of this experience might prove useful to you as you seek to meet informational needs of those who may be purchasers of your securities.

The Commission's disclosure requirements, designed to provide material information that should be available to the average investor before making an investment decision and to prevent fraud, have served as a model for others who are involved in offering exempt securities to the public. For example, although securities of banks are exempt from registration under the federal securities laws, the Federal Deposit Insurance Corporation has promulgated proposed disclosure requirements, patterned after our requirements, for banks subject to their jurisdiction which are offering securities to the public. The FDIC release states that the agency believes the proposed disclosure requirements are necessary to avoid banks being charged with fraud under the securities laws and thus endanger assets available to their depositors and it has requested other federal bank regulators to consider proposing similar disclosure requirements. Also, the Federal Home Loan Bank Board has used the Commission's

disclosure requirements as a guide for their proposed requirements relating to conversions from a mutual to a stock form of association, although securities issued by thrift institutions subject to Bank Board jurisdiction are exempt from the registration provisions of the federal securities laws. The Interstate Commerce Commission has likewise patterned proposed disclosure requirements after SEC requirements to be used in connection with issuance of securities by common carriers.

These disclosure proposals indicate that the Commission's disclosure requirements provide a useful reference point for anyone interested in developing a disclosure system. I do not mean to suggest that all of our specific requirements would be applicable, but that our general requirements can be helpful guides. It would be presumptuous of me to attempt to tell you how to serve the informational needs of the markets for municipal securities, but in my opinion there are several general types of information which an investor should be provided in order to make an informed investment decision regarding municipal securities.

First, the securities themselves, including principal, interest, maturity and any funding provision should be described accurately. Second, and closely related to this

description, would be information with respect to the tax aspects to the investor of owning the securities. Third, the terms of the offering and the plan of distribution should be disclosed. Fourth, if the underwriter or other persons involved in the offering have conflicts of interest they should be disclosed. Fifth, the purpose of the issue, or what we would term the use of proceeds, should be disclosed. Sixth, and of great importance, is economic information concerning the issuer sufficient to enable the investor to assess the credit worthiness of the issuer. This might include, where available, local business and personal income data; local employment statistics; local manufacturing data; local capital expenditures; and local mining, agricultural production and tourist expenditure data. Seventh, the form of government organization should be described and the revenues, expenditures and total debt service requirements of the municipality set forth. These suggestions are not necessarily intended to be all inclusive, but to indicate in broad terms the type of disclosure requirements applicable to initial offerings filed with the Commission.

If you determine that our experience would be beneficial to you in developing model disclosure standards,

our staff is prepared to offer assistance and you should contact Mr. Alan Levenson, Director of our Division of Corporation Finance, which processes disclosure documents filed with the Commission.

As municipal issuers broaden their capital raising efforts and as individual investors become more familiar with and capable of investing in municipal securities, there are concomitant disclosure responsibilities. Adequate disclosure becomes even more significant as municipalities are met with increasing demands for new capital and thus require greater access to the investing public as a source of financing. The Commission believes firmly in full and fair disclosure and I commend you for your efforts to improve disclosure standards in your industry. It is axiomatic that a strong public demand for municipal securities in the marketplace and complete disclosure go hand in hand so that, in the long run, municipal issuers are best served by a well-developed disclosure philosophy and practice.